HAHN CAPITAL MANAGEMENT, LLC
REGISTERED INVESTMENT ADVISORS

Mid Cap Equity Strategy 2nd Quarter 2021 Commentary

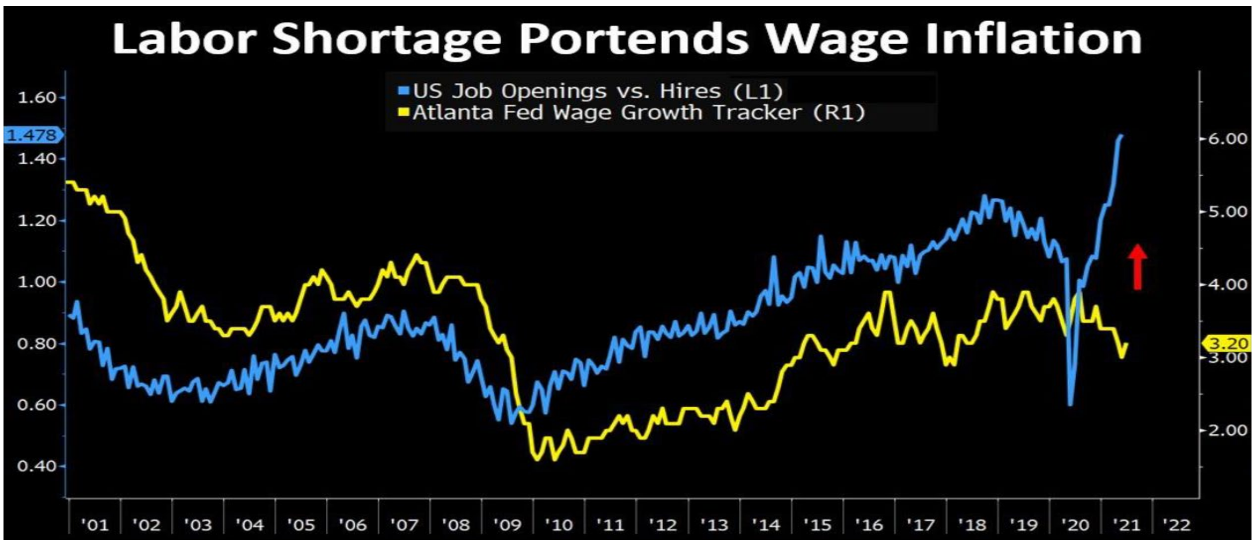
"What, Me Worry?"

The current equity market challenges even the most creative historian. Mark Twain was quoted as having said that "History doesn't repeat itself, but it often rhymes." We challenge any student of financial market history to compare the current equity market to any other in history. Buoyed by a continuation of the Federal Reserve's (the Fed) massive quantitative easing program, equity markets have continued their upward climb, defying myriad tail risks along the way. In the past quarter, the S&P500 rose 8.2% and has gained 14% in the first six months of the year; the NASDAQ 100 increased 9.5% in Q2 and is up 12.5% for the year. We are about to enter a quarterly reporting period in the US which will be the strongest quarter of earnings growth (+64%) since Q4 2009. Of course, there is an enormous "base effect" from the worst period of COVID in 2020, but 2021 S&P500 earnings in the US – which have been the subject of consistent upgrades through 2021 - are currently forecast at 191, compared to 163 in CY2019, explosive upside growth. Our Mid-Cap universe is even stronger, with the Russell Mid-Cap Value Index rising 17% through the first six months of the year, driven again by powerful positive earnings revisions, rising corporate profit margins and very low interest rates. Banks are literally begging customers, both corporate and consumer, to borrow money; and while we have yet to witness a reckless abandonment of credit quality like we did leading up to the Great Financial Crisis of 2008-2009, it is clear, that money is nearly costless and plentifully available to anyone with a pulse.

One of the biggest tail risks that have market participants most fearful is that of runaway inflation. In July, the producer price index increased at a 7.8% annual pace, the fastest since recordkeeping began in November 2010. Prices were up 1% month over month, matching the increase in June.

