JANUARY 26, 2023

SPEARS ABACUS OPPORTUNISTIC EQUITY STRATEGY

We are the downside capture people. We went down less than the S&P 500 in the 2008 financial crisis. We went down less than the S&P 500 in the 2020 Covid crash. And we went down less than the S&P 500 last year. In 2022, the Strategy declined 14.0%, net of fees, versus 18.1% for the S&P 500. 14.0%/18.1% = 77.3%. The Strategy only "captured" 77.3% of the S&P 500's decline. In our opinion, that's a good thing - much better than going down more than the S&P 500. That ratio, loss experienced divided by the loss of an index, is the basic gist of how we calculate the downside capture ratio. Over the past 3 years, in the months when the S&P 500 went down, our Strategy only experienced ~80% of the drawdown, which is to say in fancy technical terms, this Strategy has an 80% downside capture ratio over the past three years[1].

You know it has been a long thirteen-year bull market when prudent managers feel the need to explain why going down less is important. It certainly needed no explanation in the three-year bear market of 2001 – 2003 or the great financial crisis of 2008, but here goes.

Going down less can influence asset allocation. In recent years as bond yields have declined, our view is that bonds stopped being a vehicle in which one could *make* money, and instead became a tool to add stability to your portfolio. Well, "going down less" is also a way to add stability to a portfolio. Fun fact: the Strategy's 2022 decline of 14% was one percent more than the Bloomberg Aggregate Bond Index's ("Bond Index') decline of 13%. Not too shabby when one considers that the Strategy had a trailing five-year return of 7.4% a year and the Bond Index had a trailing five-year return of 0.0% a year.

We believe this is just the beginning of a period of outperformance for the Strategy as the past twelve years of historically low interest rates made the above average profitability and free-cash-flow generation of our typical holding seem merely ho-hum. Who needed a company that generates cash when corporations were able to issue twenty-year bonds with interest rates as low as 1.625%? It wasn't zero, but pretty close. Going forward, the management of the typical company we invest in will have less competition for bolt-on acquisitions, as financial buyers will now have a higher hurdle rate. Highly skilled employees that were working for unprofitable companies are now more likely to be available. All in all, we are excited to leave the "new normal" of free money behind and return to the "old normal" where borrowers are compensated for the risks they take.

[1] Past performance is not indicative of future results. Given the inherent volatility of the securities markets, it should not be assumed that investors will experience returns comparable to those shown here. Market and economic conditions could change in the future producing materially different returns than those shown here. Accordingly, no representation or warranty is made to the sufficiency, relevance, importance, appropriateness, completeness, or comprehensiveness of the market data, information or summaries contained herein for any specific purpose. The comparisons herein of the performance of the market indicators, benchmarks or indices may not be meaningful since the constitution and risks associated with each market indicator, benchmark or index may be significantly different.

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In 2022, performance benefitted from our purchases of companies in the energy industry in 2022 and 2021. It is our belief that the rush to electrify autos will take longer than Wall Street is forecasting and, in the meantime, has reduced any incentive OPEC+ had to keep prices low so that the world would stay "addicted" to oil. As a result, we believe oil prices will stay higher for longer.

As said above, the question for 2023, is how much collateral damage will be inflicted on the economy as the Fed puts the breaks on inflation? While we are waiting to find out, we prefer to err on the side of caution in the Strategy with a large cash position in the portfolio and an emphasis on companies with high margins, as any revenue disappointments are less likely to cause serious earnings damage.

The market is a barometer, not a thermometer goes the old expression, meaning it anticipates change rather than reflects it in real time. By the end of 2023 or 2024, we could see the market rallying in anticipation of an economic recovery. That said we have a large cash position because we expect there to be volatility along the way. We believe the forces that caused 2021 to be one of the most volatile years since 1950 have not yet abated. We hope to take advantage of that volatility as we did in October. The next decade may be more volatile, but that might be a perfect setup for an opportunistic investor with a low downside capture ratio.

Manny Weintraub, CFA

- 2022 was a challenging year; interest rates and inflation were to blame.
- A short, shallow recession is the consensus view. We remain cautious until proven otherwise.
- The silver lining? Higher yields are good for bond investors. Lower stock prices are good for bargain hunters.
- We maintain our strategy of investing in businesses where the underlying fundamentals remain extremely attractive. We believe patient investors will be rewarded.

I. Market Overview

2022 was a challenging year. There is no way to soft-pedal the results. In round numbers, U.S., global and emerging market stock indices each declined approximately 20%. Long term bonds fared worse, falling nearly 30%. Broadly speaking, there was no place to hide.

