COOKE & BIELER

Q2 2020

SMID Cap Value Equity

Overview

Equity indices staged a remarkable comeback in the second quarter following last quarter's quickest-ever bear market descent. Posting their best quarterly return since 1998, U.S. stocks shrugged off the continued spread of the coronavirus, dismal real-time economic data, and nationwide civil unrest sparked by the death of George Floyd. Buoyed by massive government stimulus, the hope for a COVID-19 vaccine, and indications of sequential economic improvement, value stocks performed well on an absolute basis, with the Russell 2500™ Value Index (R25IV) returning 20.60%, but they again lagged their growth counterparts. Perhaps not surprisingly, this quarter was often a story of reversals, with many stocks and sectors hardest hit in the first quarter performing best in Q2, while the strongest performers in Q1 often advanced the least in the second quarter.

Portfolio Performance & Developments

Cooke & Bieler's SMID Cap Value Strategy returned 27.86% gross of fees (27.60% net of fees), significantly outperforming the benchmark and more than offsetting its underperformance from the first quarter. Both stock selection and allocation effect were additive, with allocation effect generating the majority of the portfolio's excess return. Stock selection effect was strongest within Industrials – the sector which posed the biggest headwind in the first quarter – as some of the worst performing stocks during the March downdraft such as Colfax and PGT Innovations recovered strongly. Stock selection effect within Consumer Discretionary and Information Technology was also additive. Negative selection results came only from the Health Care sector, which posted the third best absolute benchmark return during the second quarter.

Five Largest Contributors/Detractors

	Avg Weight (%)	Total Return (%)	Contrib. to Return (bps)
Winnebago	4.6	140.7	478
Colfax	3.2	40.9	143
PGT Innovations	2.0	86.9	134
Syneos Health	2.8	47.8	133
Arrow Electronics	3.4	32.4	118

	Avg Weight (%)	Total Return (%)	Contrib. to Return (bps)
Varex Imaging	1.9	-33.3	-78
IAA	0.7	-1.8	-22
Alleghany	1.5	-11.4	-20
FirstCash	2.1	-5.6	-13
PRA Group	0.1	-4.3	-8

Source: FactSet
Past performance is not indicative of future results. The performance attribution is an analysis of a representative SMID Cap Value institutional portfolio's gross of fees return relative to the Russell 2500™ Value Index. The holdings identified do not represent all of the securities purchased, sold, or recommended for Cooke & Bieler's SMID 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

Winnebago (WGO), a leading manufacturer of recreational vehicles, was the largest contributor. WGO recovered forcefully from its first quarter lows due to surging retail demand for recreational vehicles as consumers sought out open-air, domestic vacation alternatives in the face of COVID-19 related travel restrictions and transmission fears. These purchases by first-time RV consumers should augment WGO's already strong market share momentum.

Colfax (CFX), an acquisitive conglomerate with strong welding and orthopedic franchises, was the second-largest contributor. After the stock underperformed during the first quarter, investors were pleasantly surprised to find that CFX's results prior to the emergence of COVID-19 were stronger than expected. Management also assuaged investor concerns over a potential debt covenant issue by amending their revolver at a minimal cost.

PGT Innovations (PGTI), a leading manufacturer of laminated, impact-resistant windows, was the third-largest contributor. PGTI posted strong first quarter results and indicated that it could exit the second quarter at a flat year-over-year growth rate in its core Florida construction markets, despite the economic slowdown.

SMID Cap Value Equity

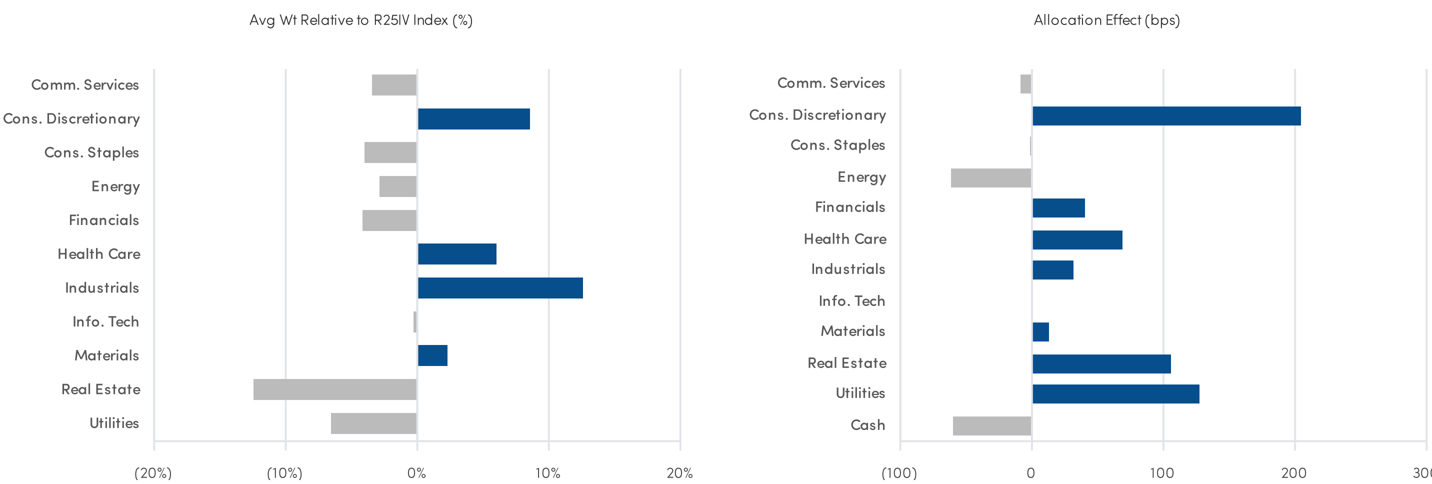
Largest Detractors

Varex Imaging (VREX), a designer and manufacturer of x-ray components, was the largest detractor. Recent results suggest that the business will be significantly negatively affected by the coronavirus pandemic, putting a large financial strain on the company.