Inflation and wage growth

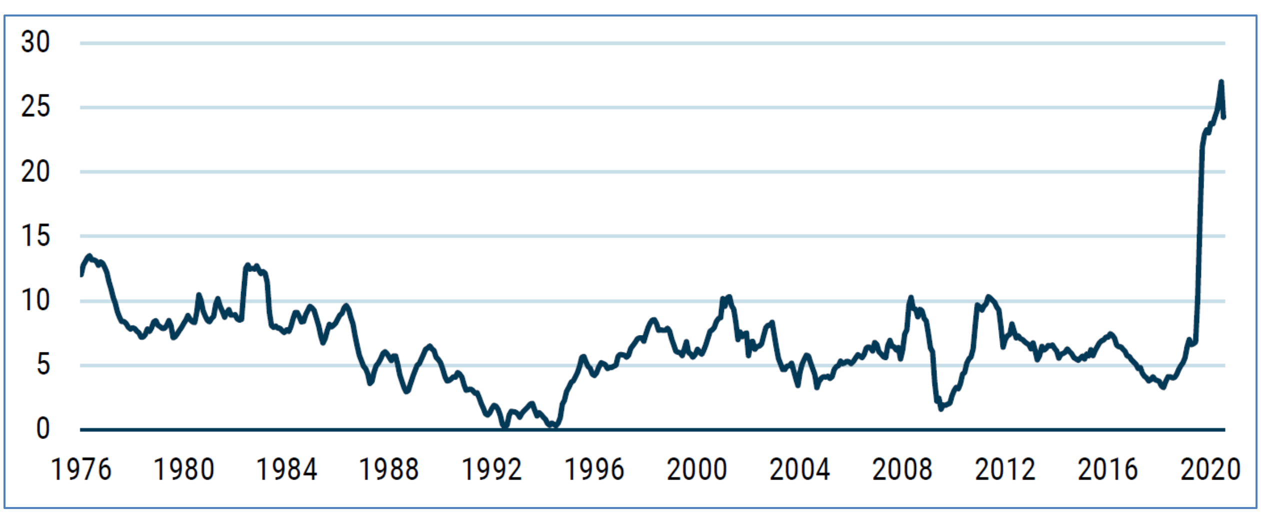
Average hourly earnings rose 3.6%, to $30.40, in June compared with the same month in 2020. That's the biggest spike since January 2009, according to data compiled by the Economic Policy Institute. Meanwhile, the Consumer Price Index, a measure of inflation, jumped 5.4% over the same period – the most since August 2008. Together, this amounts to a 1.7% loss in buying power, on average, when factoring in seasonal adjustments, according to the Bureau of Labor Statistics. This the type of phenomenon, rising inflation stoking increased wage gains but lower real incomes, is widely known as stagflation or "the wage-price spiral" and is causing many economists to flash warning signals about such a "vicious" inflationary cycle. The following chart suggests that the current labor market remains in deficit relative to recent history, suggesting wage inflation may, in fact, continue to accelerate.



Source: Bloomberg, Bureau of Labor Statistics

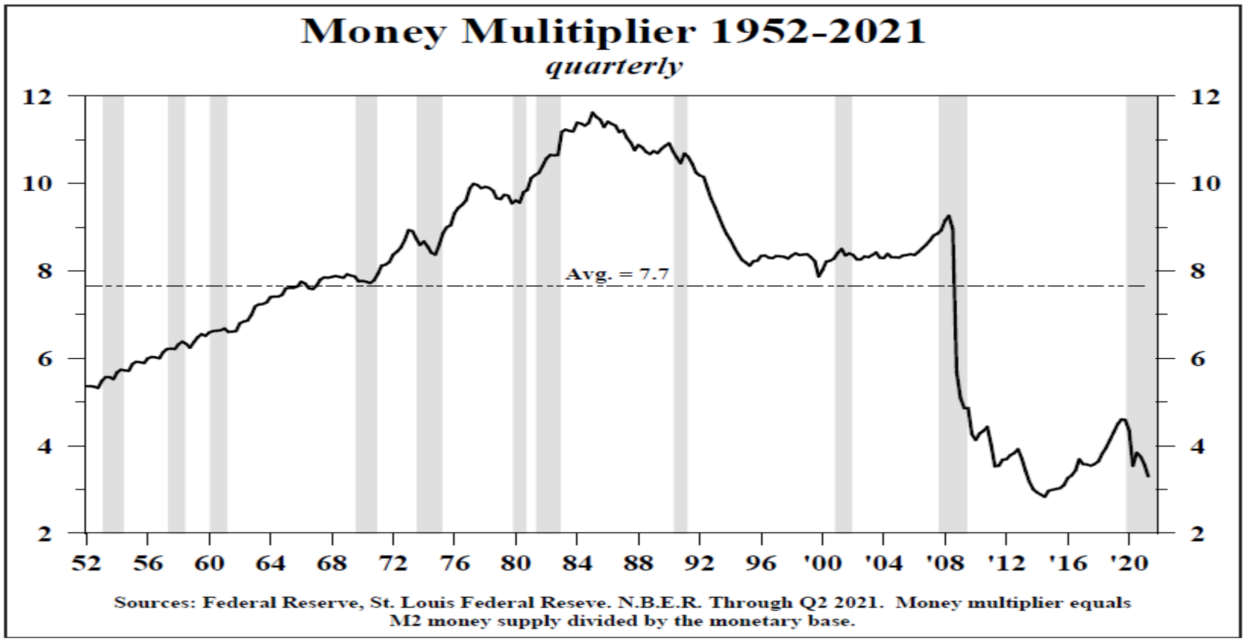
The favorite culprit for their inflationary fears? You guessed it, the Federal Reserve. Since the pandemic began, take note of the growth in M2 money supply on an annualized basis, dwarfing any prior effort to balloon the money supply. This is an unprecedented monetary experiment and one that was recently referred to by former Treasury Secretary Larry Summers as follows: "These are the least responsible macroeconomic policies for 40 years."

