JULY 21, 2022

Markets Post Worst First Half of Year In Decades – Wall Street Journal front page headline, July 1, 2022

The S&P 500 has dropped nearly 20 percent so far this year. In the second quarter alone, it declined more than 16 percent. Bonds were no safe haven. The broadest measure of high-quality bonds fell more than 10 percent, the worst first half in history (in this case, "history" dates back to about 1970).

We try to avoid rehashing statistics that are readily available in print and online. These numbers are so stark that we feel they deserve prominent mention. However, context is everything, and there are important points to keep in mind:

- Investing is not a one-way street. Assets prices have declined sharply before and will do so again.

- Our goal is to be able to withstand volatility and avoid permanent loss of capital. It is critical to be well-positioned as markets inevitably rebound.

- Our investment process is designed with precisely this fact in mind. We hold high quality, durable companies. Stock prices may fluctuate, but underlying businesses are stable.

- The best businesses get stronger during difficult periods. Weak competitors fall by the wayside.

- Front page headlines reflect the past and are generally very poor predicters of the future.

A 20% drop in stock market averages is painful, but not unusual. Declines of this magnitude have occurred a dozen times in the last 60 years or about once every five years. We were spoiled by the fact that the early Covid decline lasted a mere 30 days and that it had been 11 years since the previous similar drop.

What happened?

While there have been a number of well-publicized adverse events this year, we believe that the primary reason markets are down is money. Specifically, investor ***expectations*** about the future cost and availability of money. For the first time since the outbreak of Covid-19, and arguably since the Great Financial Crisis, investors are seriously considering the implications of a shrinking rather than expanding supply of money.

As we have written about previously, the mountain of cash that the Fed injected into the financial system had a much larger impact on the valuation of financial assets than it did on the underlying earnings of those assets. By the end of last year, most common valuation metrics were at or near all-time highs.

On December 31, 2021, the P/E Multiple[1] of the S&P 500 stood at 21.33 times expected earnings. As of June 30, the P/E Multiple has shrunk to 16 times despite the fact that expected earnings have actually increased. The entire market decline can be explained by this reduction in valuation, which, in turn, can be explained by higher interest rates and investor concerns about tighter monetary policy.

Where was the damage worst?

In order to withstand volatility, it is imperative to avoid the most overvalued assets. Over the last several years, there have been numerous instances of extreme valuation expansion. Covid related fiscal stimulus and near zero interest rates converted some portion of the population from savers to speculators, guiding some of that mountain of cash toward the riskiest assets. The boldest examples were assets with no earnings whatsoever like crypto currencies and some so-called meme stocks.

Asset	2021 Price Change	Earnings 2017 - 2021	YTD Price Change
Bitcoin	+58%	0	-57.9%
AMC Entertainment	+1,183%	$ 6.4 Billion Loss	- 50.2%

Of the 4000 or so publicly traded companies in the U.S., nearly 1000 dropped 40% or more this year. More than half of those are not expected to show a profit in 2022. Undoubtedly, some will survive and even prosper. Many will not. The result will be permanent loss of capital for shareholders.

[1] ***Valuation = Price divided by earnings*** To oversimplify, the measure of a stock's valuation is its price divided by its earnings per share. This is referred to as its Price/Earnings Ratio or P/E Multiple (sometimes just "P/E" or "multiple" for short). The same measure can be applied to broad market indices like the S&P 500.

Company	Industry	First Profits (Projections)	YTD Price Change
Carvana	Auto dealer	2025 or later	-90.3%
Aspen Aerogels	Building Products	2025 or later	-80.2%
The RealReal	Designer clothing consignment	2025 or later	-78.5%
Wayfair	On-line Furniture	2025 or later	-77.1%

By contrast, our portfolios hold companies that generate cash flow, not just accounting earnings (generally accepted accounting principles, or GAAP, leave a lot of wiggle room; cash is cash). We think cash flow is important in all environments and even more so when lending conditions are tight and financing difficult.

What about inflation?

