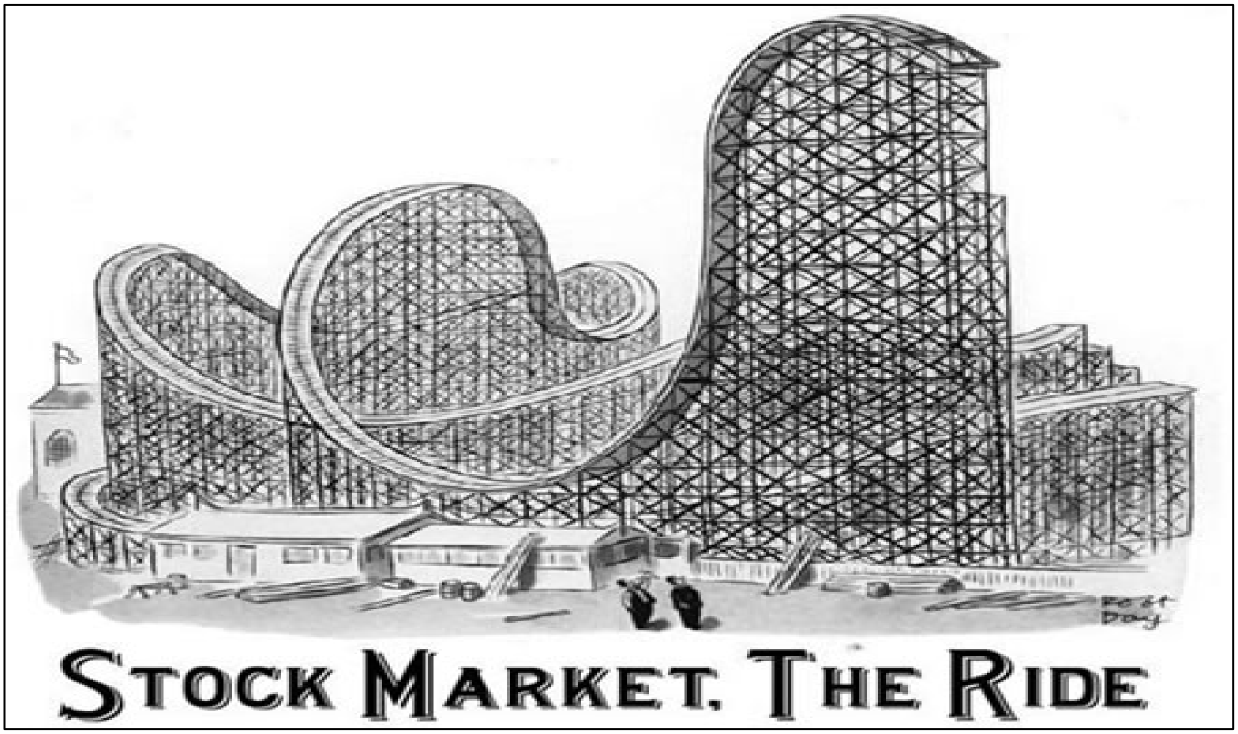
HAHN CAPITAL MANAGEMENT, LLC
REGISTERED INVESTMENT ADVISORS

Mid Cap Equity Strategy **3rd Quarter 2023 Commentary**



Source: Barrons

Following solid returns in the first half of the year, US equities experienced a pullback in Q3 driven by the significant rise in long-term interest rates and the higher-for-longer policy messaging from the Federal Reserve and other major central banks. The yield on the 10-year US Treasury bond rose 75 basis points in the 3rd quarter to 4.57%, eclipsing its previous cycle highs of October 2022, and is now up over 400 basis points since it bottomed out in March 2020 at just 0.50%. It's difficult to overstate the severity of this bond bear market. According to Bank of America, which examined available bond market data going back to the country's founding in the late 1700s, this is the worst bear market for bonds in US history. As a comparison, it's on par with the bear market in US equities following the Tech Bubble at the turn of the century. Of course, like the Tech Bubble, these types of market outcomes tend to occur when starting valuations reach extremes, whether stock P/Es or interest rates.

