Cooke & Bieler

Q4 2021

SMID 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 SMID Cap Value Strategy slightly underperformed the benchmark in the fourth quarter, returning 6.20% gross of fees (5.97% net of fees) against a 6.36% return for the Russell 2500™ Value Index. Stock selection effect was additive, though negative allocation effect overwhelmed these results. The portfolio's Consumer Discretionary holdings meaningfully outperformed their benchmark counterparts, owing mostly to Gildan Activewear and Helen of Troy. Information Technology and Health Care holdings were also positive contributors to stock selection effect. Partially offsetting these results, Industrials holdings lagged, particularly BWX Technologies and IAA. For the full year, despite strong absolute returns, the portfolio lagged the benchmark – this was largely due to stock selection within Industrials and Financials holdings, as well as an underweight position in Energy. 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)
Arrow Electronics	3.6	19.6	67
Gildan Activewear	3.7	16.5	54
H.B. Fuller	2.2	25.8	52
Arch Capital	2.9	16.4	45
ReniassanceRe	2.2	21.7	44

	Avg Weight (%)	Total Return (%)	Contrib. to Return (bps)
FirstCash	2.3	-14.2	-34
Perrigo	2.0	-17.3	-33
Schweitzer-Mauduit	1.8	-12.5	-24
BWX Technologies	2.2	-10.7	-23
IAA	2.7	-7.2	-17

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

Arrow Electronics (ARW), a distributor of electronic components and a solution provider to value added technology resellers, was the largest contributor. ARW benefited from significant margin improvement in its core components distribution business. An attractive valuation and share buybacks also caused investors to positively reevaluate the stock.

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.

H.B. Fuller (FUL), a leading global manufacturer of adhesives, was the third-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.

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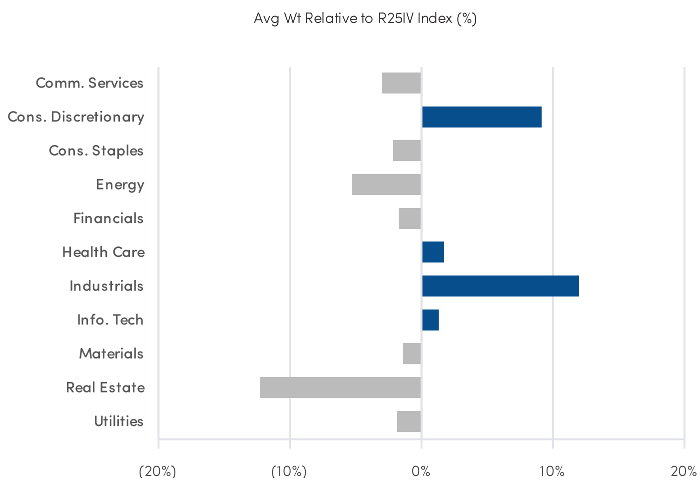
Largest Detractors

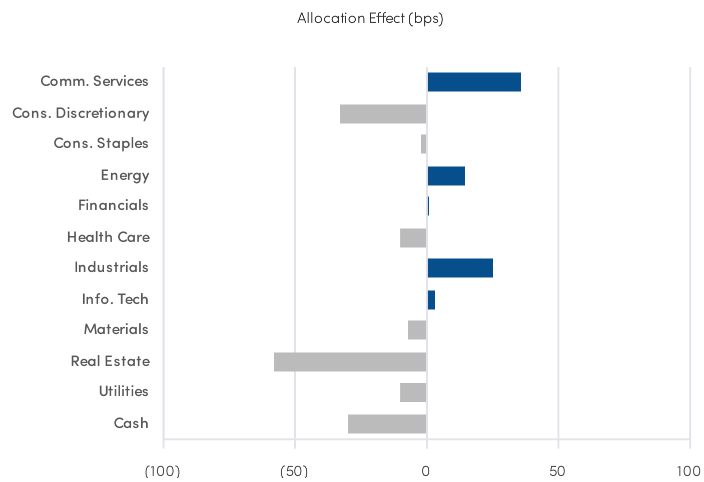
FirstCash (FCFS), the largest pawn shop operator in North America and Mexico, was the largest detractor. FCFS gave back gains made earlier in the year as investors reacted negatively to their acquisition of American First Finance, a fast growing lease-to-own business. Although there is a significant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

Perrigo (PRGO), a manufacturer and supplier of over-the-counter and generic pharmaceutical products, was the second-largest detractor. PRGO reported lower than expected results for the quarter and lowered full year guidance. Significantly reduced incidence of cough and cold symptoms during the pandemic has weighed on the company's top line growth and meaningfully suppressed profitability. We believe that this phenomenon will ultimately prove temporary and that the company's earnings power should recover significantly from current levels.

Schweitzer-Mauduit (SWM), an engineered papers and advanced materials manufacturer, was the third-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.

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 negative for the quarter. The strategy's underweight to Real Estate, one of the benchmark's best performing sectors, was the biggest impediment to relative performance, followed by a significant overweight to Consumer Discretionary, which was one of the benchmark's worst performing sectors. An underweight position in Utilities and overweight to Health Care were also headwinds. Conversely, an underweight to Communication Services, the benchmark's worst performing sector, was a partial positive offset, as was the overweight to Industrials.

Initiations

Leidos (LDOS) is the largest government services and consulting firm. Modernization of government IT infrastructure, growing healthcare spending, and the heightened threat of cyberattacks all result in a good secular backdrop for the company's services. Its current valuation is attractive for a somewhat counter-cyclical business with recurring revenues, sticky long-term customer relationships, meaningful scale, and strong cash generation.

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 SMID Cap Value Performance Disclosures