As we have written previously, the culprit has been rising interest rates and the specter of significantly higher inflation. Central banks around the world have used monetary policy (raising interest rates) to try to tame rising prices. So far, that strategy has had greater impact on financial markets than the real economy. Most growth measures have remained resilient while the labor market is historically strong. Business revenue growth has been sturdy, though rising expenses have applied modest pressure to earnings. On the other hand, stock valuations have shrunk meaningfully.

As is often the case during sharp market declines, speculative investments performed the worst. Crypto currency became front page news as price drops uncovered both well- and less-well-publicized crypto frauds. More traditional speculators were burned as well. An astonishing 613 Special Purpose Acquisition Companies (referred to as "SPACs" or blank check companies) were sold to the public in 2021. Retail investment "products", such as Exchange Traded Funds ("ETFs") were created to give even broader access to these questionable investments. In 2022, DSPC[2], an ETF that invests in an index of SPACs dropped 70%. In 2023, DSPC will close its doors and return what little remains of its investors' capital.

Very long-term "visionary" investors also felt the sting of rising interest rates. Companies with great future promise but little or no current earnings were hit particularly hard. The once highly regarded Ark Innovation ETF, ARKK, held nearly $30 billion of investor assets in early 2021 and declined 67% in 2022, as large holdings like Zoom Inc., Tesla and Shopify came down to earth.

Mainstream growth companies with higher-than-average valuations were also victims of higher rates. At Spears Abacus, we avoided the worst of these very large companies, but not all.

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[2] AXS De-SPAC ETF Source: FactSet

Name	2022 Return
Meta Platforms Inc. (Facebook)	-64.2%
Netflix, Inc.	-51.1%
Amazon.com, Inc.	-49.6%
Alphabet Inc. Class C	-38.7%
Microsoft Corporation	-27.9%
Apple Inc.	-26.3%

Looking ahead, a consensus has been reached by investors, observers and corporate executives. Most are confident that the Fed will successfully orchestrate the breaking of inflation[3]. That leaves the question of how much collateral damage will be inflicted on the economy?

> *"Just about every region with the exception of China and Japan believes there is going to be some kind of economic slowdown. Ninety-eight percent of CEOs in the U.S. think there is going to be a recession – but it's going to be short and shallow."*
>
> *- Dana Peterson, Chief Economist of the Conference Board*

The economic press will expand its vocabulary or simply return to well-worn phrases like "goldilocks economy" and "soft-landing". If this hallowed state is achieved, investors will cheer, and markets could rebound sharply. We believe this scenario is entirely possible; in it our investments would prosper. But we are mindful that optimistic projections do not always meet expectations. Consequently, our portfolios include holdings that should defend well against a more adverse environment. Rather than *predicting* dire circumstances, we think of this as *insurance* for negative events that might occur.

We always try to consider what might surprise investors in a way that would cause asset prices to fall. Of course, sometimes this is impossible. Events like Covid-19 or the war in Ukraine are manifestly unpredictable. However, there are more garden-variety surprises that might catch markets unaware. One consideration would be a longer than expected period of high inflation.

Jobs statistics have become the flavor of the month. Wage-induced inflation seems to be among central bankers' primary concerns. In previous recessions, corporations were quick to lay off workers in high-cost areas and eventually replace them with lower cost workers in China and other emerging markets. This strategy seems far less popular thanks to a shrinking labor force in developed economies and higher costs in emerging ones. In a Conference Board survey, U.S. CEOs preferred "pricing strategies" to layoffs[3]. If wages continue to rise, central bankers, particularly in the U.S., might prefer to keep interest rates higher for longer than expected.

There is a silver lining here. Though the rapid rise in interest rates caused negative returns for bonds last year, for fixed-income investors, the current environment is the most favorable in years.

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[3] Short U.S. Recession is Expected by CEOs – Theo Francis, *The Wall Street Journal* 1/13/2023 (print edition)

Where appropriate, bonds can finally have a meaningfully positive impact on portfolios. Perhaps the largest change can be seen in short-term cash reserves. A year ago, cash was kept in bank "deposit accounts" which provided safety but virtually no yield. Today, we deploy a strategy that combines higher-yielding (but still safe) money-market funds and U.S. Treasury Bills to take advantage of the fact the Fed has raised interest rates to close to 4.5%.

We have observed that major banks are generally not offering the same advice to their customers, even those with large cash balances. Banks use customer balances to fund their own lending activity which incentivizes them to pay the lowest possible rates on deposits. Thanks to aggressive Fed actions, a pickup of over 4.0% is possible for investors with checking accounts at certain banks. For further details, please contact us to learn more.