As in 2022, rising long-term yields were a negative for equities in Q3 as long-term cost of capital assumptions were adjusted upward. However, unlike 2022 when yields moved higher due to inflation, the recent market moves have been due more to supply/demand pressures. Elevated fiscal spending is causing supply issues (i.e., high Treasury issuance), while quantitative tightening by the Fed is contributing to reduced demand. In the background, there are increasing concerns about the long-term fiscal outlook given higher funding costs in a higher-for-longer environment and little confidence that budgetary solutions are imminent amid political dysfunction in Washington.

After pausing at its June meeting, the Fed raised its benchmark rate another 25bps in July and then held steady in September. Of course, the higher-for-longer stance of the Fed is less about the level of peak rates and more about how long rates will remain high before the Fed reverses course. While inflation has continued cooling, the rate of inflation is still well above the Fed's 2% target, and labor markets remain tight. Besides higher borrowing costs, the US economy is facing multiple pressures from banks' tightened lending standards to the resumption in student loan payments and the increase in energy prices. While we're not economists, we know from history that eventually tight policy and lending will slow the economy even if the timing of "the long and variable lags" is tough to predict.

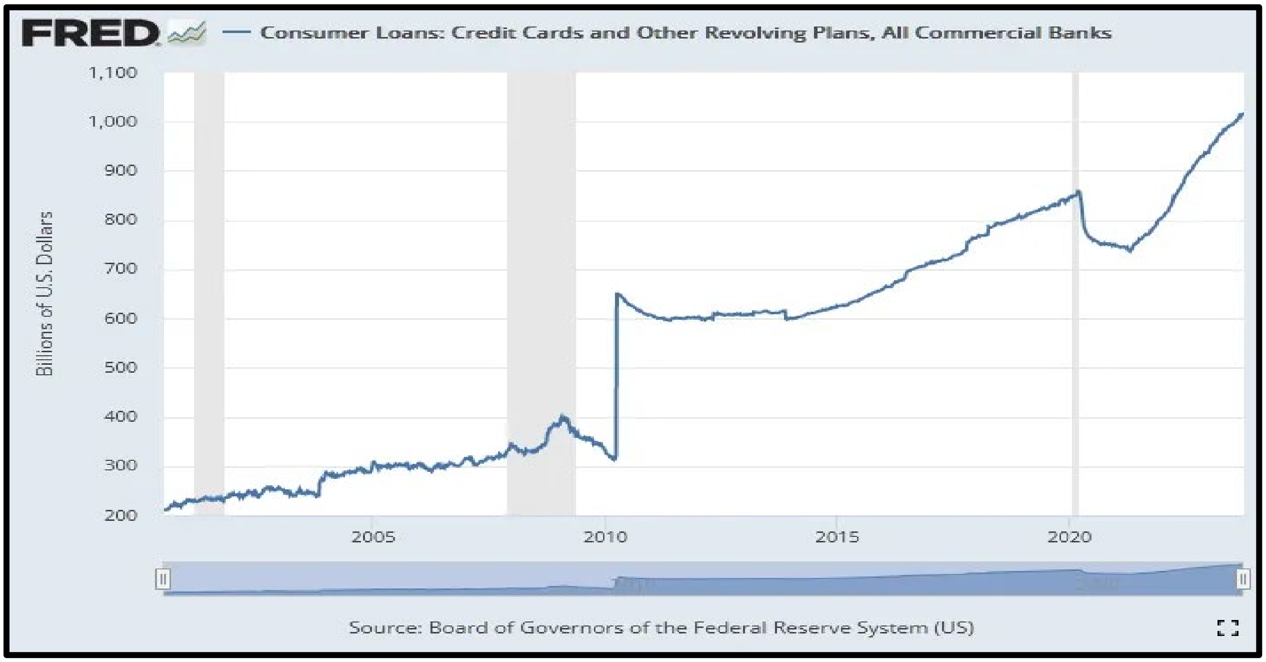
All sectors, aside from Energy and Financials, which were laggards in the first half of 2023, finished lower in Q3. The Energy sector gained 12%, making it Q3's best performer. Rising oil prices and investors' seeking value among market segments that hadn't participated as much in the stock market's year-to-date (YTD) advance drove a broad sector rotation to energy stocks. YTD, the Energy sector is up approximately 8%, following its strong outperformance in 2022. The worst performing sectors were Communication Services and Healthcare, each down about 10%. There were a few notable performance patterns by market capitalization and style (value vs. growth), though large caps tended to hold up a little better as investors continued to favor quality. The Russell Midcap® Value Index returned -4.46%, slightly outperforming the Russell Midcap® Growth Index, which fell -5.22%.

