Cooke & Bieler

Q3 2020

Mid Cap Value Equity

Overview

U.S. equity markets continued higher in the third quarter on the heels of further government stimulus, improving economic data, encouraging readouts from COVID-19 vaccine trials, and better clinical outcomes for COVID-19 patients. Though the trend reversed in September, growth stocks again led the charge, with the Russell Midcap® Growth Index up 9.37% for the three-month period versus 6.40% for the Russell Midcap® Value Index. Within the value universe mid cap stocks once again fared best, narrowing the lead amassed by their large cap peers during the Q1 market decline. Given continued resilience in consumer spending and increasing evidence of economic recovery, the generally broad-based market advance included particular strength among Consumer Discretionary and other economically sensitive constituents, though Energy stocks declined meaningfully in the face of persistently low oil prices.

Portfolio Performance & Developments

The third quarter was difficult for active managers and mid cap value managers in particular struggled to keep pace, with only 6% beating the benchmark. Cooke & Bieler's Mid Cap Value Strategy returned 4.77% gross of fees (4.58% net of fees), underperforming the Russell Midcap® Value Index. Negative stock selection effect more than offset the favorable impact of allocation effect. The portfolio's Industrials and Health Care holdings detracted most, with a number of Q2 standouts including AerCap and Hill-Rom surrendering some of their second quarter strength. Materials, Financials, and Communication Services also detracted from relative results. Consumer Discretionary holdings were a bright spot, with stocks such as American Eagle and Whirlpool surging ahead as economies reopened and consumer confidence improved. The strategy's Information Technology and Real Estate holdings also contributed to portfolio performance.

Five Largest Contributors/Detractors

	Avg Weight (%)	Total Return (%)	Contrib. to Return (bps)
American Eagle	2.9	35.9	91
Whirlpool	2.5	42.9	88
IAA	2.3	35.0	67
Gildan Activewear	2.6	27.0	61
Hanesbrands	1.8	40.8	61

	Avg Weight (%)	Total Return (%)	Contrib. to Return (bps)
Hill-Rom	2.3	-23.7	-62
TCF Financial	2.6	-19.6	-55
FirstCash	2.3	-14.8	-41
AerCap	2.2	-18.2	-40
Huntington Ingalls	1.8	-18.8	-36

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. Although disruptions caused by widespread store closures negatively affected reported results, AEO posted solid underlying fundamentals. Their Aerie brand in particular demonstrated strong momentum.

Whirlpool (WHR), a global manufacturer and marketer of home appliances, was the second-largest contributor. WHR executed solidly against a difficult backdrop, posting strong margin performance in North America and offering encouraging commentary on future profitability in its European segment. Strong overall housing and home improvement trends also benefitted share price performance in the quarter.

IAA (IAA), an owner and operator of a leading auction marketplace for the sale of total loss, damaged, and low value vehicles, was the third-largest contributor. Sales in the second quarter were more resilient than feared, as higher revenue per vehicle meaningfully offset lower volumes caused by COVID-19-related declines in driving activity. Industry volumes improved substantially further into the third quarter. IAA's profitability and cash generation capabilities remained promising despite the quarter's overall soft volumes.

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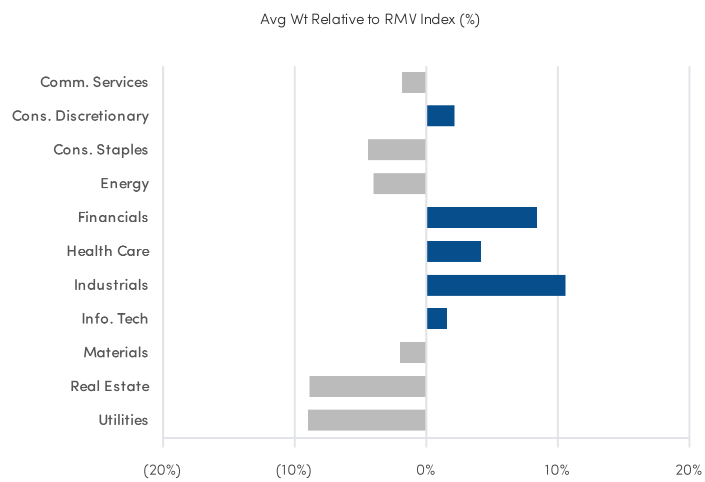
Largest Detractors

