July 23, 2020

Manager Commentary

Sometimes I write these letters and, frankly, not that much has happened over the previous three months. But then other times, like this quarter, it seems like the world has turned on its head.

Three months ago, we thought there was a possibility that the impact of Covid-19 in the United States might dissipate with warmer weather or mutations, and life could go back to normal. Today it's clear that, while economic activity has improved from the lows of March, it's going to be a long time before the economy goes back to normal.

Three months ago, President Trump and Joe Biden were running neck and neck in swing-state polling. Now, predictive markets indicate a 60% chance for Joe Biden to win the presidency.

Three months ago, the S&P 500 was down 20% for the year after suffering its worst quarter since 2008. Three months later, the S&P 500 was up 20% for the quarter, having its best quarter since 1998. The decline was clearly driven by the economic impact of the pandemic; the rise was driven by unprecedented monetary policies engineered by central banks around the world. The U.S. Federal Reserve, in late March, committed to doing "whatever it takes" to help the U.S. economy.

As a result of a terrible quarter for stocks followed by a great quarter, the Russell Midcap Index has had bone-jarring volatility and, after six months, is now down 9.1% for the year. Our SA MidCap Opportunities portfolio has had less volatility and is up 5.1%, net of fees, for the year.

Is this a harbinger of things to come? Will the large market indexes continue to exhibit more volatility than we have seen in recent years? We think so, and not just because the world seems more uncertain than it used to. The structure of the market has changed radically over the past twenty years. As more and more money has been invested in passive index funds, there are fewer active managers to buy stocks when prices are down.

When passive investors want to sell their holdings, they have to sell all of them regardless of price. That did not necessarily increase volatility when there were many active managers to buy those stocks whose prices reached absurd levels. However, passive investment funds now represent 45% of the market, up from 25% ten years ago.

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We believe that the normal volatility that we would have expected to see as a result of Covid-19 over the past six months was exaggerated by passive investment vehicles selling and buying without regard for price.

For those of us focused on price and value this volatility can lead to opportunity. And, as a result, despite the uncertainty all around us, we feel quite optimistic about the portfolio going forward.

This price volatility helps us focus the portfolio on what we believe to be the "best of both worlds" of value and fundamental momentum. Value because "cheap" stocks can provide excess returns if valuation re-rates higher and fundamental momentum because businesses that are growing have a tailwind that increases the chance that their earnings (and stock market values) will naturally grow over time. Over the years we have combined both value and fundamental momentum because we have seen too many value stocks that had low valuations because the businesses were being made obsolete by new technology, and too many growth stocks that traded at such high valuations that the risk of loss in the case of a disappointment was unacceptably high, in our opinion.

We craft these "best of both world" portfolios through our "ABCD" process which stands for Average up, Buy the business, Cut losses, and Derisk the portfolio. And that is a great lens through which to look at what happened to the portfolio in the second quarter.

Averaging up is our way of benefitting from societal changes in the portfolio by purchasing more of a sector or a company as the thesis seems to prove itself out. We generally don't get as low a valuation as when we initially bought, but in our mind the investment is less risky as there is a greater certainty of ultimate success. This quarter we increased our opportunity to make money in three themes: precious metals, medical technology, and enterprise software with purchases of Wheaton Precious Metals, a precious metal royalty company with relatively high silver exposure, Becton Dickinson, a medical technology company with an emphasis on surgical supplies, and PTC, an enterprise software company that allows collaboration among engineers through cloud-based software.

Buy the business represents our desire to focus the portfolio on businesses that have enduring competitive advantages that allow them to earn high returns on invested capital. This quarter we initiated positions in A. O. Smith, the leading manufacturer of water heaters in the U.S., Cantel Medical, a medical technology company focused on infection prevention products and Aon Corp, one of the largest insurance brokers in the world.

We cut our losses in Motorola Solutions and Ebix. Both are wonderful businesses, but Covid-19 looks likely to hit each of these businesses hard and we used the proceeds for other purchases.

And finally, we derisked the portfolio by reducing the position size of a few positions that had benefited from the crisis and were trading at higher than usual valuations. We sold shares in Citrix Systems, Broadcom, Domino's Pizza, Progressive Corp, and PayPal.