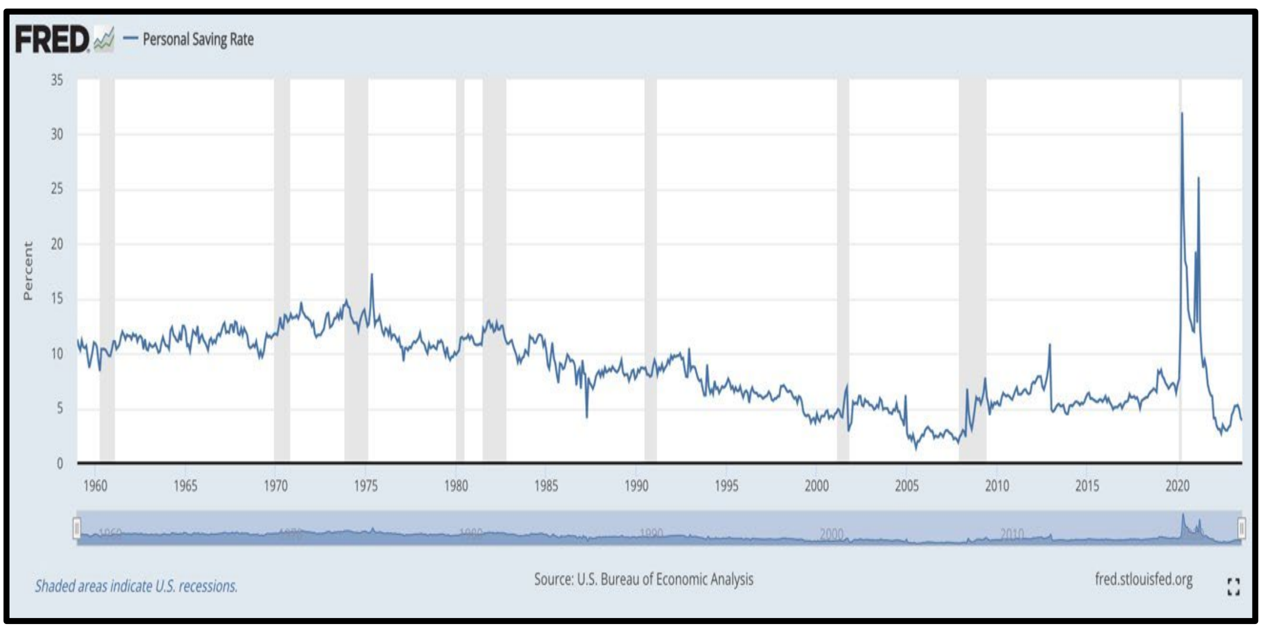
Higher interest rates are like the water that freezes in an overleveraged economy and splits it apart. Rates have certainly immobilized the housing market, where activity is at multidecade lows, prices are at the highs, and homeowners are clinging for dear life to their low fixed-rate mortgages. On September 10th, The Wall Street Journal wrote, "The worst is likely over for the U.S. housing market." We'll see about that. Housing affordability is the lowest since the 1980s. According to the California Association of Realtors, only 16% of the state's residents can afford to buy a median-priced home. Insurance costs are skyrocketing in disaster-prone states like Florida and California.

Economic carnage has been forestalled by fixed-rate debt outstanding and significant deficit spending, including "green" manufacturing, Employee Retention Tax Credits, targeted student loan forgiveness, and bank bailout facilities. Astonishingly, deficits are approaching the same percentage of GDP that they were during the Great Financial Crisis of 2008-2009.

