Mid Cap Equity Strategy — 3rd Quarter 2018 Commentary

3rd QUARTER MARKET SUMMARY

"Looking Around the Corner"

The stock market continued to exhibit extraordinary confidence in the future during the 3rd quarter. Continuing to rise in the face of myriad concerns, the market achieved new all-time highs on August 29, as measured by both the S&P 500 and Nasdaq Composite indices, which coincided with the release of an upwardly revised GDP growth estimate from the Commerce Department of 4.2% for the 2nd quarter of 2018.

Economic growth and earnings data remained robust, and this ultimately overshadowed simmering concerns around the escalating US-China trade war. The US initially targeted $34 billion of Chinese products with a 25% tariff in early July. Tariffs on another $16 billion began in late August, before a 10% tariff was implemented on a further $200 billion of Chinese goods in September (set to rise to 25% in January). Despite these measures, the US equity bull market became the longest in history on August 22.

Stability in growth and employment figures allowed the Federal Reserve (Fed) to enact its widely anticipated increase in the federal funds rate by 25 basis points in September. The committee dropped its long-standing description of monetary policy as "accommodative", and reaffirmed its outlook for further gradual hikes into 2019. Data released in September showed wages to be growing at the fastest rate since 2009, while additions to non-farm payrolls remain above 185,000 on a three-month average. During the quarter, industrial activity indicators showed little impact from the trade wars.

Over the quarter, the Information Technology and Healthcare sectors were boosted by a slew of robust earnings.

The Energy sector was weaker, with US oil companies hurt by uncertainty surrounding China's inclusion of US crude oil in its tariff-targeted products. Materials companies struggled with potentially weaker demand associated with the trade war while interest rate-sensitive stocks such as banking and housing- and construction-related companies tended to underperform due to rising interest rates.

For the Record

Our **preliminary return** for the Hahn Capital Management Mid-Cap Value Composite was 2.95% gross of fees in the second quarter of 2018. For the quarter, we underperformed our primary benchmark, the Russell Mid-Cap Value Index, by 0.35 percentage points. For the Year to Date period our return was 4.82%; we outperformed the Russell Mid-Cap Value Index by 1.69 percentage points.

For the quarter, our underperformance was primarily due to our exposure to the Real Estate, Financial Services and Consumer Discretionary sectors, partially offset by positive contributions from our exposure to the Information Technology, Industrial and Health Care sectors. The most significant negative contributors in the quarter were Mohawk Industries (MHK), CBRE Group (CBG), Carters (CRI) and Pioneer Natural Resources while the most significant positive contributors were Jacobs Engineering (JEC), Ross Stores (ROST), Euronet (EEFT) and Keysight Technologies (KEYS). Total portfolio turnover remained in line with our low historical average with only one new addition, Equinix (EQIX). In addition, we added to our position in Air Lease (AL) and reduced our positions in Host Hotels (HST), Covanta (CVA) and Ross Stores (ROST).

HCM PERFORMANCE HISTORY

% Annualized Returns As of 09/30/2018	3Q 2018	1 Year	3 Years	5 Years	7 Years	10 Years	Since Inception 06-30-88
HCM Gross of Fees	2.95%	12.11%	11.90%	8.67%	15.57%	12.48%	14.21%
HCM Net of Fees	2.70%	11.03%	10.81%	7.61%	14.46%	11.38%	13.11%
Russell Mid Cap Value Index	3.30%	8.81%	13.09%	10.72%	15.54%	11.29%	11.66%
Russell Mid Cap Index	5.00%	13.98%	14.52%	11.65%	16.09%	12.31%	11.64%

Link to: HCM Performance Disclosures

PORTFOLIO ACTIVITY

Positions Added

Equinix (EQIX) – We initiated a position in Equinix during the quarter. Equinix is the market-leading landlord to the cloud, with ownership or long-term leases on about 200 interconnected data centers in over 50 markets around the world. It has a diverse set of clients, from enterprises to telecoms to hosted cloud companies. Any entity embracing the cloud needs to have servers, telecom equipment and switching equipment that is centrally located, interconnected and secure. Those are the types of facilities Equinix operates and demand for which should continue to massively expand as we are still in the early innings of the moves to the cloud and to digitization. We were able to purchase our initial stake at a significant discount to underlying intrinsic value.

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 which 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. We were able to increase our stake at a deep discount to our estimate of intrinsic value.

Positions Reduced

Covanta (CVA) – We continued to reduce our position in Covanta as most of its near-term upside has been reflected in the current stock price. With the company trading at near our estimate of intrinsic value, we continue to allocate capital to better opportunities in our portfolio.

Ross Stores (ROST) – We reduced our position in Ross Stores during the quarter as its strong relative performance caused the stock to approach our 5% position limit. We continue to be very enthusiastic about Ross' market opportunity and fundamental business execution and note that the company increased its own estimate of North American store capacity by over 20% during the quarter. Ross continues to gain market share, execute against its organic store growth goals and generate incremental free cash flow at a very high rate of return on capital.

Host Hotels & Resorts (HST) – We reduced our position in Host during the quarter as the company continues to generate excess returns during this cycle. Host continues to reposition its hotel portfolio into markets with limited supply growth and has significantly reduced its overall hotel portfolio over the past 3-4 years while de-levering its balance sheet and returning significant capital to shareholders in the form of dividends and stock re-purchases. We believe much of the benefit of this balance sheet re-positioning has been achieved while fundamentals at its remaining hotels are reaching near-cyclical peaks, therefore necessitating a reduction in the position.

Positions Sold

There were no positions exited during the 3rd quarter.

The Market

US corporate profits are making impressive new highs in 2018 (even when excluding tax cut benefits), capital spending is up ~20% vs 2017, 32 of 35 major countries are in expansion mode (exceptions: Korea, Turkey, Hong Kong), and both stock buybacks and M&A are soaring. Despite the good news, equity markets are flattish in 2018 as stock prices pause to grow into their valuations.

While a more hawkish FED represents a growing risk to economic expansion, the overriding need to normalize monetary policy is the much more important long-term consideration and will continue apace, at least through 2019. The incremental rise in the cost of capital will also have the beneficial effect of curbing some of the less rational investment decisions of market participants and providing a better backdrop for further expansion without a severe correction or recession.

While economic activity remains strong, as evidenced by the 2nd quarter's revised 4.2% growth rate, it is important to remember that the preceding recession was particularly deep and the first several years of the recovery were exceedingly weak. With bank credit in excellent shape for this point in the expansion, due to stricter rules governing capital adequacy, the expansion remains sustainable despite its age.

Recent records in the U.S. stock market do not, in our view, mean that investors should get more aggressive in their investment stance. High expectations, elevated investor sentiment, trade disputes, and the possibility of a monetary mistake are all risks that we are acutely aware of. In particular, the recent surge in oil prices could eventually take a bite out of the U.S. economic expansion as oil price spikes have often contributed to recessions unfolding. We are agnostic about whether the bull market will continue, even with a solid economic and earnings backdrop. We remain highly confident, however, in the positive asymmetry of our portfolio relative to the unfolding risks with respect to both valuation and underlying headwinds to the continuation of the economic expansion.

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