



## 2Q23 Market Overview

Global financial markets rose in 2Q boosted by a strong advance in June. US equity markets gained for the third consecutive quarter after 2022's steep decline. Recent equity gains have been dominated by a narrow group of mega cap stocks as reflected in the performance of various indices: Russell Top 50, +13.2%; R1000, +8.6%; and R2000, + 5.2%. The NASDAQ 100 gained 15.1%, propelled by enthusiasm for AI. Commodities declined.

The FOMC paused its rate hikes in June after raising its benchmark rate from zero to 5.0% - 5.25%, over fifteen months. The pause had a hawkish tone as members signaled expectations for higher rates in the future, starting with a likely increase at the upcoming meeting in late July.

The economy has proven more resilient than many expected due to strong employment. Despite bright spots, some data suggest a recession has been pushed out rather than cancelled. The inverted yield curve, tightening bank lending standards, and signs of consumer stress point to economic weakness ahead. High yield spreads still are not flashing undue alarm, however, and remain below highs seen in 2011, 2016, and even mid-2022. The CBOE VIX closed near three-year lows. The benchmark 10-year Treasury yield rose from 3.47% to 3.81%, leaving it a bit below where it started the year.

Value lagged growth as growth stocks were buoyed by Fed's pause and less exposure to banks. The R2000V rose +3.2%, trailing the R2000G's +7.1% for the fourth consecutive quarter.

In the R2000V, Information Technology, Industrials and Health Care led the advance. Financials, Consumer Staples and Utilities lagged. Energy was a market performer for the second consecutive quarter following a standout 2022.

The S&P 500's forward P/E is now 19.1x, above its 25-year average of 16.8x. The significant small cap valuation discount to large cap persists.

## Performance Highlights

Gross of Fees	MRQ	YTD	1 Year	3 Years	5 Years	7 Years	10 Years	SI
US Small Cap Value	1.77	1.83	1.98	7.17	3.47	8.61	8.57	12.40
Russell 2000 Value	3.18	2.50	6.01	15.43	3.54	7.70	7.29	9.47
Russell 2500 Value	4.37	5.83	10.37	16.07	5.32	7.97	8.02	10.34
+/- Russell 2000 Value	-1.41	-0.67	-4.03	-8.26	-0.07	0.91	1.28	2.93
+/- Russell 2500 Value	-2.60	-4.00	-8.39	-8.90	-1.85	0.64	0.55	2.06

Net of Fees	MRQ	YTD	1 Year	3 Years	5 Years	7 Years	10 Years	SI
US Small Cap Value	1.68	1.61	1.52	6.65	2.94	8.05	7.98	11.59
Russell 2000 Value	3.18	2.50	6.01	15.43	3.54	7.70	7.29	9.47
Russell 2500 Value	4.37	5.83	10.37	16.07	5.32	7.97	8.02	10.34
+/- Russell 2000 Value	-1.50	-0.89	-4.49	-8.78	-0.60	0.35	0.69	2.12
+/- Russell 2500 Value	-2.69	-4.22	-8.85	-9.42	-2.38	0.08	-0.04	1.25

\* The Bernzott US Small Cap Value strategy inception date is January 1, 1995.

Past performance does not guarantee future results. The performance data quoted represents past performance and current returns may be lower or higher. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than the original cost. To obtain performance information current to the most recent month end please visit [www.bernzott.com](http://www.bernzott.com) or call (800) 856-2646. See last page for full GIPS compliant disclosure.



## 2Q23 Performance

The portfolio gained +1.7% on a net basis, below the R2000V's gain of +3.2% and the R2500V's rise of +4.4%. Quality factors were under pressure. Stocks with characteristics we find unattractive performed well including those with high short interest, unprofitable businesses, high earnings variability, and high stock price volatility. Despite rising interest rates, dividend paying stocks underperformed.

The majority of the portfolio's relative returns were achieved in three sectors which posted negative returns for the benchmark: Financials, Utilities, and Consumer Staples. Strong stock selection in Financials aided results. The portfolio side-stepped weakness in banks as our two holdings were flat compared to the benchmark's fall of -8.3% following the aftermath of deposit flight turmoil which intensified in March. Long-term holding Artisan Partners gained +24.8%, benefiting from market sensitivity and attractive cash flow. The portfolio held no Utilities and avoided that sector's -4.2% decline. In Consumer Staples, the portfolio's single holding was slightly positive, better than the benchmark's -5.8% fall, which made it the worst performing sector for the R2000V.

