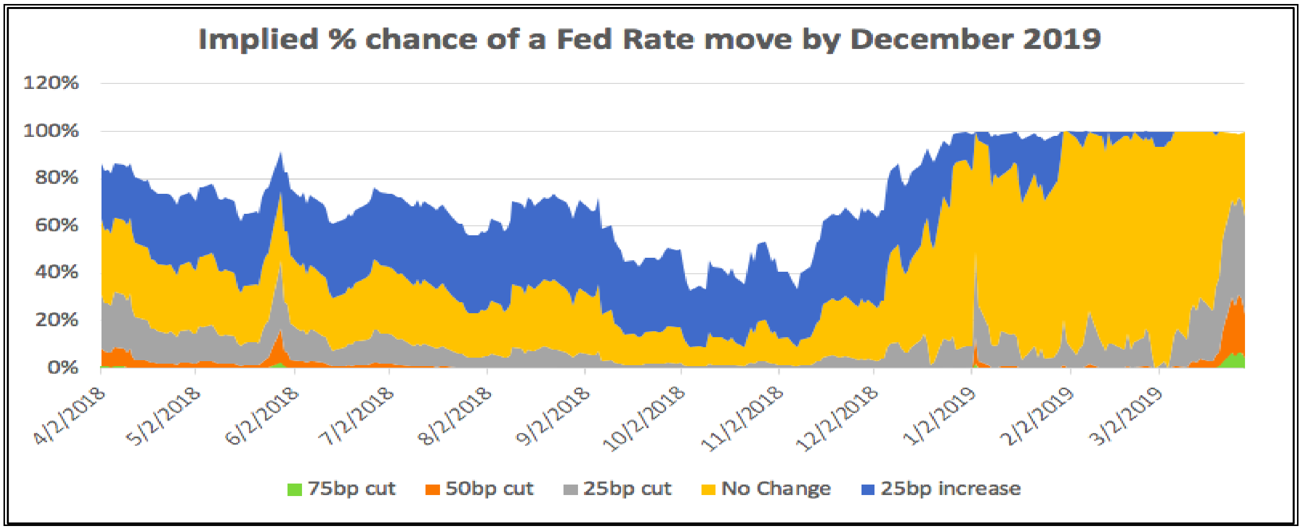
HAHN CAPITAL MANAGEMENT, LLC

Mid Cap Equity Strategy — 1st Quarter 2019 Commentary

1st QUARTER MARKET SUMMARY

The New Year has brought with it a new wave of optimism, with equities and credit rallying strongly across the world. The sell-off in equities and credit in the final quarter of last year was caused predominantly by fear of an escalation in the trade war between the US and China, higher interest rates driven by a seemingly overzealous FED, and broader worries about a slowdown in global growth. In many ways, the weakness in Q4 set the stage for the recovery in equity markets this quarter. The Federal Reserve (Fed) reacted to the market weakness and weaker global growth by easing off its more recent hawkish (relatively speaking) stance. Much of the rally this year has been built on market expectations that the Fed now won't raise interest rates again at any point in the next few years—in fact, the next move expected from the Fed by the bond market is now a cut, with 10-year Treasury yields down to 2.4%. The sharp fall in the US stock market late last year was probably also a factor in deterring the US administration from further increasing tariffs on China over the quarter. So the stock market decline last year helped to reduce two of the major risks that had caused it in the first place.



The information contained in the graph above has been obtained from JP Morgan that we believe to be reliable, but its accuracy and completeness are not guaranteed. It has been prepared solely for informative purposes.

Coming off its worst quarterly performance since 2011, the S&P 500 rebounded 13.1% in Q1 for its best quarterly performance in ten years. The rebound is being largely attributed to an oversold bounce, improving expectations for a trade deal with China, and maybe most importantly a "dovish pivot" by global central banks. While the first two months of 2019 were a virtual straight line higher, a healthy dose of caution surfaced in March as inversion extended further out on the curve to the 3M - 10YR spread for the first time since 2007

For the quarter the Nasdaq 100 and Composite indices continued their leadership role with gains of 16.6% and 16.5% followed by the small and midcap Russell 2000 and S&P 400 indices with gains of 14.2% and 14%. The large cap S&P 500 and Dow Jones Industrials followed with gains of 13.1% and 11.2%. The Russell Microcap gained 12.8%.

All indices registered gains in January and February, but for March the small- and mid-cap indices (Russell 2000, S&P 400, and Russell Microcap) finished in the red. And while the large cap INDU and SPX underperformed, they are the closest to breaking out to fresh 52-week highs.

