JULY 20, 2023

Spears Abacus Small Cap Dividend Growth 2Q23

"Attempt to be fearful when others are greedy and greedy when others are fearful" – Warren Buffett

Greed roared back into vogue in the second quarter as the economic impact of having three major U.S. banks fail in the first quarter was less bad than the market feared. This greed expressed itself both in an increase in the value of smaller speculative shares as well as in a large increase in the market value of the largest U.S. companies, as discussed in more detail below in the *Spears Abacus 2Q23 Commentary*.

But the skunk at this garden party is that monetary policy operates with a long and variable lag[1]. This in plain English means that nobody knows when the economy will see the impact of the 500 basis-point increase in the federal funds rate since March 2022. Federal Reserve officials themselves offer estimates that it might take anywhere from nine months to two years for the economy to feel the impact of this rate-hike campaign. AND it probably isn't over yet. The chairman of the Federal Reserve has stated that two more rate hikes will probably be necessary to reduce inflation to an acceptable level.

Given the uncertainty of the impact of this large increase in interest rates on the economy, our plan continues to be to avoid speculative shares and focus the portfolio on dividend-paying companies with a history of growth.

Nobody knows when and by how much the Federal Reserve's anti-inflation campaign will slow down the economy. Perhaps the worst has passed, and the increase in productivity caused by the new generative artificial intelligence will allow inflation to slow without a significant increase in unemployment over the next 12 months.

But we do know, by looking at valuation and stock-price charts, which companies and sectors are out of favor. It has been our experience that an addition to the portfolio of the shares of growing companies at a time when they are out of favor can offer two ways to win. The first is the companies may come back into favor, like U.S. Physical Therapy and Installed Building Products did this quarter. The second is that a lower valuation may reduce downward volatility, as happened when the Russell 2000 index declined 20% last year.

Whether the U.S. economy has a soft or hard landing, we believe the portfolio is well-positioned to achieve our goal of growing capital after inflation with less volatility than the Russell 2000. If the U.S. economy were to have a soft landing, in which inflation subsides without a large increase in unemployment, our portfolio of growing companies trading at reasonable valuations should move higher over time in line with their growth in earnings.

In a hard landing, however, in which a decrease in inflation only occurs after a recession and a substantial rise in unemployment, we believe that the generally capital-light nature of our typical holdings will put our portfolio in a good position relative to the Russell 2000. Our portfolio has a return on invested capital of 23%, versus 3% for the Russell 2000 Small-Cap Index[2]. Companies with a high return on invested capital tend to generate more cash than they need to operate their

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[1] https://www.stlouisfed.org/en/publications/regional-economist/2023/may/examining-long-variable-lags-monetary-policy
[2] Returns based off of last reported year for each company

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businesses. This cash may be used in an economic downturn to buy competitors or to repurchase their own stock at lower prices.

Spears Abacus Small Cap Dividend Growth:

2Q23 Performance of Top 5 Contributors[1]

Company	Ticker	% Change[2]
U.S. Physical Therapy, Inc.	USPH	24.5%
Installed Building Products, Inc.	IBP	23.3%
Kinsale Capital Group, Inc.	KNSL	24.7%
World Wrestling Entertainment, Inc.	WWE	19.0%
Coca-Cola Consolidated, Inc.	COKE	19.0%

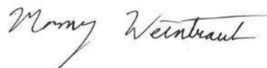
2Q23 Performance of Top 5 Detractors[1]

Company	Ticker	% Change[2]
Texas Pacific Land Corporation	TPL	-22.4%
Catalent Inc	CTLT	-34.0%
BGC Group, Inc. Class A	BGC	-15.1%
Hibbett Inc	HIBB	-38.1%
Royal Gold, Inc.	RGLD	-11.3%

[1]Top contributors and detractors are based on percentage contribution to the strategy's performance, which is impacted by both the security's performance and its position size (i.e., the top contributor may not have the best performance); if the security was purchased or sold during the quarter, performance is calculated based on the purchase or sale date.
[2] % change calculated quarter over quarter

We feel very good about the opportunities presented to us this quarter. Both to buy and to sell. We think that the next few quarters should continue to present opportunities, as the markets will likely stay volatile given the economic situation. The world keeps changing, but fear and greed go on forever.

