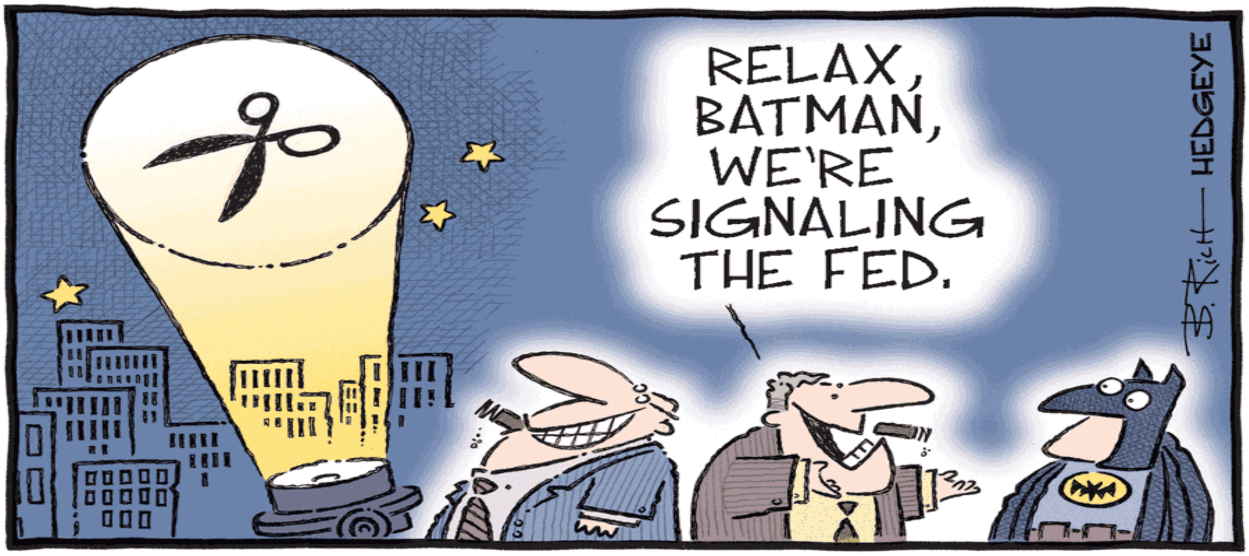
HAHN CAPITAL MANAGEMENT, LLC
REGISTERED INVESTMENT ADVISORS

Mid Cap Equity Strategy **4th Quarter 2024 Commentary**



Source: Hedgeye

Beating Back The Optimism

Stocks may have soured a bit as the fourth quarter ended, but it's hard to be bitter about the U.S. equity market when you step back and look at the bigger picture. The broad market, as measured by the S&P 500® Index, finished the year up 25%, and that comes on the heels of a 23% gain in 2023. Two back-to-back years of stellar 20%-plus returns have happened only a handful of times throughout history, and thus we believe it's important to maintain perspective despite the lackluster performance of stocks as we approached year-end.

Looking back over the course of the year, domestic stocks demonstrated their resilience time and again despite a few steep drawdowns. The various bouts of volatility—in the spring, summer and again late in the year, all seemed to be connected by a similar theme. There was much debate regarding just how much the economy was slowing and, more specifically, what the monetary policy response of the U.S. Federal Reserve (the Fed) would be. On several occasions, stocks tumbled as the presumed rate cuts kept getting pushed further out while the Fed made certain that inflation was under control. Yet stocks found their footing and headed higher time and again. Of course, it helped that economic growth proved durable and the Fed finally began cutting interest rates in September, and by more than many had expected. But once again as we approached year-end, Fed Chairman Powell seemingly disappointed the market by suggesting that there may be fewer rate cuts ahead.

Two years ago, most economists agreed that a U.S. recession seemed inevitable within twelve months. Yet here we are, two years later, and the economy has avoided contraction, inflation is subdued, profit margins are resilient, and investor confidence has been resurgent. And following a 23% return in 2024, the S&P 500 has produced its best two-year return since 1998, a year before the bursting of the Internet investment bubble.