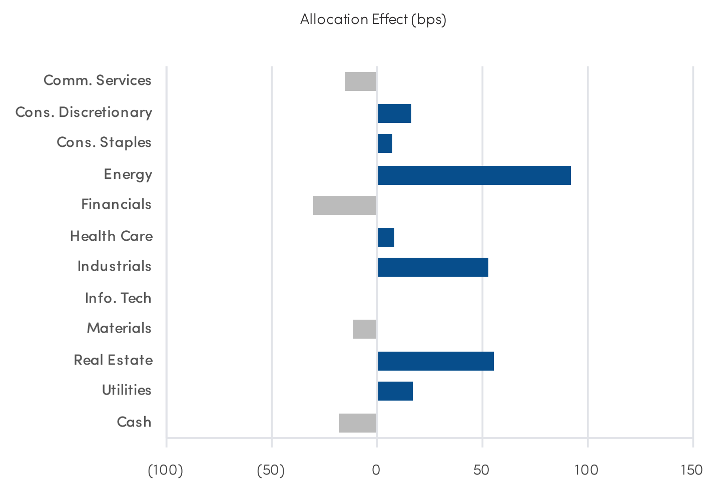
Hill-Rom (HRC), a provider of hospital beds and patient monitoring devices, was the largest detractor. HRC's valuation contracted significantly from its second quarter levels due to uncertainty about the near-term demand for hospital beds.

TCF Financial (TCF), a Midwest bank with a strong deposit base and a diversified lending platform, was the second-largest detractor. TCF lagged during the quarter as a combination of falling interest rates and rising credit costs weighed on expectations for profitability. However, TCF's recent merger with Chemical Financial should provide them with cost saving opportunities that could offset falling rates and credit losses in their diversified and conservatively underwritten loan portfolio.

FirstCash (FCFS), the largest pawn shop operator in North America and Mexico, was the third-largest detractor. FCFS reported a disappointing quarter as a combination of government stimulus payments and lower discretionary spending among their core customers caused a sharp decline in demand for pawn loans. This decline was partially offset by strong retail demand for mobile phones, laptops, and other work-from-home goods sold through their retail operations. While the drop in loan demand was unusual, we expect it to normalize over the coming quarters. The company remains solidly profitable, conservatively financed, and attractively valued.

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.

Strong sector allocation effect benefitted the portfolio's relative performance. An underweight to Energy made the most notable contribution, as the sector posted by far the benchmark's worst return and its only negative return in the quarter. Energy has been incredibly volatile this year – having been the worst performing sector in Q1, the best in Q2, and again the worst in Q3 – and remains the market's weakest sector YTD. The portfolio's underweight to Real Estate and overweight to Industrials were also additive, while an overweight to Financials and underweight to Communication Services and Materials offset some of this positive impact.

Initiations

Gentex (GNTX) is a dominant provider of interior and exterior automatic-dimming mirrors for the automotive industry, with a 90% market share. The company also sells garage opener modules, dimmable aircraft windows, and commercial smoke detectors for the fire protection industry. GNTX's core competencies in chemistry and coatings, glass processing, electronics, vision systems, software design, and automated assembly create optionality in its core market as well as in new markets. We believe that the company's strong competitive position, good secular growth prospects, strong balance sheet, and disciplined program for returning capital to shareholders make it an attractive holding.

Eliminations

Activision Blizzard (ATVI) was eliminated after its market capitalization grew beyond the strategy's appropriate range.

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Outlook

We remain generally constructive on the investing environment. The U.S. economy is exiting a recession and we expect the nascent recovery to persist as people slowly return to many pre-COVID routines, driven by human nature and emboldened by improving therapies and eventually vaccines. This process likely will not be linear, and we expect market volatility along the way, but highly accommodative fiscal and monetary policy should provide continuing support. Offsetting the improving fundamental backdrop to some degree are very high expectations embedded in valuations in parts of the market. As the economy normalizes, we expect investors will better appreciate the enormous valuation disparity between the stocks of companies that have benefitted from the pandemic and those that have been negatively impacted. We have selectively favored the latter group, emphasizing reasonably valued stocks of the best positioned, financially strong companies that possess both staying power and latent fundamental improvement potential. We expect the portfolio to perform well as underlying fundamentals progress and these characteristics are better recognized.

Sources: American College of Cardiology, APX, Axios, Bloomberg, FactSet, Forbes, Jefferies, NIH

Additional Cooke & Bieler Mid Cap Value Performance Disclosures