

Mid Cap Value Equity

Overview

U.S. equity markets continued to surge during the first quarter of 2021. Intensifying economic momentum, another enormous dose of fiscal stimulus, highly accommodative monetary policy, and expanding vaccine availability further fueled the market's appetite for risk. That appetite was voracious for the stocks of companies poised to benefit most from economic reopening and recovery, keeping small cap well ahead of the pack along with cyclical and financial issues. The resurgence of value stocks that began late last year also intensified, with value beating growth by the widest margin since Q1 2001.

Portfolio Performance & Developments

Cooke & Bieler's Mid Cap Value Strategy returned 12.62% gross of fees (12.42% net of fees), slightly underperforming the Russell Midcap® Value Index, which returned 13.05%. Sector allocation effect was modestly additive, but was more than offset by negative stock selection effect. Financials, which represents one of the largest sector weights in the portfolio, detracted most – despite all except two holdings posting positive absolute results. Industrials and Information Technology stocks were also a headwind. Conversely, the portfolio's Health Care and Consumer Discretionary companies contributed to relative performance, with especially strong returns from Labcorp, American Eagle, and Hanesbrands. Over the trailing twelve months, the strategy has recovered well post-pandemic, posting strong absolute performance and significantly outperforming the Index over that period. The portfolio has benefited from generally positive sector allocation effect and favorable stock selection within Consumer Discretionary, Real Estate, and Information Technology holdings.

Five Largest Contributors/Detractors

	Avg Weight (%)	Total Return (%)	Contrib. to Return (bps)		Avg Weight (%)	Total Return (%)	Contrib. to Return (bps)
American Eagle	3.1	46.4	143	IAA	2.5	-15.1	-36
AerCap	2.8	28.9	77	Leidos	2.6	-8.1	-21
Acuity Brands	2.0	36.4	68	Perrigo	1.9	-9.0	-21
Hanesbrands	1.7	36.0	68	FirstCash	2.8	-5.8	-5
TCF Financial	1.6	29.5	63	Helen of Troy	2.5	-5.2	-4

Source: FactSet

Past performance is not indicative of future results. The performance attribution is an analysis of a representative Mid Cap Value institutional portfolio's gross of fees return relative to the Russell Midcap® Value Index. The holdings identified do not represent all of the securities purchased, sold, or recommended for Cooke & Bieler's Mid Cap Value clients. To obtain the calculation's methodology and a list showing every holding's contribution to the overall account's performance during the quarter, contact your client service representative or email your request to contact@cooke-bieler.com.

Largest Contributors

American Eagle Outfitters (AEO), a leading teen and young adult retailer operating through the American Eagle and Aerie brands, was the largest contributor. AEO reported strong earnings despite ongoing COVID-related store closures and outlined a plan to double sales in their Aerie brand over the next three years while improving profitability.

AerCap (AER), the largest independent aircraft lessor, was the second-largest contributor. AER benefited from increased optimism for a post-COVID travel rebound. Astute management and their status as a secured lender to airlines around the world allowed them to weather the pandemic without raising new capital and positioned them to acquire GE's aircraft and engine leasing business. This deal will make AER by far the largest aircraft lessor in the world and should enhance shareholder returns for years to come.

Acuity Brands (AYI), a leader in lighting luminaires and controls, was the third-largest contributor. AYI's solid results and ability to maintain strong gross margins in a difficult commercial real estate environment increased investor confidence in the stock.

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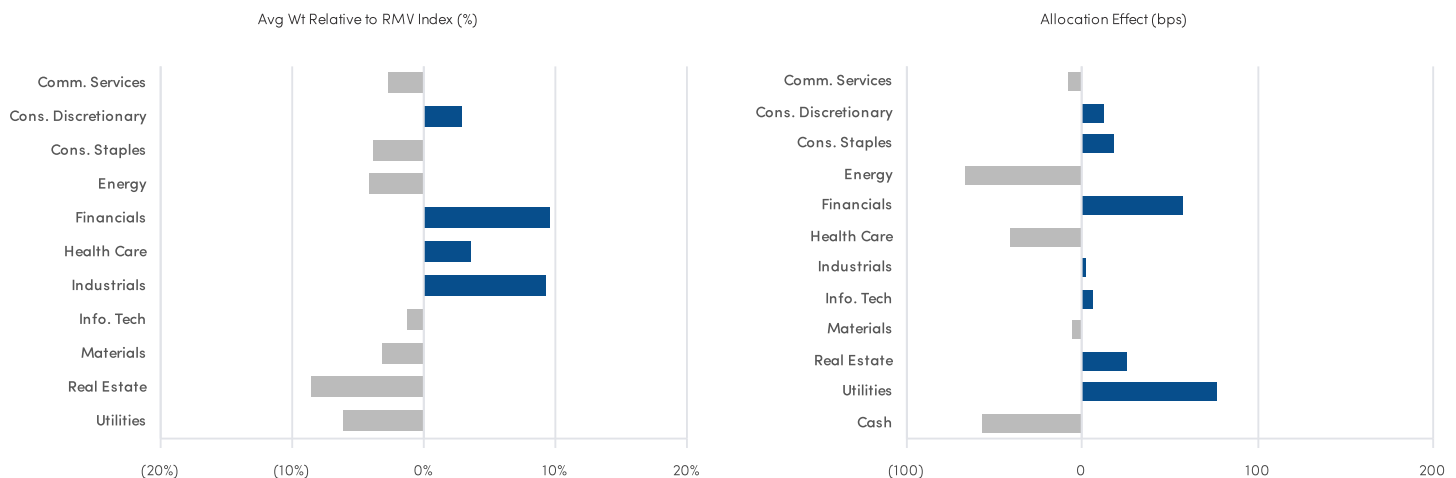
Largest Detractors

IAA (IAA), an owner and operator of a leading auction marketplace for the sale of total loss, damaged, and low value vehicles, was the largest detractor. IAA underperformed as investors drove the stock's valuation down, potentially due to concern over the sustainability of recent elevated average selling prices, worry about short-term disruption related to winter storms in Texas, or disappointment that management did not provide guidance due to COVID-19 related uncertainty.