Information Technology was the leading detractor from the portfolio's relative returns. Broadband equipment provider Adtran fell significantly as its earnings results and outlook were marred by supply chain disruptions, excess inventory, and execution challenges with the recent acquisition of ADVA. We exited the position. Materials detracted from relative returns. MP Materials, a miner of rare earth minerals, fell -18.8% as weak ore prices weighed on its stock price. The long-term outlook is bright as the EV supply chain continues to expand and the company figures prominently as a domestic source of a required resource. Consumer Discretionary hurt relative results modestly. Topgolf Callaway Brands fell -8.1% as spending from corporate outings cooled a bit at its venues. The company continues to open new Topgolf locations to capitalize on golf's popularity.

Top Relative Contributors	Ticker	Weight	Return	Relative Contribution
Encompass Health	EHC	4.51%	25.50%	0.86%
APi Group	APG	4.08%	21.26%	0.64%
Open Lending	LPRO	1.73%	49.26%	0.62%

**Encompass Health (EHC):** The inpatient rehabilitative care operator reported strong volume growth as overall health care utilization trends began to normalize. The company has staffed for growth and this likely helped it take share. Labor rates have started to ease, a positive sign for future profitability while expansion projects provide visibility for additional earnings and cash flow growth.

**API Group (APG):** The stock benefitted from solid results marked by nearly 10% revenue growth and good margin execution. The company's recurring, inspection services-based business profile may also have helped the stock as investors embraced resiliency in the face of economic uncertainty.

**Open Lending (LPRO):** Better-than-expected volumes drove earnings outperformance and jump-started the stock. Its credit union customer base appears well positioned for continued growth in near-prime auto lending, a positive indicator.

Top Relative Detractors	Ticker	Weight	Return	Relative Detraction
Adtran	ADTN	0.96%	-38.75%	-1.35%
Air Transport Services	ATSG	1.33%	-13.03%	-0.90%
World Kinect	WKC	3.26%	-18.66%	-0.68%

**Air Transport Services Group (ATSG):** The company's elevated capital spending plans through next year extend its heavy capex cycle and will impede a free cash flow recovery. As a result, we exited the position.

**World Kinect (WKC):** The company's most recent results produced margins below expectations which negatively impacted stock performance during the quarter. Demand remains firm however within their two largest segments of Aviation and Land, as overall travel has rebounded while pricing should take a step up due to contracts repricing higher.



## 2Q23 Portfolio Activity

### **Portfolio activity:**

- Bought: Golden Entertainment (GDEN), Enovis (ENOV), Mr Cooper (COOP), Plexus (PLXS)
- Sold: Adtran (ADTN), Air Transport Services Group (ATSG)

### **New Positions:**

**Golden Entertainment (GDEN):** The company is a pure play Nevada focused casino operator following the divestiture of non-core casino assets located outside of the region. The Nevada event calendar remains robust driven by the Stanley Cup Final, Formula 1 racing and Super Bowl as well as a recovery in the mid-week convention market. Substantial investments in their STRAT property should drive incremental revenue at higher margins for the next several years.

**Enovis (ENOV):** Enovis is a medical technology company that should see steady margin improvement through a shift to the higher margin, faster growing Reconstructive segment in addition to cost reduction from easing inflationary pressures. New product introductions and attractive exposure to ambulatory surgery centers should drive above-market growth. Additional bolt-on M&A should be supported by their strong balance sheet and proven business processes.

**Mr Cooper (COOP):** COOP is one of the largest mortgage servicing providers in the US. Rising residential mortgage rates benefit COOP by extending servicing duration – it's highly unlikely a low-rate mortgage will refinance to a higher rate mortgage, which helps generate tremendous free cash flow for the company. Currently trading at an inexpensive valuation, COOP has repurchased nearly 25% of its outstanding shares, dropping the share count from ~91 million to under ~70 million.

**Plexus (PLXS):** The company provides outsourced electronic manufacturing services from 28 facilities globally. It focuses on industrial, health care/life sciences, and aerospace and defense end markets and targets customer products which are complex and involve demanding regulatory environments. ROIC is a prominent metric in management's incentive compensation which speaks to business quality. After a couple years of supply chain turbulence, customers will likely refocus on outsourcing plans and that will drive new business. An uptick in its new business funnel suggests this is underway, which is an early indicator of future earnings growth.

### **Sold Investments:**

#### **Adtran (ADTN)**

#### **Air Transport Services Group (ATSG)**

### **Bernzott Capital Advisors Update:**

We ended 2Q23 managing \$520 million, with \$253 million in our US Small Cap Value strategy. As a bottom-up, fundamental value investor, we seek high quality companies we believe can compound returns over long periods while proving resilient in downturns. We believe characteristics of a high-quality company include: market leadership; recurring revenue or subscription model providing revenue visibility; high margins and operating leverage; high returns on capital; financial flexibility; and a strong management team with skin in the game and a long-term view.

