October 12, 2022

I. Market Overview

Over the last few years, we have written extensively about Federal Reserve policy and interest rates. In our view, the supply of money (which is controlled by central banks), its ebbs and flows, and the general level of interest rates have had a significant impact on asset prices, especially since the Great Financial Crisis. While central bank policy remains important, we think business fundamentals – actual corporate profits – will garner increased attention.

Why now? Because, in words and actions, the Fed has moved from easy money to tight money. Interest rates have risen dramatically, causing a rapid decline in the prices of financial assets (stocks and bonds around the world). This is no coincidence. Higher interest rates reduce the present value of long-term investments. This is also old news. The yield on the benchmark 10-year U.S. Treasury note started the year at approximately 1.5% and recently touched 4%. The impact of that change has already been felt.

	12/31/2021	**9/30/2022**	**Change**
S&P 500 Price*	4,766.18	3,585.62	-24.77%
2022 Earnings Estimate	221.74	221.84	0.05%
Price Earnings Ratio	21.49	16.16	-24.80%

*Price change only. Excludes dividends.

The simplest and most common way to look at the valuation of a stock (or a collection of stocks like the S&P 500 in the above example) is to divide the current price by earnings per share. The result is the "Price Earnings Ratio." Stock price changes result from either a change in earnings or a change in the P/E ratio.

As we can see from the table, the S&P 500 has dropped roughly 25% so far this year, while earnings estimates have actually risen a tiny bit. The decline in price is entirely explained by the decline in the P/E ratio. In turn, P/E ratios are heavily influenced by interest rates (as rates rise, P/E ratios typically fall).

Looking ahead, we believe that company earnings will take center stage and will be the more significant determinant of stock prices. We are not alone in believing that corporate profits are likely to be challenged over the next several quarters. Fundamental headwinds are well known. China's zero-Covid policy has made a dent in the global economy. The organization of Economic Cooperation and Development (OECD) estimates that the war in Ukraine has reduced total output by $2.8 trillion. Inflation has begun to undermine consumer confidence and impact corporate profit margins. The

unusually strong dollar hurt U.S. companies with global operations and foreign buyers of U.S. goods and services.

As investors and market observers begin to factor in a possible recession, inflation, currency movements, lingering supply-chain issues, and geopolitical risks, we can expect to see some earnings estimates decline. Company specific analysis will become increasingly important. In a challenging economic environment, investors will become more particular about individual stock holdings. Weaker companies with more rapidly falling earnings will be jettisoned in favor of stronger, more resilient businesses.

We believe our portfolio of companies:

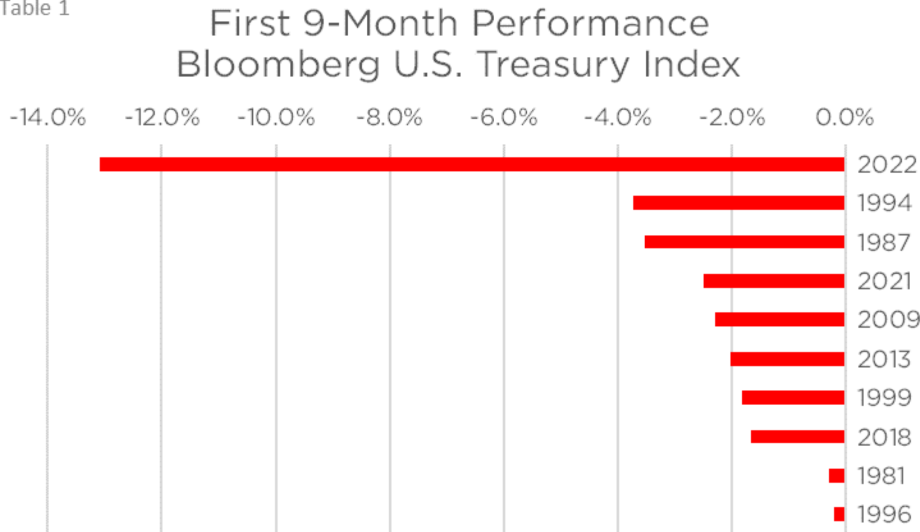
- Have resilient earnings in a variety of economic scenarios
- Maintain strong balance sheets relative to cash flow
- Generate excess cash after investing in their core businesses
- Is well positioned to weather, and ultimately benefit from, this difficult environment

We believe this is an environment that presents careful investors with attractive opportunities. It has been our experience that stronger companies will become even more competitive. The very best will attract more investor interest at the cost of weaker, less established businesses. If markets continue to be volatile, it will be critical to follow three important tenets:

- Know exactly what you are invested in
- Hold on to those companies that are strengthening their competitive positions
- Take advantage of bargains created by emotional or distressed sellers

We will implement this strategy to manage through this bear market and, as importantly, position your portfolio well for the future.