December 31, 2024	
Stock indices	**2024 return**
S&P 500	23.3%
DJIA	12.9%
Nasdaq Composite	28.6%
DJ Total Stock Market	22.2%
Russell 2000	10.0%
Qtr-end bond yields	**Yield**
US 90-day Treasury	4.30%
US 1-year Treasury	4.16%
US 10-year Treasury	4.53%
US 30-year Treasury	4.74%

Source: Bloomberg

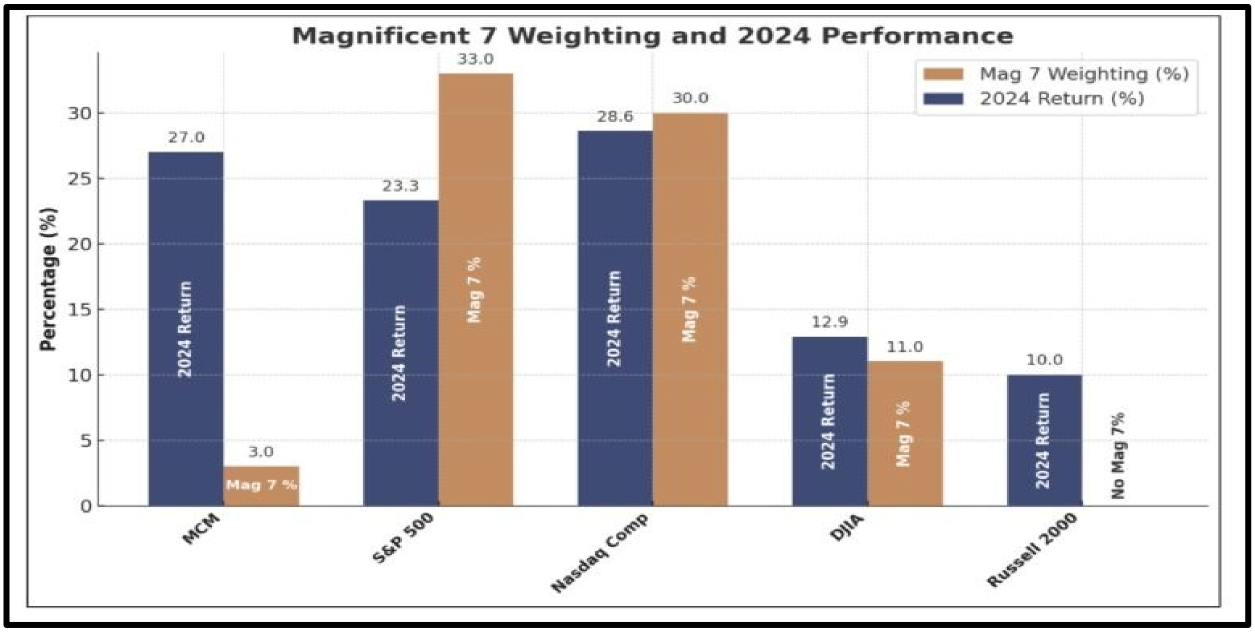
Equity valuations are undeniably elevated, with the S&P 500 currently trading at approximately 22.5x forward earnings. While this is slightly less than the late 1990s tech bubble peak of 25x, it is comparable to the recent highs of 2021. Analysts trying to justify today's valuations sound eerily like those in 1999 who, in attempting to justify stratospheric valuations, argued that quaint things like earnings were no longer important to the value of a business.

> "*The S&P 500 is a fundamentally higher-quality index today than it used to be. Companies have higher margins and less debt. And the companies now most heavily-weighted in the index are high-tech firms that can generate significant cash flow with less capital investment.*"

This assertion could have easily been taken from the pages of a research report in either 2024 or 1999. And, just as in 1999, it rings somewhat hollow today. The "Magnificent Seven" tech giants (Magnificent Seven: Apple, Microsoft, Alphabet, Amazon, Meta, Nvidia, and Tesla) responsible for so much of the overall market's 2024 return are not guaranteed to remain cash-generating powerhouses that require minimal investment. Next year alone, the traditionally capital-light Microsoft plans to invest some $80 billion in data centers to train artificial intelligence. Collectively, these seven companies are now reinvesting over 60% of their operating cash flow into capital expenditure and R&D. This shift raises questions about whether they can maintain their reputation as the capital-light cash flow machines they were in years past.

And just as a handful of stocks were responsible for an oversized percentage of the index's remarkable returns in the late 1990s (1999 S&P 500 giants: Microsoft, General Electric, Cisco Systems, Intel, Nokia, Lucent, and AT&T), the influence of these seven stocks on 2024's outstanding performance is evident in the divergence of the returns of the S&P 500 and Nasdaq Composite (heavy Magnificent Seven weighting) and the Dow Jones Industrial Average and Russell 2000 (much lower weighting.)

More than half of the S&P 500's 23% return last year came from just these seven stocks.