US Indices	Q1	March	Vs. 52-week Low	Vs. 52-week High
Nasdaq 100	16.6%	4.0%	25.2%	-4.2%
Nasdaq Composite	16.5%	2.6%	24.9%	-5.0%
Russell 2000	14.2%	-2.3%	21.5%	-11.6%
S&P Midcap 400	14.0%	-0.7%	21.1%	-7.6%
S&P 500	13.1%	1.8%	20.8%	-3.6%
Russell MicroCap	12.8%	-3.1%	19.7%	-15.5%
Dow Jones Industrials	11.2%	0.0%	19.4%	-3.8%

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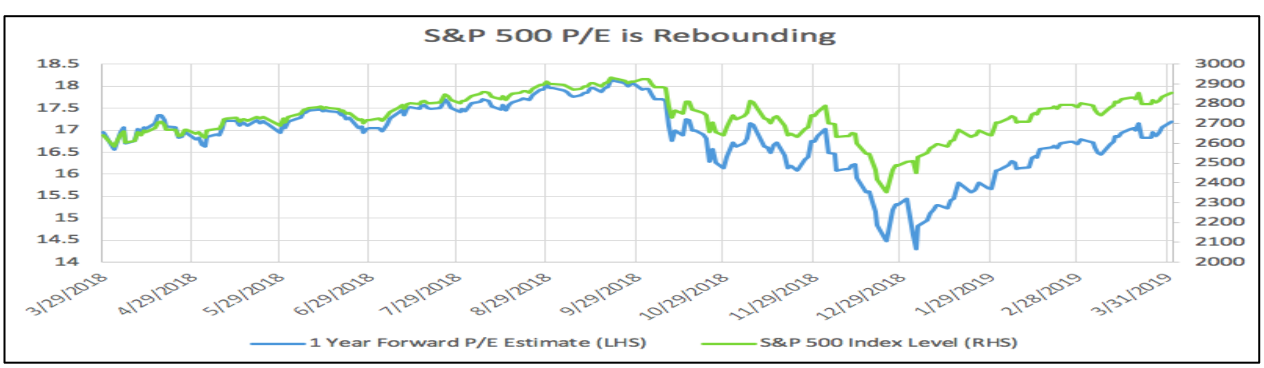
Earnings estimates have been falling since the beginning of the year. Fortunately for the stock market, interest rate expectations have also fallen sharply, supporting equities. When January began the aggregate estimate for S&P 500 earnings growth was 2.9%. However, analysts have been cutting 1Q estimates every week during the quarter and the expectation is now for an earnings decline of 3.9%, which would be the first decline in quarterly earnings since Q2 2016.

Second quarter estimates have also been falling, currently hanging on to positive territory by a thread at +0.1% for the past three weeks. Bulls seem to be hoping for an earnings rebound in Q3 and Q4 (+1.7% and +8.3% growth respectively), but this feels tenuous since Q3 estimates have also been declining and Q4 just feels as though people have not gotten around to revising them yet.

Part of the reason the market is not reacting more negatively to the low earnings growth number is the fact that revenue growth is still looking positive with estimates ranging between 4.3% and 4.8% for all four quarters in 2019. Wall Street can be more patient with a margin problem than a broader macro revenue problem. For the first quarter, the Fed's dramatic change in posture towards rate hikes has allowed equity holders to be patient. One-year forward P/E's have recovered from their December lows below 15 and sit at about 17X expected 2019 earnings. Still, P/E's remain below September 2018 levels despite the lowered earnings expectations.



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Quarterly Performance

The return of the Portfolio Composite for the quarter ended March 31, 2019 was 19.78% compared to the Russell Mid-Cap Value Index return of 14.37%, for a positive relative return of 5.41%. The primary source of outperformance during the quarter was stock selection in the Information Technology, Industrials, Real Estate and Consumer Discretionary sectors. This outperformance was somewhat offset by negative contributions from the Energy (Pioneer Natural Resources) sector and our cash holdings. From an individual stock perspective, the significant contributors included Euronet Worldwide, Keysight Technologies, and PVH Corp. The table below encapsulates the annual results for a Model account (which differs from the Portfolio Composite):

HCM Attribution Analysis - Quarter Ended March 31, 2019 vs Russell Midcap Value Index

