Cooke & Bieler

Q1 2022

Mid Cap Value Equity

Overview

Stocks turned in their worst performance since the onset of the pandemic two years ago as investors processed a seeming tsunami of bad news and pushed all major indices into negative territory. The Russian invasion of Ukraine signaled not just the largest European war in 75 years, but perhaps the most aggressive sanctions regime in history. The combination touched off a price surge in oil and other commodities, further fueling inflationary trends that were already running at 40-year highs and sending 10-year treasury yields to their highest level in two years. Recent history would suggest the Federal Reserve would react to these shocks by communicating their ability and willingness to ease monetary conditions to protect the economy. However, with their COVID-era stimulus measures still very much in force and inflation at worrying levels, the Fed instead embarked on what is forecast to be an extended tightening process by raising rates a quarter of a point in March.

The tumultuous macro backdrop led to considerable volatility and a wide dispersion of returns across sectors. The markets sold off sharply in January and February. Growth indices were particularly hard hit, as investors began to price in the impact of higher rates on these long-duration assets. March, however, brought a wave of buying, spurring a partial recovery in growth and pushing value indices almost to break-even for the quarter. As is to be expected in turbulent times, larger capitalization stocks generally performed better than smaller ones. Among sectors, Energy was the standout with soaring oil prices driving shares across the capitalization spectrum up more than 35%. Conversely, investors worried about the impact of inflation, rising rates, and general uncertainty on consumer spending and corporate margins, which drove shares of Consumer Discretionary companies down close to 10% for the quarter.

Portfolio Performance & Developments

Amidst another tumultuous quarter, Cooke & Bieler's Mid Cap Value Strategy underperformed the Russell Midcap® Value Index, posting -4.46% gross of fees (-4.64% net of fees) against a -1.82% return for the benchmark. Sector allocation effect accounted for more than all of the portfolio's underperformance, while the favorable impact of stock selection partially offset these results. Selection effect was especially strong in Financials, with insurance companies such as Alleghany, Arch Capital, and Allstate being the most notable contributors. Communication Services holdings also benefited relative results significantly, particularly Activision Blizzard and Omnicom Group. Industrials, Utilities, and Materials contributed modestly as well. Conversely, Consumer Discretionary holdings such as Helen of Troy, American Eagle, and Whirlpool posed a headwind as new recessionary fears only exacerbated existing supply chain and inflation concerns. Health Care, Consumer Staples, and Energy holdings also weighed on performance.

Five Largest Contributors/Detractors

	Avg Weight (%)	Total Return (%)	Contrib. to Return (bps)
Alleghany	2.4	26.9	66
Leidos	2.6	21.9	54
Williams Companies	1.8	30.0	47
Activision Blizzard	2.0	20.4	40
Omnicom	2.2	16.9	33

	Avg Weight (%)	Total Return (%)	Contrib. to Return (bps)
Helen of Troy	3.6	-19.9	-77
American Eagle	1.9	-33.0	-69
AerCap	2.9	-23.1	-65
Stanley Black & Decker	2.1	-25.5	-61
IAA	2.3	-24.4	-59

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

Alleghany (Y), a reinsurance and specialty insurer, was the largest contributor. The company announced it was being acquired by Berkshire Hathaway at a 25% premium to both its book value and its pre-announcement stock price.

Leidos (LDOS), a leading provider of information technology and other services to the government, was the second-largest contributor. LDOS recovered from prior underperformance as investors shifted their views on defense spending in light of the Russia-Ukraine conflict, in addition to higher civilian budgets.

Williams Companies (WMB), a gas infrastructure company that operates over 30,000 miles of pipelines, was the third-largest contributor. WMB benefited significantly from the higher energy prices caused by inflationary pressures and the Russia-Ukraine conflict.

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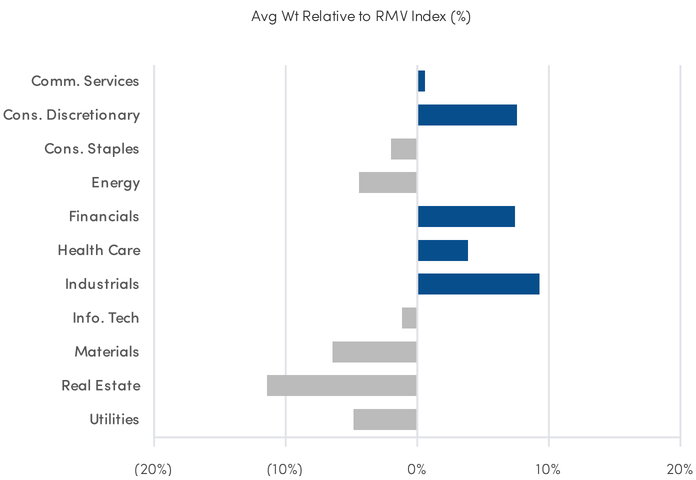
Largest Detractors

