COOKE & BIELER

Q3 2019

Small Cap Value Equity

Overview

Though investors seem outwardly skittish, the third quarter's procession of headlines – each one conceivably unsettling enough to derail this longest-ever bull market – came and went with fairly little consequence. The Russell 2000® Value Index (RUJ) generated a -0.57% return, despite a major disruption in the global oil supply, a prolonged trade dispute between the world's largest economies, renewed and amplified appeals for presidential impeachment, and turmoil in the repo market. Investors were not entirely unfazed, sending interest rates tumbling, displaying a slight preference for quality and relative aversion to small cap issues, and reflexively gravitating toward bond-proxy sectors. This choppiness was punctuated by September's significant rotation toward value and away from growth and momentum. But much like last quarter – indeed much like the last 15 years – Q3 felt more tempestuous than its point-to-point return would indicate and revealed new opportunities for patient investors.

Portfolio Performance & Developments

Cooke & Bieler's Small Cap Value Strategy returned 1.61% gross of fees (1.36% net of fees), outperforming the benchmark and extending its first half lead. Style was neither an obvious headwind or tailwind. The strategy's comparative performance was strong in the July and August period when momentum dominated the market and Index returns were negative, but also fared well in the September up-market when value returned to favor. Stock selection effect generated the vast majority of Q3's excess return, while sector allocation effect was also modestly positive. Stock selection results were fairly balanced, having a positive impact in six of the eight sectors where the portfolio had weight. Materials, Industrials, Health Care, and Financials were the strongest performers, while Consumer Discretionary was the largest detractor.

Five Largest Contributors/Detractors

	Avg Weight (%)	Total Return (%)	Contrib. to Return (bps)
Helen of Troy	3.8	20.7	74
Schweitzer-Mauduit	3.4	14.3	47
PRA Group	2.2	20.1	42
Entegris	1.3	26.3	33
Plexus	3.4	7.1	26

	Avg Weight (%)	Total Return (%)	Contrib. to Return (bps)
NOW Inc.	1.7	-22.3	-39
Malibu Boats	1.4	-21.0	-34
TCF Financial	1.9	-8.6	-28
MEDNAX	2.1	-10.3	-25
Gates Industrial	1.8	-11.7	-24

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

Helen of Troy (HELE), a diversified consumer and household products company, was the largest contributor this quarter. The company saw rapid growth in its Housewares division and better than expected sales in its Beauty division. The secular revenue growth and margin potential in its Healthcare segment should become even more apparent now that it has fully lapped some very strong prior year results driven by an unusually severe flu season.

Schweitzer-Mauduit (SWM), an advanced materials provider to tobacco, industrials and auto end markets, was the second-largest contributor this quarter. SWM was a leading detractor last quarter, but this quarter's strong margin performance gave investors renewed confidence in SWM's full year financial performance targets.

PRA Group (PRAA), a buyer and collector of distressed consumer debts, was the third-largest contributor this quarter. The company showed continued progress in improving its margins by reducing its cost to collect and was able to deploy significant amounts of capital into new receivables at what appear to be attractive prices.

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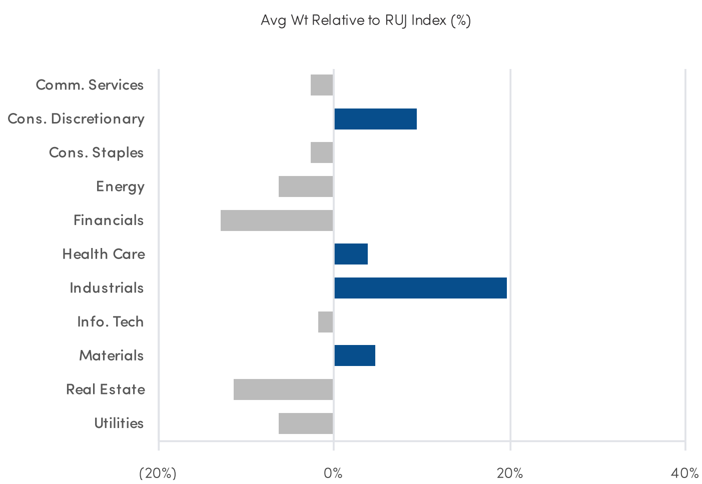
Largest Detractors

