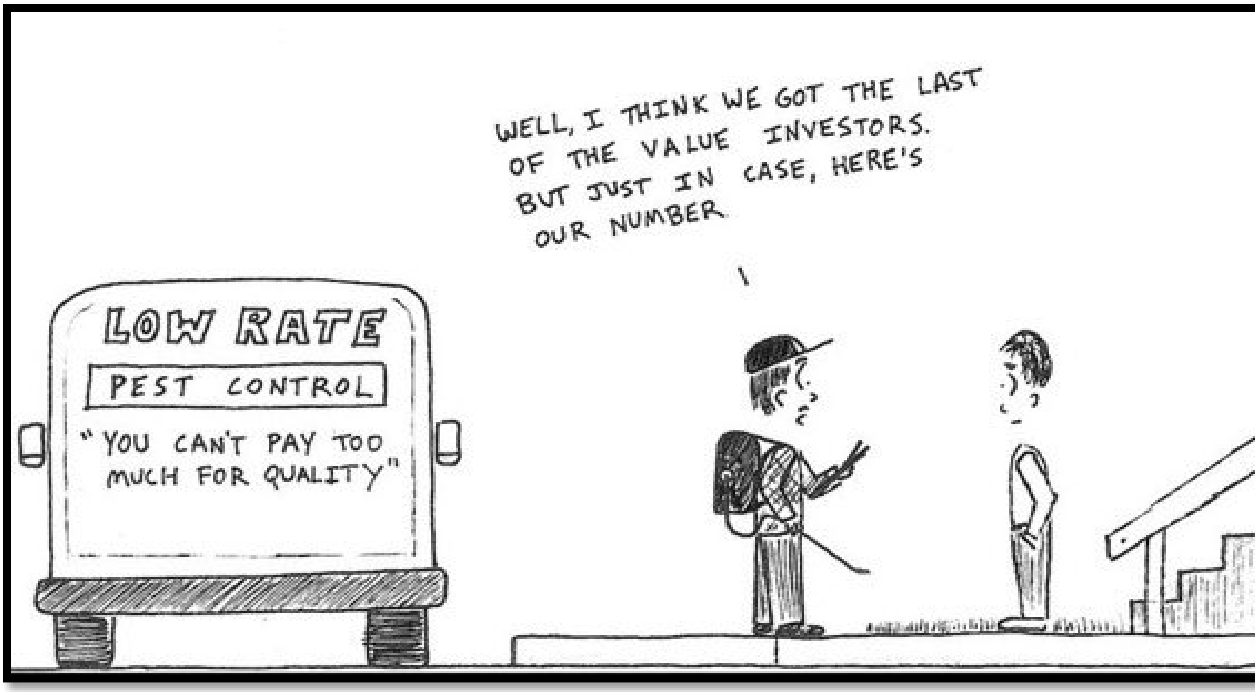
HAHN CAPITAL MANAGEMENT, LLC

Mid Cap Equity Strategy **2nd Quarter 2020 Commentary**

Divergence



Source: Valuewalk

When this quarter began, the stock market was just beginning to pick itself up from one of the worst and quickest declines in history. The 34% decline from February 19 to March 23 this year was an indication of just how weak the economy would be in the second quarter. The economic numbers released over the past three months confirmed the story the stock market predicted. The unemployment rate peaked at 14.7% as over 20 million jobs were lost in the economic lockdown. The housing market saw large declines in both starts and permits for new homes. The consumer, who had been the engine for economic growth, was essentially shutdown causing consumer spending and consumer confidence to plunge in the second quarter. First quarter GDP fell 4.8% and second quarter GDP is expected to decline by an astounding 50.0%. Two consecutive quarters of negative GDP growth officially qualifies as an economic recession. This will mark the first recession since 2008/2009.