IAA (IAA), an owner and operator of the leading marketplace for the sale of loss, damaged, and low value vehicles, was the second-largest detractor. IAA was a new portfolio holding this quarter, purchased during the second half of the quarter. We were drawn to IAA's strong market share in the consolidated and secularly growing North American salvage auction industry along with its durable competitive advantages and credible margin expansion opportunities.

Alleghany (Y), a diversified insurance and reinsurance company, was the third-largest detractor. The underfollowed insurer was left behind by the strong market really despite the lack of any negative fundamental news. Having initiated Y late in the first quarter, we used the weakness to build out the position.

Sector Positioning



Source: FactSet
Past performance is not indicative of future results. The performance attribution is an analysis of a representative SMID Cap Value institutional portfolio's gross of fees sector return relative to the Russell 2500™ Value Index. Please see additional performance disclosures at the end of this document.

Sector allocation effect was positive in eight of 11 economic sectors and accounted for approximately 60% of the portfolio's excess return in the second quarter. Key drivers included the portfolio's overweight to Consumer Discretionary – the second best performing sector within the benchmark – and an underweight to Utilities and Real Estate – two of the worst performing sectors within the benchmark. The portfolio's underweight in Energy posed a modest headwind in the quarter as benchmark constituents rebounded from their first quarter lows, but the sector remains the biggest laggard year to date.

SMID Cap Value Equity

Initiations

Arch Capital Group (ACGL) was added back to the portfolio after it was eliminated in early January 2020 to make room for better opportunities. Subsequent market volatility provided the opportunity to reinitiate the stock three months later at about 40% below our exit price and at a significant discount to our estimate of fair value. Our original thesis – that ACGL's niche approach to underwriting, emphasis on risk management, and appreciation for capital preservation will lead to above-average returns – has not changed. We believe their market position is likely to strengthen during any prolonged downturn.

American Woodmark (AMWD) is the second-largest residential cabinet and vanity manufacturer in the United States. AMWD is a demonstrated share gainer thanks to its competitively advantaged, low-cost supply chain. Having recently acquired a leading manufacturer of in-stock cabinetry sold at a lower price point – a category in which AMWD has not previously participated – management intends to leverage its unique installation network and existing relationships to penetrate the entry-level housing and multifamily market segments.

IAA (IAA) owns and operates a leading marketplace for the sellers of total loss, damaged, and low value vehicles, with approximately 80% of sales volume coming from insurance companies. The company has about 200 sites across the U.S., Canada, and the U.K., many close to major population centers. These sites provide a broad facility footprint that improves pick-up, storage, titling, and turnaround to an eventual online sale to a highly fragmented group of diverse and global buyers. IAA has strong market share in the consolidated and secularly growing North American salvage auction industry. The company's competitive advantages (scale, relationships, network effect, technology, well-located sites, and processing and logistics expertise), in combination with execution of credible margin expansion opportunities, should lead to attractive incremental returns on capital and strong free cash flow generation.

Eliminations

Norwegian Cruise Lines (NCLH) was eliminated as the cessation of all sailings due to COVID-19 caused the stock to become unanalyzable.

PRA Group (PRAA) was sold to make room for better opportunities.

Outlook

The market's resilience in the midst of unimaginable circumstances has been no less than miraculous. Just three months ago we warned against reflexively seeking safety. Now, with stock prices nearly back to pre-pandemic levels and many valuations at historic highs, we worry investors are being cavalier about still elevated economic, political, and social uncertainties. This quick and sharp reversal reflects the fickle, unpredictable nature of investors' impulses. We recognize sentiment often moves markets in the short term, but sentiment-driven strategies transform investing into a game of chance. We also know that fundamentals ultimately drive stock prices and that companies with sustainable, favorable underlying economics are positioned to drive long-term outperformance. So, as always, we remain intently focused on long-term fundamental investing. Given current circumstances, we are evaluating the portfolio's existing and prospective holdings through the lens of two critical questions: does the company have the near-term financial wherewithal and liquidity to endure a prolonged economic downturn, and is the business positioned to thrive in the post-COVID world. We are confident the portfolio is composed of companies well positioned to survive the downturn and ultimately succeed. The market recently began to recognize these characteristics after largely ignoring them during the February/March meltdown, but there appears to be further upside based on the portfolio's meaningfully discounted valuation.

Sources: APX, Bloomberg, FactSet, Forbes, Financial Times, MarketWatch

Additional Cooke & Bieler SMID Cap Value Performance Disclosures