International Small Cap Strategy

Representative Commentary — 1Q22

Performance

			Annualized			
	1Q22	**1YR**	**3YR**	**5YR**	**7YR**	**10YR**
International Small Cap Composite (Gross)	-14.48%	-12.41%	4.50%	4.63%	6.37%	8.81%
International Small Cap Composite (Net)	-14.70%	-13.29%	3.47%	3.61%	5.32%	7.74%
MSCI EAFE® Small Cap (Net) Index	-8.53%	-3.63%	8.50%	7.41%	7.30%	8.30%

Please see the important performance and other related disclosures at the end of this Commentary, which are an integral part of this quarterly Commentary Newsletter.

In the first quarter of 2022, the market intensified its shift from Growth to Value against a backdrop of rising interest rates and COVID becoming an endemic. In March, Russia's invasion of Ukraine shook the world. In addition to the grave human toll, the ongoing assault sent oil prices surging toward 15-year highs, with similar spikes in other commodities. That led to cascading inflationary pressures in a global environment that remained beset by supply chain frailties. The current watchword was "tightening," whether referring to the belts on consumers with their spending, corporate balance sheets, or central bank quantitative monetary policies. On the last point, the Federal Reserve embarked on its well-telegraphed plan to increase the federal funds rate—though only by 25 basis points in March—and reducing the $9 trillion asset portfolio it amassed—soon at the steady rate of -$95 billion per month. That paralleled similar actions by the Bank of England, which increased rates for the third consecutive time, and the European Central Bank, who announced plans to end its bond buying sooner than expected. Among the major economies, the Bank of Japan remained staunchly in the dovish camp. Stimulus measures were also announced during China's National People's Congress, supporting a rebound in Chinese equities towards the end of March. Nonetheless, global inflation continued to rise.

Economic activity began to climb in February, though the war in Eastern Europe quickly reversed that for manufacturing and service activities. However, while equity markets stumbled badly in January with one of the worst calendar year starts in some time, they began clawing their way up by March. For the quarter, U.S. equities fell -5%, somewhat better than developed non-U.S. markets at -6% and emerging markets at -7%.

Within the non-US universe, there were better returns for larger stocks than smaller capitalizations and value outperformed growth. Among the small cap stocks, value sectors such as Energy and Material sectors were propelled by the gains in underlying commodity prices. Longer duration sectors such as Communication Services and Information Technology pulled back on the risk of rising interest rates. Health Care and Consumer Discretionary sectors also lagged the broader benchmark.

Amidst this environment, the International Small Cap Portfolio underperformed the MSCI EAFE Small Cap benchmark primarily driven by stock selection. Holdings in the Emerging Markets had a neutral impact on performance while relative weakness was seen in Europe, Japan, and Asia Pacific Ex Japan. There was weakness in the Industrials and the Materials sectors; that was somewhat offset by strength in Information Technology.

Regional Performance: Europe

Throughout the quarter, global markets faced headwinds on the prospects for quantitative tightening, rising commodity prices, and continuing supply chain shortages. Moreover, Europe bore the brunt of the contagion effect from the war in the Ukraine. Our selection and relative overweight to Europe detracted from performance. By country, our holdings in Finland, United Kingdom, and Spain hurt while Denmark helped.

Multiple compression in a rising rate environment hurt some of our holdings, including Sweden based **Nordic Entertainment (NENT)**, the region's leading entertainment provider. While subscriber growth was higher than expected, shares declined by -21%. Its near-term earnings are taking a hit given NENT's heavy investments in content; but we appreciate the strong visibility of their pipeline and are confident that they will reap the fruits of their investments. Retreating from its position as a top 2021 contributor with a -34% correction was UK-based **Future plc**. They are a specialty content publisher transitioning from print-to-digital-platform. The group continues to perform well, benefitting from ongoing momentum in digital advertising and its share price performance contradicts the group's upgraded full year outlook. Recent discussions with management were reassuring for 2022, and the CEO also purchased stock. In light of the rising rate environment and its impact on long duration companies, we pared back our exposure to both NENT and Future, though they firmly remain core holdings.