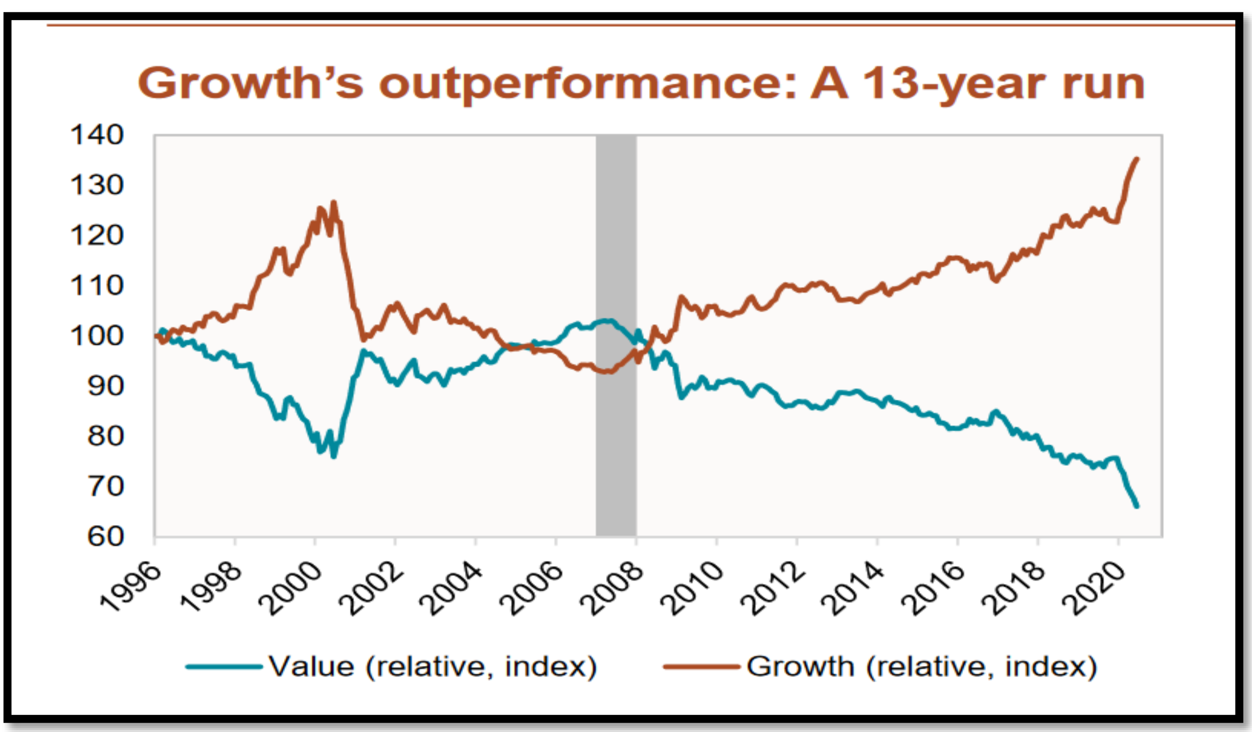
Despite all the current news and anxiety, the stock market had an excellent quarter as it looked toward a better future. This was the best quarter since 1987. The technology-heavy NASDAQ led the way with returns just over 30% and surpassed the 10,000 mark for the first time. The S&P 500 and the Dow Jones Industrial Average posted gains of nearly 20% in the second quarter. Despite the strong rebound in risk assets, traditional portfolio hedges such as government bonds and gold have held up well. US Treasuries are up about 9% year to date, while gold is up close to 18%. As economies have started to reopen, economic data has shown signs of a sharp rebound.

For example, US retail sales rose 17% month-on-month in May, while UK retail sales rebounded by 12%. While sales are still down 6% and 13% year-on-year, respectively, the speed and magnitude of the bounce back is a clear positive.

The other positive is that central banks globally have made clear that they stand willing to use their full firepower to keep government and corporate borrowing costs low. The Bank of England, for example, recently increased its quantitative easing program by a further GBP 100 billion, helping to keep UK 10-year Gilt yields low, at around 0.2%. 10-year U.S. Treasuries meanwhile are hovering around generational lows of about 0.6%. The worst-case scenario of the Covid crisis morphing into a liquidity crunch has thus been avoided (at least for Corporate America), and central banks don't appear to be in the mood to back away from providing liquidity support where necessary. This central bank support has helped US high yield rally by nearly 10% this quarter, while global investment grade credit rallied by almost 9%. Fed Funds futures do not discount any future FED Funds rate increases as far out as 2023, so low interest rates seem here to stay for the intermediate term, at least.

The S&P 500 looks to be pricing in a V-shaped economic recovery, but it is worth noting that sector performance tells a more differentiated story. For example, online retailers are up very strongly year-to-date, while department stores are down sharply, along with other sectors that have been most affected by virus-driven closures, such as hotels, airlines, retail REITS, energy companies and banks. While most of the worst-performing sectors year-to-date have also lagged during the rally since late March, energy companies have been one of the best-performing sectors, as oil prices partially recovered. And some of the best-performing sectors year-to-date, such as food retailers and supermarkets, have lagged the most during the rally. So it is important to look beneath the index level for both opportunities and risks and to be aware that many companies aren't starting the second half of this year where they were at the beginning of the year, even though some indices may give that impression. Value stocks are down 17% this year, while growth stocks are up 6%.

How extreme has the divergence become? You can judge for yourself!



