COOKE & BIELER

Q1 2023

Mid Cap Value Equity

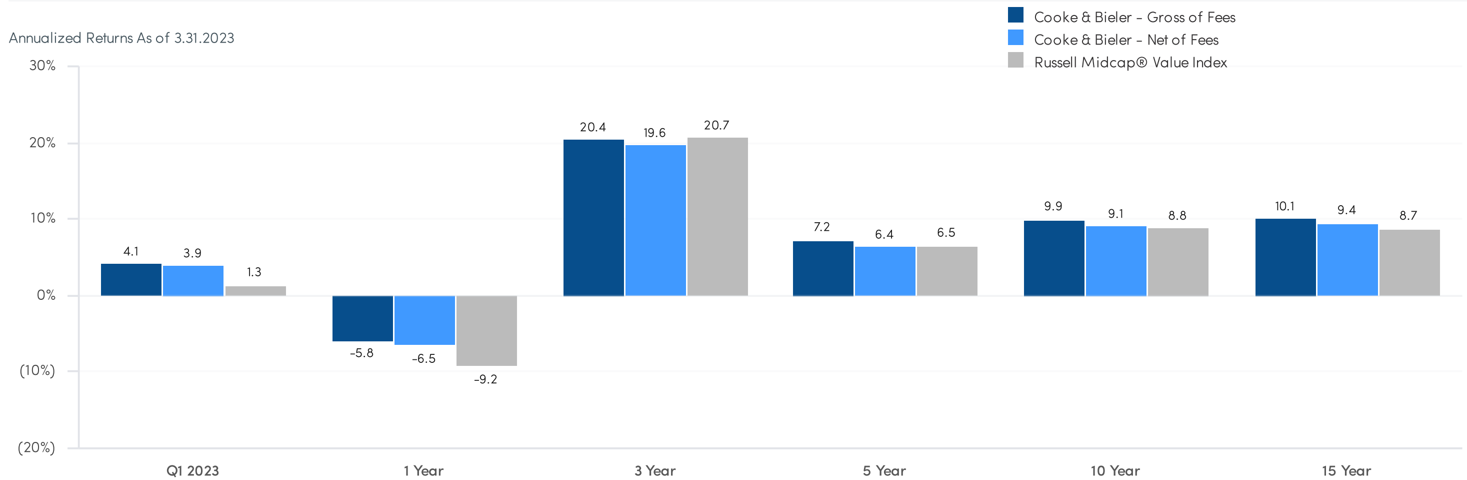
Overview

The first three months of 2023 have already taken markets on an eventful ride. Initially, investors indulged the bullish peak inflation and soft landing narratives that emerged in late 2022, fueling a broad rally through the end of January. Higher than expected inflation reports in early February, though, tempered that enthusiasm and spurred a retreat when hawkish Federal Reserve commentary pushed interest rates higher. By early March, that retreat further deteriorated into a deeper sell-off when several regional banks unexpectedly failed. Almost as quickly, fear gave way to optimism that the crisis would not be systemic. The Fed used its balance sheet to inject substantial liquidity into the banking system and investors embraced the possibility that central banks would change policy course sooner than later. The resulting late quarter market surge ultimately pushed most major equity indices into positive territory. Returns across investment styles, market capitalizations, and economic sectors varied widely, with growth indices advancing sharply, value indices posting flattish results, and large cap stocks outperforming small cap issues. At the sector level, the biggest winners were Information Technology, Communication Services, and Consumer Discretionary constituents – many of which posted double-digit returns. Energy stocks, on the other hand, followed the prevailing trend of last year's leaders becoming this year's laggards, while concerns about the liquidity of smaller banks weighed on Financials stocks at the lower end of the capitalization spectrum.

Portfolio Performance & Developments

Cooke & Bieler's Mid Cap Value Strategy significantly outperformed the benchmark during the volatile first quarter, posting a 4.12% return gross of fees (3.92% net of fees) against the Russell Midcap® Value Index's 1.32% return. Sector allocation effect and stock selection effect were both additive to relative results, with stock selection being the primary driver. Financials holdings continued to shine, with Brookfield Asset Management, Progressive, and RenaissanceRe contributing most. Information Technology and Industrials holdings also added to results. Conversely, Consumer Discretionary holdings continued to struggle, with Helen of Troy, Hasbro, and Hanesbrands detracting most as investors continued to grapple with a potential recession amid mixed economic data.

Mid Cap Value Equity Composite Performance



Source: Factset and Russell®

Past performance is not indicative of future results. All investing involves risk, including loss of principal.

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Contributors & Detractors

Largest Contributors

Open Text (OTEX), an enterprise software company, was the largest contributor. The company reported stronger than expected cloud revenue and cloud bookings, a positive sign in its transition from selling traditional licenses to selling software subscriptions.

Arrow Electronics (ARW), a distributor of electronic components and a solution provider to value added technology resellers, was the second-largest contributor. Investors rewarded ARW for strong execution as it achieved record sales and operating margins, despite a decrease in units sold. Investors generally favored the technology sector this quarter after worrying about the sector's growth prospects last year.

ESAB (ESAB), a manufacturer of welding and gas control equipment and consumables, was the third-largest contributor. Investors rewarded ESAB for strong execution, resulting in organic revenue growth and margin expansion. Following their recent spin-off, management continues to improve its communication to investors – particularly related to bolt-on opportunities within the gas controls space – improving investor sentiment.