There is increasing financial pressure among indebted businesses and citizens who don't own assets. "Due to the higher burden of interest expense, tighter lending conditions and more limited capital access resulting from stress in the banking sector and inflation uncertainty," Fitch projects a high-yield default rate of 4.5%-5% to end 2023, up from 1.3% last year and 0.5% in 2021. Excess pandemic "savings" (handouts really) have been depleted. The credit card delinquency rate has crept up to post-credit crisis levels, and for borrowers from small banks, the metrics are worse than 2009 and 2020. Due to higher shrink and cost inflation, dollar stores aren't doing so hot, but pawn shops are thriving. The working-class anthem "Rich Men North of Richmond" reached the top of the music charts. One person struggling with the rising cost of debt payments lamented to *The Wall Street Journal*, "The only place to cut corners is basic human activities." The following two charts demonstrate just how much pressure is on domestic consumers. Revolving debt (primarily credit card-related) just crossed $1 trillion for the first time ever, the U.S. personal savings rate is at secular lows and the average interest rate on revolving debt is at a 40 year high.

No Stress on Consumers?

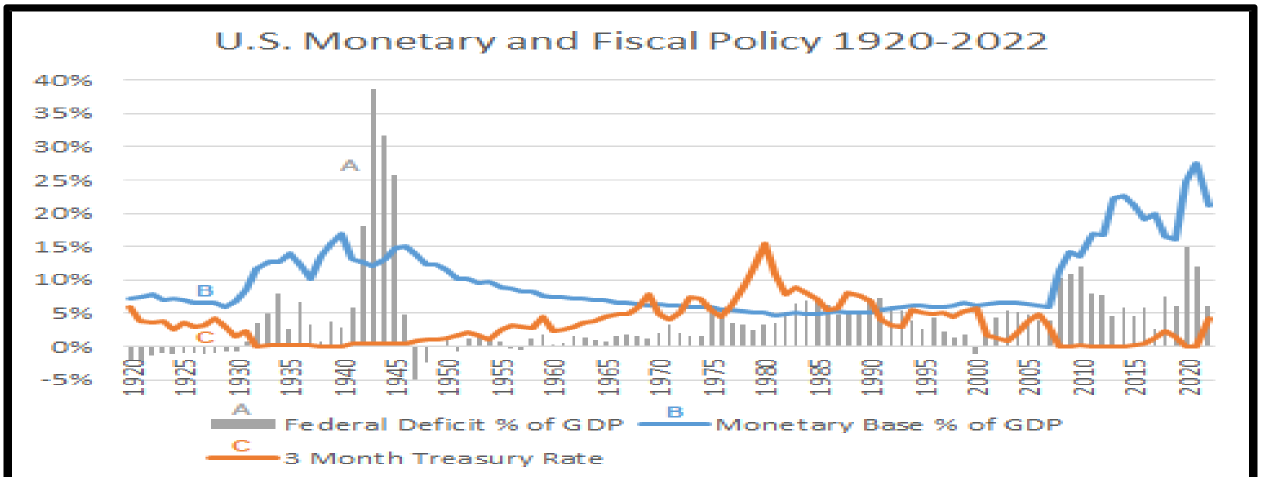


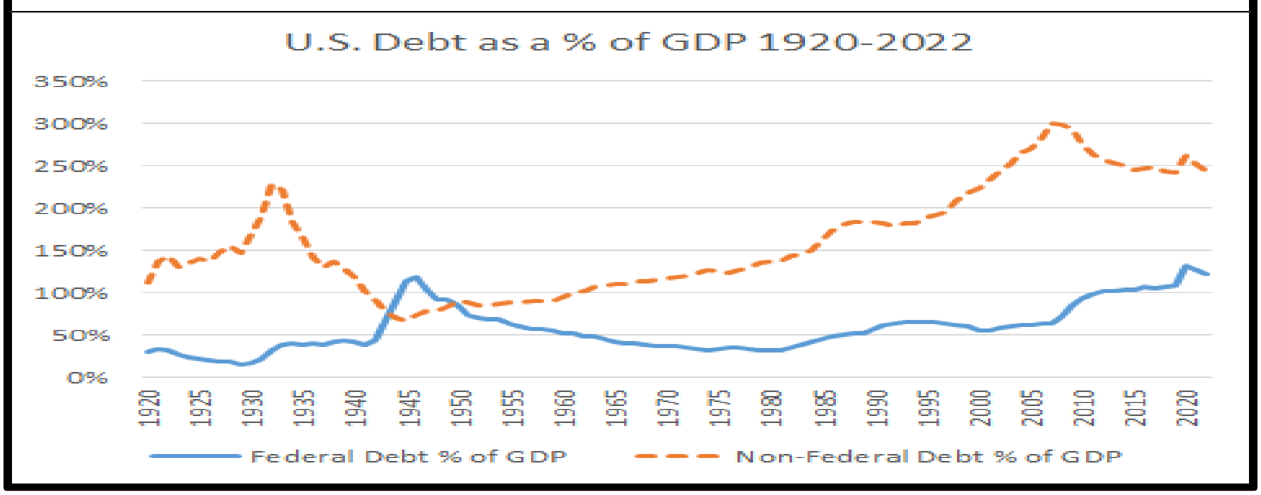


The Fed does not seem to be in the mood to provide any near-term relief to the U.S. consumer. While we also strongly feel the Fed's propensity is to cut rates in response to what is increasingly looking like a weak economy in 2024, the recently released Fed dot plot (The Fed's own view of what future short-term rates look like to them) says otherwise. The September dot plot, upwardly revised from June, shows a median expected Fed funds rate of 5.125% at the end of next year, 3.875% in 2025, 2.875% in 2026, and 2.5% longer term. For an