	Average Port. Weight	Benchmark Weight	Over/ Underweight	Contribution Return	Actual Return	Stock Alpha	Sector Alpha
Industrials	21.32	12.29	9.03	4.36	19.59	0.93	0.20
Info Tech	14.32	8.90	5.42	4.64	36.32	2.12	0.34
Real Estate	14.96	14.31	0.66	3.06	22.72	0.83	0.02
Financials	13.76	17.38	-3.62	1.75	14.76	0.39	0.06
Cons. Disc.	13.33	8.88	4.44	2.37	19.28	0.63	-0.03
Health Care	12.15	7.02	5.14	1.82	16.56	0.11	0.11
Cash	4.55	0.00	0.00	0.03	0.61	-0.56	-0.56
Energy	2.30	6.07	-3.77	0.36	16.03	-0.32	-0.19
Materials	2.27	6.03	-3.77	0.15	6.83	0.00	0.10
Cons. Stpls.	0.00	4.85	-4.85	0.00	0.00	0.20	0.20
Comm. Svcs.	0.00	3.12	-3.12	0.00	0.00	0.22	0.22
Utilities	0.00	11.14	-11.14	0.00	0.00	0.28	0.28
						4.83	**0.75**

HCM Model Portfolio – Relative Performance by Stock – Quarter Ended March 31, 2019

Company	Average Position	Contribution Return	Actual Return	Alpha
EURONET WORLDWIDE INC	5.32	1.73	39.28	0.73
KEYSIGHT TECHNOLOGIES IN	4.91	1.67	40.46	0.64
PVH CORP	3.56	0.99	31.24	0.49
JACOBS ENGINEERING GROUP INC	4.08	1.03	28.94	0.40
EQUINIX INC	3.34	0.86	29.28	0.36
GENPACT LTD	3.73	1.00	30.68	0.28
CARTER'S INC	2.99	0.65	24.15	0.27
CBRE GROUP INC - A	4.29	0.89	23.50	0.25
ALEXANDRIA REAL ESTATE EQUIT	3.17	0.70	24.54	0.20
HEXCEL CORP	4.26	0.81	20.88	0.17
EMCOR GROUP INC	2.55	0.52	22.59	0.14
ROPER TECHNOLOGIES INC	2.23	0.56	28.53	0.12
LABORATORY CRP OF AMER HLDGS	3.21	0.60	21.07	0.11
FIRST REPUBLIC BANK/CA	3.19	0.47	15.82	0.11

FIDELITY NATIONAL FINANCIAL	1.91	0.31	17.28	0.08
AGILENT TECHNOLOGIES INC	4.07	0.71	19.15	0.07
SEI INVESTMENTS COMPANY	2.76	0.34	13.10	0.03
BANKUNITED INC	0.23	0.12	10.97	0.02
IDEX CORP	2.22	0.46	20.56	0.00
BLACK KNIGHT INC	0.85	0.16	20.95	0.00
EAST WEST BANCORP INC	2.70	0.30	10.70	-0.01
MID-AMERICA APARTMENT COMM	3.98	0.57	15.38	-0.03
ROSS STORES INC	4.56	0.55	12.22	-0.05
ROSS STORES INC	4.56	0.55	12.22	-0.05
MOHAWK INDUSTRIES INC	2.00	0.17	7.86	-0.08
ALBEMARLE CORP	2.34	0.15	6.83	-0.09
AIR LEASE CORP	3.72	0.40	14.14	-0.14
WABTEC CORP	1.78	0.09	5.11	-0.16
BECTON DICKINSON AND CO	4.74	0.50	11.18	-0.22
SLM CORP	0.91	-0.24	-12.07	-0.21

HCM PERFORMANCE HISTORY

% Annualized Returns As of 03/31/2019	1Q 2019	1 Year	3 Years	5 Years	7 Years	10 Years	Since Inception 06-30-88
HCM Gross of Fees	**19.78%**	**5.75%**	**11.00%**	**7.46%**	**10.73%**	**16.43%**	**13.96%**
HCM Net of Fees	**19.53%**	**4.90%**	**9.99%**	**6.44%**	**9.68%**	**15.33%**	**12.87%**
Russell Mid Cap Value Index	**14.37%**	**2.89%**	**9.50%**	**7.22%**	**11.30%**	**16.39%**	**11.36%**
Russell Mid Cap Index	**16.54%**	**6.47%**	**11.82%**	**8.81%**	**11.99%**	**16.88%**	**11.39%**