Leidos (LDOS), a leading provider of information technology and other services to the government, was the second-largest detractor. LDOS suffered from investor concerns about a pause in the defense spending cycle driven by the new Democratic administration. Current deficits resulting from the pandemic also impacted investors' outlook. Lastly, a recent acquisition was poorly timed given the pandemic, as the acquired company is suffering significantly from decreased demand for airport security and related equipment.

Perrigo (PRGO), a manufacturer and supplier of over-the-counter and generic pharmaceutical products, was the third-largest detractor. PRGO lagged during the quarter due to short-term earnings pressure from an unusually mild cold season and the lingering effects of last year's pantry loading.

Sector Positioning



Source: FactSet

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Sector allocation effect was additive for the quarter, with the majority of sectors contributing to the strategy's outperformance. The portfolio's meaningful underweight in Utilities, one of the benchmark's worst performing sectors, and the overweight to Financials were the most notable drivers. The underweights to Real Estate and Consumer Staples were also additive as perceived safe-haven sectors did not fare as well during the continued market exuberance. Partially offsetting these positive results, the portfolio's underweight in Energy was again a headwind given the sector's very strong performance during the quarter. The overweight to Health Care – one of the weaker performers – and the underweight to Communication Services and Materials holdings also detracted from relative results.

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Initiations

Armstrong World Industries (AWI) is the leading North American manufacturer of non-residential ceiling systems. Its pricing power, mix trends, and margins are among the most favorable and consistent in the building products industry. AWI's commercial new construction and renovation end markets are depressed due to COVID-related weakness, but the favorable competitive dynamics and profitability of AWI's mineral fiber ceilings business should persist after non-residential construction activity recovers. Mix tailwinds should accelerate as a broader set of customers seek out more differentiated ceiling tiles and systems designed to improve air quality.

Atmos Energy (ATO) is one of the largest regulated gas utilities in North America. With over 70% of earnings generated in Texas, Atmos has favorable regulatory relationships and a long runway of capital projects centered around modernizing their distribution and transmission system to improve safety and reliability. ATO's low debt levels and dividend payout ratio provide flexibility and lessens the company's dependence on the equity markets to fund its growth. Negative investor sentiment and concerns about the role of natural gas utilities in decarbonization created an opportunity for us to enter the position. We monitor these risks and believe them to be generally overstated relative to ATO's fundamentals. Given ATO's advantageous geographic footprint and the favorable economics for gas utility customers, we believe the company has a good line of sight to strong fundamental returns over the next decade.

Stanley Black & Decker (SWK) is an industrial and household tools manufacturer with strong brands and technologies. We expect that they should have a significant opportunity to expand distribution in their lawn products segment through their acquisition of MTD Products.

Eliminations

Donaldson (DCI), Eaton (ETN), Johnson Controls (JCI), and Snap-on (SNA) reached their price targets and were eliminated.

TCF Financial (TCF) was eliminated to make room for better opportunities in the wake of their acquisition by Huntington Bancshares.

Outlook

Markets are clearly forecasting a strong recovery fueled by pent up consumer demand and ongoing fiscal and monetary stimulus. However, with indices well above pre-pandemic levels, even a strong recovery may not be enough to sustain further gains. Though investors are prone to forget it in moments of enthusiasm, valuations matter – and large parts of the market are currently expensive even relative to optimistic assumptions. The most extreme examples of this disconnect are currently found among smaller capitalization stocks, where in some cases social media has driven waves of buying, willfully oblivious to any fundamental assessment of value. However, valuations are stretched among larger capitalization stocks as well, and at current prices we are quite sure many of these investments will turn out badly.

While markets are efficient over the long run, in the short term they are driven by human emotion and it is impossible to predict when fickle natured sentiment will turn. The wise investor must remain focused on business fundamentals and valuations. A year ago – in light of a once-a-century pandemic – we were working diligently to re-underwrite the portfolio, with a focus on companies' abilities to survive a severe and prolonged downturn. Today, our challenge is finding value in a market that has quickly forgotten about risk. Regardless of the market environment, the core features of our process and discipline remain consistent: exhaustive research to identify businesses that can compound value, insistence on conservative balance sheets that can withstand economic shocks, and a patient focus on buying businesses below intrinsic value.

Sources: Advent Portfolio Exchange, Bloomberg, FactSet, Russell, The Wall Street Journal, Zacks Investment Research

Past performance is not indicative of future results. The material presented represents the manager's assessment of the Mid Cap Value institutional portfolio and market environment at a specific point in time and should not be relied upon by the reader as research or investment advice regarding any particular security or sector. The above commentary and portfolio attribution are based on a representative Mid Cap Value institutional portfolio for the quarter ending 3/31/21. The portfolio attribution is gross of fees. Certain client portfolios may or may not hold the securities identified above due to the respective account's guidelines, restrictions, required cash flows, or other relevant considerations. The performance attribution is an analysis of the portfolio's return relative to the Russell Midcap® Value Index. The holdings identified do not represent all of the securities purchased, sold, or recommended for Cooke & Bieler's Mid Cap Value clients. To obtain the calculation's methodology and a list showing every holding's contribution to the overall account's performance during the quarter, contact your client service representative or email your request to contact@cooke-bieler.com.

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