Source: Bloomberg

Reflecting on 2024 and the state of Value entering 2025, we are reminded that bull markets often grow divided, with investor confidence increasing on the surface while the market cycle ages, and ugly valuation excesses remain hidden and are increasingly ignored. That is until the valuation excesses become too much to ignore. If this is again the case, we believe that 2025 may be the year that exposes the market's excesses, revealing to investors the historic valuation levels and growing risk factors that can no longer be ignored.

There is a very good reason that valuation is being ignored by investors: despite an absolute return for the Russell 1000 Value Index (RLV) of approximately 19% over the last two years, the Russell 1000 Growth Index (RLG) outperformed this by more than 4x for an absolute return of 87%. That would make this the worst two-year relative period for Value in 45 years, comparable only to the two-year periods that ended with growth bubbles arguably bursting in 2020 and 1999.

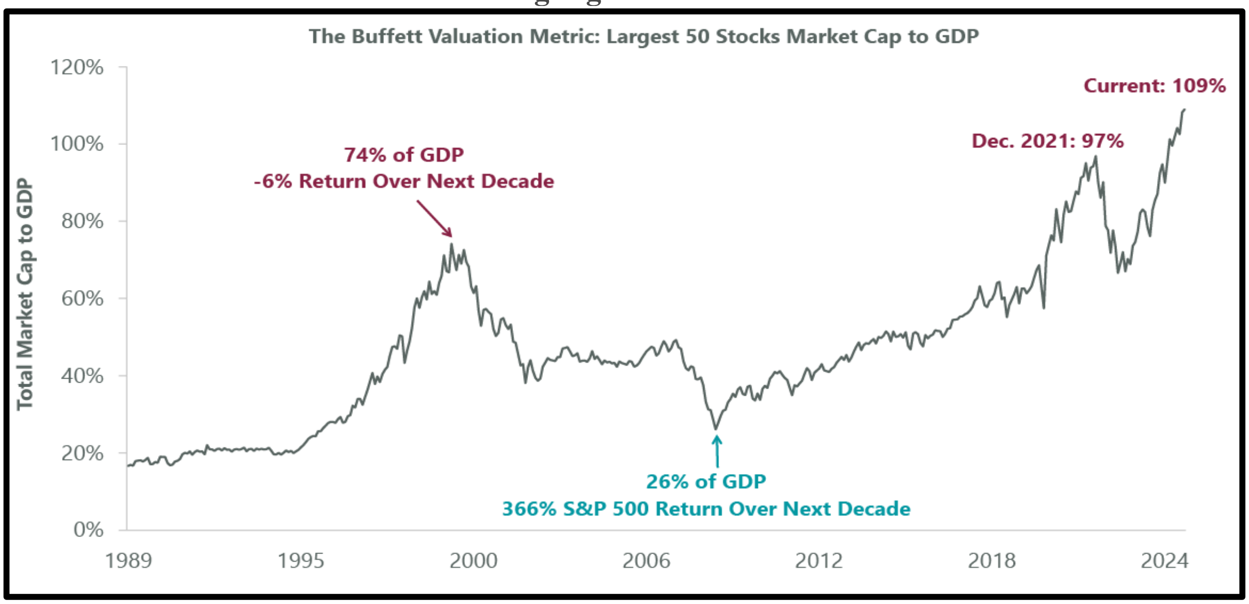
The fourth quarter of 2024 certainly didn't help value managers, as growth beat value by another 9%, helped by a drop for the RLV of almost 7% in December alone. This resulted in the total return ratio of value relative to growth dropping to 40-year lows.

Value to Growth Drops to 40-Year Lows

Source: Bloomberg

While relative extremes are one thing, the bigger risk is that absolute valuation measures of the market have also risen to historic extremes. One of our favorite measures of long-term valuation comes from Warren Buffett, who argued that the total value of equity market capitalization relative to the overall economy was “the best single measure of where valuations stand at any given moment.” That measure climbed to historic highs of 230% in 2024 and may explain why Mr. Buffett has built Berkshire Hathaway cash levels to a record $325 billion. However, given the extreme concentration of U.S. markets in mega cap stocks, an arguably better measure narrows the Buffett indicator to just the 50 largest U.S. stocks. By this measure, valuation extremes tower above the 2000 Internet mega cap bubble and the growth liftoff during COVID. If you have been wondering why Mr. Buffett has been selling stocks and accumulating the largest pile of cash in the history of Berkshire Hathaway, look no further than the chart below.

