Oct. 20, 2020

Manager Commentary

“So much uncertainty." That’s the refrain I keep hearing. The outcome of the US Presidential election is uncertain. Even the timing of the results of the US Presidential election is uncertain. What will be the composition of Congress, and what policies might be enacted? How long will the Covid-19 pandemic last? When will there be a vaccine? When will enough of the population take the vaccine? What is the future of work? What is the future of cities?

How can one invest when there is so much uncertainty?

This much is clear: giving up is not an option. If you were to sell a large proportion of your assets and put it in cash, then you are investing in cash – a very liquid security that won’t fluctuate in price, but will pay you almost no interest. That’s your investment. Maybe you think you will find a better time later to invest that money in stocks or long-term bonds. Perhaps, but it’s a near certainty that inflation will erode the real value of your cash over time; trying to pick a time to get back in the market just adds more uncertainty to your portfolio.

However, just because some things are uncertain doesn’t mean that everything is uncertain. Will the sun come up tomorrow? Yes, it will. Will consumption of healthcare in the US increase as four million baby boomers turn 65 in 2020? Yes, it will. And we also know that electronic payments will increase relative to cash, financial exchanges will continue to have an important role in the trading of financial assets, and corporate spending on software, bandwidth and cybersecurity will continue to increase.

Given that the future is always unknown, the art of portfolio management is combining what is known with what is uncertain to create a portfolio that aims to preserve and grow wealth in any scenario.

The scenario we think most likely in the near term is that interest rates will stay low supporting equity valuations, that democratic institutions in the United Sates will continue to function no worse than in the year 2000, and that the implementation of a Covid-19 vaccine will take most of 2021.

And we believe that our fundamental momentum strategy that aims to take the best of growth and value is a great way to invest in these uncertain times. We invest in companies and industries that have above-average financial characteristics, but only average valuation. This is a way to benefit from economic growth while reducing the risk of a valuation correction in a bear market.

To implement our strategy, we are continually applying the “ABCD” process that we developed over the past thirty years. It stands for Average up, Buy the business, Cut losses, and Derisk the portfolio.

We average up because we want the portfolio to benefit from multi-year trends. Novice investors might be tempted to sell a position just because it has gone up in price. But as famed investor Peter Lynch once said, “Selling your winners and holding onto losers is like cutting the flowers and watering the weeds."

We aim to buy businesses that have high returns on invested capital. Usually this means that the companies will generate more cash than they need to grow the business. We believe Wall Street analysts systematically undervalue this “free cash flow” because they assume in their spreadsheets that it is used to pay down low-cost debt. This ignores the possibility of an accretive acquisition or innovative capital return.

We tend to cut losses because we learned long ago that we don’t get everything right. Your portfolio has investments in a variety of companies and industries that we believe have a high probability of being good investments, but in all investments the unexpected happens frequently. It has been our experience that, in general, accepting a loss and moving on is more profitable than buying more of an investment that has decreased in value.

We derisk the portfolio by trimming positions in the portfolio where the stock price has grown significantly more than earnings and cash flow. We are often happy to own these companies in the long term, but companies with high valuations can often be vulnerable in downturns like we had in the first quarter of this year, and we aim to have a portfolio that is less volatile than the S&P 500.

Average Up
In the third quarter, we increased our position in a corporate software company, PTC. The company has benefited from the need for employees to work from home, but we think Wall street is underestimating how long this tailwind will last. We also bought more shares of CME, which is the leader in listed financial products, primarily futures; we continue to find CME’s unique financial profile and countercyclical qualities very attractive.

Buy The Business

We initiated positions in four companies with strong franchises. Given the relatively cheaper valuations among smaller companies, it is no surprise that all four are on the smaller side. We bought shares in Allstate, the personal lines insurance company, with a strong history of compounding book value per share; Tabula Rasa Healthcare, a developer of medical software that optimizes drug regimens and reduces medication-related risk, which has consistently grown organic revenue over 20% each year; Curtis-Wright Corporation, an innovative engineering company focused on military defense, commercial aerospace, and power; and Qurate, the parent company of QVC, a capital-light retailer with a strong core base of customers and e-commerce fulfillment capabilities.