Link to: HCM Performance Disclosures

PORTFOLIO ACTIVITY

Positions Added

SLM Corporation (Sallie Mae) (SLM) – SLM Corporation (SLM), better known as Sallie Mae, is the largest private student lending company in the United States. Created by Congress in 1972 as a Government Sponsored Enterprise (GSE), SLM was originally chartered to provide liquidity to the student loan market (similar to "Fannie Mae" and "Freddie Mac" in the mortgage lending market), purchasing federally insured student loans from banks. Over time, SLM became the largest holder and servicer of student loans in the nation, and, in 2004, SLM completed its privatization, no longer operating as a GSE. However, in 2010 the Health Care and Education Reconciliation Act was passed, eliminating privately-originated government-guaranteed student loans. This led to SLM restructuring its business model and focusing on originating and servicing its own privately-originated student loans.

The US student lending market is comprised of two main categories: (1) government loans, which are issued by the US Government and comprise ~90% of total student loans, and (2) private student loans, which are issued by private lenders and contain no government insurance. SLM competes in the niche market of private student lending, which is ~$120 billion in size and where loans are originated based on the credit worthiness of the students' parents who cosign the loans along with the student borrower. Increased regulation and the elimination of government guaranteed loans for private lenders following the financial crisis caused many industry participants to leave the market and what was once a highly fragmented market, with no one lender holding more than 8% market share, has now become highly concentrated with three banks controlling ~97% of the market and SLM alone holding ~54% market share.

Lending in general is a commodity business and very few banks have been able to carve out a sustainable competitive advantage in this market – SLM is one of those few banks. With over 50% market share, SLM is over two times larger than its nearest competitor and has the largest sales force in the industry with relationships at more than 2,400 schools across the US. This gives SLM significant scale advantages in a niche lending product that is expensive to originate/service and complicated to underwrite. This market domination and scale advantage allows SLM to operate at higher margins vs traditional banks and earn higher returns on invested capital as the barriers to entry in the industry are significant.

In addition to SLM's strong position within the industry, the student lending market itself is attractive as it is the only lending category that has <u>never</u> experienced a Y/Y decline in financing needs over the past 50 years. The industry also has a counter-cyclical element to its growth as college attendance has historically increased during recessions as more people try to improve their employment credentials by pursuing higher education degrees during times of high unemployment.

Beyond general market growth, SLM should be able to outpace industry growth as it continues to grow its newly created parent and graduate student loan products. In addition, there have been various discussions among government officials to curtail some of the government's student lending programs, particularly graduate school student lending. While we find the likelihood of this happening low, it has the potential to substantially increase SLM's addressable market if it were to happen.

SLM operates with a conservative financing structure. On the asset side of its balance sheet, SLM originates and holds private student loans that are ~90% cosigned by the borrower's parent(s) who have an average FICO score of ~750. Given the limited availability for borrowers to discharge student loans in bankruptcy and SLM's strict lending standards, the current loans on SLM's balance sheet have historically experienced lower defaults vs other consumer lending products. On the liability side of its balance sheet, SLM maintains an 80/20 financing structure between consumer deposits and securitization funding, respectively. This allows SLM to match fund the duration of its assets and liabilities to protect the bank in any interest rate environment. In addition, SLM is ~10% funded with equity, maintaining a CET1 ratio of ~11.50% - well above the regulatory minimum of 7.0% - which will protect the bank in a recessionary environment.

At our entry price, we were able to purchase a significantly above average bank that is conservatively run with a sustainable competitive advantage at an "average bank" price. Given our outlook for the industry's growth and SLM's earnings power, we believe this purchase price will result in above market returns over long periods of time.

Positions Increased

Air Lease (AL) – We added to our position in Air Lease during the quarter as the company continued to execute on its organic expansion by taking delivery of commercial aircraft that are pre-leased to its airline customers. Our research indicates that Air Lease, based on its current commercial aircraft order book and lease commitments, should be able to increase its earnings at a mid-teens rate over the next 4-5 years. The stock price should increase at that rate (more if there is valuation expansion) while the company continues to develop new lines of business. Recent developments with Boeing's 737 MAX aircraft will have a very slight impact on Air Lease's forward outlook, pushing out the timing of some future revenues but our long term investment thesis remains very much intact. We were able to increase our stake at a deep discount to our estimate of intrinsic value.