Buffett Ratio Highlights Extreme Concentration

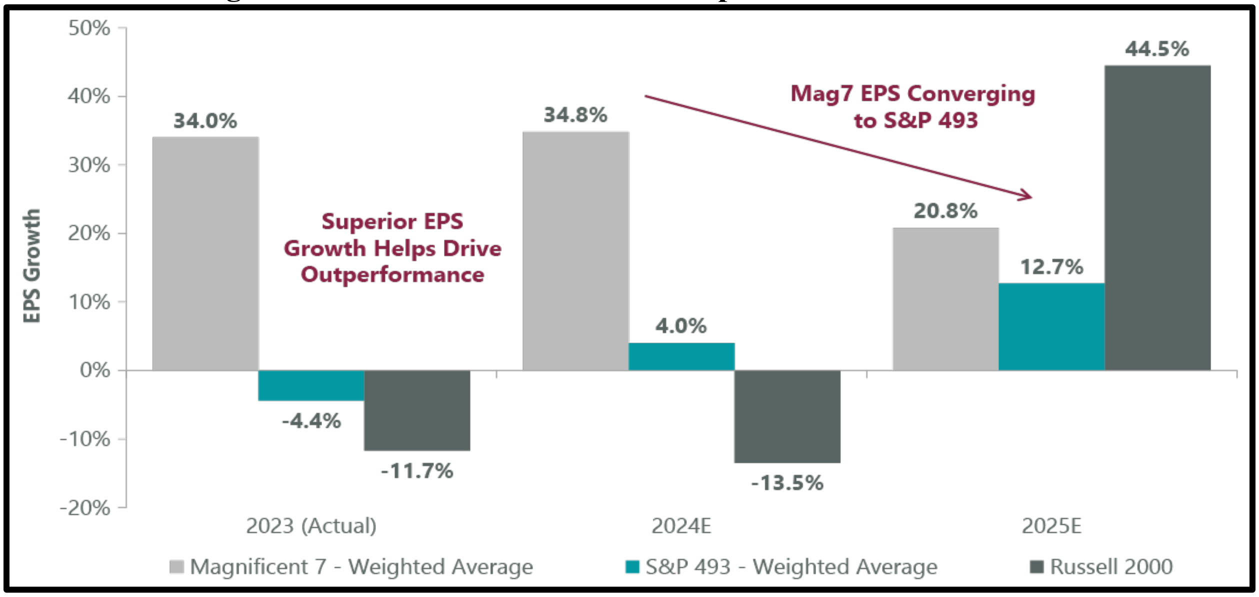


Source: Bloomberg

Factors to Keep an Eye on in 2025

- **Continued Goldilocks:** This is supported by a continuation of lower inflation and Fed easing and combined with a pro-business Trump agenda from tax cuts and lower regulation. We do think we will see increasing deal activity and that animal spirits of optimism will continue. Look no further than the massive investment spending around AI. We are also seeing signs that bank loan growth is accelerating, which would further support growth. The true silver lining of this scenario is that we would expect the market to sustainably broaden as the relative earnings growth of the market outside of the Magnificent Seven is positioned to accelerate meaningfully. This is also where our own material earnings and free cash flow growth advantage over our index could really matter in driving absolute and relative returns.

Earnings for the S&P 493 & Small/Mid-Cap Stocks Are Set to Accelerate



Source: Bloomberg

- **Inflation Upside:** It wouldn't take much for the economy to run too hot. Inflation seems to have bottomed well above the 2% Fed target and, in addition to its already moderately rising, many of Trump's policies, including tariffs and immigration, are directly inflationary. Additionally, we think it will be very difficult to contain the fiscal largesse that a dysfunctional political system has become addicted to. In addition, the animal spirits and accelerating loan growth mentioned above are both inflationary impulses that have been missing over the last few years. The market is not positioned for inflation risk, and we are concerned that higher long-term Treasury yields in this scenario would start to weigh heavily on market valuations.

- **Recession:** A recession seems like a low near-term probability given current observation. However, the main paradox in Trump policies is if the Department of Government Efficiency (DOGE) has any success in cutting the $2 trillion in government spending they are targeting, the economy would slow dramatically from much lower fiscal spending. The ability to meaningfully cut deficits and withstand resulting political pain seems quite remote, but how much are you willing to bet against Elon Musk if his support from Trump holds up? Fortunately, we do not have to make a major bet against Musk's efforts as defensive sectors and low-volatility stocks have all fallen out of favor given the recent jump in animal spirits.