The yield on the 10-year U.S. Treasury Note peaked at around 3.50%, a whopping 2% (percentage points) higher than just a year ago. The increase can be traced back to inflation that has proved more severe and persistent than most ever imagined. Consumers immediately feel the pressure of inflation on highly visible essentials like gasoline, food and utility bills or discretionary items like air travel. But it is the expectations of inflation that concern policy makers at the Federal Reserve the most. Once inflation expectations become entrenched, it is difficult to get the consumer to stop spending as the belief is that things will only get more expensive. The cycle become vicious, and inflation becomes self-fulfilling.

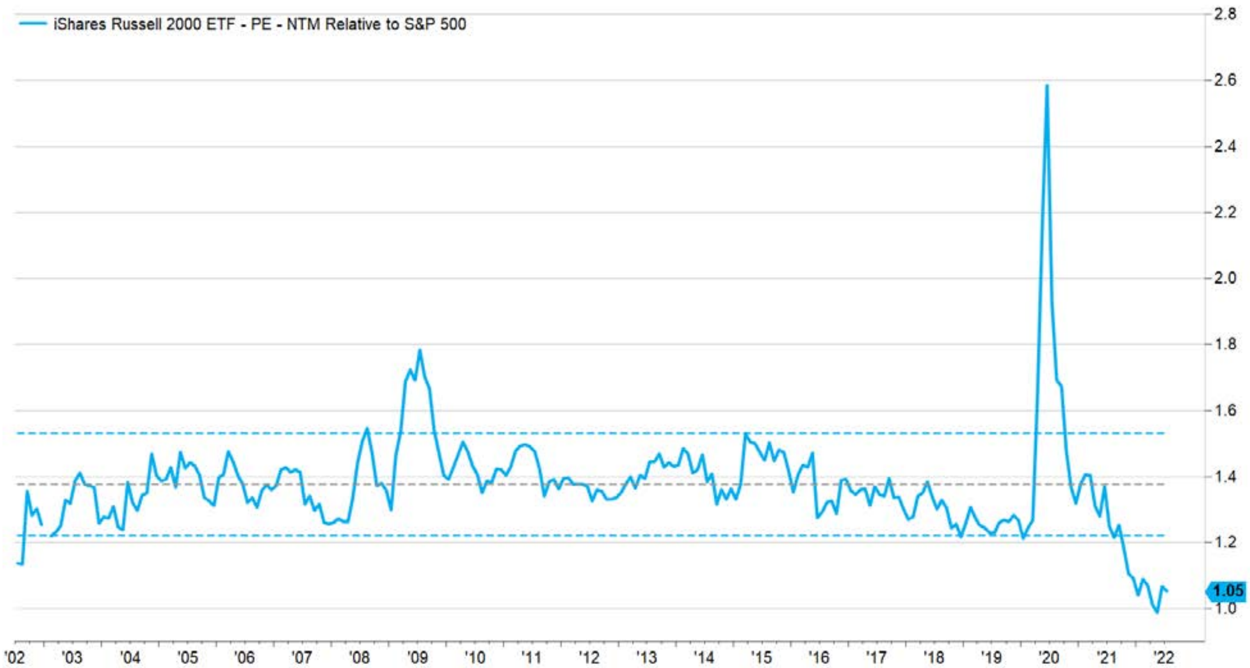
After some waning confidence during the quarter, the market now believes that the Fed will be successful. Inflation expectations have come back down to 2.0%-2.5% over the long term, rather than the high single digit rates we are seeing today. As one problem is solved, another potentially arises. Tighter monetary policy often leads to a recession.

We believe that this is the risk that investors will focus on in the coming months. We are already seeing the first signs. In the last week of the quarter, the 10-year Treasury rate dipped below 3%. Credit spreads[2] are increasing, indicating that lenders are less inclined to extend cheap credit to lower quality borrowers. If this proves to be the case, the high quality and resiliency of our stock and bond holdings should prove even more valuable relative to riskier and more expensive securities.

[2] Credit spreads measure the difference in borrowing costs between the U.S. Treasury and lower quality borrowers.

