



# CAMBIAR SMALL CAP VALUE COMMENTARY 2Q 2023



# MARKET REVIEW

The U.S. equity markets continued to move higher in the second quarter, with the S&P 500 Index advancing 8.7%. The market rally peaked in June, as worries surrounding the debt ceiling gave way to fears of missing out on the upside in stocks. Small cap companies also gained ground in the quarter, with the Russell 2000 Index posting a return of 5.2%. On a style basis, growth stocks remain firmly in control vs. their value counterparts.

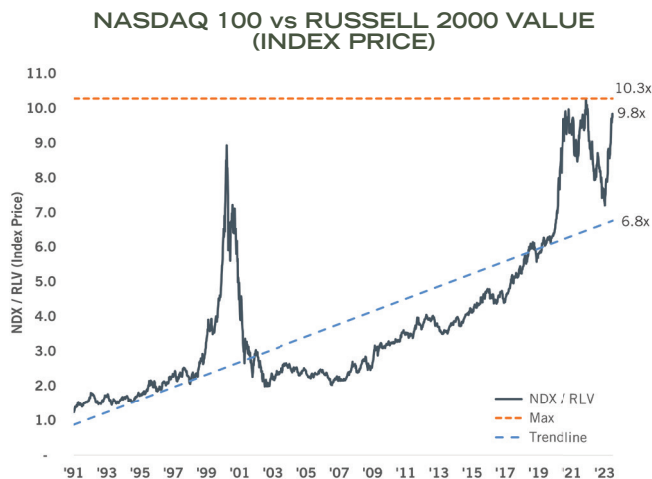
Despite a 500 basis point surge in interest rates over the past 18 months, the much-anticipated recession has yet to materialize, as the U.S. economy remains resilient and a tight labor market continues to fuel strong consumer spend patterns. Delta Airlines CEO Ed Bastien recently used the term 'revenge travel' in characterizing the robust travel volumes that are poised to surpass pre-COVID levels. The realization that we are nearing the upper bound in the Fed's tightening campaign has been an additional tailwind for risk assets.

The strong back-to-back quarterly returns for the S&P 500 results in a year-to-date gain of 16.9%, one of the best first half returns on record. The market advance has been top-heavy in nature, evidenced by the more modest YTD return of 6% for the equal-weight S&P 500. Although mega cap tech stocks dominate the leaderboard, the rally has not been as skinny as one would assume. Through June 30th, 143 stocks within the S&P have posted above-market returns – spanning a variety of sectors. The risk-on sentiment has undoubtedly favored growth stocks thus far, but there have been opportunities to participate outside of the 'Enormous Eight' (FAANG+Microsoft/Nvidia/Tesla).

## Nasdaq vs. Small Cap Value Stocks – A Tale of Two Markets

The year-to-date rally in tech stocks has been nothing short of exuberant, with the 31.7% gain for the Nasdaq Index the strongest first half return since 1983. Although still below peak levels in late 2021, the Nasdaq's advance has been relatively unabated since the start of the year. Investor optimism towards tech has been a combination of factors – an anticipated end to rate hikes, safe haven appeal during the banking collapse in 1Q, and more recently the hype around artificial intelligence (AI).

In contrast, small cap value stocks have been a virtual afterthought thus far in the year, with the Russell 2000 Value Index returning 2.5% through the end of June. The small value index has certainly been weighed down by the challenges incurred by the regional banks earlier in the year; that said, the Nasdaq-to-Russell 2000 Value price ratio is now revisiting prior peak levels last set during the pandemic period in 2020 (having already passed the tech bubble in the late 1990s):



The initial reaction to the above may be 'this time it's different', and we acknowledge that many of today's tech businesses are proven business models with real revenue. Yet valuation is a key consideration, as future returns are a function on the price paid at attachment. On this basis, the Nasdaq is trading at 26.3x P/E (1-year forward) vs. 10.1x for the R2000V Index. Put another way, tech stocks are trading at historically expensive levels, while small cap stocks are priced for a recession...something has to give. We view the reward-to-risk profile for small caps to be extremely attractive for investors with a multi-year time horizon.