Quarterly Performance

The return for the Hahn Capital Management Mid-Cap Value Composite was ***-0.39% gross of fees and -0.64% net of fees in the fourth quarter of 2024***. For the quarter, we outperformed our primary benchmark, the Russell Mid-Cap Value Index, by 1.36 percentage points gross of fees and outperformed by 1.11 percentage points net of fees.

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

The most significant relative performers during the quarter were CBRE Group (CBRE), WabTec (WAB), Virtu Financial (VIRT), and Emcor Group (EME), while the most significant underperformers were Brown Forman (BFB), Alexandria Real Estate (ARE) and Occidental Petroleum (OXY).

Hahn Capital Quarterly Performance Attribution – 4Q 2024

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	22.30%	17.61%	4.69%	4.57%	6.26%	-1.69%	0.40%	-0.38%	0.02%	0.00%	0.02%
Information Technology	6.24%	8.93%	-2.69%	-1.85%	1.55%	-3.40%	-0.08%	-0.21%	-0.29%	0.00%	-0.29%
Real Estate	14.64%	9.91%	4.73%	-5.03%	-6.84%	1.80%	-0.21%	0.31%	0.10%	0.00%	0.10%
Industrials	20.50%	17.30%	3.21%	2.34%	-2.30%	4.64%	0.07%	0.98%	1.05%	0.00%	1.05%
Health Care	11.87%	8.43%	3.44%	-5.21%	-10.41%	5.20%	-0.30%	0.67%	0.37%	-0.01%	0.36%
Consumer Discretionary	4.30%	9.27%	-4.97%	0.74%	-3.49%	4.23%	0.09%	0.19%	0.28%	0.00%	0.28%
Materials	0.00%	7.07%	-7.07%	0.00%	-10.44%	10.44%	0.65%	0.00%	0.65%	0.00%	0.65%
Communication Services	5.82%	3.25%	2.57%	6.67%	4.96%	1.71%	0.17%	0.09%	0.26%	0.00%	0.26%
Energy	2.68%	5.62%	-2.94%	-3.69%	9.68%	-13.38%	-0.31%	-0.37%	-0.68%	0.00%	-0.68%
Consumer Staples	3.28%	5.67%	-2.39%	-22.41%	-3.82%	-18.59%	0.05%	-0.68%	-0.63%	-0.01%	-0.64%
Utilities	0.00%	6.92%	-6.92%	0.00%	-3.15%	3.15%	0.11%	0.00%	0.11%	0.00%	0.11%
Cash	8.35%	0.00%	8.35%	1.29%	0.00%	1.29%	0.35%	0.00%	0.35%	0.00%	0.35%
Total Portfolio - Net of Fees				**-0.17%**	**-1.74%**	**1.57%**	**0.98%**	**0.60%**	**1.58%**	**-0.01%**	**1.57%**

Relative Performance by Stock – Quarter Ended December 31, 2024

	Top Four Holdings Total Attribution			Bottom Four Holdings Total Attribution			Top Four Sectors Total Attribution			Bottom Four Sectors Total Attribution	
1	CBRE GROUP INC - A	0.63%	1	BROWN-FORMAN CORP-CLASS	-0.67%	1	Industrials	1.05%	1	Energy	-0.68%
2	VIRTU FINANCIAL INC-CLASS A	0.48%	2	INTERCONTINENTAL EXCHANG	-0.62%	2	Materials	0.65%	2	Consumer Staples	-0.64%
3	SEI INVESTMENTS COMPANY	0.45%	3	FIDELITY NATIONAL FINANCIAL	-0.48%	3	Health Care	0.36%	3	Information Technology	-0.29%
4	GENPACT LTD	0.44%	4	OCCIDENTAL PETROLEUM COR	-0.37%	4	Not Classified	0.35%	4	Financials	0.02%

HCM MID-CAP VALUE COMPOSITE PERFORMANCE HISTORY

% Annualized Returns As of 12/31/2024	4Q 2024	1 Year	3 Years	5 Years	7 Years	10 Years	Since Inception 06-30-88
HCM Gross of Fees	-0.39%	13.30%	0.04%	7.18%	7.72%	8.26%	13.10%
HCM Net of Fees	-0.64%	12.20%	-0.96%	6.12%	6.66%	7.20%	12.01%
Russell Mid Cap Value Index	-1.75%	13.07%	3.88%	8.60%	7.72%	8.10%	11.05%
Russell Mid Cap Index	0.62%	15.34%	3.79%	9.92%	9.65%	9.63%	11.29%

Link to: HCM Performance Disclosures

PORTFOLIO ACTIVITY

New Positions

CoStar Group Inc. (CSGP) – We initiated a position in CSGP during Q4 24. Costar owns the industry-leading database of commercial real estate (CRE) data. Costar also owns leading commercial real estate marketplaces Apartments.com (multi-family listings for 20+ unit properties) and Loopnet.com (CRE property listings). CEO Andy Florance created the CRE software vertical when he founded CoStar in 1986 and has expanded the business into a $30 billion market leader in CRE software services.

