Cooke & Bieler

Q2 2021

SMID 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.

Portfolio Performance & Developments

Cooke & Bieler's SMID Cap Value Strategy lagged the benchmark in the second quarter, returning 2.29% gross of fees (2.07% net of fees) against a 5.00% return for the Russell 2500™ Value Index. Sector allocation and stock selection both detracted from the portfolio's relative performance. Weakness in the portfolio's Industrials holdings generated more than all of the negative selection effect, mainly due to underperformance by American Woodmark, AerCap, 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 Consumer Discretionary and Health Care holdings were a partial positive offset, with particularly strong performance coming from Gildan, American Eagle, and Syneos. 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	3.7	20.9	67
American Eagle	2.4	28.4	64
Syneos Health	2.4	18.0	40
FirstCash	2.7	16.9	37
Varex Imaging	1.3	30.9	33

	Avg Weight (%)	Total Return (%)	Contrib. to Return (bps)
American Woodmark	2.6	-17.1	-46
Schweitzer-Mauduit	2.5	-16.7	-44
Winnebago	3.6	-11.1	-39
AerCap	2.8	-12.8	-36
BWX Technologies	2.4	-11.6	-28

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

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.

Syneos Health (SYNH), an outsourced contract research organization, was the third-largest contributor. SYNH outperformed due to continuing strong new business wins, profitability improvement, and accelerating industry consolidation.

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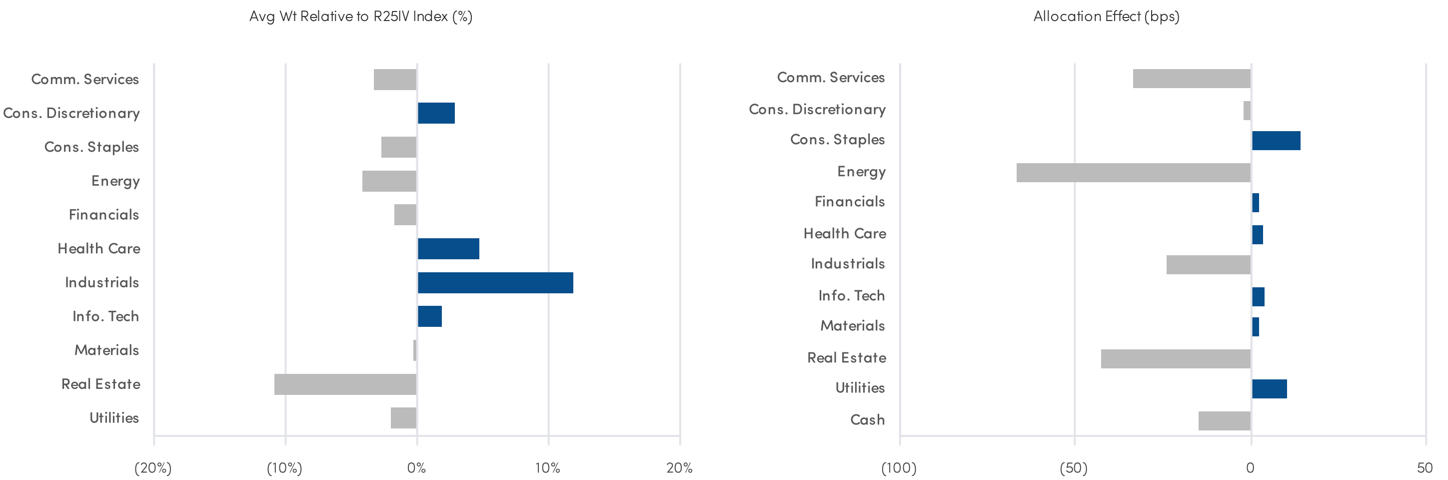
Largest Detractors

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.

Winnebago (WGO), a leading manufacturer of recreational vehicles, was the third-largest detractor. WGO has continued to perform well on a fundamental basis by winning shares in the towables market segment, improving margins in its motorized division, and expanding its long-term profit potential. However, the stock suffered due to investor concerns that near-term demand will soften as COVID-related comparisons become more difficult over the next few quarters.

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.

Overall sector allocation effect was negative, though it was additive in six of the 11 sectors. An underweight to the highly volatile Energy sector detracted most, as Energy posted the highest return of all benchmark sectors for both the quarter and the year-to-date periods. Similarly, an underweight to another top performing benchmark sector, Real Estate, was the next largest drag on relative results. Partially offsetting these headwinds were underweight positions in Consumer Staples and Utilities – 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.

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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. 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 on the margin, 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. We believe the 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

Additional Cooke & Bieler SMID Cap Value Performance Disclosures