Cooke & Bieler

Q2 2021

Small Cap Value Equity

Overview

U.S. equity markets advanced for the fifth consecutive quarter, posting solid gains in the second quarter led by large cap stocks. Though all major indices were up, underlying return composition diverged wildly across style and size. Among small cap stocks, value slightly outperformed growth, while at the other end of the spectrum large cap growth and mid cap growth handily topped value. Across large and mid, the lowest quality companies underperformed. That trend was very different in the small cap value category, where many of the same drivers witnessed early in the year reemerged in late April and non-earning, low sales growth companies dominated the Index return. In fact, one such holding in the Russell 2000® Value Index accounted for 25% of the Index's total return during the quarter.

Portfolio Performance & Developments

Cooke & Bieler's Small Cap Value Strategy lagged the benchmark in the second quarter, returning 1.55% gross of fees (1.29% net of fees) against a 4.56% return for the Russell 2000® Value Index. Sector allocation and stock selection both detracted from the portfolio's relative performance. Weakness in the portfolio's Industrials holdings generated the vast majority of the negative selection effect, mainly due to underperformance by American Woodmark, Air Lease, and BWX Technologies. Materials holdings also weighed on results, predominantly driven by Schweitzer-Mauduit, which was the second largest overall detractor following a strong showing in Q1. Contributions from the portfolio's Financials and Health Care holdings were a partial positive offset, with particularly strong performance coming from FirstCash, Syneos, and Varex Imaging. Despite the relative performance shortfall so far in 2021, absolute performance remains strong, as does absolute and relative performance over longer time periods.

Five Largest Contributors/Detractors

	Avg Weight (%)	Total Return (%)	Contrib. to Return (bps)
Gildan Activewear	4.1	20.9	78
American Eagle	2.4	28.4	65
FirstCash	3.6	16.9	50
Syneos Health	2.6	18.0	43
Varex Imaging	1.3	30.9	34

	Avg Weight (%)	Total Return (%)	Contrib. to Return (bps)
American Woodmark	3.7	-17.1	-67
Schweitzer-Mauduit	2.8	-16.7	-51
Air Lease	2.3	-14.5	-34
Winnebago	3.5	-11.1	-33
BWX Technologies	2.5	-11.6	-29

Source: FactSet
Past performance is not indicative of future results. The performance attribution is an analysis of a representative Small Cap Value institutional portfolio's gross of fees return relative to the Russell 2000® Value Index. The holdings identified do not represent all of the securities purchased, sold, or recommended for Cooke & Bieler's Small 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

Gildan Activewear (GIL), the largest basic apparel manufacturer, was the largest contributor. GIL has seen demand for its imprintable garments rebound as the economy reopens and group events return. Additionally, the company's cost control efforts have structurally improved its margin profile and should increase normal earnings power once demand has fully recovered.

American Eagle Outfitters (AEO), a leading teen and young adult retailer operating through the American Eagle and Aerie brands, was the second-largest contributor. AEO posted strong sales and margins led by its Aerie brand. Long a hidden gem within AEO's business, Aerie has reached a size where it is attracting more attention from investors who are now better reflecting its value in the company's stock price.

FirstCash (FCFS), the largest pawn shop operator in North America and Mexico, was the third-largest contributor. FCFS recovered from underperformance earlier in the year. The company's pawn loan business showed signs of stabilization as government stimulus payments continued to flow through the system and consumer liquidity began to normalize. Their retail merchandise business continues to generate strong margins, benefiting from healthy customer demand as well as reduced competition due to supply chain disruptions and retail closures.

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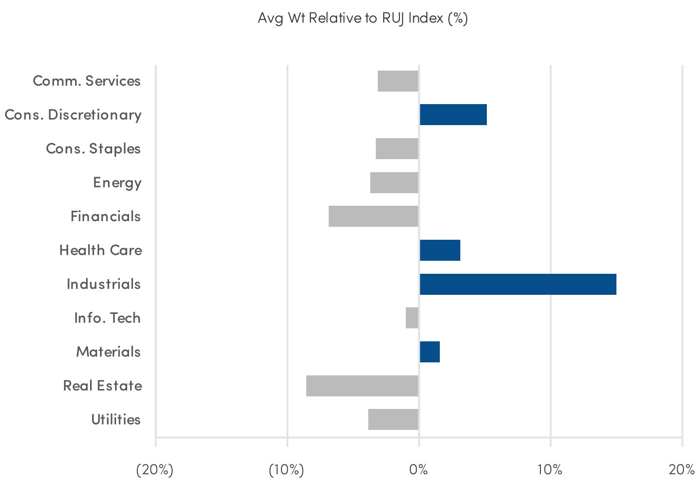
Largest Detractors