M2 Monetary Aggregate (Year/Year Growth Rate) 1975-2021



Source: Federal Reserve

The U.S. government is incentivized to underreport systemic inflation so that they can collect extra tax revenues on nominal growth while also containing inflation-indexed expenses. The Fed supports it in these goals. Inflation also helps reconcile historic debt-to-GDP burdens by boosting nominal instead of real GDP. Given the massive fiscal and monetary stimulus that has been thrown at the U.S. economy, it would be logical to assume that there is a much greater risk of inflation, higher treasury bond yields and an existential tail risk to equity returns looking forward. Fortunately, there is much more than meets the eye when it comes to the inflation outlook. For one, given the heavily indebted nature of most advanced world economies and the U.S. in particular, the marginal impact on economic growth and inflation becomes increasingly impotent. The following chart demonstrates the collapse in the money multiplier effect over time as the U.S. economy has become more indebted.



The benefit of the debt-financed fiscal operation goes away under the weight of the debt. First, there is the evidence of diminished returns, which is derived from the overuse of a factor of production, which is the same as saying the government debt financed multiplier is negative. In other words, one dollar of government debt financed operations, at the end of the day, will reduce GDP by more than a dollar; therefore, the economy is worse off. Increasing deficits in an over-indebted economy slows growth after a brief transitory acceleration. In the long-term, this is bad news for everyone and everything. In the near- to intermediate-term, it means that the inflation that we are experiencing today is inevitably transitory. It also means that the rallies in just about every commodity are a fade and that the signal being given by the treasury bond market (yields have barely budged after a surge earlier in the year) is the one to which equity investors should continue to pay attention.

Quarterly Performance

Our 2nd Quarter 2021 return for the Hahn Capital Management Mid-Cap Value Composite was 6.46% gross of fees. For the quarter, we outperformed our primary benchmark, the Russell Mid-Cap Value Index, by 0.80 percentage points. For the quarter, sector allocations to Utilities (no holdings), Utilities (no holdings), Real Estate and Health Care (relative to the benchmark) contributed, while those to Financial Energy (no holdings) and cash detracted. The most significant relative performers during the quarter were SLM Corp.(SLM), Agilent(A), Equinix(EQIX) and Roper (ROP), while the most significant underperformers were Air Lease (AL), Virtu (VIRT), EastWest Bancorp (EWBC), and Euronet Worldwide (EEFT).