There were stock specific challenges this quarter. For example, UK-based **RWS,** a language and intellectual-property (IP) support services provider, dropped by -44%. Shares in RWS slumped after the company said it expected 2022 results to be at the lower end of expectations. Despite short-term growth headwinds from the Russia/Ukraine crisis and slower IP filing activity, the company's growth outlook remains solid on significant investments to expand into the fast-growing artificial intelligence data annotation market. Neighboring France housed the portfolio's largest detractor **Orpea**, which plunged by -63%. It is the leading European operator of retirement homes. In February, a book was published in France which contained allegations against the private nursing home industry and particularly targeted Orpea. Faced with such reputational risk and creating unknowns around the business model attributes, we exited the name. Delivering better share price performance on positive idiosyncratic news was **Topdanmark,** Denmark's second largest non-life insurance company. Shares climbed 7% on back of the company's solid execution. They continue to invest heavily in technology, thus enabling them to generate better-than-expected returns. In March 2022, Nordea announced that it would buy Topdanmark's life and pension business for 270 million euros which also boosted sentiment.

While we have limited exposure to Ukraine and Russia, geopolitical tensions created heavy selling pressure in the Nordic region due to its proximity to Russia. **Valmet** is a Finnish process technology provider, supplying entire production lines and mills to pulp and paper end markets. During the quarter, Valmet completed its merger with global valve manufacturer Neles Corporation, which should be beneficial for long-term growth. Nonetheless, Valmet's share price retreated by -24% as it traded in line with the Finnish market. We took profits early in the quarter on back of Valmet's strong 2021 share price performance. Later in the quarter, we further reduced our exposure to Valmet and other industrial manufacturing holdings in recognizing the rising risk of elevated input (commodity) prices. The war also further exacerbated supply chain woes. This was notable in the global automotive supply chain as Ukraine housed an established production cluster. In its latest earnings, Spain-based **CIE Automotive,** a producer of automotive components, reached its 2021 targets but it did not provide targets for 2022 due to the current geopolitical situation and its shares dropped by -25%. We believe that CIE will fare better than other peers as it has multiple local production sites across the globe. We expect it will manage the disruptions through ongoing cost efficiency improvements, an ability to pass on higher raw material costs to clients, and will come out stronger.

Finally, some of our holdings benefited from their exposure to the energy sector. Delivering better performance in France was **GTT** which develops membrane containment systems for LNG (liquefied natural gas) vessels. We purchased the name in December 2021 in view of a record-breaking year in order intake as there is a global supply/demand imbalance between transport vessels and LNG demand. Shares jumped 21% on its exposure to the energy sector and we added to the position. Also benefitting from the rally in the energy sector was Germany-based **Friedrich Vorwerk** which provides turnkey solutions for energy infrastructure. After a challenging 2021 operating environment, the company reported strong fourth quarter results. Management published solid guidance and noted their order backlog is higher than expected, signaling an excellent growth trajectory going into 2022. As a result, shares moved ahead by 30%.

Regional Performance: Japan

Japan was our second weakest region during the quarter. Our semiconductor material holdings were impacted by negative sentiment and concerns the semis cycle had peaked. **Toyo Gosei** manufacturers photosensitive materials, organic chemicals and solvents. Despite steady earnings growth, management guided for lower growth as orders pulled forward ahead of price hikes and its shares retreated -34%. We saw a similar decline in fellow peer **Tri Chemical Laboratories** which manufacturers ultra-fine gases and chemicals ("precursors") for semiconductors. In response to management's conservative guidance and the stock's share price volatility, we sold Tri Chemical which lost -37% for the period that it was held in the portfolio.

In the real estate sector, home renovation management company **Katitas** faced profit taking and retreated -27% after delivering strong performance in 2021. While COVID has limited their ability to source properties, inventory levels are slowly improving. We believe its share price has absorbed the negative sentiment related to higher material cost and look forward to Katitas enacting a 2% price hike across its network starting in April.

With elevated commodity prices on the horizon, our environmental and recycling names fared relatively better. New to the portfolio is **Organo,** a leading Japanese water treatment engineering company. In addition to recovering demand from other end markets such as industrials, utilities, restaurants, and medical / office customers post-COVID, accelerating expansion plans by leading semiconductor companies globally will continue to support demand for Organo's solutions. Longer term, the need to recycle and conserve water will become much more acute due to water shortages and greater environmental awareness of water conservation. Shares climbed 19% since it was purchased.