CSGP operates six business segments: CoStar, Information Services, Multifamily, LoopNet, Residential and Other Marketplaces.

CoStar: CoStar's flagship product is the industry leader in integrated CRE database platforms. Data includes proprietary information on properties, leasing, sales, comparable sales, tenant and demand statistics, digital images, drone videos and 3D tours.

Information Services: CoStar is the industry leader in real estate and lease management software. Products include Real Estate Manager (property management and valuation), Risk Analytics (credit and regulatory risk modeling and management), and STAR reports (hotel metrics benchmarking). End markets served include property owners, brokers, banks, investment managers and the hospitality sector.

Multifamily: Flagship site, Apartments.com, is the industry leader in apartment listing sites. Costar also provides tools to facilitate the rental process (online tenant applications, background and credit checks, rental payment processing).
LoopNet: Costar is the industry leader in CRE marketing sites (Loopnet.com, CityFeet.com and Showcase.com). LoopNet is the most visited CRE marketplace for properties for-sale or for-lease.

Residential: Homes.com is a residential property marketplace in the early stages of development. Homes.com is the only marketplace that funnels traffic to the listing agent and sells advertising packages to agents. Like its multifamily strategy, Costar has built out a dedicated residential sales force to aggressively expand its residential business.

Other Marketplaces: Additional leading niche online marketplaces include Ten-X (CRE auction platform), Land.com (rural land listings) and BizBuySell (operating business and franchise listings).

Hahn Capital had the opportunity to take a position in CSGP due to a sell-off in high growth technology stocks driven by a recent spike in 10-year Treasury rates. CSGP is an industry leader with proprietary data, a strong balance sheet with $5 billion in cash, and a strong management team. CSGP has a strong pathway to continued growth through product extensions, market expansion and M&A.

Positions Increased

There were no positions increased during the quarter.

Positions Reduced

There were no positions reduced during the quarter.

Positions Sold

Air Lease (AL) – We sold our position in Air Lease during the quarter as the company's stock price reached our intrinsic value measure. Air Lease continues to operate at an acceptable level; however, we have found other areas for investment that appear more attractive at the current time.

Outlook

Economic & Market Outlook

What to worry most about as we enter 2025

I. The Absurd Valuation of US Mega Cap Stocks

In 1990, I landed a job at a prominent hedge fund in Connecticut, trading equity index futures with counterparts around the world, including the 10 or so largest global banks and investment banks. At that time, that firm traded 10 times more of those products based on the Nikkei Index compared to the U.S. Index futures such as the S&P 500, such was the disinterest in the U.S, market.

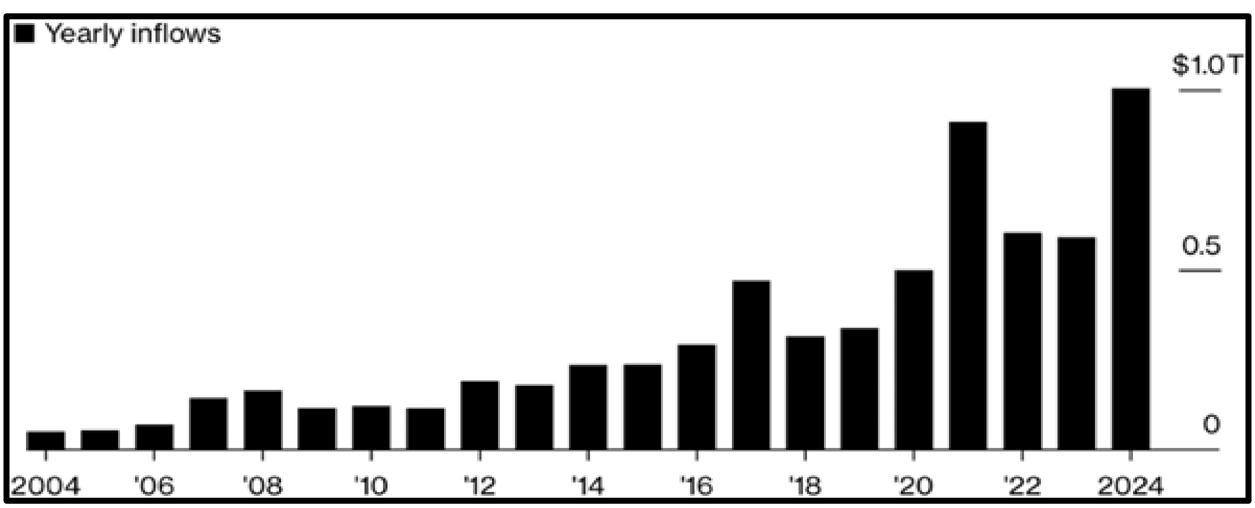
As you may remember, the Nikkei 225 Index peaked in August 1990 before the bubble burst, a downturn which led to losses of about 80% over the next 19 years. In the years after the Great Financial Crisis (GFC) of 2008, the Nikkei 225 began to recover; however, the old peak of August 1990 was only surpassed in May 2023, almost 33 years later. In other words, it took almost half a lifetime to fully recover from the large losses caused by the burst of the Japanese wealth bubble.