LabCorp (LH) – We added to our position in LabCorp during the quarter as the market continues to underestimate the long-term growth opportunity for the company; primarily due to short-term headwinds from lower reimbursement rates from Medicare on some diagnostic tests. LabCorp is at the very forefront of the effort to diagnose and treat medical conditions before they become acute and expensive. In addition, LabCorp is forging ahead of the competition in clinical testing, growing at a much faster rate than competitors due to its broad lab patient database. We were able to acquire these additional shares at a very deep discount to our estimate of the company's intrinsic value.

Positions Reduced

Keysight Technologies (KEYS) – We reduced our position in Keysight during the quarter as it approached our 5% position limit due to continued outperformance of its shares. This is the 2nd consecutive quarter that we have had to reduce our position in KEYS for this reason, underscoring the degree of outperformance that we have experienced with the stock. Unlike some of our other positions, however, KEYS continues to dramatically outperform our (and the market's) earnings projections so despite the dramatic rise in the stock price, the underlying intrinsic value has also risen dramatically. Therefore, we continue to expect some future outperformance at Keysight, though it will be at a less torrid pace than we have experienced over the past two years.

Carlisle Companies, Inc. (CSL) – We continued to reduce our position in Carlisle during the quarter as a combination of rising valuation, management turnover and an aggressive acquisition program has caused us to become more cautious on the long-term outlook for this diversified manufacturing company. Carlisle maintains a dominant position in roofing systems but has had very limited success in diversifying away from this business, which continues to generate the vast majority of its overall profits.

Idex Corp. (IEX) – We substantially reduced our position in Idex during the quarter as the valuation accorded to the company has expanded dramatically over the past several years. Despite several best-in-class business units, there is limited scope for the company to deploy additional capital (due to high valuations for potential acquisitions) and our view that the industrial cycle is extended by any reasonable historical standard. With a much more limited upside in the near term, we reduced our position by almost 60%.

Euronet Worldwide, Inc. (EEFT) – We reduced our position in Euronet during the quarter as the position rose above our 5% position limit. Euronet is one of the rare companies in the mid-cap payment technology space that has compounded earnings at a mid-teens rate over the past 7-8 years but whose stock has not become over-priced as a result. Thus, despite the significant appreciation in the stock and outperformance for the portfolio, the stock remains modestly priced and we remain significantly overweight.

<u>Positions Sold</u>

Bank United, Inc. (BKU) – We sold our remaining shares of Bank United during the quarter as we viewed the deployment of that capital into our other new opportunities (see our Sallie Mae discussion above) as a superior use of this capital. BankUnited experienced a significant leadership change over the past 12 months with founder and former CEO John Kanas leaving the board of directors and substantially exiting his position. A significant part of our original investment thesis called for an eventual build-up and sale of the BankUnited as its large FDIC guaranteed work-out portfolio was wound down. The thesis for this investment largely played out as we had expected without the final benefit of the sale of the business to a larger super regional bank. Depsite our view that this was still likely to happen, we viewed the opportunity to invest in Sallie Mae as a significant improvement in risk-adjusted returns for the portfolio.

<u>Outlook</u>

It is our view that we are far closer to the end of the current economic cycle than the beginning, owing to the record level of corporate profitability (enhanced significantly by President Trump's tax reform efforts) and a long, steady recovery in employment, economic demand and accommodative monetary policy. More recently, the yield curve inverted (if only briefly), economic demand indicators have turned down, consensus estimates are falling and the market has recovered substantially from the December 2018 lows. While we have no opinion on the short-term direction of the stock market, stock valuations (broadly speaking) and tighter monetary conditions clearly point to a time for greater caution and more modest expectations.

The good news is that the underlying strength of your portfolio holdings creates a very positive comparison to the broader index against which we are measured. Our portfolio companies have superior economics, better growth prospects and much lower financial leverage than the broad universe of mid-cap companies available for investment. Any sustained economic downturn will ultimately provide a backdrop for our portfolio companies to consolidate their industry leadership, improve their opportunity sets for future growth and return substantial capital to shareholders; these are among the key factors that caused us to select them for ownership.

As we have stated before, we remain dedicated to our core philosophy that risk management is key to superior long term investment results. It is an exhaustive process of looking at risk in its many dimensions: Business model, balance sheet, agency, governance, liquidity, foreign exchange, input price, labor inflation, environmental, social. These are just a starting point for the exhaustive process through which we determine the likelihood of permanent loss of capital, our first and foremost consideration with any prospective investment. We continue to view our role as stewards of hard earned capital and the preservation of that capital as paramount. We thank you for your continued faith in that approach.

Sincerely,

John Schaeffer	Michael Whitfield
President and CIO	Dir. of Research and Co-Portfolio Manager