Rounding out the contributors was **Kadokawa**, a comprehensive entertainment publisher that monetizes its significant anime library across an increasing array of e-books, mobile games, and movie titles. Early in the quarter, the company reported weaker-than-expected profit hampered by lower printed book sales and a one-time write-off, and we opportunistically added to our position on this price weakness. Later in the quarter, shares rebounded on back of its highly successful Elden Ring Video game launch and the stock closed out the quarter with a 3% gain.

Regional Performance: Asia Pacific Ex-Japan, Middle East, and Americas

The portfolio's Asia Pacific Ex-Japan holdings underperformed. Our underweight to Asia Pacific Ex-Japan and Middle East also detracted from performance. **Pushpay Holdings** is a New Zealand based software firm that provides online payments and engagement solutions for churches predominantly in the US. Late last year, the company revised down its full-year guidance as its expansion to Catholic Church customers had been slower than expected. With continuing concerns on its total addressable market and increased competition, we exited the name which declined -31% for the period that it was held this quarter. Faring better and new to the portfolio was **APM Human Services**, a leading Australian human services provider with a focus on disability and employment. The company is well-placed to benefit from the rise in government spending on unemployment, disability, and aged care. APM reported better than expected first half operating results. Notable growth came from Australia, where a tight labor market drove better job placement outcomes. The company also benefitted from increased demand for vocational training and mental health support services. Shares rose 21% since we initiated the position.

Over in the Americas, another winner was **Cargojet (CJT),** a cargo forwarder specializing in "middle mile" air cargo in Canada. CJT doubled their forecasted capex versus 2021 levels in response to client requests. In late March, Cargojet announced a long-term strategic agreement with DHL to provide global air-transportation services and shares appreciated 16% for the quarter.

Regional Performance: Emerging Markets

Within the Emerging Markets, Latin America was an area of strength while Asia lagged. The Chinese market dislocated in early 2022 over COVID lockdowns and ADR delisting risk. After a steep selloff in 2021, Brazil saw strong inflows to start the year. Benefitting from those tailwinds with a 49% rise was **TOTVS**, the largest SAAS software provider in Brazil. The company reported a significant beat in its fourth quarter results and continues to show impressive operating trends, highlighted by strong growth in its management software business. The magnitude of its earnings beat demonstrates the resilience of demand for the company's products and its pricing power and the company's operating leverage.

Conclusion

As events in Eastern Europe unfold, they create new risks with new global responses. At the same time, central banks launched a period of monetary tightening that may be anything but transitory. As long-time bottom-up investors, we understand the importance of having a steady hand on the tiller when navigating such waters, though recognize how the investment terrain constantly evolves. By combining those experiences and evaluations, we seek investments that may capitalize on new opportunities, may have become more attractive at lower valuations, or a blend of both. As always, we are available for any questions you might have as we endeavor to protect the assets you have entrusted with us.

General Disclosure:

The holdings discussed represent a particular point in time. It should not be assumed that the securities continue to be held, and/or continue to be held in the same percentage, and/or were held continuously throughout the period. In addition, the holdings of a particular client account may differ from the information provided. Securities discussed do not represent the entire portfolio and, in aggregate, may represent only a small percentage of a portfolio's holdings. Information is subject to change without notice. It should not be assumed that any of the securities discussed were or will prove to be profitable. Past performance does not guarantee future results.

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This composite generally invests in MSCI EAFE® stocks with market capitalizations below $5.0 billion at time of purchase. Portfolios will hold approximately 70-75 securities. The process is fundamental research driven. Historical turnover has averaged 41% per year. Composite inclusion threshold $500,000. Fee basis is 100 points. The composite creation date is April 1, 2012.

This composite had a significant cash flow policy from April 1, 2015 to December 31, 2016. A significant cash flow is defined as an external flow that exceeds 10% of the composite's market value on the day of the cash flow. Effective 01/01/2017, the significant cash flow policy has been removed.