# SMALL CAP VALUE

## CONTRIBUTORS

Top Five	Avg. Weights	Contribution
Rambus Inc.	2.27	0.50
M.D.C. Holdings	2.43	0.43
AMN Healthcare	1.65	0.42
U.S. Physical Therapy	2.09	0.39
PGT Innovations	2.49	0.31

## DETRACTORS

Bottom Five	Avg. Weights	Contribution
HealthStream	2.16	-0.20
Addus HomeCare	2.36	-0.21
United Bankshares	1.78	-0.24
WNS Holdings	1.94	-0.42
Mercury Systems	1.69	-0.56

The Top 5/Bottom 5 chart provided is based on a representative account managed in the strategy. The contribution to return is based on net returns and considers factors including the individual security's total return and the average weight of the holding during the quarter. See Disclosure – Top 5/Bottom 5 Chart for more information.

	2Q 2023	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception
Small Cap Value <sub>(gross)</sub>	1.2%	8.5%	14.6%	15.0%	7.8%	7.8%	9.6%
Small Cap Value <sub>(net)</sub>	1.0%	8.1%	13.6%	14.1%	6.9%	6.8%	8.5%
Russell 2000 Value	3.2%	2.5%	6.0%	15.4%	3.5%	7.3%	6.6%

Small Cap Value Composite Inception Date: 11.30.2004 / See Disclosure

The Cambiar Small Cap Value (SCV) strategy posted a positive return for the second quarter, while trailing the Russell 2000 Value Index. The relative underperformance was a combination of the market environment as well as below-benchmark performance across a handful of sectors. Looking beyond the quarter, the SCV strategy remains ahead of the benchmark on a year-to-date basis and over most rolling timeframes.

Although difficult to draw any firm conclusions (good or bad) from strategy performance over a 90-day timeframe, we believe the SCV portfolio performed in line with expectations for the quarter. While the 'risk on' underpinning that drove market gains was most apparent in growth stocks, investor preference for high beta/high momentum equities also impacted performance within the value space. The Cambiar team remains focused on identifying companies that demonstrate above-average internal financial/operating performance that is reflective of a structural product and/or advantaged market position. We then want to buy these businesses at a fair valuation relative to past peak-to-trough levels. We anticipate that this approach may lag during periods of relatively high capital market risk tolerance, but should evidence inherent underlying financial durability in times of market stress. The over-arching objective is to deliver through-the-cycle excess returns with less risk.

The SCV strategy continues to maintain good overall balance in terms of sector allocation, business diversification, and perhaps most importantly variance of return drivers across the portfolio. Buy/sell activity in the quarter consisted of three new purchases and two sales. There were no material changes in overall positioning, and the portfolio ended the quarter with a cash position of ~5%.

In reviewing index performance on a sector basis, Technology, Industrials, and Healthcare led to the upside, while Financials, Utilities, and Consumer Staples lagged in the quarter. On this measure, the SCV strategy was well-positioned, as the portfolio was overweight the outperforming sectors and had less exposure to the lagging areas of the market. Yet this positive sector allocation was offset by trailing stock performance – particularly in Industrials and Healthcare.

Cambiar's historically high allocation to Industrials is due to the broad mix of attractive business models that fall under this classification. Although the SCV portfolio registered solid 2Q gains in the sector from PGT Innovations and BWX Technologies, these contributions were offset by declines in Mercury Systems and WNS Holdings. Defense contractor Mercury Systems has a 40-year track record, and the company is a key strategic



partner for larger peers in the industry. The selloff in the quarter was in response to a mixed earnings release that included a downward revision to gross margins. The contraction in margins is due to a near-term mix shift in contracts from production (~40% GM) to development (~30% GM). While disappointed by this near-term development, we believe the current headwinds facing the company are transitory. The presence of activist investors further illustrates the underlying franchise value in Mercury – on both a standalone basis or as a takeout candidate.