II. Fixed Income Commentary



This year marks the worst nine-month start for the Bloomberg U.S. Treasury Index by a wide margin (Table 1) since its inception in 1974. Every area of fixed income has shown significant weakness, from municipal bonds, to U.S. Treasuries and corporate debt. However, the common theme has been that the longer dated a security is, the worse performance has been. For example, the U.S. Treasury issued a note last year with a 11/15/2051 maturity. With the increase in interest rates this year, the note is down over 32%. While the note continues to be backed by the full faith and credit of the U.S. Government, and thus is not likely a credit concern, the mark-to-market in its value has been extreme.

The increase in interest rates is mostly due to investors recalibrating how much the Federal Reserve will have to tighten monetary policy in order to tame volatile inflation figures. At the beginning of the year, markets were predicting that the overnight Fed Funds rate would end 2022 at 0.83%[1]. The current expectation is that the Fed will end its rate-raising campaign at close to 4.50% sometime in early 2023.

This is the steepest Fed tightening in 41 years, and we doubt that raising rates above 4.50% will be necessary to achieve the Federal Reserve's policy goals. This suggests that the worst of the interest rate increases is over.

Our belief that the Fed is almost complete with its rate-rising campaign is not to suggest that there are no longer potential pitfalls ahead. Emerging market and high yield debt still face significant challenges, and while both may cause contagion fears in markets, neither should pose a systemic risk. For bond

1 According to the implied overnight rate for the U.S. futures model tracked by Bloomberg.

investors, we continue to preach knowing what one owns via individual securities, while focusing on quality and matching maturities to meet spending needs.

III. Spears Abacus MidCap Equity Strategy discussion – Manny Weintraub, Manager

We have been doing this for a very long time. We have been working on Wall Street since 1989; we have been managing portfolios since 1998. Earnings have compounded, and portfolios have increased in value. The bull markets of 2003 to 2007 or 2010 to 2019 were in retrospect a halcyon period to search for and potentially invest in high-quality companies that were out of favor. As the markets rose, we had the pleasure to help clients meet the obstacles and opportunities of their financial lives. In fact, these good years sort of blend together. Bear markets, on the other hand, leave their mark.

The bear market of 2008, for example, remains indelibly etched on the brain. We know where we were when Lehman went under, when Merrill Lynch merged with Bank of America in a "shotgun wedding," when short-selling financials was banned and the stock market ripped higher, and when the initial bailout plan was rejected by congress and the stock market tanked. We also remember which strategies we used to ameliorate that decline and to position for the next upturn.

We raised cash, focused the remaining portfolio on companies with low levels of leverage and high returns on investment, and tried to keep in mind how much we could make in a recovery. Later, when wide-spread market pessimism gave us the opportunity, we put 20% of the portfolio in small-capitalization stocks that were trading at what we believed to be steep discounts to their intrinsic values assuming a typical economic recovery. Those small-cap investments were very profitable in 2009.

We are following the same playbook in this bear market. Raising cash when we see the opportunity but keeping in mind how much higher prices could be in a recovery.

In the third quarter of 2022, we raised cash in August as the market rallied and only started putting it to work on September 28, when the market started to hit new lows again. We continue to focus the portfolio on companies with high returns on invested capital and business models that we believe are relatively durable in a recession. We believe that is a large part of why our portfolio has declined less than the S&P 500 for the first nine months of the year. We believe it is too early to get more aggressive and to make an above-average commitment to smaller, mid-cap companies in the portfolio until we see some progress on the triple threat of rising interest rates, inflation, and deglobalization. We don't need all three to improve, but even one would be nice.

When we invested cash in the quarter, we mostly increased position sizes of companies that we already owned. Many we had sold out of the portfolio at higher prices. The only completely new position in the portfolio is Church & Dwight, a leading manufacturer of cleaning and personal care products, which we bought after the stock dropped 10% when the company reduced sales expectations by 2%. This is a stable company with a history of growth trading at its lowest valuation in five years. We think the price could be substantially higher if an earnings recession comes for the stock market in general. At that time, a company that only has had a sales decline of 2% could look very attractive.

Time flies when you are having fun but crawls in a bear market. Sometimes you just need to be patient.

MidCap Opportunities

SPEARS / ABACUS

Quarterly
Fact Sheet
As of September 30, 2022

Investment Strategy Overview

Spears Abacus' MidCap Opportunities strategy is a long-only equity strategy that seeks to minimize downside participation and deliver attractive risk-adjusted returns over a market cycle. The team's investment approach focuses on high quality, growing companies (fundamental momentum) trading at attractive valuations (value). Utilizing this approach, the goal is to construct a concentrated portfolio designed to participate in the upside of equity markets while limiting downside risk through disciplined stock selection and risk management.

