Q1 2021 Factor Performance Comments

Index	Q1 2021
MSCI All Country World	4.18%
MSCI All Country World Ex-US	2.95%
Russell 1000	5.91%
Russell 2500	10.93%

Key Points:

- Our key selection factors of Shareholder Yield, Momentum, and Value were largely consistent across universes for the quarter. Value and Shareholder Yield outperformed in all universes, while Momentum underperformed.
- Lower market cap stocks outperformed on the quarter and year across universes, which was a tailwind for factor allocations relative to cap-weighted indexes.
- Poor quality stocks that do not meet our criteria for Value, Momentum, Earnings Quality, Earnings Growth, and Financial Strength are excluded from factor allocations and were a detractor from returns as low-quality companies outperformed.

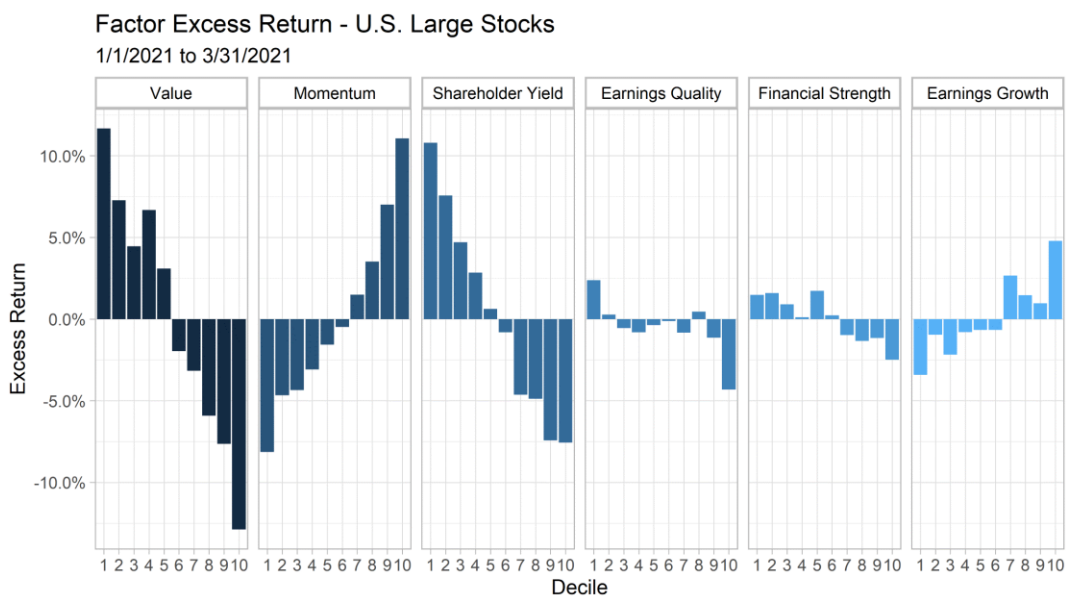
The first quarter of 2021 is in the books and it was an active one. The U.S. Capitol was stormed for the first time since 1814. An inauguration occurred. Fiscal stimulus was implemented. Many SPAC's were launched. A few funds failed in spectacular fashion. Big Tech stumbled from its high pedestal. For the first time in decades, the augur of inflation is top of investors' minds. Central Bankers the world over attempted to thread the needle of stimulus—not too much, not too little, but just enough to not exhume the pre-GFC spirit of moral hazard. And finally, we started the arduous process of vaccinating the world.

The first quarter equity rally was an extension of that which has been raging since November 2020. Three successive vaccine announcements in that month put everyone on notice that there would be a light at the end of the COVID tunnel. The actual administration of vaccines in the first quarter has allowed that light to burn brighter.

Since November, the S&P 500 index is up 23%. While that is an astounding number for such a short period of time, it glosses over what is happening under the hood of the equity markets—a massive rotation away from deflationary assets (mega cap tech, gold, bonds) and towards reflationary assets (cyclicals, small value, and commodities). This rotation is evident in factor returns when considering their underlying factor exposures.