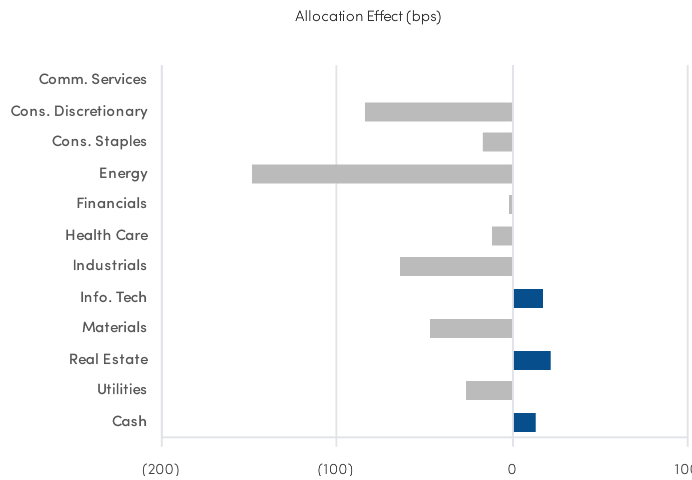
Helen of Troy (HELE), a diversified consumer and household products company, was the largest detractor. As the pandemic fades, HELE has seen above average demand for its home healthcare products normalize. Investors, however, are overlooking the offsetting benefit of economic reopening on its highest margin products, the resilience of its housewares segment, the accretion from its latest acquisition, and the market share momentum in its beauty franchise.

American Eagle Outfitters (AEO), a leading teen and young adult retailer operating through the American Eagle and Aerie brands, was the second-largest detractor. AEO reported strong sales and margins, but results were dampened by increased product and shipping costs. Investors are concerned AEO will struggle to pass on cost increases and will be forced to sacrifice either margins or market share as well as the potential for a consumer recession.

AerCap (AER), the largest independent aircraft lessor, was the third-largest detractor. Investors reacted negatively to the company's exposure to Russian airlines. In response to sanctions, Russian airlines have breached their contracts for aircraft and engines belonging to AER worth about $2.5B. While the fate of these planes and resulting insurance claims is hard to assess, the company's overall exposure should prove to be manageable, and we believe AER remains well positioned longer term.

Sector Positioning





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 sector return relative to the Russell Midcap® Value Index. Please see additional performance disclosures at the end of this document.

Allocation effect detracted from relative performance in the first quarter. An underweight to Energy – by far the standout performer in the benchmark with a return of over 40% – was the primary driver. An overweight to the pro-cyclical Industrials and Consumer Discretionary sectors as well as an underweight to Materials and Utilities posed more modest headwinds. The portfolio's underweight to the more economically sensitive Real Estate and Information Technology sectors generated a partial positive offset.

Initiations

Carmax (KMX) is an independent used car retailer that operates through both brick & mortar and online channels with over $20 billion in annual sales. KMX sells vehicles through direct retail and wholesale auction channels, supporting its retail business with ancillary products such as financing, warranty, and service plans. The company's scale enables it to make more data-driven decisions on its inventory to avoid significant depreciation. We expect KMX to gain share in the fragmented used car market due to its low-friction customer experience, increasing use of technology, and willingness to leverage different business segments to achieve strong results for the company as a whole.

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Eliminations

Reliance Steel (RS) reached its price target and was eliminated.

Outlook

No investment style outperforms against every market backdrop. However, every period of sustained underperformance requires honest introspection about the team's analysis and process as well as an open minded search for potential improvements. With underperformance concentrated in the portfolio's Consumer Discretionary and Industrials holdings, we have re-underwritten these positions, evaluating the drivers of demand for their products, their competitive positions, and pricing power in an inflationary environment. While the market seems to be pricing in a severe consumer recession lasting indefinitely, along with severe margin pressure driven by supply chain disruption and inflation, we believe the portfolio holdings' company-specific long term fundamental drivers remain firmly intact. Moreover, even if the earnings of our holdings were to decline by more than half, certain of these businesses would still trade at single digit multiples of EPS. This combination of attractive fundamentals and enticing valuations justifies the portfolio's concentration in these sectors and sets a strong foundation for longer term prospective investment returns. Conversely, the market's assessment of the Energy sector – the other big driver of portfolio underperformance – has overshot sustainable reality, and here we remain confident in our relatively subdued long term view of these businesses and the resulting underweight position.

While recent performance has been very disappointing, the fundamental performance of our portfolio holdings remains strong, and in most cases has continued improving. Which is not to say that its pro-cyclical tilt is impervious to broader economic weakness, but our experience is that it is better to own businesses that can outperform across cycles rather than guess at short term economic developments. This differentiated perspective and positioning has worked against the portfolio's performance recently, but these unique views have also been the source of significant longer term historical outperformance. Our experience is that patience and steadfast focus is generally rewarded over time.

Sources: APX, Bloomberg, CNBC, The Economist, FactSet, The New York Times, The Wall Street Journal

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 3/31/22. 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.

Additional Cooke & Bieler Mid Cap Value Performance Disclosures