Source: Bloomberg

Over the past three months, markets have staged a comeback led by U.S. tech stocks, producing a bubble in which pricing matters little to its beneficiaries. Whatever the sentiment of investors, the flood of money into tech stocks, owing to their supposed immunity to the pandemic and any resulting economic downturn, will likely deliver disastrous results to those newly involved. In the meantime, they will continue to experience extraordinary returns: as long as other investors make the same decisions at the same time, they are all rewarded – at least for a while. Notable examples include Zoom Video Communications with $800m of TTM (trailing twelve months) revenue priced at $72b; Shopify with $1.7b of TTM revenue priced at $107b; Virgin Galactic with no revenue priced at $3b (formerly above $7b); and, Nikola Corp with no revenue priced at $34b, equivalent to the valuation of Ford. In many cases, we find it unlikely that investors will collect their principal in the future, let alone receive an adequate return on their money. Concurrently, many speculators have been animated with the buy-the-dip mentality, whereby any price decline is construed as an attractive purchase opportunity, regardless of its magnitude or a stock's current valuation. As a result, whimsical buying has occurred in the riskiest of stocks, such as the SAAS (software-as-a-service) stocks and more recently, soon to be bankrupt companies such as Hertz and Chesapeake Energy, both of whose dire conditions had been well telegraphed prior to their respective 2nd quarter bankruptcy filings. Investors in these sectors have become untethered to the laws of mathematics, mistaking momentum for sound investing principles.

Overall, the market has rallied on the back of fiscal and monetary stimulus, combined with the reopening of economies. We believe the monetary support is here to stay, but that in some countries there is a risk that fiscal stimulus may become less generous. Meanwhile, resurging Covid infection rates could lead to additional social distancing measures being imposed or voluntarily adopted.

Like much of pandemic life today, equity markets are downright strange. Who would have thought rampant stock speculation could coexist with runaway coronavirus fears? Yet, witness the proposed secondary stock offering of bankrupt Hertz stock, or the zero-revenue, hydrogen truck startup Nikola's $34 billion market value. If the market is a voting machine in the short term, far too many voters appear to have gone mad. No one, however, should be too surprised. Gambling, fear, and greed are constant fixtures in financial markets. Fortunately, the market is a weighing machine in the long term as real value accumulates in the form of profits and cash flows. On that score, we look forward to harvesting capital gains and dividends in the coming years as the cash flows produced by our companies generate real spendable dollars.

Quarterly Performance

Our **preliminary return** for the Hahn Capital Management Mid-Cap Value Composite was 17.69% gross of fees in the second quarter of 2020. For the quarter, we underperformed our primary benchmark, the Russell Mid-Cap Value Index, by 2.26 percentage points. For the quarter, sector allocations to Utilities (no holdings), Information Technology, Consumer Staples (no holdings), Consumer Discretionary, Industrials and Healthcare contributed positively (relative to the benchmark), while those to Energy, Real Estate, Materials, Communication Services (no holdings) and Cash detracted. The most significant relative performers during the quarter were EastWest Bancorp (EWBC), Bank of NT Butterfield & Sons (NTB), LabCorp (LH), and First Republic Bank (FRC), while the most significant underperformers were Ross Stores (ROST), Becton Dickinson (BDX), Jacobs Engineering Group (J), and Euronet Worldwide (EEFT).

Hahn Capital Quarterly Performance Attribution – 2Q20

QTD HCM vs. Russell Mid-Cap Value Index - Quarter Ended 06/30/2020

LINKED PERFORMANCE BY SECTORS

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	18.34%	13.38%	4.96%	15.58%	12.41%	3.17%	-0.38%	0.60%	0.22%	0.00%	0.22%
Industrials	16.81%	12.11%	4.70%	17.70%	23.89%	-6.19%	0.15%	-1.02%	-0.87%	0.00%	-0.87%
Financials	15.15%	16.47%	-1.32%	27.10%	18.08%	9.01%	0.07%	1.25%	1.32%	0.00%	1.32%
Information Technology	14.00%	8.03%	5.97%	20.10%	26.51%	-6.41%	0.43%	-0.88%	-0.45%	0.00%	-0.45%
Health Care	13.79%	8.42%	5.36%	18.27%	19.98%	-1.72%	0.02%	-0.26%	-0.24%	0.00%	-0.24%
Consumer Discretionary	10.46%	8.29%	2.17%	12.88%	37.45%	-24.58%	0.37%	-2.44%	-2.07%	0.00%	-2.07%
Materials	2.01%	7.37%	-5.35%	37.68%	25.29%	12.39%	-0.27%	0.23%	-0.04%	0.00%	-0.04%
Energy	1.52%	3.97%	-2.46%	40.08%	55.02%	-14.94%	-0.65%	-0.17%	-0.82%	0.00%	-0.82%
Communication Services	0.00%	3.93%	-3.93%	0.00%	24.49%	-24.49%	-0.17%	0.00%	-0.17%	0.00%	-0.17%
Consumer Staples	0.00%	5.43%	-5.43%	0.00%	13.17%	-13.17%	0.38%	0.00%	0.38%	0.00%	0.38%
Utilities	0.00%	12.59%	-12.59%	0.00%	3.53%	-3.53%	2.20%	0.00%	2.20%	0.00%	2.20%
Cash	7.93%	0.00%	7.93%	0.13%	0.00%	0.13%	-1.71%	0.00%	-1.71%	0.00%	-1.71%
Total Portfolio				**17.72%**	**19.95%**	**-2.24%**	**0.44%**	**-2.68%**	**-2.24%**	**0.00%**	**-2.24%**

