Cooke & Bieler

Q4 2021

Small Cap Value Equity

Overview

Investors entered the quarter confident that the worst of the COVID-19 pandemic was behind us, while being increasingly numb to pervasive price pressure and supply chain chaos. Sentiment faltered in late November with the emergence of the highly-transmissible Omicron variant and the Federal Reserve's explicit acknowledgement of more deep-rooted inflationary forces. Just as quickly, though, market participants seemed to conclude that these risks were manageable. Omicron's symptoms appeared less severe than previous variants and therapeutic treatments were progressing quickly. And – surprisingly – investors grew convinced the Fed's hawkish pivot would perhaps stifle growth, but would ultimately succeed in quickly tamping the world's inflationary embers.

This magic-bullet theory fueled the market's quick recovery to new highs in December, led by rate sensitive sectors – and pushed full-year performance for Cooke & Bieler's value benchmarks to impressive levels. Larger cap stocks generally outperformed small cap issues, but style trends were mixed, with growth beating value handily at the upper end of the capitalization spectrum and lagging among small and mid-cap stocks. For the full year, small and mid-cap growth stocks significantly lagged their value peers, while large cap growth stocks outperformed value for the fifth consecutive year.

Portfolio Performance & Developments

Cooke & Bieler's Small Cap Value Strategy outperformed the benchmark in the fourth quarter, returning 4.71% gross of fees (4.45% net of fees) against a 4.36% return for the Russell 2000® Value Index. Allocation effect was additive, while stock selection effect detracted from results. Selection was most negative among the portfolio's Industrials holdings, owing mostly to BWX Technologies and IAA. Financials holdings also posed a headwind to relative performance. The portfolio's Health Care holdings meaningfully outperformed their benchmark counterparts and provided a partial offset. Information Technology and Energy holdings were also positive contributors to stock selection effect. For the full year, despite strong absolute returns, the portfolio lagged the benchmark – this was largely due to stock selection within Industrials and Consumer Discretionary holdings, as well as underweight positions in Energy and Real Estate. However, over three and five-year periods, the portfolio has strongly outperformed the Index.

Five Largest Contributors/Detractors

	Avg Weight (%)	Total Return (%)	Contrib. to Return (bps)
H.B. Fuller	2.2	25.8	54
Gildan Activewear	3.4	16.5	51
PGT Innovations	2.9	17.7	49
Rush Enterprises	2.1	23.6	48
Syneos Health	2.7	17.4	45

	Avg Weight (%)	Total Return (%)	Contrib. to Return (bps)
FirstCash	2.7	-14.2	-37
Schweitzer-Mauduit	2.1	-12.5	-27
BWX Technologies	2.3	-10.7	-24
Perrigo	1.7	-17.3	-23
IAA	3.4	-7.2	-21

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

H.B. Fuller (FUL), a leading global manufacturer of adhesives, was the largest contributor. The company executed well in a difficult environment by effectively offsetting elevated raw materials costs with price increases and gaining market share through product availability and innovation.

Gildan Activewear (GIL), the largest basic apparel manufacturer, was the second-largest contributor. Gildan's revenues now exceed pre-pandemic levels on a run rate basis despite depressed end market demand. In addition, the company's structural margin improvement efforts have pushed normal earnings power 50% higher than in 2019.

PGT Innovations (PGTI), a leading manufacturer of laminated, impact-resistant residential windows, was the third-largest contributor. PGTI generated good organic growth in both its Southeastern and Western business groups as housing starts and renovation activity remain robust. Pricing actions have begun to flow through to margins and the company should see year-over-year margin improvement in the upcoming quarter.

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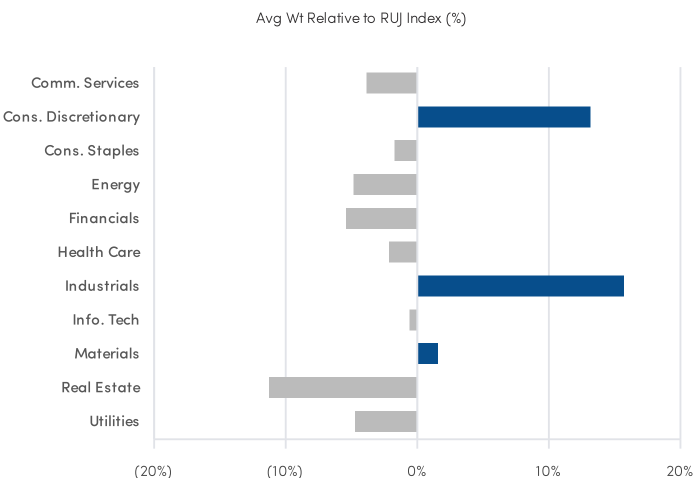
Largest Detractors