U.S. Large Stocks

The panel below shows the excess performance of the six factor themes we monitor within U.S. large cap stocks. We think of Value, Momentum, and Shareholder Yield as selection factors—helping identify stocks we want to own and overweight. Earnings Quality, Financial Strength, and Earnings Growth are quality factors that allow us to avoid stocks with non-cash driven earnings, weak balance sheets, and questionable underlying businesses. Column 1 for each of the panels are the highest ranking on a factor while column 10 is the lowest ranking. Historically, owning the highest ranked and avoiding the lowest ranked has resulted in successful investment outcomes.



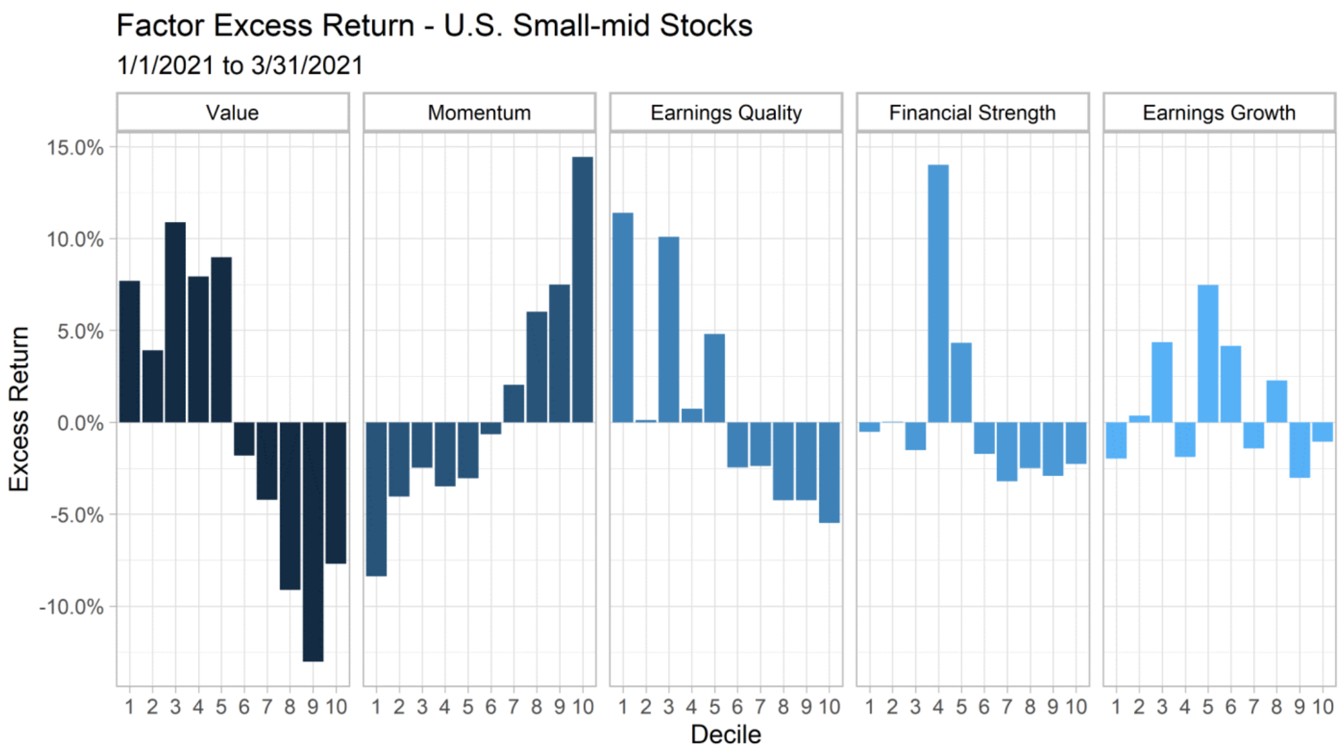
Value stocks (column 1) outperformed expensive growth stocks (column 10) by an expansive 25%--unwinding about ¼ of growth's 94% outperformance in 2020. Given value's cyclically-oriented sector makeup, this was to be expected in a reflationary environment. Expensive growth stocks as a group tend to be heavily overweighted to Tech, Communications, and Health Care and away from Energy, Materials, and Industrials.