As of June 30, 2020

YTD PERFORMANCE ATTRIBUTION ANALYSIS

Notable Performers by Sector
HCM vs. Russell Mid-Cap Value Index

HCM Attribution Analysis - Quarter Ended June 30, 2020 vs Russell Midcap Value Index

GICS Sector	Average Port. Weight	Benchmark Weight	Over/ Underweight	Contribution Return	Actual Return	Stock Alpha	Sector Alpha
Real Estate	17.71%	13.85%	3.86%	-1.06%	-5.00%	3.00%	-0.28%
Industrials	17.67%	11.98%	5.69%	-4.31%	-22.02%	-1.22%	0.12%
Financials	15.77%	17.27%	-1.50%	-4.17%	-23.93%	0.32%	0.21%
Information Technology	13.90%	7.80%	6.10%	-2.11%	-16.47%	-1.25%	0.69%
Health Care	12.99%	7.89%	5.09%	-0.16%	-3.53%	-0.27%	0.79%
Consumer Discretionary	11.02%	8.46%	2.56%	-4.04%	-32.51%	-1.12%	-0.22%
Materials	2.00%	6.99%	-4.99%	0.05%	6.89%	0.26%	-0.36%
Energy	1.64%	4.32%	-2.68%	-0.61%	-34.54%	0.15%	0.88%
Communication Services	0.00%	3.92%	-3.92%	0.00%	0.00%	0.00%	-0.22%
Consumer Staples	0.00%	5.14%	-5.14%	0.00%	0.00%	0.00%	-0.46%
Utilities	0.00%	12.37%	-12.37%	0.00%	0.00%	0.00%	-0.40%
Cash	7.30%	0.00%	7.30%	0.03%	0.53%	1.07%	1.07%
Total Portfolio						**-0.11%**	**1.82%**

HCM Model Portfolio – Relative Performance by Stock – Quarter Ended Mar 31, 2020

As of June 30, 2020

Attribution Analysis - Notable Performers by Sector & Stock

Notable Performers by Sector

Quarter Ended 06/30/2020 - 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	EAST WEST BANCORP INC	0.64%	1	ROSS STORES INC	-1.88%	1	Utilities	2.20%	1	Consumer Discretionary	-2.07%
2	BANK OF N.T. BUTTERFIELD&SON	0.43%	2	BECTON DICKINSON AND CO	-0.85%	2	Financials	1.32%	2	Cash	-1.71%
3	LABORATORY CRP OF AMER HLDGS	0.36%	3	JACOBS ENGINEERING GROUP IN	-0.66%	3	Consumer Staples	0.38%	3	Industrials	-0.87%
4	FIRST REPUBLIC BANK/CA	0.30%	4	EURONET WORLDWIDE INC	-0.50%	4	Real Estate	0.22%	4	Energy	-0.82%

Year-to-Date Ended 06/30/2020 - 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	EQUINIX INC	1.87%	1	EURONET WORLDWIDE INC	-1.32%	1	Real Estate	2.72%	1	Consumer Discretionary	-1.33%
2	ALEXANDRIA REAL ESTATE EQUIT	0.73%	2	AIR LEASE CORP	-0.89%	2	Not Classified	1.07%	2	Industrials	-1.10%
3	ROPER TECHNOLOGIES INC	0.50%	3	HEXCEL CORP	-0.79%	3	Energy	1.04%	3	Information Technology	-0.56%
4	MID-AMERICA APARTMENT COMM	0.50%	4	PVH CORP	-0.79%	4	Financials	0.54%	4	Consumer Staples	-0.46%

