

## Market Observations & Portfolio Commentary

### Quarterly Market Update

US stocks posted mid to high single digit gains during Q2. Solid economic data and improving corporate earnings were positives, partially offset by concerns about rising inflation, the timing of potential changes to monetary policy from the Fed, and the possibility of future tax increases. Growth outperformed Value across the market cap spectrum except in the Small Cap space. For the most part, cyclical sectors outperformed defensive, though it was mixed among mid and Large Cap stocks. With regard to factors driving performance during Q2, the dynamics weren't linear down the market cap spectrum. Amid Large Cap stocks, Growth and Quality factors had the most positive impact on relative performance, while Value factors had a negative impact. Amid Mid and Small Cap stocks, Volatility and Yield had the most positive impact, while the remaining factors produced mixed results.

### Key Performance Takeaways for the Quarter

- The London Company Small Cap portfolio declined 0.1% gross (-0.3% net) during the quarter vs. a 4.6% increase in the Russell 2000 Value Index. Both sector exposure and stock selection were headwinds to relative performance.
- We are bottom-up stock pickers, but sector exposures influenced relative performance as follows:
  - *What Helped:* Underweight Financials & Utilities (two weaker performing sectors)
  - *What Hurt:* Underweight Comm. Services & Energy (two better performing sectors)
- The Small Cap portfolio trailed the benchmark in Q2, which isn't surprising given the continued low quality, high beta leadership environment amid Mid & Small Cap stocks. We did have a couple holdings stumble during the quarter, but nearly all of the recent performance shortfall during this recovery can be attributed to what we don't own versus what we do.

### Top 3 Contributors to Relative Performance

- **Armstrong World Industries (AWI)** – AWI continued its rally in Q2 reflecting improving market conditions and an increased normalization of business/office space operations. AWI also saw a quicker than expected recovery in pricing during Q2.
- **First Industrial Realty (FR)** – FR outperformed following underperformance in the 2H 2020 rally. Industrial real estate fundamentals remain strong, driven by secular e-commerce tailwinds, and FR is executing to plan.
- **Evoqua (AQUA)** – We purchased AQUA in late Q2. In our brief period of ownership, it outperformed reflecting hope for the passage of an infrastructure bill plus solid operating results.

### Top 3 Detractors from Relative Performance

- **Haemonetics (HAE)** – HAE declined roughly 40% during Q2 following the announcement of the pending loss of a large client. Following the significant drop in the share price, we decided to maintain the position. We continue to hold reflecting the opportunity for growth in the plasma division and pricing gains from the new system, Nexsys PCS. Many of HAE's clients have already upgraded to the new system, including three of the company's largest clients with no issues.
- **NewMarket (NEU)** – NEU underperformed following a weak earnings report driven by rising base oil prices combined with growing concerns over the ramp of hybrid and electric vehicles.

NEU's margins tend to suffer in periods of rising base oil prices until they roll over and NEU can capture the lag in spreads.

- **Churchill Downs (CHDN)** – CHDN pulled back during Q2 after strong performance in 2020. We viewed CHDN's execution through the worst of the pandemic as exceptional, and we continue to be positive on management's capital allocation decisions. In our view, the recent underperformance is noise and not indicative of a change in the long-term fundamentals,