*The statements contained herein are solely based upon the opinions of Bernzott Capital Advisors and the data available at the time of publication of this report, and there is no assurance that any predicted results will actually occur.*

Bernzott Capital Advisors claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Bernzott Capital Advisors has been independently verified for the periods of Jan. 1, 1995 through December 31, 2019. Verification assesses whether the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The US Small Cap Value composite has been examined for the periods of Jan. 1, 1995 through December 31, 2019. The verification and performance examination reports are available upon request.

	# of Portfolios in Composite at period end	Total Composite Assets (\$ millions) at period end	Composite Equity Only Assets (\$ millions) at period end <sup>4</sup>	Composite Dispersion (%)	Composite 3 Yr Standard Deviation	Russell 2000 Value 3 Yr Standard Deviation	Russell 2500 Value 3 Yr Standard Deviation	Total US Small Cap Value Assets <sup>1</sup> (\$ millions)	Total Firm-wide Assets Under Management (\$ millions)	Composite Assets as a % of US Small Cap Assets at period end	Composite Assets as a % of Firm-wide Assets at period end	Bernzott Gross of Fees (%)	Bernzott Net of Fees (%)	Russell 2000 Value (%)	Russell 2500 Value (%)
2013	35	237.4	222.3	0.8	12.33	16.32	15.08	267.0	513.6	88.91	46.22	34.38	33.53	34.52	33.33
2014	35	269.1	260.0	0.4	10.25	12.77	11.25	274.7	528.7	97.96	50.90	6.73	6.06	4.22	7.11
2015	37	257.9	246.5	0.5	12.62	13.11	12.03	339.9	577.2	75.88	44.68	-6.91	-7.46	-7.47	-5.49
2016	34	385.3	365.7	0.3	13.16	15.38	13.17	405.9	655.3	94.92	58.80	17.62	16.99	31.74	25.20
2017	37	404.5	385.3	0.2	12.47	13.97	11.81	512.7	854.4	78.90	47.34	28.18	27.54	7.84	10.36
2018	42	444.1	421.3	0.3	13.41	15.76	13.58	470.0	793.8	94.49	55.95	-5.18	-5.71	-12.86	-12.35
2019	41	585.8	558.8	1.3	15.14	15.90	14.43	618.2	1,046.4	92.07	54.39	26.97	26.28	22.39	23.56
2020	30	685.8	670.9	0.5	25.31	26.49	25.40	792.7	1,225.4	86.51	55.96	15.83	15.22	4.63	4.88
2021	35	823.3	795.2	0.3	23.83	25.35	24.49	831.0	1,244.6	98.90	66.14	13.34	12.76	28.27	27.78
2022	31	525.7	496.5	0.2	26.61	27.66	26.84	526.6	848.8	99.83	61.93	-21.35	-21.75	-14.48	-13.08

*Equity product inception: January 1, 1995. 1 The difference between this column and the "total composite assets at period end" is the accounts that do not meet the size parameter for the composite and any new account under management that has not met the waiting period to join the composite. 2 Presented composite performance prior to October 1, 2006 is based upon equity only returns including allocated cash. Composite performance following October 1, 2006 is based on total account returns. \* - To accommodate the needs of our high net worth non-institutional clients, Bernzott Capital Advisors has and will purchase equities across the capitalization spectrum, and not limit those purchases to the small cap universe. Effective October 1, 2010, the composite was redefined to only include those clients with a specific small cap mandate. This redefinition and client accommodation has resulted in a decline of AUM in the US Small Cap Value composite without impacting firm wide AUM.*

#### GIPS Compliance Requirements:

Bernzott Capital Advisors is an equity portfolio investment manager that invests in U.S.-based securities. Bernzott Capital Advisors is defined as an independent investment management firm that is not affiliated with any organization.

The US Small Cap Value Composite includes all fully discretionary portfolios that invest in small capitalization U.S. stocks that are considered to have risk-adjusted returns purchased, at reasonable prices. The composite includes concentrated portfolios of market leading companies with consistent operating performance, significant recurring revenue, solid operating margin, moderate leverage and strong returns on capital. A size parameter of \$250,000 is applied for composite membership. As of October 1, 2006, composite asset performance is derived from total account performance and eligible accounts are added to the composite after accounts are under management for two complete quarters. Prior to October 1, 2006, the composite was constructed from fully discretionary small cap equity only portfolios and fully discretionary small cap equity segment carve outs of accounts included in the firm composite. Prior to October 1, 2006, accounts were included in the composite their first full quarter under management. The benchmark is the Russell 2000 Value Index (taken from published sources). The Russell 2500 Value Index is provided as a secondary benchmark.