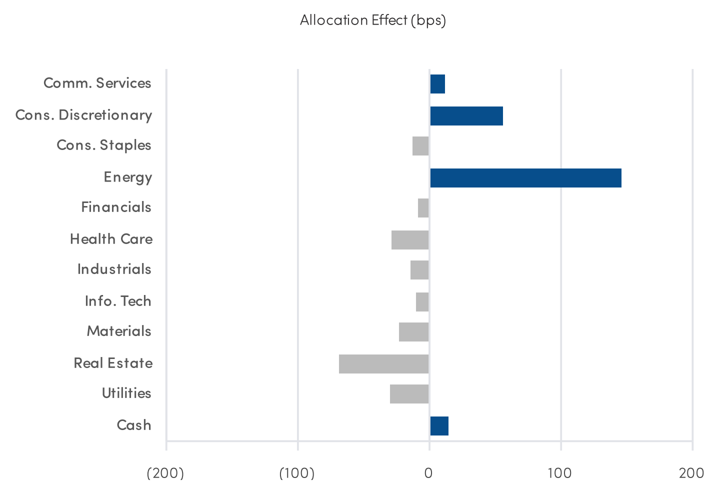
NOW Inc. (DNOW), a distributor of industrial products to oil and gas producers, was the largest detractor this quarter. DNOW's valuation suffered from concerns about global oil demand and softer than anticipated crude prices despite the curtailment of Saudi production following attacks on its facilities.

Malibu Boats (MBUU), the leading manufacturer of performance sports boats, was the second-largest detractor this quarter. Though the performance sport boat category is performing well at the retail level and is outgrowing the overall industry by a wide margin, dealer inventory remains slightly elevated as certain of MBUU's competitors are having less success. Investors are concerned that the promotional environment may intensify and demand may weaken with the broader economy.

TCF Financial (TCF), the new corporate entity resulting from the merger between Chemical Financial and old TCF, was the third-largest detractor in its two months of trading. The combined entity has strong deposit and lending franchises in the Midwest and ample scope for cost cutting. The stock of the new company lagged post-merger for non-fundamental reasons.

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 modestly positive on an aggregate basis. The portfolio's significant underweight in Energy – by far the worst performing sector in the benchmark with a staggering -20.97% return – was the biggest driver. An overweight in Consumer Discretionary and zero weight in Communication Services were also additive. The positive effect in these three sectors overcame the negative allocation effect in every other sector. Portfolio weakness was most pronounced in the high-yielding Real Estate and Utilities sectors, with additional headwinds coming from the portfolio's relative allocations to Health Care, Materials, Consumer Staples, and Industrials.

Initiations

BWX Technologies (BWXT) owns and operates the only two commercial Category 1 NRC-licensed manufacturing facilities in the U.S., making the company an indispensable supplier of naval nuclear reactors needed for submarines and aircraft carriers, which are integral parts of the U.S. Navy's highly visible, long-term ship build plan. This positioning should continue to lead to a steady stream of cash flows that management will ably deploy in a balanced fashion including re-investing capital to sustain its critical core offering, returning capital to shareholders, and investing in adjacent growth opportunities.

Hanesbrands (HBI) is a basic apparel company that sells underwear, intimates, socks, and activewear. The company uses a combination of innovation and brand-building to command premium pricing for its products. Hanesbrands has a low-cost, diversified manufacturing complex, which is 90% owned by the company. Management has several options for increasing shareholder value, including organic growth, margin enhancement, acquisitions, and use of cash flow to repurchase shares or pay down debt. HBI's current valuation too aggressively discounts the potential for a slowdown in its fast-growing Champion brand as well as the threat of private label competition.

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Eliminations

MTS Systems (MTSC) and **World Fuel Services (INT)** were eliminated after reaching their price targets.

HFF, Inc. (HFF) was acquired by **Jones Lang LaSalle (JLL)**. The market capitalization of the combined entity was no longer appropriate for this strategy, so JLL was sold shortly after the acquisition.

Outlook

The stock market enters the fourth quarter with major indices up double digits for the year, but facing a clearly slowing economy and a well-known though concerning list of geopolitical risks. The Fed has signaled its intent to cushion any shocks, but low global interest rates and years of quantitative easing raise questions as to how helpful it can be. With valuations less supportive than they were entering the year, conditions seem likely to get bumpy, although we would not underestimate the market's ability to climb the wall of worry. Regardless of the exact path the markets take, we have learned we can rely on them to be more volatile than their underlying fundamentals – a backdrop conducive to idea generation. As always, our focus is on identifying businesses at compelling valuations that generate attractive fundamental returns for our clients, often taking advantage of others' impatience.

Sources: APX, Bloomberg, CNBC, FactSet, MarketWatch, Morgan Stanley, Reuters, S&P Global, The Hill, The New York Times, The Wall Street Journal, US News

Additional Cooke & Bieler Small Cap Value Performance Disclosures