HCM MID-CAP VALUE COMPOSITE PERFORMANCE HISTORY

% Annualized Returns As of 06/30/2020	2Q 2020	1 Year	3 Years	5 Years	7 Years	10 Years	Since Inception 06-30-88
HCM Gross of Fees	17.69%	-10.02%	3.67%	4.33%	6.76%	11.73%	13.20%
HCM Net of Fees	17.44%	-10.96%	2.63%	3.30%	5.71%	10.64%	12.10%
Russell Mid Cap Value Index	19.95%	-11.81%	-0.54%	3.32%	6.56%	10.29%	10.57%
Russell Mid Cap Index	24.61%	-2.24%	5.79%	6.76%	9.40%	12.35%	10.99%

Link to: HCM Performance Disclosures

PORTFOLIO ACTIVITY

Positions Increased

Euronet Worldwide (EEFT) – We added to our long term holding in Euronet as the stock continues to trade at a greater than 30% discount to its underlying intrinsic value. The company has no net debt, $800 million in cash and dominant businesses in ATM management, pre-paid cards and money transfer. We believe the company has best-in-class management and will have greater than $8 per share in operating earnings in 2022, with a 25% return on equity. Euronet will have a difficult 2020 due to the impact of economic activity levels on its business, none of which represents a permanent impairment.

Sallie Mae (SLM) – We added to our holding in Sallie Mae as this specialty bank (focused entirely on student lending) continues to grow very materially its number of customers, has managed its credit exposure very effectively and is likely to see demand for student loans increase dramatically over the next several years. There is a direct correlation between periods of recession leading to greater student loan demand as more people seek to go to school (because of poor job market conditions) and those who do got school needing to borrow a larger proportion of the cost (more difficult financial conditions). This portends very well for Sallie Mae. We were able to add to our position at a discount to tangible book value and the company also pays a 2% dividend yield as well.

Positions Reduced

Equinix (EQIX) – We slightly reduced our position in Equinix during the quarter as this data center real estate owner had outperformed so materially over the past 6 months that it had become a greater than 5% position in the portfolio. In keeping with our long-held risk management principles, we reduced it but remain materially overweight this stock. Demand for secure, robust and redundant data centers that are co-located with other large data users is exploding due to the growth in demand for cloud computing, e-commerce and other demands for network interconnection. As the global leader, Equinix maintains a significant pricing and demand premium relative to its competitors and continues to increase market share and drive profitability through scale and organic expansion.

Outlook

Many risks remain. First, the Federal Reserve and other central banks have been clear that they can only lend, not spend, and so will not necessarily be able to save companies that face solvency concerns, rather than just liquidity concerns. Some companies will therefore still face bankruptcy, and we have unfortunately already seen some examples this past quarter.

In addition, the virus has not been fully contained, nor a vaccine approved. In continental Europe, Australasia and some parts of Asia, including China, new infections have fallen to low levels and economies are reopening. In the UK, new infections have also continued to fall, albeit not to as low levels as in Europe. However, in the US, the number of new infections is rising again, while several emerging markets, including India and much of Latin America, have been unable to get the virus under control. This raise the potential re-introduction or extensions of closure mandates, thus inhibiting economic recovery.

Another risk comes in the form of potential fiscal fatigue from governments, which could potentially roll back their fiscal stimulus too soon, before the virus has been fully contained and the economy and labor markets allowed to recover. In the US, incomes have so far been supported by stimulus checks and unusually generous unemployment benefits, which are due to expire at the end of July. If these benefits are not extended, many unemployed Americans could experience a significant reduction in their incomes in the second half of the year. State and municipal budgets are a disaster and a reckoning is coming as the federal government has focused so far only on consumer and corporate bail-outs. Our home state of California is staring at a $50 billion deficit for the current fiscal year and with some of the highest tax rates in the nation, limited ability to further hike rates in a dramatic fashion.

Political risks also remain, with the US election fast approaching, tensions between China and the rest of the world escalating and Brexit still unresolved. On a positive political note, the European Union has taken steps towards reducing the risk of a politically induced rerun of the European sovereign debt crisis. The proposed recovery fund would essentially provide support to some of the worst-affected countries, such as Italy and Spain, from countries such as Germany and France.

We are frustrated by the yawning valuation gap between many of our portfolio companies and our estimates of their fair value but heartened by the quality these businesses and their ability to drive growth and profitability over our long-term time horizons. Our overall portfolio is currently valued at a double-digit discount, over 13%, to fair value. This discount falls in the top 20% of our quarterly value estimates over the past 30 years, a reason for significant optimism about the future.

Sincerely,

John Schaeffer
President and CIO

Michael Whitfield
Dir. of Research and Co-Portfolio Manager