economy that has run on effectively 0% rates for the 15 years ended January 2022, that represents a much higher cost of doing business, it should dramatically curtail consumption, and our debt-loaded economy will strain under those higher rates. So, what is keeping the economy so strong in 2023?

Simple, it's the incredible level of fiscal spending that has occurred since the COVID crisis. The following two charts illustrate the incredible rate of recent government spending as well as the severely rising level of overall indebtedness.

Although the numbers are not yet final, it appears as though the government fiscal deficit will exceed 7% of GDP, something that has happened only three times in U.S. history (World War 2, The Great Financial Crisis and the COVID crisis). According to data from the U.S. Treasury Department, the government's fiscal deficit for the first nine months of the 2023 fiscal year accumulated to $1.4 trillion. The U.S. public debt has exceeded $32.6 trillion, which is equivalent to approximately $100,000 per American citizen.





Source: The Federal Reserve Bank

Quarterly Performance

The return for the Hahn Capital Management Mid-Cap Value Composite (see table below) was ***-3.56% gross of fees and -3.81% net of fees in the third quarter of 2023***. For the quarter, we outperformed our primary benchmark, the Russell Mid-Cap Value Index, by 0.90 percentage points gross of fees and 0.65 percentage points net of fees.

For the quarter, sector allocations to Industrials, Health Care and Consumer Discretionary contributed, while those to Financials, Real Estate, and Materials detracted.

The most significant relative performers during the quarter were Emcor (EME), Blacknight (BKI), Jacobs Solutions (J), and Ross Stores, while the most significant underperformers were Euronet (EEFT), Keysight (KEYS), Albemarle (ALB), and Mid-America Apartment Communities (MAA).

