

Oct. 26, 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.

As the United States economy adjusts to whatever the new normal will be, we believe that many of the winners and losers will be small companies. There is no question that small companies involved in travel and indoor activities had steep declines in profits and share prices in 2020. But we believe that it is also true that small companies will be on the frontlines of figuring out what a new normal will be. The need to work, vacation, or be entertained has not changed. How that will happen and what companies will help meet that need remains a question.

The Spears Abacus Small Cap Dividend Growth portfolio allows investors to benefit from the growth of small US companies with a strategy that has historically had less volatility than the Russell 2000 small cap index. We invest in companies that are profitable and, for the most part, choose to pay dividends.

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 States 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.

We believe that the US economy will recover as Covid-19 vaccines are distributed and US small cap stocks will recover alongside the economy.

We believe our Small Cap Dividend Growth strategy solves a problem for investors in US small cap stocks that want to invest in dynamic smaller companies, but don't want a portfolio of speculative companies.

Whether it's low interest rates or Robinhood traders, it seems that something has sparked a speculative boom in small cap growth stocks. As of the end of the quarter the Russell 2000 Growth index was trading at 124 times forward earnings for companies that had a trailing twelve-month return on invested capital of negative 1%. Small cap growth investors are investing in a portfolio of unprofitable companies that they hope will be the next big thing. We wish them all the best, but this type of investing is not for everyone.

Those investors that don't want a portfolio of speculative companies might have turned to small cap value stocks believing that the stocks represented solid companies trading at low valuations. These investors were willing to be the "tortoise" to the growth investors "hare" believing that their portfolio of small cap value might grow slower over time, but at least it might be less volatile as the companies had real earnings and low valuations.

Unfortunately for the typical small cap value investor, the Russell 2000 value is down 21.5% through the first nine months of the year as many of its components are in cyclical industries. More than 25% of the index is in financials which are suffering with low interest rates and potential credit losses. Around 9% of the index is in real estate; a levered asset class including malls, hotels and office buildings. The cyclical nature of small cap value earnings leaves the Russell 2000 Value index trading at 20.5 times forward earnings with a trailing-twelve month return on invested capital of 0%. Again, we hope that this investment works out for small cap value investors, but we also hope that these investors ask themselves if what has happened in this downturn is what they expected would happen when they made their initial investment.

The Spears Abacus Dividend Growth strategy is much more diversified in terms of sector allocation compared to the Russell 2000 Value index, is trading at a lower multiple of forward earnings, and exhibited less volatility in the market declines of the first quarter. Our portfolio is neither growth nor value, but we like to believe it represents the best of both worlds and achieves the goals held by many current small cap value investors.



In the third quarter the Spears Abacus Small Cap Dividend Growth strategy continued its recovery along with the US economy rising 2.0% while the Russell 2000 went up 4.9%. Year to date our portfolio is down 11.8% while the Russell 2000 is down 8.7%. Since inception at the end of 2016, we have had annualized returns of 2.8%, net of fees, versus 4.3% for the Russell 2000. With half the Russell 2000 in growth stocks, this is not the point in the cycle at which we would expect to be exceeding the returns of the Russell 2000.

Below is a table of the top contributors to, and detractors from, our investment performance for this quarter. The number one contributor was AMN Healthcare Services, a staffing company specializing in nurses and clinicians, which also happened to be the number one detractor last quarter. The suspension of elective surgeries and demand for healthcare workers has led to some market dislocation, but as we expected, earnings are beginning to normalize and steady growth should resume next year. The number one detractor was 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. The impact of Covid-19 on the healthcare system has led to delayed contract starts but we believe the company remains well positioned in a very important, growing marketplace. After selling shares earlier this year at a much higher price, we opportunistically increased our position size during the quarter.

3Q20 Performance of Top 5 Contributors¹

Company	Ticker	% Change
AMN Healthcare Services, Inc	AMN	29.2%
Domino's Pizza, Inc.	DPZ	15.1%
Qurate Retail, Inc. Class A	QRTEA	22.5%
Catalent Inc	CTLT	16.9%
Medifast, Inc.	MED	19.3%

3Q20 Performance of Top 5 Detractors¹

Company	Ticker	% Change
Tabula Rasa Healthcare, Inc.	TRHC	-25.5%
Strategic Education, Inc.	STRA	-23.9%
Western Alliance Bancorp	WAL	-16.0%
Switch, Inc. Class A	SWCH	-12.1%
Texas Pacific Land Trust	TPL	-24.1%

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 security was purchased/sold during the quarter, performance is calculated based on purchase/sale date.

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, but the US economy has weathered difficult times in the past and come out stronger for it. We think the US will recover in 2021 and that the companies in our portfolio are well positioned to benefit from the recovery.

With all best wishes for a healthy autumn,



Manny Weintraub, CFA



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)	-11.8%	-6.3%	1.1%	-	-	3.8%
SA Small Cap (net)	-12.5%	-7.3%	0.0%	-	-	2.8%
Russell 2000	-8.7%	0.4%	1.8%	-	-	4.3%

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 9/30/20; ²All statistics based on weighted unless otherwise notes; index based on aggregate; ³Dividend yield of total portfolio including cash; ⁴ROIC calculated using cash returns for portfolio holdings; ⁵Sector weights excluding cash; ⁶Downside capture gross since inception, monthly basis vs Russell 2000; 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	3.8%	-
Dividend Yield	1.55%	1.63%
Market capitalization (\$b)	4.7	2.7
Harmonic Avg. TTM P/E	18.7x	59.3x
Harmonic Avg. NTM P/E	17.9x	36.6x
LT Debt / Total Capital	0.52x	0.51x
Median Net Debt / EBITDA	2.0x	3.8x
Return on Invested Capital	20%	0%
NTM Revenue Growth	7%	5%
Median Payout Ratio	30%	100%
% of holdings paying dividend	84%	43%
Active Share	96%	-

Sector Diversification ⁵	SA	Russell 2000
Consumer Discretionary	10.7%	13.4%
Consumer Staples	3.1%	3.4%
Energy	1.5%	2.0%
Financials	17.7%	14.7%
Health care	20.1%	21.5%
Industrials	13.0%	15.2%
Information Technology	16.5%	13.4%
Materials	5.2%	4.0%
Real Estate	8.2%	6.6%
Communication Services	2.3%	2.4%
Utilities	1.1%	3.3%
Total	100.0%	100.0%

Efficiency Measures ^{6,7}	SA	Russell 2000
Annualized Excess Return	-0.4%	-
Annualized Alpha	0.0%	-
Beta	0.86	-
Volatility	18.7%	20.9%
Upside Capture	88%	-
Downside Capture	88%	-
Sharpe Ratio	0.1	0.1
Sortino Ratio	0.2	0.2
Information Ratio	-0.1	-
Tracking Error	5.8%	-
Turnover (trailing 1 year)	53%	-

PLEASE SEE ADDITIONAL DISCLOSURES ON THE FOLLOWING PAGE

Top 10 Holdings	% of Portfolio
Virtu Financial, Inc. Class A	3.3%
Domino's Pizza, Inc.	2.8%
Royal Gold, Inc.	2.4%
Tabula Rasa Healthcare, Inc.	2.2%
PRA Health Sciences, Inc.	2.2%
World Wrestling Entertainment, Inc. Class A	2.2%
A. O. Smith Corporation	2.2%
Morningstar, Inc.	2.1%
Cantel Medical Corp.	2.1%
BWX Technologies, Inc.	2.0%
Total	23.6%

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*