Hahn Capital Quarterly Performance Attribution – 2Q 2021

BENCHMARK: Russell Midcap Value Index
PORTFOLIO: Model Account

GICS Sector	PORT Weight	BENCH Weight	DIFF Weight	PORT Return	BENCH Return	DIFF Return	SECTOR SELECT	STOCK SELECT	ACTIVE CONTR	PASSIVE CONTR	TOTAL CONTR
Real Estate	17.64%	10.10%	7.55%	13.72%	10.32%	3.40%	0.35%	0.58%	0.93%	0.00%	0.93%
Industrials	16.92%	17.47%	-0.55%	3.48%	3.64%	-0.16%	0.02%	-0.02%	0.00%	0.00%	0.00%
Financials	20.44%	16.35%	4.10%	3.26%	6.65%	-3.39%	0.05%	-0.70%	-0.65%	0.00%	-0.65%
Information Technology	14.64%	9.23%	5.42%	5.15%	4.27%	0.88%	-0.06%	0.13%	0.07%	0.00%	0.07%
Health Care	12.39%	7.36%	5.03%	9.25%	8.12%	1.13%	0.12%	0.15%	0.27%	0.00%	0.27%
Consumer Discretionary	10.81%	12.40%	-1.59%	5.01%	4.25%	0.77%	0.01%	0.09%	0.10%	0.00%	0.10%
Materials	2.08%	7.98%	-5.90%	15.56%	7.44%	8.13%	-0.10%	0.16%	0.06%	0.00%	0.06%
Energy	0.00%	4.30%	-4.30%	0.00%	14.83%	-14.83%	-0.38%	0.00%	-0.38%	0.00%	-0.38%
Communication Services	1.29%	4.01%	-2.73%	11.37%	2.81%	8.56%	0.08%	0.11%	0.19%	0.00%	0.19%
Consumer Staples	0.00%	3.76%	-3.76%	0.00%	2.30%	-2.30%	0.12%	0.00%	0.12%	0.00%	0.12%
Utilities	0.00%	7.05%	-7.05%	0.00%	-0.16%	0.16%	0.42%	0.00%	0.42%	0.00%	0.42%
Cash	3.79%	0.00%	3.79%	0.03%	0.00%	0.03%	-0.21%	0.00%	-0.21%	0.00%	-0.21%
Total Portfolio				**6.52%**	**5.61%**	**0.91%**	**0.41%**	**0.50%**	**0.91%**	**0.00%**	**0.91%**

Relative Performance by Stock – Quarter Ended June 30, 2021

Quarter Ended 06/30/2021 - Portfolio vs Russell Midcap Value Index

	Top Four Holdings	Total Attribution		Bottom Four Holdings	Total Attribution		Top Four Sectors	Total Attribution		Bottom Four Sectors	Total Attribution
1	SLM CORP	0.39%	1	AIR LEASE CORP	-0.67%	1	Real Estate	0.93%	1	Financials	-0.65%
2	AGILENT TECHNOLOGIES INC	0.33%	2	VIRTU FINANCIAL INC-CLASS A	-0.49%	2	Utilities	0.42%	2	Energy	-0.38%
3	EQUINIX INC	0.28%	3	EAST WEST BANCORP INC	-0.35%	3	Health Care	0.27%	3	Cash	-0.21%
4	ROPER TECHNOLOGIES INC	0.27%	4	EURONET WORLDWIDE INC	-0.30%	4	Communication Services	0.19%	4	Industrials	0.00%

HCM MID-CAP VALUE COMPOSITE PERFORMANCE HISTORY

% Annualized Returns As of 06/30/2021	2Q 2021	1 Year	3 Years	5 Years	7 Years	10 Years	Since Inception 06-30-88
HCM Gross of Fees	6.46%	52.41%	14.21%	14.42%	10.38%	12.36%	14.23%
HCM Net of Fees	6.21%	51.04%	13.09%	13.31%	9.30%	11.26%	13.12%
Russell Mid Cap Value Index	5.66%	53.06%	11.86%	11.79%	9.34%	11.75%	11.66%
Russell Mid Cap Index	7.50%	49.80%	16.45%	15.62%	12.03%	13.24%	12.02%

Link to: HCM Performance Disclosures

PORTFOLIO ACTIVITY

New Positions

There were no new positions added during the quarter.

Positions Increased

We increased our position in Virtu during the quarter. Virtu has continued to build underlying earnings power which has gone unnoticed by the market due to the tremendous volatility over the past year. We estimate that underlying earnings power currently stands at over $3 per share and is growing at double digits due to the addition of new products, services and a continuing geographic expansion of Virtu's core market making and execution services. We added to the position at a greater than 20% discount to our estimate of underlying intrinsic value.

Positions Reduced

There were no positions reduced during the quarter.