Cut Losses

We sold our shares in Molina Healthcare, a company that could be negatively impacted by the Supreme Court nomination of Amy Coney Barrett and the Supreme Court's upcoming decision on the fate of the Affordable Care Act.

Derisk The Portfolio

Lastly, we reduced the position size of several of our higher growth companies where share prices have increased significantly more than earnings and cash flow (i.e. the valuation multiple has gone up), and thus valuation poses a greater risk. We sold shares in Globus Medical, IQVIA, and PayPal.

There is no doubt that, from a political and public health point of view, these are the most uncertain times that we have ever seen, and there remains the potential for volatility in the months ahead. But we believe that the trends toward digitization of commerce and corporate infrastructure, increased consumption of medical care, modernization of national defense, and increased trading in financial instruments are the type of long-term certainties that can drive a portfolio forward for the next decade.

With all best wishes for healthy autumn,

Manny Weintraub

Manny Weintraub, CFA

MidCap Opportunities

SPEARS ABACUS

Quarterly
Fact Sheet
As of September 30, 2020

Investment Strategy Overview

Spears Abacus' MidCap Opportunities strategy is a long-only equity strategy that seeks to preserve capital on an absolute basis 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 reasonable 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 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)	11.2%	18.8%	12.4%	11.3%	11.5%	11.1%
SA MidCap (net)	10.2%	17.4%	10.9%	9.8%	10.1%	9.5%
Russell Midcap	-2.4%	4.5%	7.1%	10.1%	11.8%	9.3%
S&P 500	5.6%	15.2%	12.3%	14.2%	13.7%	9.1%

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; [6]Sector weights excluding cash; [7]Returns for less than one year not annualized; YTD as of 9/30/20

PLEASE SEE ADDITIONAL DISCLOSURES ON THE FOLLOWING PAGE

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

	SA	Russell Midcap
Number of Securities	20	-
Cash Weight	6.3%	-
Dividend Yield	0.89%	1.75%
Market capitalization ($b)	46.3	18.3
Harmonic Avg. TTM P/E	21.1x	26.4x
Harmonic Avg. NTM P/E	18.8x	22.2x
LT Debt / Total Capital	0.50x	0.49x
Net Debt / EBITDA	6.4x	2.9x
Return on Invested Capital	16%	4%
Estimated LT Growth	12%	11%
Payout Ratio	22%	46%
Downside Capture (3-Year)	55%	-
Active Share	99%	-

Top 10 Holdings

	% of Portfolio
Wheaton Precious Metals Corp	7.3%
CME Group Inc. Class A	6.5%
Fiserv, Inc.	6.4%
Intercontinental Exchange, Inc.	6.2%
Fidelity National Information Services, Inc.	6.0%
Franco-Nevada Corporation	5.6%
Becton, Dickinson and Company	5.5%
Virtu Financial, Inc. Class A	5.4%
Domino's Pizza, Inc.	5.3%
IQVIA Holdings Inc	5.0%
Total	**59.1%**

Sector Diversification[6]

	SA	Russell Midcap
Consumer Discretionary	8.0%	10.7%
Consumer Staples	0.0%	3.6%
Energy	0.0%	6.1%
Financials	26.2%	19.4%
Health care	21.0%	17.0%
Industrials	7.4%	13.3%
Information Technology	23.6%	12.9%
Materials	13.7%	3.9%
Real Estate	0.0%	6.8%
Communication Services	0.0%	4.2%
Utilities	0.0%	2.1%
Total	100.0%	100.0%

Market Cap Breakdown[1]

	SA	Russell Midcap
$0 to $5 billion	18.2%	9.2%
$5 billion to $15 billion	5.2%	39.3%
$15 billion to $50 billion	38.8%	51.4%
$50billion to $100 billion	32.6%	0.0%
Greater than $100 billion	5.1%	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	31
Senior Analyst	
Daniel Wetchler	11

Style

GARP

Inception Date

31-Mar-04

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