WNS Holdings is a business process management company, providing a range of services on an outsourcing basis to a diverse (and global) client base. The company is led by an experienced management team and has a net cash balance sheet. The drawdown in the stock price was largely due to the potential threat that AI may have on WNS' business model. We disagree with this assessment – WNS is not a commodity call-center; rather, the company provides high value-add services and is often firmly integrated in their clients' operations. We believe the recent price action to be an overreaction and continue to maintain our position.

Individual highlights in the quarter included Rambus (semiconductors – Technology) and M.D.C. Holdings (homebuilder – Consumer Discretionary). Within Healthcare, U.S. Physical Therapy and newer purchase AMN Healthcare Services also performed well, although these gains were offset by modest losses in Addus HomeCare and HealthStream. While aggregate performance within Healthcare was below expectations for the quarter, stock selection within the sector has been a strong positive for the SCV portfolio in 2023, as well as over a trailing 1- and 3-year basis.

After a volatile start to the year, small cap banks stabilized (a bit) in the second quarter. The most impactful headwind (deposit flight) subsided in 2Q; however, ongoing unknowns in the form of tightening lending standards, potential regulatory changes, and exposure to commercial real estate contribute to Cambiar's underweight allocation to banks. The portfolio's holdings in Financials remain split between select bank positions and non-credit specialty insurance/reinsurance businesses. Our bank positions possess strong capital positions and operate in regions with solid growth opportunities (e.g., Texas). An end to rate hikes would be a positive catalyst for banks – via more stable net interest margins as well as an upward re-pricing of loan and securities portfolios.

## LOOKING AHEAD

As we look ahead to the second half of 2023, the U.S. equity markets will have a tough act to follow, with the rise in stocks over the first six months of the year surpassing many strategists' full-year forecasts. Given current market momentum, the path of least resistance may continue to be to the upside. That said, there is a lot of optimism priced into certain segments of the market at present – valuations assigned to many tech stocks are one such example. We would not be surprised if the second half of 2023 saw a rotation in market leadership from growth to value. The combination of elevated multiples and law of large numbers (e.g., the market cap for Apple exceeds the entire Russell 2000 Index) may result in more restrained price gains for many mega cap tech stocks, yet upside participation from lagging areas such as small caps, financials, energy, and healthcare would be a positive development from a market breadth perspective.

We believe the diffuse nature of the small cap equity market provides an attractive opportunity set for active managers to deliver alpha. The market's recession obsession has been more detrimental to smaller cap companies (relative to large caps) in 2023, given their predominant domestic footprint and therefore heightened sensitivity to U.S. economic growth trends. Yet these concerns are reflected in the lower multiples assigned to many small cap companies, with the asset class trading at a low absolute valuation vs. their history as well as relative to large caps.

In aggregate, we are generally pleased with how the Cambiar strategies have performed thus far in 2023, with the portfolios exhibiting positive stock selection across a number of sectors. Buy and sell decisions remain an output of our fundamental work at the company level, with the goal of finding investments that can outperform regardless of the macroeconomic backdrop.

We appreciate your continued confidence in Cambiar Investors.

# DISCLOSURE

Cambiar Investors, LLC (Cambiar) is an independent registered investment adviser with the United States Securities and Exchange Commission. Registration does not imply a certain level of skill or training. Cambiar claims compliance with the Global Investment Performance Standards (GIPS®).

Cambiar's Small Cap Value Composite includes discretionary, taxable and tax-exempt portfolios, including portfolios that are part of broker-affiliated or broker-sponsored programs, including wrap programs, that waive commission costs or bundle fees including commission costs. The records of the portfolios in the composite are maintained on Cambiar's systems. Portfolios in the composite invest in equity securities of small-cap companies. Cambiar's Small Cap Value Composite includes portfolios that primarily invest in stocks with a market capitalization range between \$500 million and \$5 billion. The typical number of securities in the small cap value portfolio is 45-55 holdings. As of January 1, 2022, the Cambiar Small Cap Value Composite (Institutional) was renamed the Cambiar Small Cap Value Composite and was redefined to include portfolios that are part of broker-affiliated or broker-sponsored programs, including wrap programs. Prior to this redefinition, for the period 2014-2021, the composite included only institutional and high net worth portfolios that were not part of these programs. Prior to 2014, the composite included all institutional, high net worth and program small cap accounts. These program accounts have been reintroduced because they are managed with similar policies, objectives, and holdings. There is no minimum asset level for the composite. From 2014 to March 2020, the minimum asset level for the composite was \$1,000,000 and prior to this timeframe it was \$100,000. The Small Cap Value Composite includes proprietary assets.