With all best wishes,



Manny Weintraub, CFA

Spears Abacus 2Q23 Commentary

I. Market Overview

A snapshot of the most recent quarter is almost indistinguishable from the one that preceded it. At least in terms of equity markets. In the second quarter, the S&P 500 was a touch stronger than the first (8.7% vs 7.5%). Combining the two yields a year-to-date total return of 16.9%, bringing that benchmark to within 10% of its all-time high. Given what seems to be a challenging environment*, this strength has surprised many. Peeking behind the aggregate statistic reveals that, more broadly speaking, stock markets have not been quite as friendly as the Index suggests.

***Challenging Environment**

- *Rapid rise in short-term interest rates*
- *Near banking crisis (impending regulatory changes)*
- *More stubborn than predicted inflation*
- *Debt ceiling standoff*
- *Accelerating tension in Russia/Ukraine*
- *Stalled recovery from China*

By far the most prominent feature in 2023 has been the outsized influence of a small handful of very large companies. Eight stocks were responsible for more than two-thirds of the performance of the S&P 500. Without them, the benchmark would have been up by only about 5%. Still respectable for a six-month period, but hardly noteworthy.

As always, it is more helpful to examine specifics than gloss over generalities. The Mega-Cap 8, like the FAANG stocks of the last decade, are a familiar gang. Not surprisingly, technology is a common theme uniting the group. Each company is either a provider or beneficiary of dominant technologies. Some fall into both camps. So far this year, the Mega-Cap 8's average return is an eye-popping 84%.

This statistic requires context. This same group averaged a negative return of 46% in 2022. The cruel math of negative results is evident. Only two, Apple and NVIDIA, have surpassed previous high-water marks, and Microsoft is close. Meta, Tesla, Amazon, and Netflix remain between 25% and 40% below previous highs.

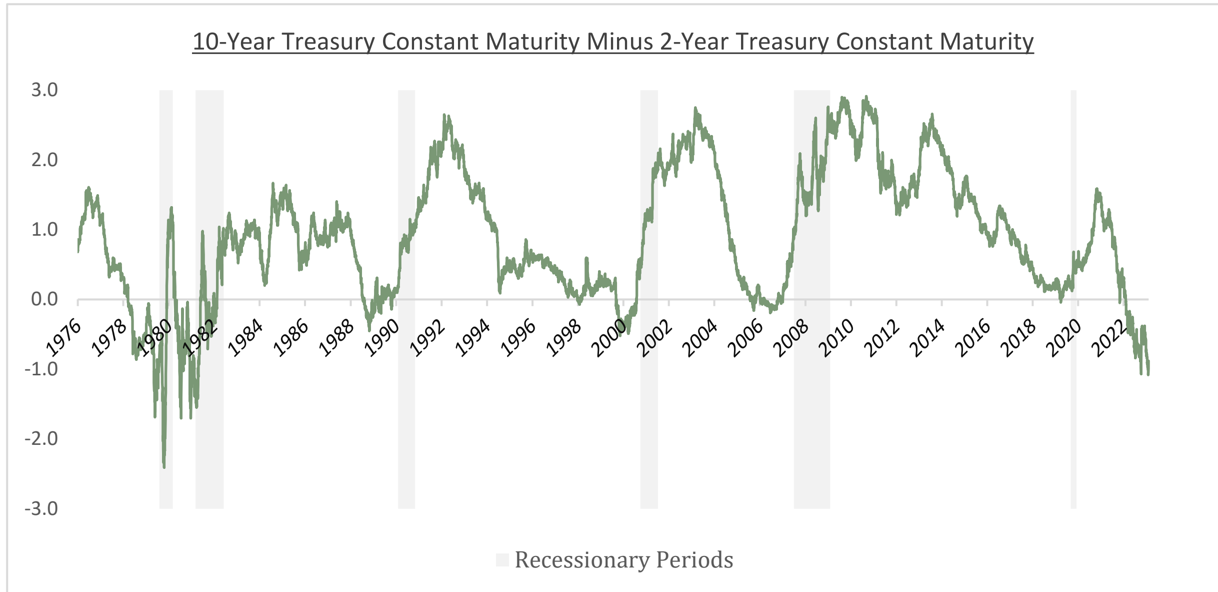
When eight so decisively outperform 492, it begs the question of how this anomaly will be resolved. Will the leaders fall back to the pack, or will the laggards catch up? To help to find the answer, we make two observations. First, the Mega-Cap 8 are hardly monolithic. While each trades at a higher-than-average valuation, there is a significant range from the lowest (Alphabet) to the highest (Tesla). Second, the remaining 492 companies trade at an average valuation of 16.5 times consensus 2023 earnings estimates, implying that there are bargains to be found.