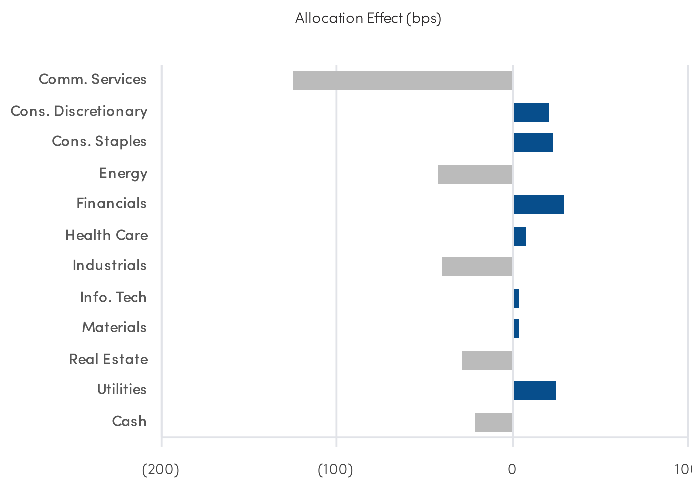
American Woodmark (AMWD), a leading kitchen and bath cabinet manufacturer with a focus on value price points, was the largest detractor. AMWD has seen strong volume trends across all channels, but product pricing is lagging raw material inflation, particularly in lumber prices. The company stands to gain market share as demand for entry-level housing and opening price point cabinets outpaces the growth of the overall housing market. Additionally, AMWD should be able to improve its margin profile as it passes higher input costs onto its customers.

Schweitzer-Mauduit (SWM), an engineered papers and advanced materials manufacturer, was the second-largest detractor. SWM navigated the pandemic well thanks to its diverse mix of products spanning tobacco, industrial, and medical end markets, managing to grow earnings power on an organic basis and complete a well received, transformative acquisition. Recent raw material inflation has created some near-term uncertainty in the company's margin outlook, but we believe its long-term prospects remain favorable.

Air Lease (AL), a leading aircraft leasing company with clients across the globe, was the third-largest detractor. AL gave back some of its post-pandemic gains amid concerns global air travel would be slow to recover as the pandemic continues to rage in much of the world.

Sector Positioning





Source: FactSet
Past performance is not indicative of future results. The performance attribution is an analysis of a representative Small Cap Value institutional portfolio's gross of fees sector return relative to the Russell 2000® Value Index. Please see additional performance disclosures at the end of this document.

Sector allocation effect was negative in the quarter, though it was additive in seven of 11 sectors. The primary driver was an underweight to the breakout benchmark performer, Communication Services. The sector returned more than 50% at the benchmark level, attributable almost entirely to a 400%+ speculative surge in shares of AMC Entertainment. The portfolio's underweight to Energy and Real Estate, as well as its overweight to Industrials, also detracted from relative results. Partially offsetting these headwinds were underweight positions in Financials, Utilities, and Consumer Staples – the only benchmark sectors with negative absolute returns.

Initiations

Ingredion (INGR) is an agricultural commodities refiner that produces sweeteners, starches, and other ingredients. The company has been transitioning away from its prior role as a basic core refiner and into a hybrid core refiner and specialty products company. The specialty products often require more complex conversion steps and garner higher returns for the company.

RenaissanceRe (RNR) is a reinsurer with strong human capital, underwriting tools, and customer relationships. In addition, they are a leading outsourced underwriter for third-party capital, generating accretive (and growing) fee income. They have managed well through a difficult time for the industry, growing book value per share meaningfully and positioning themselves to deploy capital opportunistically into an increasingly attractive underwriting environment. Having sold RNR as it approached fair value in the first quarter of 2020, we were able to re-initiate the position after its market cap fell within the range of our small cap universe due to recent underperformance.

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Eliminations

Axalta Coating Systems (AXTA) was eliminated to make room for better opportunities.

Kadant (KAI) reached its price target and was eliminated.

Extended Stay America (STAY) was acquired by a joint venture between Blackstone and Starwood at a price we believed to be significantly below its intrinsic value.

Outlook

Only a little more than a year ago the global pandemic was raging, the U.S. economy was locked down in deep recession, and the stock market was in free fall. Today, the pandemic is receding quickly in the U.S., the economy is growing at or near unprecedented rates, and the stock market is hitting new highs. Though relieved to be comfortably removed from last year's tumult, we are vigilant by nature and worry that the market has come too far, too fast. We see clear signs of speculation, including very tight high yield spreads, scores of companies going public conventionally and via SPACs, and numerous cases of nonsensical price movements spurred by internet rumors. Surging earnings growth has fueled the optimism, but as the economy laps the worst of the downturn, growth off normalized levels will be more challenging and valuations are stretched in many cases. We see a more trying investing environment going forward – one characterized by greater volatility, more modest and dispersed returns, and driven more by fundamentals than by sentiment.

Our long term, fundamental approach has tended to thrive in similar environments. A year ago, the portfolio favored stocks of financially strong, well-positioned companies that were negatively affected by the initial fallout of the pandemic as investors fled these businesses in favor of perceived safe havens. This paid large dividends in the early stages of the pandemic. Unfortunately, that advantage has more than evaporated over the last 12 months, leaving the portfolio modestly behind the Index since the onset of the pandemic at the beginning of 2020. Nonetheless, we are confident that the style headwinds now working against the portfolio will reverse, and we believe our holdings' current combination of advantaged business economics and discounted valuations creates both upside in an advancing market and downside protection in a challenging one.

Sources: Advent Portfolio Exchange, Barrons, Bloomberg, FactSet, MarketWatch, Morningstar, Reuters, Stock Analysis

Past performance is not indicative of future results. The material presented represents the manager's assessment of the Small 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 Small Cap Value institutional portfolio for the quarter ending 6/30/21. 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 2000® Value Index. The holdings identified do not represent all of the securities purchased, sold, or recommended for Cooke & Bieler's Small Cap Value clients. To obtain the calculation's methodology and a list showing very 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 Small Cap Value Performance Disclosures