

July 27, 2021

Manager Commentary

“Consumer Prices Jump 5% in May, fastest pace since the summer of 2008”
- ***CNBC, June 10th, 2021***

My world changed when I was nine years old. Coming home from school on the Upper West Side of Manhattan, I saw my favorite pizzeria, the one on Columbus Avenue that had a neon sign that read “One Slice 25 Cents,” had been forced to cover up the “25 Cents” with aluminum foil. A handwritten “35 Cents” sign hung in the window. The comfortable stable world that had induced a pizzeria owner to invest in a neon “25 Cents” sign existed no longer, nor did my personal sense of price stability.

Did the world change again in the second quarter of 2021 when the Consumer Price Index had its fastest increase in over a decade, or is this wave of inflation just transitory until stimulus checks and pandemic savings are spent and supply chains normalize?

We don’t know. Nobody knows. Yes, inflation could retreat back to its pre-pandemic levels, or this could be the beginning of a multi-year rise in wages for the average worker. When a trend, like disinflation, has continued for many decades, it can be risky to position the portfolio for that multidecade trend to suddenly stop. We prefer, instead, to look for growing companies with high levels of profitability that, we believe, would do well in either an inflationary or disinflationary environment.

The average operating margin of the companies in our portfolio is 18% versus 9% for the Russell 2000 small-cap index. Not only does this indicate a strong competitive position versus competitors, but it reduces the risk of a significant margin squeeze in an inflationary environment if costs were to rise quicker than revenue.

The second quarter was a strong one for the Spears Abacus Small Cap Dividend Growth strategy with a return of 6.8%, net of fees, versus 4.3% for Russell 2000. Year to date the portfolio is up 19.5%, net of fees, versus 17.5% for the index, despite having lower volatility since inception. While we have been pleased with risk-adjusted absolute performance for a long time, relative performance to the index began to improve in March when speculation in unprofitable companies began to subside which, we believed, was inevitable as the benefits from monetary policy and fiscal stimulus slowed. Speculation might seem fun to novice investors while its profitable, but in the end valuation and earnings growth are the bedrock of durable stock price appreciation.



We believe our focus on both valuation and earnings growth makes the SA Small Cap Dividend Growth strategy a smart choice for investors looking to capitalize on the resurgence of small-cap value stocks that began in October 2020. Despite the index's strong performance since October, we have outperformed the Russell 2000 Value Index by 3.4% a year with less volatility since inception of the strategy in 2017.

We are pleased that other investors have awakened to the importance of valuation, but frankly, we believe, passive investors in the Russell 2000 Value Index have driven up valuations for small-cap value stocks to the point where they will have a hard time making money over the next year or two, as fund flows have pushed the forward price-to-earnings valuation on the value index to a 10% premium over its five-year average.

In fact, as of June 30, 2021, our portfolio is trading at almost the same valuation as the Russell 2000 Value (19.1x vs. 19.3x) despite having a higher next-twelve-month forecasted revenue growth (12% versus 9%) and a much higher trailing ROIC (23% vs. 3%). In our opinion, this disparity will not last, the SA Small Cap portfolio is a New York strip steak selling for the same price as 80% ground beef.

A great example of the type of profitable growing company that we are always searching for is InMode, which also happens to be our largest contributor for the quarter, as you can see from the table below. InMode is a leading global provider of innovative, minimally invasive surgical medical treatment solutions. Over the last several years, InMode has been able to rapidly take market share in the global aesthetics markets, including face and body contouring, medical aesthetics, and women's health, and we believe that its technology will continue to disrupt those markets for years to come. Despite nearly doubling revenue since 2019, the stock continues to trade at a relatively low valuation considering the business's high growth, strong free cash flow, and pristine balance sheet.

Our largest detractor was Strategic Education, the parent company of Strayer University, a college focusing on first generation college students, and Capella University, a graduate school with a focus on working adults. While the Covid-19 crisis was a boon to the graduate school, profitability has been hurt at the undergraduate level. Nevertheless, the graduate school and other divisions continue to grow. We believe that the stock should trade higher once the economy reopens.