Mega-Cap 8 Valuation[3]	2023 PE
Alphabet Inc. Class C	22.3
Meta Platforms Inc. Class A	24.0
Apple Inc.	32.1
Microsoft Corporation	35.1
Netflix, Inc.	39.3
NVIDIA Corporation	55.9
Amazon.com, Inc.	81.5
Tesla, Inc.	82.3
Average	*46.6*

[3] Source: Factset. Based on consensus 2023 earnings per share.

II. Looking Forward

The yield on the two-year U.S. Treasury note is more than 1% greater than that of the ten-year maturity. This is not normal. As can be seen from the chart below, it has not occurred since 1981. It is common wisdom that this so-called "inverted yield curve" presages a recession. It has done so correctly for the six official recessions in the U.S. over the last 50 years. Those economists forecasting an impending recession generally point to the inversion as evidence. Yet one full year after the yield curve first inverted, the economy is still showing surprising strength.



Source: FRED: Federal Reserve Bank of St. Louis. Data from 06/01/1976 to 07/07/2023.

The glass is half-empty crowd will point out, correctly, that history shows that a recession could begin as long as two years after the onset of an inverted yield curve. A more optimistic view is that being right six times in a row is no guarantee of future accuracy and that the economy could remain robust for the foreseeable future.

There is a trove of data to support either position. Eventually, one will be proven correct. However, it is important to remember that Covid-19 related shocks have been largely unprecedented. We truly are in uncharted territory. Never before has the global economy come to a complete stop. While there have been instances of supply-chain interruption, never have so many broken at the same time. We have never experienced the same degree of demand destruction, followed by a tsunami of pent-up demand. We do not really know whether Covid rendered traditional forecasting tools completely ineffective. But, as seasoned investors, we do know that now is not the time to bet the ranch on tenuous predictions.

Fortunately, we have other tools at our disposal. We have always looked to company-specific analysis to provide guidance. In general, we seek out those businesses that are less impacted by the overall economy. In uncertain times like these, we work doubly hard to maintain that discipline. Should a

recession occur, stock prices will likely retreat, including the prices of the companies we own for you. However, we strongly believe that none will be fatally impaired, no matter how unfriendly the climate.

Such an environment could present meaningful opportunities for new investments. We have higher-than-usual cash balances available to take advantage of attractive higher yields on short-term Treasuries. As mentioned, the average stock is currently reasonably valued. Should future market weakness occur, we will have a shopping list ready.

III. Artificial Intelligence

It was hard to go a day during the second quarter without reading a headline about artificial intelligence (AI.) Among investors, there has been a significant debate about who wins and who loses. The debate is far from settled.