Hahn Capital Quarterly Performance Attribution – 3Q 2023

QTD HCM vs. Russell Mid-Cap Value Index - Quarter Ended 09/30/2023

LINKED PERFORMANCE BY SECTORS

BENCHMARK: Russell Midcap Value Index
PORTFOLIO: Representative 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
Financials	15.25%	16.56%	-1.31%	-6.88%	1.04%	-7.91%	-0.04%	-1.22%	-1.26%	-0.01%	-1.27%
Information Technology	9.97%	9.62%	0.36%	-0.82%	-4.85%	4.02%	0.00%	0.27%	0.27%	0.01%	0.28%
Real Estate	17.97%	10.37%	7.60%	-10.53%	-7.89%	-2.64%	-0.24%	-0.49%	-0.73%	0.00%	-0.73%
Industrials	21.65%	18.73%	2.92%	4.46%	-4.56%	9.02%	0.01%	1.85%	1.86%	0.00%	1.86%
Health Care	12.04%	7.33%	4.71%	-4.49%	-9.91%	5.43%	-0.27%	0.67%	0.40%	0.00%	0.40%
Consumer Discretionary	7.20%	9.32%	-2.12%	-4.89%	-7.76%	2.87%	0.06%	0.20%	0.26%	0.01%	0.27%
Materials	2.83%	7.75%	-4.93%	-23.61%	-4.45%	-19.17%	-0.02%	-0.60%	-0.62%	0.00%	-0.62%
Communication Services	2.21%	3.32%	-1.11%	-15.85%	-9.84%	-6.00%	0.07%	-0.15%	-0.08%	0.00%	-0.08%
Energy	4.09%	5.44%	-1.34%	10.65%	12.53%	-1.89%	-0.22%	-0.04%	-0.26%	0.00%	-0.26%
Consumer Staples	0.00%	4.11%	-4.11%	0.00%	-8.82%	8.82%	0.19%	0.00%	0.19%	0.00%	0.19%
Utilities	0.00%	7.46%	-7.46%	0.00%	-7.21%	7.21%	0.22%	0.00%	0.22%	0.00%	0.22%
Cash	6.79%	0.00%	6.79%	1.36%	0.00%	1.36%	0.50%	0.00%	0.50%	0.00%	0.50%
Total Portfolio - Net of Fees				**-3.70%**	**-4.46%**	**0.75%**	**0.27%**	**0.48%**	**0.75%**	**0.00%**	**0.75%**

Relative Performance by Stock – Quarter Ended September 30, 2023

Quarter Ended 09/30/2023 - 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	EMCOR GROUP INC	0.92%	1	EURONET WORLDWIDE INC	-1.36%	1	Industrials	1.86%	1	Financials	-1.27%
2	BLACK KNIGHT INC	0.87%	2	KEYSIGHT TECHNOLOGIES IN	-0.71%	2	Not Classified	0.50%	2	Real Estate	-0.73%
3	JACOBS SOLUTIONS INC	0.79%	3	ALBEMARLE CORP	-0.57%	3	Health Care	0.40%	3	Materials	-0.62%
4	ROSS STORES INC	0.35%	4	MID-AMERICA APARTMENT CO	-0.24%	4	Information Technology	0.28%	4	Energy	-0.26%

HCM MID-CAP VALUE COMPOSITE PERFORMANCE HISTORY

% Annualized Returns As of 09/30/2023	3Q 2023	1 Year	3 Years	5 Years	7 Years	10 Years	Since Inception 06-30-88
HCM Gross of Fees	-3.56%	4.49%	8.97%	4.79%	7.48%	6.70%	12.83%
HCM Net of Fees	-3.81%	3.45%	7.90%	3.75%	6.42%	5.65%	11.73%
Russell Mid Cap Value Index	-4.46%	11.05%	10.98%	5.18%	6.83%	7.92%	10.72%
Russell Mid Cap Index	-4.68%	13.45%	8.09%	6.38%	8.68%	8.99%	10.88%

Link to: HCM Performance Disclosures

PORTFOLIO ACTIVITY

New Positions

There were no new positions added to the portfolio during the quarter.

Positions Increased

Alexandria Real Estate (ARE) – We added to our position in Alexandria Real Estate, the number one provider in the world of laboratory and research space, to the global pharmaceutical and bio-pharmaceutical industries. Since our original purchase of ARE, company earnings have risen by 50% on a per share basis and company cash flow per share is up a similar amount. The company has deleveraged its balance sheet and has a 10-year pipeline of new projects that it will need to deliver for customers. We believe it is one of the best run real estate companies in the world. The company also boasts a dividend yield of over 5%.

Euronet Worldwide (EEFT) – We added to our position in Euronet during the quarter. We have owned Euronet for more than 15 years, and it has never been more undervalued than it is today. At a current price of $77 per share, Euronet trades at only nine times (9x) the $8.25 per share it is expected to earn in 2024. In addition, the company has an excellent balance sheet with $1.9 billion in cash compared to a total market capitalization of only $3.8 billion.

Intercontinental Exchange (ICE) – We added to our position in ICE during the quarter as they successfully closed their acquisition of Black Knight, Inc. (BKI – a holding in the portfolio) and experienced a surge in energy trading volumes over the past several months. ICE has exceeded our short-term expectations, and we continue to view its outlook very positively with multiple drivers of growth and excellent levels of profitability, which we believe will continue to improve.