Russell 2000 Value Index measures the performance of those Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values. The Russell 2000 index is an index measuring the performance of approximately 2,000 smallest-cap American companies in the Russell 3000 Index, which is made up of 3,000 of the largest U.S. stocks. It is a market-cap weighted index. The Russell 2500 Value Index measures the performance of the small to mid-cap value segment of the US equity universe. It includes those Russell 2500™ companies that are considered more value oriented relative to the overall market as defined by Russell's leading style methodology.

Gross-of-Fees returns reflect only the deduction of trading costs. Net performance returns reflect the deduction from gross performance of all trading costs, actual management fees and embedded fees. Since January 1, 2005 non-fee-paying accounts represent <1% of the composite assets. For the period Jan. 1, 2004 through Dec. 31, 2004 non-fee-paying accounts represent 1% of the composite assets. For the period Jan. 1, 1998 through Dec. 31, 2003 non-fee-paying accounts represent 2% of the composite assets. Bernzott performance is stated in US dollars. Prior to 10/1/06 the annual composite dispersion was an asset-weighted standard deviation calculation for the equity only portion of the account in the composite for the entire year and calculations did not take into account the effect of cash. Following that date, the annual composite dispersion is an asset-weighted standard deviation calculation using total account returns. 1995 and 1996 dispersion values are presented as n/a since five or fewer accounts are in the composite for the entire annual periods presented. Returns are presented gross and net of management fees and include the reinvestment of all income.

For institutional client accounts in the US Small Cap Value strategy, the management fee schedule is as follows: 0.90% on the first \$10 Million; 0.80% on the next \$15 Million; 0.75% on the next \$25 Million and 0.65% on the balance. For private client accounts, the management fee schedule is as follows: 1% on the first \$2 Million; 0.75% on the next \$3 Million; 0.50% on the balance.

Special circumstances unique to a specific client may result in the negotiation of fees different than those set forth herein. We generally aggregate separate accounts of a single relationship for billing purposes. We may serve certain non-profits qualified under Section 501(c)3 IRC at a discount and we waive fees for employees and related parties.

Bernzott's composite was created July 1, 1999 and composite membership parameters were revised December 1, 2006 effective October 1, 2006. A complete list of Bernzott's composites is available upon request. The policies of valuing portfolios, calculating performance and preparing compliant presentations are available upon request. Bernzott does not utilize leverage, derivatives or short positions. Bernzott does not have any significant company events to disclose. A size parameter of \$250,000 is applied for composite membership. The minimum account size was implemented January 1, 2001. As of October 1, 2006, composite asset performance is derived from total account performance. Prior to October 1, 2006, the composite was constructed from fully discretionary small cap equity only portfolios and fully discretionary small cap equity segment carve outs of accounts included in the firm composite. Prior to January 1, 2004, the composite was known as the Small/Mid Cap Domestic Equity Composite. There was no change in the investment process as a result of the composite name change. Prior to October 1, 2006, carve-out portfolio segments were included in this composite and cash was allocated to the composite on a set percentage of 5%. As of October 1, 2006, portfolio segments are not included in this composite and all cash and cash equivalents are included in performance. An account will be removed from the composite membership if a cash outflow reduces the account value below the minimum size parameter. Additional information regarding the treatment of significant cash flows is available upon request.

**Past performance is not indicative of future results.** The statements contained herein are solely based upon the opinions of Bernzott Capital Advisors and the data available at the time of publication of this report, and there is no assurance that any predicted results will actually occur. This material is not investment advice. Not every client's account will have these exact characteristics. The actual characteristics with respect to any particular client account will vary based on a number of factors including but not limited to: (i) the size of the account; (ii) investment restrictions applicable to the account; and (iii) market exigencies at the time of the investment. Bernzott reserves the right to modify its current investment strategies and techniques based on changing market dynamics or client needs. The information provided in this report should not be considered a recommendation to purchase or sell any particular security. It should not be assumed that any of the composite characteristics discussed were or will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable.

*Prior to April 2013, Schmetter & Associates, LLC. (S&A) served as an independent institutional sales and marketing representative for Bernzott Capital Advisors. S&A continues to receive 20-25% of collected revenue from specified institutional clients. S&A is not a broker/dealer. BCA currently employs two business development professionals. This professionals receive a % of collected revenue from specified institutional clients. All fees paid by Bernzott Capital are in hard dollars. No additional amount is ever billed to any client as a result of such payments.*

*Bernzott Capital Advisors is a registered investment adviser, registered with the SEC. Registration does not imply a certain level of skill or training. More information about the adviser, including the investment strategies, fees and objectives are more fully described in the firm's Form ADV Part 2, which is available upon request by calling (800) 856-2646, or can be found by visiting [www.bernzott.com](http://www.bernzott.com).*