Take for example Adobe, which in the span of just a few weeks went from being viewed as an AI loser to an AI winner. The narrative shifted from "AI is going to render creative workers obsolete, reducing the number of people using Adobe software" to "look what you can do with AI embedded in Adobe software!" From the beginning of the quarter to mid-May, the stock declined over 10%. From mid-May to mid-June, the stock went up almost 50%. In reality, not much changed. Adobe has been integrating increasing amounts of artificial intelligence into its design software for years, and investors today have little more clarity about what the "AI revolution" means for Adobe than they did when the quarter began.

We don't know what the future holds (we tried asking ChatGPT) but the ongoing debate about how artificial intelligence, large language models, etc. will reduce demand for Adobe's software, and many other companies' products and services, reminds us of the Jevons Paradox.

In 1865, an English economist, William Jevons, observed that contrary to intuition, after the introduction of the far more efficient Watt steam engine, England's coal consumption increased rather than decreased. Put simply, additional coal demand resulting from new applications enabled by the more efficient engine more than offset the improvement in fuel economy.

We think the same lesson applies. People won't simply be content to use ChatGPT and its successors to accomplish the same things more efficiently. They will use technological advancement to do things that aren't possible or practical today.

IV. Personal Finance

The steep increase in interest rates over the past 12 months has created a two-tiered population of debtors. Or more accurately, a two-tiered population of debts, sometimes for the same borrower. On one hand, those who incurred debt at a fixed rate prior to the increases are still enjoying historically low interest rates and debt-service payments, and likely will for years, if not decades. Conversely,

variable (or floating) rate loans, and debts more recently incurred, are now at significantly higher rates. The interest-rate payments may render that debt a bad financial decision.

Many borrowers who were able to obtain mortgages at extremely low fixed rates also utilize home equity lines that have floating rates tied to prime. Prime today is 8.25%. Likewise, brokerage margin rates are over double digits, and loans secured by portfolios have rates in the high single digits. Borrowers became accustomed to carrying debt on a permanent basis, as it was not difficult to earn a rate of return higher than the interest-rate cost.

In today's bifurcated debt world, it is even more important to analyze whether a loan is still serving its purpose. For example, with cash accounts earning 5% interest, holding cash is a far better investment than paying off debt with an interest rate that is lower than that level (a fixed-rate mortgage, for example). Likewise, when interest on loans becomes higher than can be reasonably earned through prudent investing, paying off floating-rate debts (like home equity lines of credit) may be the wisest decision.

Given this higher hurdle for investment returns and the rapid moves of rates of interest, we would be happy to work through these decisions with you.

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Small Cap Dividend Growth

Quarterly
Fact Sheet
As of June 30, 2023

Investment Strategy Overview

Spears Abacus' Small Cap Dividend Growth Equity strategy is a long-only investment strategy that seeks to outperform the Russell 2000® Index with less volatility over a market cycle. The strategy offers the opportunity to participate in the higher growth of small caps while limiting downside risk.

Philosophy: The strategy invests in U.S. small cap dividend paying stocks, a subset of the small cap universe which has outperformed non-dividend paying peers over the long term with less volatility.* Active stock selection from this unique universe significantly increases the probability of generating attractive long-term risk-adjusted returns.

Approach: Using a "quantamental" approach, a proprietary screening methodology and fundamental analysis are applied in a disciplined process to identify relatively attractive companies, creating a repeatable and methodical decision making process.

Portfolio Construction: Despite the focus on dividend paying stocks, the portfolio aims to combines the best of both growth and value. Sector weights are maintained within 3% of the Russell 2000® across a portfolio of 70-100 stocks.