As of the end of the quarter, we have structured the portfolio around several key themes and trends, including payments, enterprise software, market exchanges, healthcare, data monetization, and precious metals. Clearly these are uncertain times, but we have positioned the portfolio to benefit from trends that we believe are certain: more transactions will be done electronically; companies that use technology to their benefit will win in the marketplace; the global population will age; personal and corporate data will remain a valuable resource and governments around the world will continue to run up large deficits.

With all best wishes for a healthy summer,

Manny Weintraub, CFA

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MidCap Opportunities

SPEARS ABACUS

Quarterly
Fact Sheet
As of June 30, 2020

Investment Strategy Highlights

Spears Abacus' MidCap Opportunities strategy is a long-only equity strategy that seeks to preserve capital on an absolute basis and outperform the Russell Midcap® index. Following a disciplined process, a proprietary screening methodology and fundamental analysis are applied to identify companies with an asymmetric risk / reward ratio, wherein each company's likely upside is disproportionately large compared to its worst-case scenario downside. Target investment characteristics include:

- High return on invested capital and strong free cash flow
- Resilient business with solid long-term growth prospects
- Strong balance sheet and effective capital allocation
- Positive fundamental momentum
- Attractive valuation

Managed by
SA MidCap Opportunities Team

Portfolio Manager
Manny Weintraub

Years of Investment Experience
30 Years

Style
GARP

Inception Date
31-Mar-04

Sector Diversification[1]	SA	Russell Midcap
Consumer Discretionary	5.5%	12.0%
Consumer Staples	0.0%	4.4%
Energy	0.0%	3.0%
Financials	23.0%	11.6%
Health care	24.2%	13.3%
Industrials	8.4%	14.4%
Information Technology	24.5%	19.1%
Materials	14.4%	4.9%
Real Estate	0.0%	8.0%
Communication Services	0.0%	3.0%
Utilities	0.0%	6.2%
Total	**100.0%**	**100.0%**

Top 5 Holdings	% of Portfolio	YTD Return
Wheaton Precious Metals Corp	6.8%	48.7%
Fiserv, Inc.	6.3%	-15.6%
Virtu Financial, Inc. Class A	6.2%	50.6%
Intercontinental Exchange, Inc.	5.9%	-0.4%
Becton, Dickinson and Company	5.8%	-11.4%
Total	**31.1%**	

Portfolio Statistics[2,3]	SA	Russell Midcap
Number of Securities	18	-
Cash Weight	12.7%	-
Dividend Yield	0.87%	1.92%
Market capitalization ($b)	46.4	14.3
Harmonic Avg. TTM Price/Earnings	23.3x	23.4x
Harmonic Avg. NTM Price/Earnings	20.3x	23.9x
LT Debt / Total Capital	0.55x	0.48x
Net Debt / EBITDA	2.4x	2.9x
Return on Invested Capital (ROIC)	14%	5%
Estimated Long-Term Growth (3-5 Y	11%	10%
Payout Ratio	24%	43%
Downside Capture (trailing 3 year)	50%	-
Active Share	99%	-

Performance[4]	YTD	Annualized Total Returns				
	YTD	1 Yr.	3 Yr.	5 Yr.	10 Yr.	Inception
SA MidCap (gross)	5.7%	8.2%	11.7%	8.2%	12.2%	11.0%
SA MidCap (net)	5.1%	6.9%	10.3%	6.8%	10.8%	9.3%
Russell Midcap	-9.1%	-2.3%	5.8%	6.8%	12.3%	9.0%
S&P 500	-3.1%	7.5%	10.7%	10.7%	14.0%	8.6%

[1]Sector weights excluding cash
[2]All statistics based on weighted average unless otherwise noted, index based on aggregate
[3]Downside capture trailing 3 years, monthly basis vs Russell Midcap
[4]Returns for less than one year not annualized; YTD as of 6/30/20

Source: FactSet, Spears Abacus

PLEASE SEE DISCLOSURES ON THE FOLLOWING PAGE

Inception: March 31, 2004

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MidCap Opportunities
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