SMID Cap Value Equity

Q1 2023

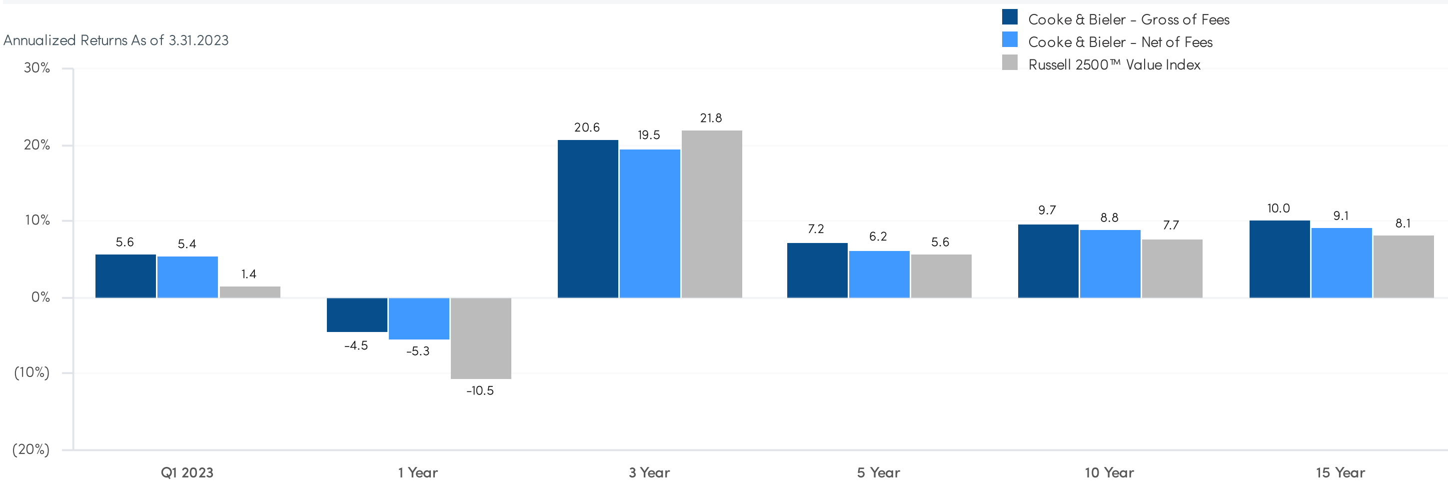
Overview

The first three months of 2023 have already taken markets on an eventful ride. Initially, investors indulged the bullish peak inflation and soft landing narratives that emerged in late 2022, fueling a broad rally through the end of January. Higher than expected inflation reports in early February, though, tempered that enthusiasm and spurred a retreat when hawkish Federal Reserve commentary pushed interest rates higher. By early March, that retreat further deteriorated into a deeper sell-off when several regional banks unexpectedly failed. Almost as quickly, fear gave way to optimism that the crisis would not be systemic. The Fed used its balance sheet to inject substantial liquidity into the banking system and investors embraced the possibility that central banks would change policy course sooner than later. The resulting late quarter market surge ultimately pushed most major equity indices into positive territory. Returns across investment styles, market capitalizations, and economic sectors varied widely, with growth indices advancing sharply, value indices posting flattish results, and large cap stocks outperforming small cap issues. At the sector level, the biggest winners were Information Technology, Communication Services, and Consumer Discretionary constituents – many of which posted double-digit returns. Energy stocks, on the other hand, followed the prevailing trend of last year's leaders becoming this year's laggards, while concerns about the liquidity of smaller banks weighed on Financials stocks at the lower end of the capitalization spectrum.

Portfolio Performance & Developments

Cooke & Bieler's SMID Cap Value Strategy significantly outperformed the benchmark during the volatile first quarter, posting a 5.63% return gross of fees (5.39% net of fees) against the Russell 2500™ Value Index's 1.40% return. Sector allocation effect and stock selection effect were both broadly additive to relative results. Financials and Industrials holdings – namely RenaissanceRe, ESAB, and PGT Innovations – were the most significant contributors. Health Care holdings also added to results. Conversely, Consumer Discretionary holdings continued to struggle, with Helen of Troy, Hasbro, and Hanesbrands detracting most as investors continued to grapple with a potential recession amid mixed economic data.

SMID Cap Value Equity Composite Performance



Source: Factset and Russell®

Past performance is not indicative of future results. All investing involves risk, including loss of principal.

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Contributors & Detractors

Largest Contributors

ESAB (ESAB), a manufacturer of welding and gas control equipment and consumables, was the largest contributor. Investors rewarded ESAB for strong execution, resulting in organic revenue growth and margin expansion. Following their recent spin-off, management continues to improve its communication to investors – particularly related to bolt-on opportunities within the gas controls space – improving investor sentiment.

PGT Innovations (PGTI), a leading manufacturer of laminated, impact resistant windows, was the second-largest contributor. PGTI generated strong quarterly results in an environment that has been challenging for most building products companies. Organic sales continued to grow thanks to the company's niche focus in attractive geographies as well as early signs of outsized strength for its impact-resistant windows following hurricane-driven awareness in the prior quarter. Additionally, potential interest from a strategic acquirer in late March pushed the share price higher.

Open Text (OTEX), an enterprise software company, was the third-largest contributor. The company reported stronger than expected cloud revenue and cloud bookings, a positive sign in its transition from selling traditional licenses to selling software subscriptions.

Largest Detractors

Columbia Banking System (COLB), a regional bank operating primarily in the Pacific Northwest, was the largest detractor. Shares of COLB sold off along with other regional banks amid investor concerns about capital and liquidity following several high-profile regional bank failures. Importantly, as a result of the merger with Umpqua Holdings, the company's balance sheet was largely marked to market in late February, leaving the company with few of the embedded losses that have concerned investors lately.