Spears Abacus Small Cap Dividend Growth Strategy discussion – Manny Weintraub, Manager

In the five and a half years that we have been managing this strategy, we have never seen small caps as attractive relative to large caps. The chart below shows how the valuation of the Russell 2000 Index of small-cap companies relative to the S&P 500 Index of large-cap companies has collapsed over the first half of this year:



We get why small caps are down. Perhaps some investors are selling because small-cap stocks are a less liquid market than large-cap stocks, and they want to get out before other people sell their small-cap stocks, driving down the price. Or maybe some investors are selling because 40% of the components of the Russell 2000 Index were unprofitable as of the end of last year. And as we discussed earlier, those are the exact companies that will suffer fundamentally now that capital has a cost.

But we believe this knee-jerk trading of passive vehicles linked to the Russell 2000 Index has provided a great opportunity for fundamental investors. Our portfolio has a return on invested capital of 25% relative to 4% for the Russell 2000 Index. We own the companies that generate more cash than they need to run their business. That's why many of them pay dividends. Maybe it's time to look at volatility as a feature, not a bug, because we now have the opportunity to add to companies at valuations that we never thought we would see.

A company like A. O. Smith, the largest manufacturer of water heaters and boilers, is a good example; 80% of their North American boiler sales are replacing old boilers – this is not a discretionary purchase. They are deploying the free cash flow from this stable business into high-growth water treatment solutions, which now represent over 10% of sales. The company has no debt and is trading at 15 times forward earnings per share, versus its five-year average of 21

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times. We believe this is the proverbial baby thrown out with the bath water, and just one of many.

We are excited about our strategy's prospects not just relative to the Russell 2000 Index of small-cap companies (which it has outperformed with less volatility since inception), but relative to the large-cap companies as well. Our portfolio trades at a PE of 13.8 times earnings, versus 15.8 times for the S&P 500. Our portfolio has less exposure to a strong dollar, which has the potential to hurt large-cap earnings by as much as 8% next year.

And while the past ten years have seen strong relative performance for the mega-cap companies over small-cap, that could very well reverse in the coming decade: The DOJ is suing Google for violating antitrust laws; Amazon has grown so large that it can no longer power through a consumer slowdown by gaining market share; and Apple revolutionized the world with the smartphone in 2011. We are not predicting gloom and doom for these wonderful companies. We are only pointing out that we believe it was a uniquely good decade for what have become mega-cap companies. And even with that wonderful decade, the twenty year returns of the Russell 2000 Index and the S&P 500 Index are very similar given how well small-caps did in the decade of the 2000s.

An investment in the Spears Abacus Small Cap Dividend Growth strategy seeks to provide diversification from mega-caps that have just had a great decade while still allowing investors to maintain exposure to profitable U.S. based companies.

Every quarter we like to share a table of the top contributors to, and detractors from, our investment performance. Our greatest performance contributor was Switch, a leader in innovative exascale data centers, which has an agreement to be acquired by a leading digital infrastructure investment firm. Our greatest detractor was Virtu Financial, a provider of market making services that is out of favor due to concerns over potential regulatory changes. We believe the shares are very attractive trading at six times earnings estimates, with a 4.3% dividend yield, and will continue to benefit from structurally higher volatility.

2Q22 Performance of Top 5 Contributors[1]

Company	Ticker	% Change
Switch, Inc. Class A	SWCH	8.9%
CDK Global, Inc.	CDK	12.8%
Coca-Cola Consolidated, Inc.	COKE	13.5%
Texas Pacific Land Corporation	TPL	11.5%
Paya Holdings Inc Class A	PAYA	12.1%

2Q22 Performance of Top 5 Detractors[1]

Company	Ticker	% Change
Virtu Financial, Inc. Class A	VIRT	-36.5%
InMode Ltd.	INMD	-39.3%
Amedisys, Inc.	AMED	-39.0%
Sabre Corp.	SABR	-49.0%
Cambium Networks Corporation	CMBM	-41.3%

[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.

Important Note About SA Investor Commentaries

This letter should not be relied upon as investment advice. Any mention of particular stocks or companies does not constitute and should not be considered an investment recommendation by SA. Any forward-looking statement is inherently uncertain. If you would like to learn more about SA and its investment program, please contact us at www.spearsabacus.com.