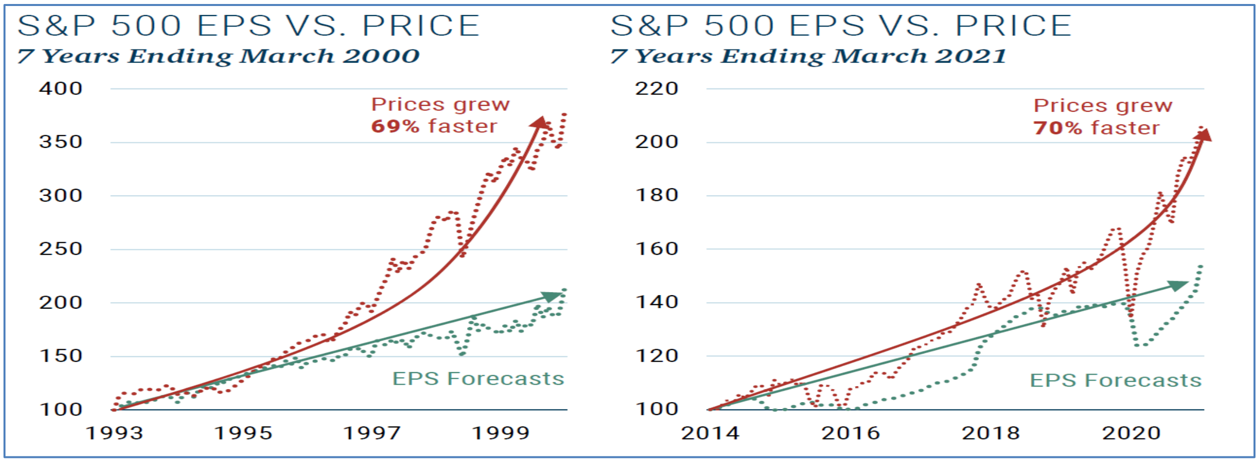
Positions Sold

There were no positions sold during the quarter.

Outlook

During the quarter, the real earnings yield on the S&P 500 turned negative and hit a 40-year low (an event that did not even happen during the Internet bubble of the late 1990s). Combine that with long-standing negative real yields on Treasuries, throw in some of the tightest credit spreads in history for good measure, and it is difficult to get excited about traditional asset classes and their prospects. It gives us no pleasure to remind our clients that broad U.S. stock valuations, by almost any backward or forward-looking measure that we've come up with, are at very elevated levels. While we remain optimistic on the long-term prospects for U.S. stocks, we continue to tilt our portfolio toward value and stable growth while continuing to maintain a quality bias.

We have been questioned from time to time, given our focus on valuations, whether we have given enough credit to some of these high-growth, new-business-model "disruptors." First, we have all sorts of models that take current optimistic growth forecasts into account. Many individual companies are deserving of their current high multiples, there are surely more growth Unicorns than at any other time in U.S. economic history. There is another Shopify, another Amazon, even another Alphabet (Google). Unfortunately, they're also ALL being priced that way, and for us, that is a bridge too far. As evidence, we present the following charts:



Source: I/B/E/S. S&P Global

Yes, earnings grew faster than expected over each reference period. Yes, interest rates declined dramatically in each respective reference period. The left chart above compares earnings per share (EPS) forecasts with the S&P 500 price index in the 7-year period leading up to March 2000. Back then, the excitement of new technologies combined with growing confidence in the Fed had expectations running high. Wall Street EPS forecasts were rising healthily. Prices, unfortunately, moved even faster – 69% faster.

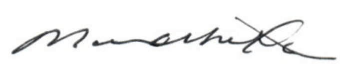
Today history is rhyming. The new business model opportunities are uniquely compelling – high growth, asset-light, network effects, high switching costs, disruptive business models. Wall Street earnings forecasts are rising healthily. The problem is that prices are again growing 70% faster.

From a portfolio construction perspective, we continue to advocate for more of a stable growth bias that consists of a tilt toward certain real estate assets and other enterprises whose outlook is uncorrelated with the financial conditions that have led to extreme valuations in certain growth sectors. Healthcare should continue to pace economic growth in the U.S. along with certain areas of consumer spending and infrastructure-related industrials.

We continue to look forward to a world that is not dominated by Covid-19-related headlines, though with the emergence of the Delta variant of this insidious disease, it looks like the new normal will be with us for a little while yet. We miss meeting with clients, interacting in the office with our colleagues and the energy that those conditions provide to us. We wish you a prosperous and healthy 2nd half of the year and thank you for your continued faith in us as loyal stewards of your precious capital.

Sincerely,

John Schaeffer
President and CIO



Michael Whitfield
Dir. of Research and Co-Portfolio Manager