Helen of Troy (HELE), a diversified consumer and household products company, was the second-largest detractor. HELE posted weaker year-over-year results despite stronger than expected demand for cold and flu products. Additionally, in early March, the CFO departed and shares retreated on the news. In the interim, the company will be in the capable hands of its previous long-time CFO. In the longer term, we believe recent free cash flow strength should continue and the company should return to its history of margin improvement.

Globe Life (GL), a life and health insurer targeting underserved lower- and middle-income Americans, was the third-largest detractor. Rising interest rates and large investment portfolios have caused investor concern over the health of many life insurers' assets, weighing on industry valuations.

Sector Positioning

Sector allocation effect was additive during the first quarter, with most sectors contributing to the strategy's outperformance. The significant overweight to Consumer Discretionary, one of the best performing sectors within the benchmark, was the largest tailwind. An underweight to Financials, the worst performing benchmark sector, was also additive as the sector saw instances of indiscriminate selling following the collapse of multiple regional banks. The strategy is underweight Financials as a whole, as well as being significantly underweight banks specifically, and we believe those in the portfolio are better capitalized and more conservatively positioned than the broader industry. Somewhat offsetting these positive results, the underweight to Materials, one of the better performing sectors within the benchmark, detracted from results.

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Initiations & Eliminations

Initiations

APi Group (APG) is an acquisitive business services provider with expertise in fire safety and security, along with a smaller specialty contracting unit servicing primarily telecom and utility companies. The company's inspection-first strategy and its recent acquisition of Chubb Fire & Security have increased its percentage of recurring, higher margin service revenue to 50% of sales. We believe that the continued outgrowth of service-focused revenue and internal investment on Chubb should lead to sustainable profitability improvement.

Flowers Foods (FLO) is North America's second-largest packaged bread manufacturer, with 17% branded market share and a portfolio that includes the number one bread, number one organic loaf bread, and number one gluten-free loaf bread. The company has benefited from a decades-long wave of industry consolidation and has now sufficiently scaled its national distribution network. Innovation and brand strength matter in the retail packaged bread industry and we believe the company's earnings over the next several years should benefit from a shift toward higher margin categories.

Glacier Bancorp (GBCI) is a regional bank headquartered in Kalispell, Montana, with $26 billion in assets. Operating across eight states in the Mountain West, the company serves mostly rural and secondary markets through 17 local bank brands. This strategy has resulted in a granular and stable deposit base which we believe positions the company well both for the current environment and the longer term.

Markel (MKL) is a property and casualty insurance company focused primarily on underwriting hard to place insurance policies (excess and surplus lines). MKL has specialized underwriting expertise, a conservative underwriting culture that focuses on profits over volume, and a management team that acts like owners with a long-term mindset. The company's investment portfolio leans more heavily on public equities than most peers' portfolios, generating higher but more volatile returns while maintaining an investment philosophy that emphasizes quality and capital preservation. MKL has also acquired a collection of privately held non-insurance businesses over the last 15 years.

Teleflex (TFX) is a manufacturer of a diverse portfolio of single-use, disposable medical devices and products used primarily in critical care settings around the world. Over the past decade, management has used the company's strong free cash flow generation and balance sheet to broaden its portfolio through margin accretive acquisitions, supplementing its established portfolio of industry-leading catheters. We believe that the combination should produce attractive organic revenue and earnings growth over time.

Eliminations

Enovis (ENOV) was eliminated to make room for better opportunities.

Syneos Health (SYNH) was eliminated due to diminished confidence in the company's long-term fundamental prospects.

Notable Stock Updates

Columbia Banking System (COLB) is a regional bank headquartered in Tacoma, Washington, serving primarily the Pacific Northwest. The company completed its merger with previous portfolio holding **Umpqua Holdings (UMPQ)** during the quarter, with the combined entity retaining the Columbia Banking System name. COLB primarily serves high net worth individuals and families as well as small- and medium-sized businesses. The combined business is strongly capitalized and well positioned to grow both deposits and loans over time.

Ritchie Bros. Auctioneers (RBA) owns and operates the leading auction marketplace for used construction, agricultural, mining, and transportation equipment. RBA completed its acquisition of previous portfolio holding **IAA (IAA)** in a stock-and-cash transaction during the quarter. We believe that the combination should accelerate RBA's promising satellite yard strategy and improve IAA's ability to service insurance customers during catastrophic events. We believe there are also significant opportunities for RBA's strong management team to create shareholder value by executing on cost and revenue synergies.

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Outlook

Having shrugged off the failure of several regional banks and the forced consolidation of a large Swiss banking house, markets enter the second quarter with strong momentum. For the moment, investors seem inclined to take a constructive view of most developments, with strong data taken as a sign of economic resilience and weak data, or signs of financial stress, taken as evidence the Federal Reserve will soon end its year-long series of rate increases. There are clearly risks to this buoyant mood, however, as the effects of the Fed's dramatic tightening program are still materializing and we think more negative surprises seem likely. That said, we have long maintained that it is more productive to focus on company-specific fundamentals than to guess at macroeconomic outcomes. As always, we believe competitively advantaged businesses that create value for their customers, are conservatively managed, and are appropriately financed will generate attractive returns for their shareholders over time if purchased judiciously. Viewed in this light, economic dislocation creates more opportunities than risks for patient and disciplined investors.

Sources: Bloomberg, FactSet, The New York Times

Additional Cooke & Bieler SMID Cap Value Performance Disclosures