Please contact SA if your financial situation or investment objectives have changed in any way or if you wish to impose new restrictions or modify existing restrictions on your accounts. You should be receiving, at least quarterly, a statement from your custodian showing transactions in your accounts. SA urges you to compare your custodial statements to any statements that you receive from SA.

Small Cap Dividend Growth

SPEARS ABACUS

Quarterly Fact Sheet
As of June 30, 2022

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)	-18.5%	-16.7%	4.2%	6.4%	-	7.1%
SA Small Cap (net)	-18.9%	-17.5%	3.1%	5.3%	-	6.0%
Russell 2000	-23.4%	-25.2%	4.2%	5.2%	-	5.6%

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 6/30/22; [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	76	-
Cash Weight	4.4%	-
Dividend Yield	1.18%	1.28%
Market capitalization ($b)	4.8	2.5
Harmonic Avg. TTM P/E	15.3x	23.1x
Harmonic Avg. NTM P/E	13.8x	17.0x
LT Debt / Total Capital	0.29x	0.47x
Return on Invested Capital	25%	4%
NTM Revenue Growth	10%	10%
Median Payout Ratio	20%	33%
% of holdings paying dividend	84%	43%
Active Share	96%	-

Sector Diversification[5]

	SA	Russell 2000
Consumer Discretionary	12.2%	10.1%
Consumer Staples	3.9%	3.8%
Energy	4.8%	5.5%
Financials	17.7%	17.1%
Health care	16.9%	16.9%
Industrials	13.1%	15.0%
Information Technology	17.1%	13.7%
Materials	6.3%	4.2%
Real Estate	5.7%	7.3%
Communication Services	1.7%	2.8%
Utilities	0.0%	3.5%
Total	100.0%	100.0%

Efficiency Measures[6,7]

	SA	Russell 2000
Annualized Excess Return	1.4%	-
Annualized Alpha	2.1%	-
Beta	0.86	-
Volatility	19.0%	21.1%
Upside Capture	93%	-
Downside Capture	86%	-
Sharpe Ratio	0.3	0.2
Sortino Ratio	0.5	0.3
Tracking Error	6.3%	-
Turnover (trailing 1 year)	22%	-

PLEASE SEE ADDITIONAL DISCLOSURES ON THE FOLLOWING PAGE

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Top 10 Holdings

Top 10 Holdings	% of Portfolio
Switch, Inc. Class A	4.3%
Virtu Financial, Inc. Class A	3.7%
World Wrestling Entertainment, Inc. Class A	2.9%
CDK Global, Inc.	2.8%
InMode Ltd.	2.7%
Royal Gold, Inc.	2.6%
Amedisys, Inc.	2.6%
Morningstar, Inc.	2.5%
Carriage Services Inc.	2.3%
Qualys, Inc.	2.1%
Total	28.6%

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

Managed by

Spears Abacus Small Cap Dividend Growth Team

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

Style

Blend

Inception Date

31-Dec-16

Spears Abacus Advisors LLC is an independent investment management firm registered with the U.S. Securities and Exchange Commission under the Investment Advisers Act of 1940. This material is intended to inform you of services available through Spears Abacus.

Preliminary performance figures are unaudited. Past performance may not be indicative of future results and every investment program has the potential for loss as well as profit. The Composite is the dollar-weighted linked monthly returns of those accounts sharing the objective of the respective strategy. Composite accounts were managed by Manny Weintraub while he was the portfolio manager at Integre Asset Management, LLC. Mr. Weintraub joined forces with Spears Abacus in January 2020 and will continue to manage the strategy. Accounts are included in the composite at the beginning of the first full month following the month during which the account came under management. Accounts that are terminated remain in the composite until the last full month the portfolio is under management, and the composite continues to include terminated portfolios for all periods prior to their termination. Individual account results will vary from that of the composite based on fee structures, investment restrictions, the timing of contributions and withdrawals and other factors.

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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**C. Mitchell Conover, Gerald R. Jensen & Marc W. Simpson (2016) What Difference Do Dividends Make?, Financial Analysts Journal, 72:6, 28-40, DOI: 10.2469/faj.v72.n6.1*