Target Investment Characteristics

- High return on invested capital and high free cash flow
- Strong balance sheets and effective capital allocation
- Exceptional management and positive fundamental momentum
- Attractive valuation and asymmetric risk-reward

What Makes Us Different^

- Higher growth, better quality, and lower valuation versus the Russell 2000
- Down the middle approach to avoid the excesses of small cap benchmarks
- Less risk than your typical small cap portfolio
- Unique universe with history of outperformance

Performance[1]

	Avg Annual Total Returns					
	YTD	1 Yr.	3 Yr.	5 Yr.	10 Yr.	Inception
SA Small Cap (gross)	6.1%	11.9%	13.0%	4.8%	-	7.8%
SA Small Cap (net)	5.6%	10.8%	11.9%	3.7%	-	6.7%
Russell 2000	8.1%	12.3%	10.8%	4.2%	-	6.6%

Source: Spears Abacus, FactSet. Inception Date 12/31/2016. ^See portfolio statistics and efficiency measures. [1]Returns for less than one year not annualized; YTD as of 6/30/23; [2]All statistics based on weighted average unless otherwise noted; index based on aggregate; [3]Dividend yield of total portfolio including cash; [4]ROIC calculated using LTM cash returns for portfolio holdings; [5]Sector weights excluding cash; [6]Efficiency measures gross since inception, monthly basis; [7]Based on Risk Index = Russell 2000, Risk Free Index = 3 Month T-Bill

Portfolio Statistics[2,3,4]

	SA	Russell 2000
Number of Securities	87	-
Cash Weight	4.7%	-
Dividend Yield	1.26%	1.44%
Market Capitalization ($b)	5.2	2.9
Harmonic Avg. TTM P/E	16.0x	24.1x
Harmonic Avg. NTM P/E	15.8x	21.4x
LT Debt / Total Capital	0.29x	0.46x
Return on Invested Capital	23%	3%
NTM Revenue Growth	5%	2%
Median Payout Ratio	20%	38%
% of Holdings Paying Dividend	86%	43%
Active Share	96%	-

Sector Diversification[5]

	SA	Russell 2000
Consumer Discretionary	9.8%	10.5%
Consumer Staples	4.4%	3.4%
Energy	4.4%	6.8%
Financials	16.4%	15.2%
Health care	18.4%	16.8%
Industrials	18.2%	17.5%
Information Technology	10.0%	13.7%
Materials	8.5%	4.5%
Real Estate	5.5%	6.1%
Communication Services	4.1%	2.4%
Utilities	0.4%	3.0%
Total	**100.0%**	**100.0%**

Efficiency Measures[6,7]

	SA	Russell 2000
Annualized Excess Return	1.2%	-
Annualized Alpha	1.8%	-
Beta	0.87	-
Volatility	19.4%	21.5%
Upside Capture	93%	-
Downside Capture	88%	-
Sharpe Ratio	0.3	0.2
Sortino Ratio	0.5	0.4
Tracking Error	6.2%	-
Turnover (trailing 1 year)	26%	-

PLEASE SEE ADDITIONAL DISCLOSURES ON THE FOLLOWING PAGE

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Top 10 Holdings

Top 10 Holdings	% of Portfolio
A. O. Smith Corporation	3.0%
U.S. Physical Therapy, Inc.	2.7%
World Wrestling Entertainment, Inc. Class A	2.6%
Installed Building Products, Inc.	2.6%
Coca-Cola Consolidated, Inc.	2.5%
Kinsale Capital Group, Inc.	2.3%
InMode Ltd.	2.3%
Royal Gold, Inc.	2.2%
Graphic Packaging Holding Company	2.1%
Qualys, Inc.	2.0%
Total	24.3%

Source: Spears Abacus, FactSet. [1]Portfolio weightings including cash

Managed by

Spears Abacus Small Cap Dividend Growth Team

Portfolio Manager	Years Experience
Manny Weintraub	33
Senior Analyst	
Daniel Wetchler	13

Style

Blend

Inception Date

31-Dec-16

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The Russell 2000® Index measures the performance of the small-cap segment of the US equity universe. The Russell 2000® Index is a subset of the Russell 3000® Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. The Russell 2000® is constructed to provide a comprehensive and unbiased small-cap barometer and is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true small-cap opportunity set.

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