Target Investment Characteristics

- High return on invested capital and high free cash flow
- Resilient businesses benefiting from long-term thematic trends
- Strong balance sheets and effective capital allocation
- Exceptional management
- Attractive valuation and asymmetric risk-reward

What Makes Us Different

- We make new investments when the crowd is selling
- We look for companies that are temporarily unpopular because of something that *might* go wrong
- We quickly admit when we are wrong and sell losers
- We like high quality businesses with long-term tailwinds that should do well in *any* environment
- We focus on ROIC and FCF instead of commonly used metrics like *adjusted* EPS
- Our portfolio will not look like the Russell Midcap or S&P 500
- We are more likely to average up than average down
- We have a track record of generating excess returns in periods of high volatility

Performance[7]

	Annualized Total Returns					
	YTD	1 Yr.	3 Yr.	5 Yr.	10 Yr.	Inception
SA MidCap (gross)	-18.8%	-18.2%	4.8%	6.6%	9.0%	9.6%
SA MidCap (net)	-19.5%	-19.2%	3.5%	5.2%	7.7%	8.0%
Russell Midcap	-24.3%	-19.4%	5.2%	6.5%	10.3%	8.9%
S&P 500	-23.9%	-15.5%	8.2%	9.2%	11.7%	8.6%

Source: Spears Abacus, FactSet. Inception Date 3/31/2004. [1]All statistics based on weighted average unless otherwise noted; [2]Dividend yield of total portfolio including cash; [3]ROIC calculated using cash returns for portfolio holdings; [4]Long-term growth is based on the consensus 3-5 year EPS growth forecast; [5]Downside capture trailing 3 years, monthly basis vs Russell Midcap; Alpha based on Risk Index = Russell Midcap, Risk Free Rate = 10 Year Treasury note; [6]Sector weights excluding cash; [7]Returns for less than one year not annualized; YTD as of 9/30/22

PLEASE SEE ADDITIONAL DISCLOSURES ON THE FOLLOWING PAGE

Portfolio Statistics[1,2,3,4,5]

	SA	Russell Midcap
Number of Securities	22	-
Cash Weight	14.8%	-
Dividend Yield	0.99%	1.65%
Market capitalization ($b)	38.7	19.6
Harmonic Avg. TTM P/E	16.6x	16.7x
Harmonic Avg. NTM P/E	13.6x	13.9x
LT Debt / Total Capital	0.27x	0.47x
Return on Invested Capital	18%	8%
Estimated LT Growth	14%	14%
Payout Ratio	19%	28%
Downside Capture (3-Year)	69%	-
Volatility (3-Year)	19.1%	23.1%
Active Share	98%	-

Top 10 Holdings

	% of Portfolio
Schlumberger NV	5.9%
Centene Corporation	5.9%
Intercontinental Exchange, Inc.	5.9%
Wheaton Precious Metals Corp	5.1%
Franco-Nevada Corporation	5.1%
Analog Devices, Inc.	4.9%
PTC Inc.	4.9%
Adobe Incorporated	4.7%
Fiserv, Inc.	4.6%
Dropbox, Inc. Class A	4.6%
Total	51.7%

Sector Diversification[6]

	SA	Russell Midcap
Consumer Discretionary	0.0%	11.8%
Consumer Staples	3.8%	3.6%
Energy	10.9%	5.1%
Financials	14.0%	13.4%
Health care	13.4%	10.7%
Industrials	0.0%	15.5%
Information Technology	42.4%	16.6%
Materials	11.9%	5.9%
Real Estate	0.0%	8.1%
Communication Services	3.6%	3.3%
Utilities	0.0%	6.0%
Total	100.0%	100.0%

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Market Cap Breakdown[1]

	SA	Russell Midcap
$0 to $5 billion	10.6%	7.7%
$5 billion to $15 billion	17.1%	35.6%
$15 billion to $50 billion	36.4%	56.6%
$50billion to $100 billion	30.4%	0.0%
Greater than $100 billion	5.5%	0.0%
Total	100.0%	100.0%

Portfolio Construction

- 15-25 Stocks
- Primarily U.S. based
- Max 30% industry concentration limit
- Target market capitalization below $60 billion

Source: Spears Abacus, FactSet. [1]Market cap weights excluding cash

Managed by

Spears Abacus MidCap Opportunities Team

Portfolio Manager	Years Experience
Manny Weintraub	32
Senior Analyst	
Daniel Wetchler	12

Style

GARP

Inception Date

31-Mar-04

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Comparisons to the S&P 500 TR (Total Return) and Russell 3000® are for informational purposes only, as the composites may hold securities not in the S&P 500 TR (Total Return) and Russell 3000® and may have more or less volatility and risk than an investment in the S&P 500 TR (Total Return) and Russell 3000®. Management fee information available upon request.

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