2Q21 Performance of Top 5 Contributors¹

Company	Ticker	% Change
InMode Ltd.	INMD	30.8%
Switch, Inc. Class A	SWCH	30.2%
Coca-Cola Consolidated, Inc.	COKE	39.3%
BGC Partners, Inc. Class A	BGCP	17.6%
Domino's Pizza, Inc.	DPZ	27.1%

2Q21 Performance of Top 5 Detractors¹

Company	Ticker	% Change
Strategic Education, Inc.	STRA	-16.6%
BWX Technologies, Inc.	BWXT	-11.6%
Virtu Financial, Inc. Class A	VIRT	-10.3%
Sabre Corp.	SABR	-15.7%
CDK Global, Inc.	CDK	-7.8%

¹Top contributors / detractors based on percentage contribution to the portfolio'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.

We are proud to offer you the opportunity to participate in the growth of small-cap stocks while, historically, ameliorating the declines associated with small-cap investing that can be so frustrating. We believe that the future is bright for our portfolio as the economy reopens and look forward to communicating with you in the fall.

With all best wishes for a great summer,

A handwritten signature in black ink that reads "Manny Weintraub". The signature is written in a cursive, flowing style.

Manny Weintraub, CFA

Small Cap Dividend Growth

SPEARS / ABACUS

Quarterly
Fact Sheet
As of June 30, 2021

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 combine 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)	20.0%	54.7%	10.7%	-	-	13.2%
SA Small Cap (net)	19.5%	53.2%	9.6%	-	-	12.0%
Russell 2000	17.5%	62.0%	13.5%	-	-	14.0%

Source: Spears Abacus, FactSet. Inception Date 12/31/2016. ^See portfolio statistics and efficiency measures. ¹Returns for less than one year not annualized; YTD as of 6/30/21; ²All statistics based on weighted unless otherwise noted; index based on aggregate; ³Dividend yield of total portfolio including cash; ⁴ROIC calculated using cash returns for portfolio holdings; ⁵Sector weights excluding cash; ⁶Efficiency measures gross since inception, monthly basis; ⁷Based 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	3.2%	-
Dividend Yield	0.94%	0.84%
Market capitalization (\$b)	4.9	3.3
Harmonic Avg. TTM P/E	21.7x	55.5x
Harmonic Avg. NTM P/E	19.1x	29.5x
LT Debt / Total Capital	0.30x	0.48x
Median Net Debt / EBITDA	1.4x	3.0x
Return on Invested Capital	23%	2%
NTM Revenue Growth	12%	10%
Median Payout Ratio	24%	60%
% of holdings paying dividend	79%	43%
Active Share	95%	-

Sector Diversification ⁵	SA	Russell 2000
Consumer Discretionary	13.1%	11.9%
Consumer Staples	3.2%	3.2%
Energy	3.2%	4.3%
Financials	17.1%	14.8%
Health care	19.0%	21.2%
Industrials	12.9%	14.2%
Information Technology	15.5%	13.5%
Materials	5.0%	3.9%
Real Estate	7.7%	6.9%
Communication Services	2.6%	3.8%
Utilities	0.0%	2.4%
Total	100.0%	100.0%

Efficiency Measures ^{6,7}	SA	Russell 2000
Annualized Excess Return	-0.8%	-
Annualized Alpha	0.9%	-
Beta	0.86	-
Volatility	19.2%	21.3%
Upside Capture	90%	-
Downside Capture	88%	-
Sharpe Ratio	0.6	0.6
Sortino Ratio	1.0	0.9
Tracking Error	6.3%	-
Turnover (trailing 1 year)	51%	-

PLEASE SEE ADDITIONAL DISCLOSURES ON THE FOLLOWING PAGE

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SPEARS / ABACUS

Top 10 Holdings	% of Portfolio
InMode Ltd.	3.3%
BGC Partners, Inc. Class A	3.1%
Tabula Rasa Healthcare, Inc.	2.9%
Switch, Inc. Class A	2.8%
World Wrestling Entertainment, Inc. Class A	2.5%
Qurate Retail, Inc. Class A	2.4%
Texas Pacific Land Corporation	2.3%
Morningstar, Inc.	2.3%
Paya Holdings Inc Class A	2.1%
Installed Building Products, Inc.	2.0%
Total	25.8%

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

Managed by

Spears Abacus Small Cap Dividend Growth Team

Portfolio Manager	Years Experience
Manny Weintraub	31

Senior Analyst

Daniel Wetchler	11
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Style

Blend

Inception Date

31-Dec-16

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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*