Momentum inverted versus long-term historical norms—high momentum underperformed low momentum. It isn't surprising that momentum is struggling in this environment as the losers of the past (value) are gaining favor as past winners are losing favor.

Shareholder Yield tends to be aligned with value in its performance, as was the case in the first quarter. Fueling the gains of stocks ranking highly on the factor were a smattering of companies within Industrials, Consumer Discretionary, and Financials.

U.S. Small-Mid Stocks

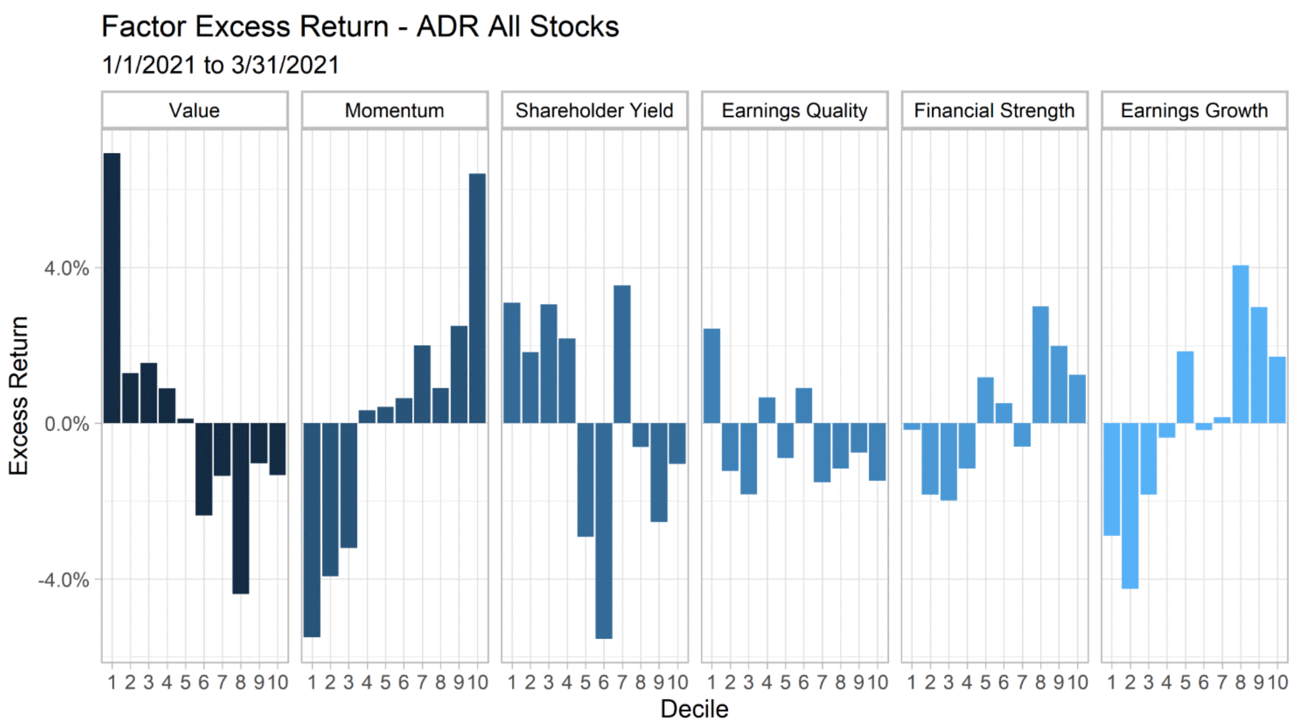
The panel below shows the excess performance of the six factor themes we monitor within U.S. small-mid cap stocks. Column 1 for each of the panels are the highest ranking on a factor while column 10 is the lowest ranking. Historically, owning the highest ranked and avoiding the lowest ranked has resulted in successful investment outcomes.



Value stocks (column 1) outperformed expensive growth stocks (column 10) by 15%--unwinding a decent chunk of growth's outperformance in 2020. The spread in the first quarter and 2020 was not as wide as for Large stocks as the main drivers of the disparity were mega cap Tech. As was also the case in the large cap space, momentum inverted versus long-term historical norms. Again, it is not surprising that momentum is struggling in this environment as past losers (value) are gaining favor—most notably the Energy and Financial complex.