From 2014 to 2021, the composite contained accounts with only gross performance. Prior to 2014 and as of January 1, 2022, the gross returns reflect accounts with both gross and "pure" gross performance. Gross returns are reduced by transaction costs. "Pure" gross returns do not reflect the deduction of any expenses, including transaction costs. "Pure" gross returns are applicable to separately managed accounts that are part of broker-affiliated or broker-sponsored programs, including wrap programs, that waive commission costs or bundle fees including commissions (SMAs). "Pure" gross returns are supplemental information. Net returns are reduced by transaction costs and actual investment advisory fees and other expenses that may be incurred in the management of the account. SMAs often incur bundled fees, charged by the wrap sponsor or affiliated broker, that may include transaction costs, investment management, portfolio monitoring, consulting services, and custody fees. Net returns for SMAs are calculated by deducting the investment advisory fees from the client's account as reported by the wrap sponsor or affiliated broker, or as received by Cambiar. Cambiar clients may incur actual fee rates that are greater or less than the rate reflected in this performance summary. Fees will vary based on the assets in the accounts. Returns are reported in U.S. dollars.

Performance results for the Small Cap Value Composite are evaluated against the Russell 2000® Value Index. The Russell 2000 Value Index is a float-adjusted, market capitalization weighted index comprised of firms in the Russell 2000® Index that experience lower price-to-book ratios and lower forecasted growth values. The Russell 2000 Index is a float-adjusted, market capitalization weighted index that measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which consists of 3,000 of the largest U.S. equities. The index assumes no management, custody, transaction or other expenses. The Russell 2000 Value Index is a broadly based index that reflects the overall market performance and Cambiar's returns may not be correlated to the index. The index is unmanaged and one cannot invest directly in an index. Cambiar's performance and the performance of the Russell 2000 Value Index include the reinvestment of all income.

For additional information, including a GIPS Composite Report for the strategy presented herein and/or a list of composite descriptions, please contact: Cambiar Investors LLC, 200 Columbine Street, Suite 800, Denver, CO 80206, 1.888.673.9950, info@cambiar.com. **Past performance is no indication of future results and, as is the case with all investment advisors who concentrate on equity investments, Cambiar's future performance may result in a loss.** All information is provided for informational purposes only and should not be construed as an offer to buy or as a solicitation to buy or sell. GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. **This communication is intended for non-wrap use only.**

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**Top 5/Bottom 5 Chart:** For the quarter, the total portfolio return for the representative account was 1.13% (gross) and 0.94% (net). The net performance is calculated assuming the highest applicable fee rate currently being offered to prospective clients for the strategy. As compared to the representative account, the composite performance shown is the asset-weighted performance of related accounts which may include accounts of varying types including pooled vehicles/mutual funds, separate accounts, and retail/wrap (directed) accounts. Cash flows, holdings and other activities may vary across accounts in the composite which can result in materially different performance between the composite (or other accounts in the composite) and the representative account.

The net contribution for individual holdings is calculated by determining each security's contribution to return as a percentage of the account's gross performance, then multiplying that percentage by the account's net performance. Fees and expenses are not charged to individual investments, and net performance of individual holdings are provided for illustrative purposes and to meet regulatory requirements. Different calculation methodologies can result in materially different net returns for individual holdings. Please refer to the net performance of the representative account, which best represents the net performance an investor would have received if they had invested in the strategy for the period shown.

A complete list of each security that contributed to the performance of the Cambiar portfolio mentioned above is available upon request. Please contact Cambiar at 1.888.673.9950 for additional information.

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