Take a look at the chart below. As you can see, since we came out of the GFC in early 2009, US equities have performed *dramatically* better than European equities, and one is entitled to wonder why one should invest in anything but US equities.

Source: Bloomberg

The extraordinary returns on (certain) US stocks have led to a huge appetite for equities amongst US retail investors, and nowhere is that more visible than when you look at flows into US equity ETFs which, for the first time ever, surpassed $1 trillion last year (see chart below). Needless to say, record inflows aren't necessarily all new money but, we would argue that a fair amount of it is.

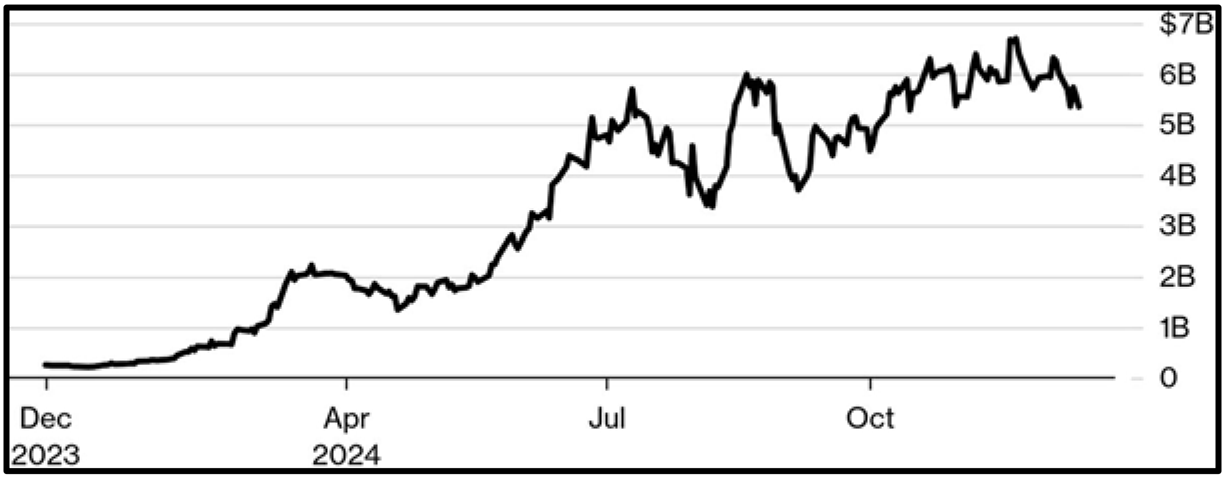
ETF Inflows



Source: Bloomberg

Sophisticated investors may have begun to realize that Trump's policy program will, if implemented as announced, come at a huge price; however, around the speculative fringes, the risk-talking is getting bigger by the day. Single stock ETFs, which are almost exclusively bought by retail investors, are more popular than ever. According to Bloomberg, leveraged, single-stock ETFs have been particularly popular in 2024. The graphic depicts money flowing into an ETF which invests exclusively in Nvidia common stock on a leveraged basis. As you can see, assets under management have risen from a few hundred million dollars to well over $5 billion over the last 12 months.