Bonds that now have reasonable yields are a good reminder that sharp market declines like the one we endured in 2022 set the stage for bargain hunting. Last year's turmoil is forcing investors to differentiate between speculative and proven, between those that promise and those that deliver. This year is off to a good start. While the average stock may drop further, investors will benefit from owning the most resilient businesses that provide goods or services to growing segments of the economy. At Spears Abacus we continue to focus on just such investments and maintain our long-term optimism.

II. Personal Finance

A reminder that with the change of the calendar year comes a few federal tax rule changes that may be relevant to you. As always, we recommend you speak with your own tax advisor about your particular circumstances including any state or local tax changes. Effective this year:

- The annual gift exclusion amount has increased to $17,000 per person per year (increased from $16,000)
- The lifetime credit amount for gifting or inheritance (including generation-skipping) increased significantly due to inflation adjustments. For 2023, the lifetime credit is $12.92 million per person, and therefore $25.84 million for a married couple. It is currently scheduled to revert back to $5 million (adjusted for inflation since 2018) in 2026, although we expect additional changes before then.

Also of potential interest, the required minimum distribution (RMD) age for non-Roth retirement plans has increased to 73 as of this year.

We would be pleased to discuss these changes, and any opportunities they present, with you and/or your tax advisor.

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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.

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OPPORTUNISTIC EQUITY

SPEARS / ABACUS

Quarterly
Fact Sheet
As of December 31, 2022

Investment Strategy Overview

Spears Abacus' Opportunistic Equity strategy is a long-only investment 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

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 S&P 500 or Russell 3000
- 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 Opp Eq (gross)	-13.1%	-13.1%	6.0%	8.7%	10.6%	9.9%
SA Opp Eq (net)	-14.0%	-14.0%	4.8%	7.4%	9.4%	8.4%
Russell 3000	-19.2%	-19.2%	7.1%	8.8%	12.1%	9.2%
S&P 500	-18.1%	-18.1%	7.7%	9.4%	12.6%	9.2%

Source: Spears Abacus, FactSet. Inception Date 12/31/2003. [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 3000; Alpha based on Risk Index = Russell 3000, Risk Free Rate = 10 Year Treasury note; [6]Sector weights excluding cash; [7]Returns for less than one year not annualized; YTD as of 12/31/22

PLEASE SEE ADDITIONAL DISCLOSURES ON THE FOLLOWING PAGE

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

	SA	Russell 3000
Number of Securities	31	-
Cash & Equivalents Weight	18.3%	-
Dividend Yield	1.16%	1.61%
Market capitalization ($b)	83.0	360.9
Harmonic Avg. TTM P/E	17.8x	17.9x
Harmonic Avg. NTM P/E	15.5x	16.8x
LT Debt / Total Capital	0.40x	0.43x
Return on Invested Capital	22%	10%
Estimated LT Growth	13%	12%
Payout Ratio	27%	30%
Downside Capture (3-Year)	80%	-
Volatility (3-Year)	19.0%	21.8%
Active Share	94%	-

Top 10 Holdings

	% of Portfolio
Church & Dwight Co., Inc.	4.3%
Mastercard Incorporated Class A	4.1%
Broadcom Inc.	3.9%
Intercontinental Exchange, Inc.	3.9%
CME Group Inc. Class A	3.9%
IQVIA Holdings Inc	3.8%
Centene Corporation	3.6%
Franco-Nevada Corporation	3.6%
Adobe Incorporated	3.5%
Wheaton Precious Metals Corp	3.5%
Total	**38.1%**

Sector Diversification[6]

	SA	Russell 3000
Consumer Discretionary	2.3%	10.2%
Consumer Staples	8.7%	6.7%
Energy	6.7%	5.3%
Financials	17.7%	12.3%
Health care	15.2%	15.5%
Industrials	0.0%	9.9%
Information Technology	33.1%	24.5%
Materials	8.6%	3.0%
Real Estate	2.2%	3.3%
Communication Services	5.5%	6.0%
Utilities	0.0%	3.1%
Total	**100.0%**	**100.0%**

Market Cap Breakdown[1]	SA	Russell 3000
$0 to $5 billion	3.8%	6.7%
$5 billion to $15 billion	11.5%	9.1%
$15 billion to $50 billion	33.5%	19.0%
$50billion to $100 billion	27.8%	12.5%
Greater than $100 billion	23.4%	47.4%
Total	100.0%	100.0%

Portfolio Construction

- 25-35 Stocks
- Primarily U.S. based
- No market capitalization preference
- Max 30% industry concentration limit

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

Managed by

Spears Abacus Opportunistic Equity Team

Portfolio Manager	Years Experience
Manny Weintraub	32

Senior Analyst

Daniel Wetchler 12

Style

GARP

Inception Date

31-Dec-03

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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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