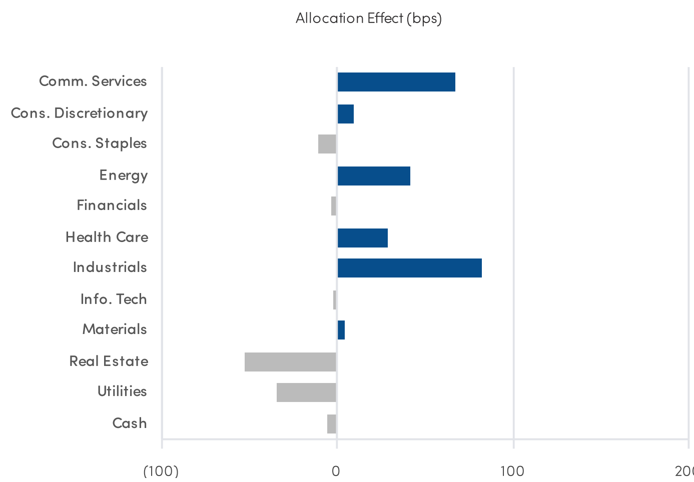
FirstCash (FCFS), the largest pawn shop operator in North America and Mexico, was the largest detractor. FCFS gave back gains made earlier in the year as investors reacted negatively to their acquisition of American First Finance, a fast growing lease-to-own business. Although there is a significant overlap in target customers, investors worried that the acquisition would shift the company's focus away from its core pawn business.

Schweitzer-Mauduit (SWM), an engineered papers and advanced materials manufacturer, was the second-largest detractor. SWM continues to face supply chain bottlenecks which are preventing the company from fully satisfying end user demand in certain of its faster growing product categories.

BWX Technologies (BWXT), a provider of nuclear reactors needed for submarine and aircraft carrier propulsion, was the third-largest detractor. The company provided medium term guidance below consensus expectations and discussed elevated investments in both their medical radioisotopes product and in capacity expansion to accommodate increasing shipbuilding rates. While earnings growth will likely be muted in the short term, free cash flow generation should be significant.

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 additive for the quarter. An overweight to Industrials, one of the benchmark's top performing sectors, and an underweight to the benchmark's worst-performing sector, Communication Services, were the most significant drivers of performance. The strategy's underweight to the Energy sector, which surrendered some performance after a strong start to the year, and its underweight to the Health Care sector, which was hampered by struggling biotech constituents, also added to results. Conversely, underweight positions in Real Estate and Utilities detracted from performance.

Initiations

Huntington Ingalls (HII) is a military shipbuilder for the U.S. Navy, and is the Navy's sole supplier for nuclear-powered aircraft carrier construction, refueling, and deactivation. The American military ship-building business is a low-growth but stable duopoly driven by long construction lead times and long term contracted backlogs. With the recent award of two carriers, HII's backlog has expanded from two to five times its revenue. HII's well protected and highly visible revenues, in addition to probable modest margin increases and the winding down of their current capital expenditure schedule, make it an attractive holding.

Eliminations

Hexcel (HXL) was eliminated to make room for better opportunities.

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Outlook

Following a strong finish to an exceptionally strong year, equity markets enter the new year ostensibly in good shape. The U.S. economy undeniably has positive momentum supported by growing demand, which is attributable to declining unemployment, higher wages, and ongoing effects of unprecedented fiscal stimulus. Household and corporate balance sheets are healthy. Consequently, earnings are poised to continue growing and could surprise to the upside if supply chain pressures ease. Interest rates remain low and valuations contracted in 2021 as earnings growth exceeded stock price appreciation. Overall, stocks are not egregiously expensive and in some cases are attractive. Investor optimism is understandable.

While we share some of the optimism, we see a more challenging investing environment going forward. The economy has normalized for the most part, and highly supportive fiscal and monetary policies are winding down. Input cost increases, labor shortages, and supply chain disruptions are potential threats to corporate profitability, as is the low inflation and interest rate backdrop that has stoked equity market sentiment for years. The ride for investors is likely to get bumpier and less rewarding, with returns more modest and varied at the stock level, depending on the interplay between fundamental performance and expectations embedded in valuations.

We are unequivocally optimistic about the portfolio. Though it was not reflected in 2021 relative performance, we were pleased with the portfolio's fundamental progress which far outpaced its return during the year, leaving it with an unusually enticing valuation profile entering 2022. The portfolio is composed of a select group of quality companies with favorable underlying economics consistent with our long standing bottom-up fundamental approach. 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. Today, many of these safe-haven businesses have been left behind in the enthusiasm for the recovery. Some of them have solid long-term growth profiles and we are identifying opportunities among this set, positioning the portfolio in reasonably-priced companies poised to compound earnings power at attractive rates, with less economic sensitivity than a year ago. That combination of advantaged business economics and discounted valuations creates both upside in an advancing market and downside protection in a challenging one.

Sources: APX, Bloomberg, CNBC, CBS, The Economist, FactSet, Forbes, Washington Post

Additional Cooke & Bieler Small Cap Value Performance Disclosures