Fidelity National Financial (FNF) – We increased our position in FNF during the quarter as we believe overall levels of title insurance activity have probably bottomed out. Despite this fact, FNF remains highly profitable, generates significant free cash flow and has been actively repurchasing its own shares in the open market.

Wabtec (WAB) – We again increased our position in Wabtec during the quarter as its orders and backlog have increased substantially due to its Tier 1 railroad customers starting to catch up to several years of deferred capital expenditures. We believe that Wabtec is at the front end of a multi-year upgrade cycle by those customers which will lead to increasing levels of revenue and earnings growth in 2023 and beyond.

Positions Reduced

Emcor Group (EME) – We reduced our position in Emcor this quarter, primarily as a risk-reduction move, as the stock's increased valuation had advanced the position size to above our threshold. Due to significantly positive momentum in the business, Emcor's earnings have risen over 4-fold since our initial purchases and the position size has recently exceeded our 5% limit, necessitating the reduction. The underlying business continues to execute well with a record backlog and several new initiatives that should continue to drive greater profitability.

Positions Sold

There were no positions sold during the quarter.

Outlook

Economic & Market Outlook

Monetary and fiscal indicators continued to tighten significantly in the third quarter pointing towards a material slowdown in the U.S. economy. Negative money growth, increasing fiscal deficit, rising real interest rates, and central banking guidance of higher short term interest rates are creating a classic 'credit crunch.'

This credit crunch comes as the economy progresses further down the current financial cycle, slowing growth and limiting upward pressures on inflation.

On inflation, clearly there's been progress in bringing the rate of it down, as year-over-year CPI has fallen from over 9% in 2022 to 4% in less than a year's time. However, even at 4%, CPI remains far above the Fed's 2% target. If inflation bounces back, or fails to continue to decline, then the Fed could easily hike rates further, like the Bank of Canada and Reserve Bank of Australia did in the last quarter. Those higher rates would likely weigh further on economic growth.

Other major considerations indicate that the U.S. economy is far weaker than recognized. Productivity, or output per hour in the nonfarm sector, declined at a record pace over the past ten quarters. Neither a rising standard of living nor increasing corporate profitability are achievable over time without higher productivity. For the eleven quarters since the pandemic/recession ended, real average hourly earnings (which cover 119 million full-time wage and salaried workers) fell at a 2.9% annual rate. This is the largest decline registered in any economic expansion of comparable length since the earnings series originated. While firms (particularly smaller ones) continued to add employees, the rate of increase in wages has lagged inflation. Moreover, while establishments have continued to add employees, they have simultaneously reduced the number of hours that their staff are working. Since January, non-farm payrolls have increased by 1.2 million, but the average workweek has dropped from 34.6 hours to 34.4 hours, leaving aggregate hours worked virtually unchanged. To restore productivity, firms will need to rationalize their workforce, which will simultaneously reduce labor costs, inflation and household purchasing power.

Portfolio Strategy & Positioning

Value remains cheap. Aside from the pandemic years of 2020 to 2021, mid-cap value hasn't been this cheap relative to mid-cap growth since the aftermath of the tech bubble. The Russell Midcap® Value Index trades for 14.4X FY1 estimated earnings. The Russell Midcap® Growth Index trades at 26.2X FY1 estimates. The average and median valuation spreads between these indices have been 9.6 and 6.5 percentage points over the past 25 years. Today, it is 11.8 percentage points. Thus, we feel good about our opportunity set today and the long-term forward return potential that exists among mid-cap value stocks.

The valuation spread remains wide despite mid-cap value closing the gap significantly over the past three years.

As of the end of the quarter, the Russell Midcap® Value Index's 3-year annualized return of 11.0% was more than 8 percentage points higher than the Russell Midcap® Growth Index's 2.6% return. This was driven by the extended starting valuations of growth stocks and the influence of rising interest rates. This is a big shift, but history has shown these value/growth cycles can persist for several years.

We remain focused for the long-term, on process and risk, with the goal of sustainable wealth creation. Without your understanding and support in this effort, it would truly be a fruitless enterprise, particularly considering the more volatile markets we are now experiencing. We wish you the best for the remainder of 2023.

Sincerely,

John Schaeffer
President and CIO

Michael Whitfield
Dir. of Research and Co-Portfolio Manager

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