International ADR Stocks

The panel below shows the excess performance of the six factor themes we monitor within ADR All Stocks. The universe includes developed and emerging markets. Emerging markets peaked around mid-February, which roughly coincided with a low in the trade-weighted dollar. As USD strengthened about 4% from that point into the close of the quarter, it took the wind out of EM's sails. On the chart below, column 1 for each of the panels are the highest ranking on a factor while column 10 is the lowest ranking. Historically, owning the highest ranked and avoiding the lowest ranked has resulted in successful investment outcomes.



Value stocks (column 1) outperformed expensive growth stocks (column 10) but not nearly at the margins experienced in the U.S. This is similar to what was experienced in 2020—growth's dominance was not as acute. Momentum inverted as it did in other universes versus long-term historical norms. Shareholder Yield also tends to be aligned with value in its performance outside the U.S., as was the case in the first quarter.

Current Positioning and Outlook

Describing the uncertainty of financial markets and "black swan" events, an 1890 issue of *The Spectator* stated:

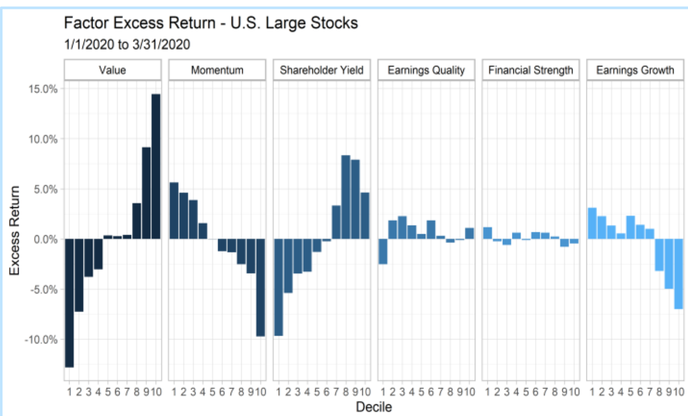
> *"The profoundest chess-player may see an inevitable mate, and yet, if the chandelier falls upon the pieces, may never win that game."*

Using this analogy, 2020 was the ultimate *"falling chandelier"*. Regardless of asset class or investment philosophy, last year presented an extremely difficult market for investors to navigate. Challenged by the worst pandemic in a century, a contentious Presidential election, and unprecedented fiscal / monetary policy, suffice it to say that the environment was "uncertain".

There is an old saying that *"we don't rise to the level of our expectations, we fall to the level of our training."* In the context of investing over the last 18 months, this meant maintaining conviction in time-tested and empirically based strategies as markets spiraled out of control. While it is difficult to refrain from sacrificing long-term planning for short-term reactions in such periods of heightened uncertainty, there is no better time to focus on long-term evidence.

For our portfolios, this meant not being reactionary when all of our selection factors were significantly inverted during last year's market crash. The evidence over decades of empirical research demonstrated that Value, Momentum, and Shareholder Yield are efficacious factors, but may not be in shorter time frames.

In that vein, the factor returns from this quarter and the first quarter of last year are almost an exact mirror of each other:



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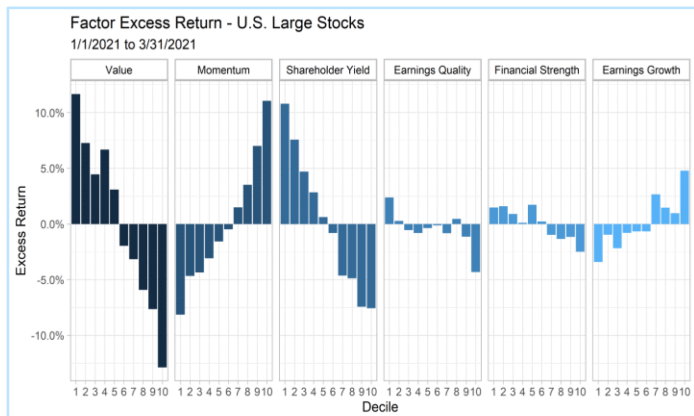
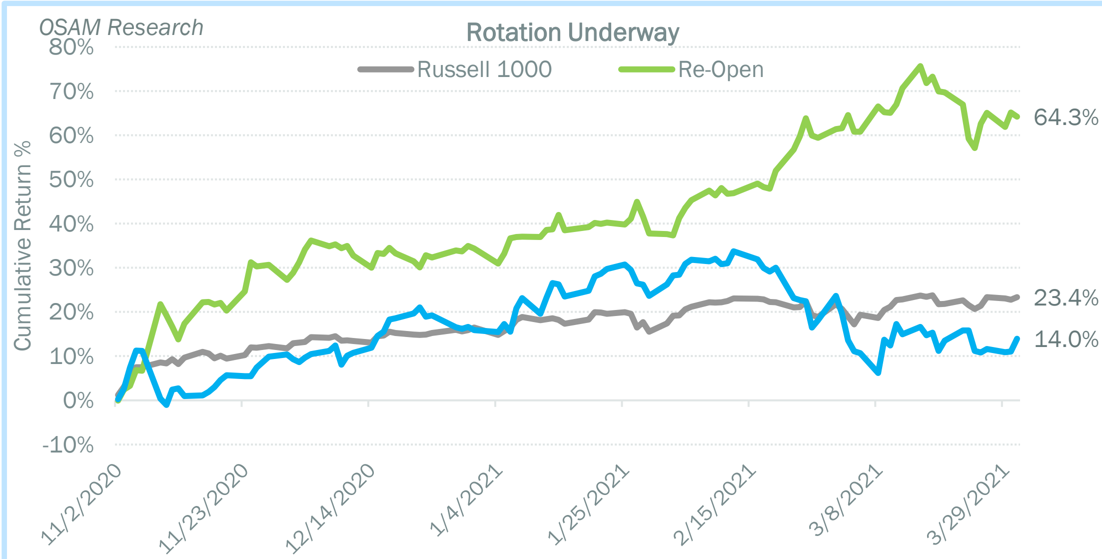


Q1 - 2021

So, the obvious question for investors is what changed? The simple but honest answer is that the market finally received some semblance of clarity on the light at the end of the tunnel as COVID-19 vaccines began distribution last Fall. The CDC now reports that 41.7% of US citizens over the age of 18 have received at least one dose, and 24.4% are fully vaccinated.

With a rough timeline for "returning to normalcy" in place, investors questioned their assumptions from earlier in the pandemic that life as we know it had irrevocably changed. The popular "work from home trade" in stocks like Zoom, Chewy, Peloton, and Doordash shifted to a "re-opening trade" in stocks like Disney, American Airlines, Dine Brands, and Planet Fitness.



As the economy continues re-opening and business activity rebounds in sectors that suffered most in a "work from home" paradigm, we believe that our strategies are well positioned moving forward on two fronts.

First, as outlined in last quarter's commentary, we believe that the COVID pandemic has forced traditionally Value and legacy companies to modernize and evolve their business operations to utilize software and technology more heavily. Target and Kroger remain prime examples of companies that pivoted their businesses for the better due to COVID-19.

Second, driven by the underlying factors, our strategies have recently favored positioning in cyclical sectors like Financials, Industrials and Materials, which are aligned to perform well in the current reflationary environment. These sectors are also beneficiaries of the re-opening trade and vaccine rollout that provide a pathway for economic normalization. It seems likely that pent-up business demand and capital expenditures continue to trend upward as more doses of the COVID-19 vaccines are administered, which should be supportive of companies and sectors that were most acutely impacted by the COVID-induced demand shock.

With these two positional advantages, and by concentrating our portfolios into the companies with reasonable balance sheet strength, earnings growth, cash-driven earnings, and return capital to shareholders at supernormal rates, we believe that we are well positioned to capitalize on the current environment.

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The risk-free rate used in the calculation of Sortino, Sharpe, and Treynor ratios is 5%, consistently applied across time.

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- **Composite Performance Summary**

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