GraniteShares 2x Long Nvidia Daily ETF AUM



Source: Bloomberg

II. The Impact of Trump's Policy Program

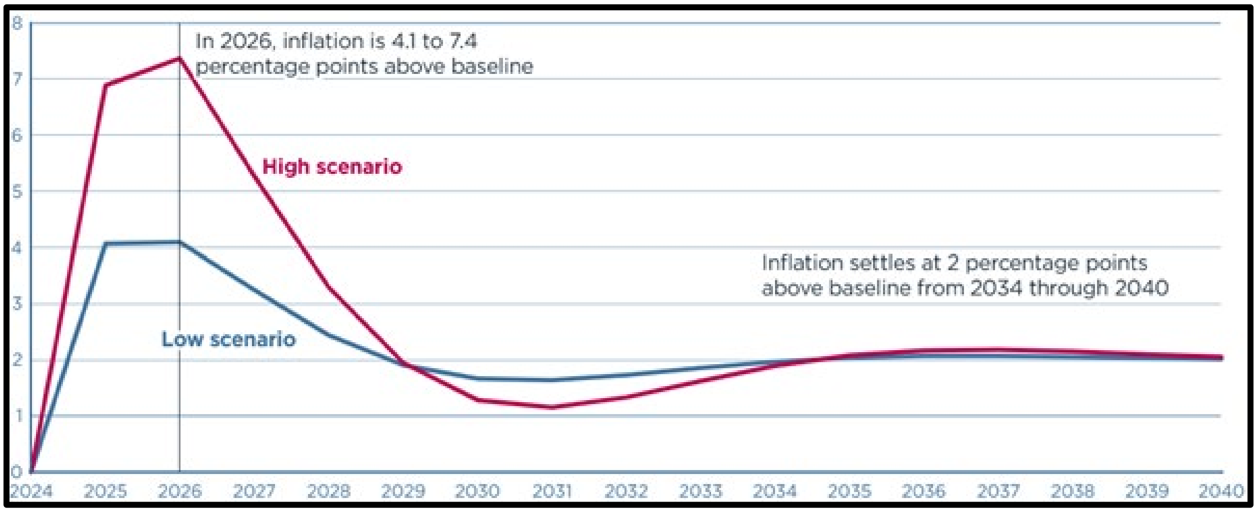
US Election Day turned out to be a sweep for the Republican Party. At least for the next two years, Trump will benefit from a control of Congress. Therefore, he will enjoy sufficient powers to act on most of the promises he made when campaigning. That said, one thing is what he says he'll do. Another thing is what he ends up doing.

The most likely near-term changes are those that can be executed under the Executive Order mandate and, in that category, tariffs and deportation of illegal immigrants stand out. Trump is clearly intent on using tariffs as a weapon against trading counterparties, and you should expect him to act quickly.

He is keen to demonstrate that he meant it seriously when he talked about raising them, and it won't require months of preparatory work in Congress. Precisely by how much and vis-à-vis which countries is difficult to say, though. When it comes to Trump, we have learned that what he does is not necessarily predicated on what he says he will do. And he obviously uses the threat of tariffs as a negotiation tactic.

Let's assume Trump goes for the Full Monty – the High Scenario in the chart below. As you can see, the impact on US inflation will be dramatic. Even a much softer version, where tariffs are increased less dramatically and fewer illegal immigrants deported (the Low Scenario in the chart), will have a significant impact on US inflation.

Projected percentage point change in US CPI from baseline under two scenarios, 2024-40



Source: Peterson Institute for International Economics

2025 is therefore likely to end up in a power struggle between hardcore MAGA supporters and more pragmatic Republicans in Congress who realize that, if fully implemented, Trump's policy program could lead to economic misery. If the MAGA movement wins that battle, the Fed will almost certainly need raise interest rates to fight the induced inflation, and that may be costly. Mortgage holders will suffer, and so will US equity markets. Under those conditions, 2025 could turn out to be a rather dubious experience.

This is not to say that we are bearish on the market, we are not. The potential to reduce deficits by dramatically reducing government waste and corruption could have a critically positive effect on our nation's most dire economic issue, deficit spending. Reduction of government red tape, a streamlined tax code and an overhaul of foreign aid programs alone could have an impact of hundreds of billions of dollars. American exceptionalism was never really gone but we could indeed be entering a golden era for it, highlighted by the $500 billion investment program into AI infrastructure announced by a consortium of Microsoft, Oracle and Softbank. We continue to find highly attractive investment opportunities across a wide spectrum of industries with excellent long-term potential for superior returns. We wish you the very best in 2025 and thank you for your continued support.

John Schaeffer
President and CIO

Michael Whitfield
Dir. of Research and Co-Portfolio Manager