Largest Detractors

Helen of Troy (HELE), a diversified consumer and household products company, was the largest detractor. HELE posted weaker year-over-year results despite stronger than expected demand for cold and flu products. Additionally, in early March, the CFO departed and shares retreated on the news. In the interim, the company will be in the capable hands of its previous long-time CFO. In the longer term, we believe recent free cash flow strength should continue and the company should return to its history of margin improvement.

Baxter International (BAX), a manufacturer of a diverse portfolio of lifesaving medical products, was the second-largest detractor. The company has struggled with extensive supply chain disruptions and pervasive input cost inflation over the past year, resulting in a series of earnings disappointments. Recent indications that these issues will continue to weigh on earnings in 2023 pressured the stock's valuation meaningfully.

M&T Bank (MTB), a large regional bank with robust cost discipline and conservative underwriting standards, was the third-largest detractor. MTB suffered from concerns about the stability of the banking system in the wake of the collapse of Silicon Valley Bank. Additionally, investors became increasingly concerned about the company's exposure to credit risk on commercial real estate loans.

Sector Positioning

Sector allocation effect was additive during the first quarter, with most sectors contributing to the strategy's outperformance. Overweight positions in Consumer Discretionary and Industrials were the largest tailwinds while an underweight to Energy was also additive as the sector faltered following strong performance in 2022. Somewhat offsetting these positive results, an overweight to Financials was a headwind as the sector saw instances of indiscriminate selling following the collapse of multiple regional banks. While the strategy is overweight Financials as a whole, it is underweight banks, and we believe those in the portfolio are better capitalized and more conservatively positioned than the broader industry. An underweight to Materials, one of the better performing sectors within the benchmark, also detracted from results.

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Initiations & Eliminations

Initiations

Discover Financial Services (DFS) is an owner and operator of a closed-loop branded credit card network targeting prime consumers. DFS also offers unsecured personal loans in addition to mortgage, home equity, and debt consolidation loans, with assets largely deposit funded. We believe DFS should be able to retain its card niche by making incremental strides in improving its network while maintaining a disciplined credit culture and returning capital to shareholders through share repurchases.

Glacier Bancorp (GBCI) is a regional bank headquartered in Kalispell, Montana, with $26 billion in assets. Operating across eight states in the Mountain West, the company serves mostly rural and secondary markets through 17 local bank brands. This strategy has resulted in a granular and stable deposit base which we believe positions the company well both for the current environment and the longer term.

LKQ (LKQ) is in the business of rebuilding, refurbishing, and distributing aftermarket auto parts. We believe LKQ has significant competitive advantages due to its ability to source used and compromised vehicles at a scale unmatched by its competitors. We also believe LKQ will benefit as insurers increasingly begin to accept recycled parts for auto repairs.

Markel (MKL) is a property and casualty insurance company focused primarily on underwriting hard to place insurance policies (excess and surplus lines). MKL has specialized underwriting expertise, a conservative underwriting culture that focuses on profits over volume, and a management team that acts like owners with a long-term mindset. The company's investment portfolio leans more heavily on public equities than most peers' portfolios, generating higher but more volatile returns while maintaining an investment philosophy that emphasizes quality and capital preservation. MKL has also acquired a collection of privately held non-insurance businesses over the last 15 years.

Teleflex (TFX) is a manufacturer of a diverse portfolio of single-use, disposable medical devices and products used primarily in critical care settings around the world. Over the past decade, management has used the company's strong free cash flow generation and balance sheet to broaden its portfolio through margin accretive acquisitions, supplementing its established portfolio of industry-leading catheters. We believe that the combination should produce attractive organic revenue and earnings growth over time.

Eliminations

Enovis (ENOV) and **Warner Music Group (WMG)** were eliminated to make room for better opportunities.

PACCAR (PCAR) and **Progressive (PGR)** reached their price targets and were eliminated.

Synchrony Financial (SYF) was eliminated due to concerns that the CFPB's proposal to limit credit card late fees could significantly damage the company's business model.

Syneos Health (SYNH) was eliminated due to diminished confidence in the company's long-term fundamental prospects.

Notable Stock Updates

Ritchie Bros. Auctioneers (RBA) owns and operates the leading auction marketplace for used construction, agricultural, mining, and transportation equipment. RBA completed its acquisition of previous portfolio holding **IAA (IAA)** in a stock-and-cash transaction during the quarter. We believe that the combination should accelerate RBA's promising satellite yard strategy and improve IAA's ability to service insurance customers during catastrophic events. We believe there are also significant opportunities for RBA's strong management team to create shareholder value by executing on cost and revenue synergies.

Q1 2023

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Outlook

Having shrugged off the failure of several regional banks and the forced consolidation of a large Swiss banking house, markets enter the second quarter with strong momentum. For the moment, investors seem inclined to take a constructive view of most developments, with strong data taken as a sign of economic resilience and weak data, or signs of financial stress, taken as evidence the Federal Reserve will soon end its year-long series of rate increases. There are clearly risks to this buoyant mood, however, as the effects of the Fed's dramatic tightening program are still materializing and we think more negative surprises seem likely. That said, we have long maintained that it is more productive to focus on company-specific fundamentals than to guess at macroeconomic outcomes. As always, we believe competitively advantaged businesses that create value for their customers, are conservatively managed, and are appropriately financed will generate attractive returns for their shareholders over time if purchased judiciously. Viewed in this light, economic dislocation creates more opportunities than risks for patient and disciplined investors.

Sources: Bloomberg, FactSet, The New York Times

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