### Trades During the Quarter

- **Exited: Bruker (BRKR) & STORE Capital (STOR)** – Sold due to market cap considerations, as each reached ~\$10B.
- **Initiated: Essential Properties (EPRT)** – EPRT is a triple-net lease REIT focused on middle-market companies, which operate service-oriented or experience-based businesses. Net lease real estate offers downside protection through long leases with contracted escalators. We believe EPRT should be able to grow adjusted funds from operations faster than peers given its small denominator and experienced management team.
- **Initiated: CTS Corp. (CTS)** – CTS creates sensing & motion devices and connectivity components for automotive systems, industrial, aerospace/defense, and medical industries. CTS is small enough to design custom products but large enough to serve all global auto OEMs. CTS should benefit from the secular global trends of electrification, IoT & automation. CTS has a strong balance sheet and trades at an attractive valuation.
- **Reduced: Tempur-Sealy (TPX), Penske Automotive (PAG) & Landstar System (LSTR)** – Trimmed on strength due to market cap considerations, as each are now ~\$7B.
- **Exited: GATX (GATX)** – Sale reflects all-time high relative valuation and our desire to reduce large Industrials weighting.
- **Initiated: Murphy USA (MUSA)** – MUSA is a fuel retailer with most of its store network in Walmart parking lots. MUSA operates a low-price, high-volume strategy and has an advantaged cost structure, due to its small footprint stores and high fuel volumes. MUSA has a strong balance sheet, trades at an attractive valuation, and is very shareholder friendly.
- **Initiated: Evoqua (AQUA)** – AQUA is the largest US national water treatment provider in a highly fragmented industry. AQUA is well positioned as the dominant player to capitalize on complex regulatory and sustainability industry trends. AQUA has a very stable business, a high degree of recurring revenue and a very diversified client & project mix. Its service contracts have price escalators and are increasingly take-or-pay.

### Looking Ahead

We maintain a positive view on the US economy and expect strong real GDP growth in 2021. Nearly half of the population has been vaccinated, and most of the economy has re-opened. Consumers are in great shape along with the manufacturing and services sectors of the economy. Fiscal and monetary policy should continue to be accommodative in the near-term. Despite the positives, we recognize that risks remain. Inflation concerns, talk of tax hikes, elevated valuations, and a more reactive Fed are noteworthy factors looming over markets. While we believe fundamental conditions remain positive, we note a confluence of market concerns could lead to increased volatility and more muted returns for equities in the near term.

**Performance**

As of June 30, 2021

	QTD	YTD	One Year	Three Years	Five Years	Ten Years	Inception to Date
Small Cap (Gross)	-0.1	10.7	47.1	10.8	10.2	10.2	13.0
Small Cap (Net)	-0.3	10.3	46.1	10.0	9.4	9.5	12.5
Russell 2000 Value	4.6	26.7	73.3	10.3	13.6	10.9	10.1

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**Disclosure notes**

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**Composite Creation/****Inception Date:** September 30, 1999

**Composite Definition:** The Small Cap strategy invests mainly in conservative, low-beta small cap equities with a focus on above-average downside protection. Primarily we seek profitable, financially stable small cap companies that consistently generate free cash flow, high returns on unleveraged operating capital, trade at significant discounts to their intrinsic values, and are run by shareholder-oriented management. Positions are usually within the market capitalization range of the major, domestic small cap indices. Accounts in this product composite are fully discretionary taxable and tax-exempt portfolios with a minimum of \$100,000 in assets. The product is measured against the Russell 2000 Index and has a creation and inception date of September 30, 1999. There is no use of leverage, derivatives or short positions. All actual fee-paying discretionary portfolios are included in one or more composites that have been managed for a full calendar quarter with limited restrictions and similar objectives. Composite may include accounts under dual contract.

**Benchmark Description:** Primary: Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. Russell 2000 is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership. Secondary: Russell 2000 Value Index measures the performance of small-cap segment of the U.S. equity universe. It includes those Russell 2000 Index companies with lower price-to-book ratios and lower forecasted growth values. Benchmark returns are not covered by the report of independent verifiers. The Small Cap product is typically compared to the Russell 2000 Index. Any comparison to the Russell 2000 Value is for illustrative purposes

only.

**Performance and Fees:** Gross of fee returns are calculated gross of management and custodian fees and net of transaction costs. Net of fee returns are calculated net of actual management fees and transaction costs and gross of custodian and other fees. Returns may be net of miscellaneous fund expenses. The gross figures do not reflect the deduction of investment advisory fees. For example, an account that earned 15% per year for 10 years would have an accumulated return of 305% before fees and 270% after fees, assuming a 1% fee. Returns are calculated and stated in US dollars. Returns are calculated gross of withholding taxes on foreign dividends and interest. Dividends are reinvested. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request.

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