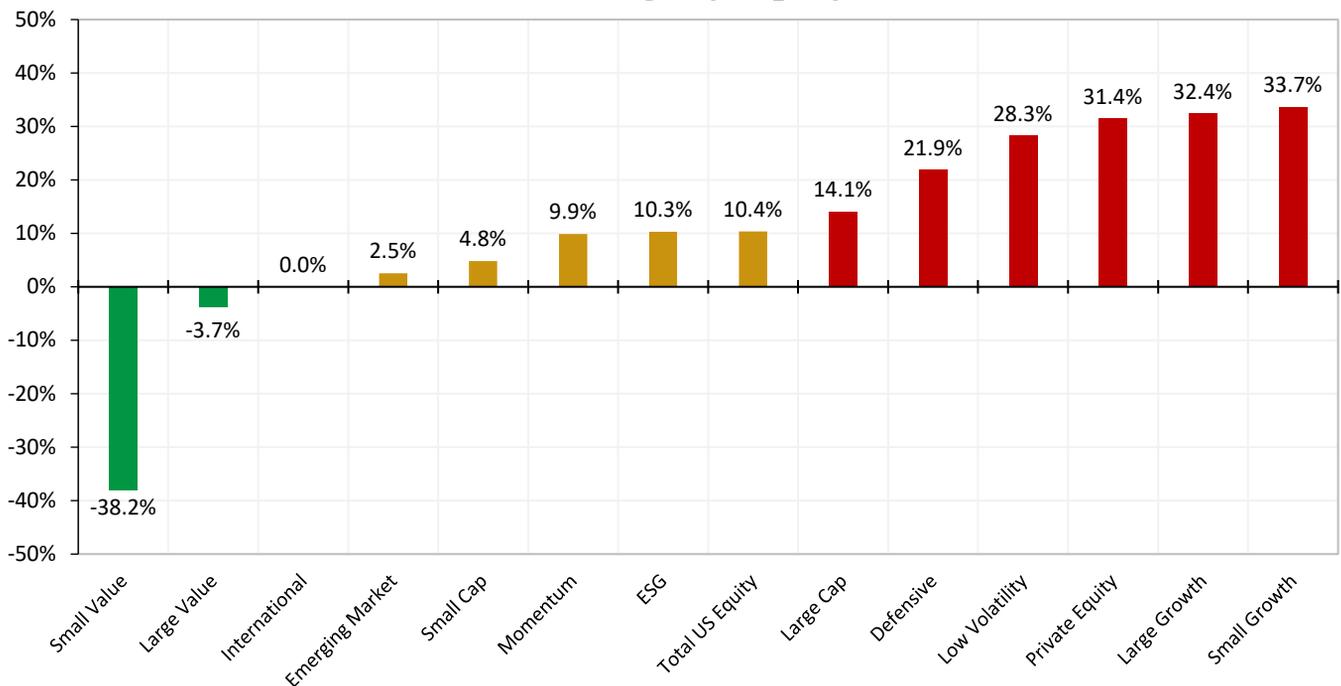


Small Growth passing baton to Small Value

J. Paulo Silva, CFA

Small value equities are valued -38% below their 10-year average (as of 4/30/2020), while growth, defensive, low volatility, and ESG factors exceed the bubble threshold of +30%. This dispersion has reached a 20-year high, in line with the dot-com bubble. However, bubbles can last a long time with infrequent reversion catalysts. We believe as the economy starts to reopen from the COVID-19 pandemic, we will likely start to experience yield curve steepening as the Fed has vowed to keep shorter-term interest rates at zero as longer-term rates start to rise as the recovery starts to take shape. The pandemic has favored growth stocks, such as biotech's developing the COVID-19 vaccine and software companies that benefit from recent telecommuting trends, which has widened the spread of growth to value to near historic highs.

Current P/E vs Last 10 Year Average by Equity Factor (as of 4/30/2020)

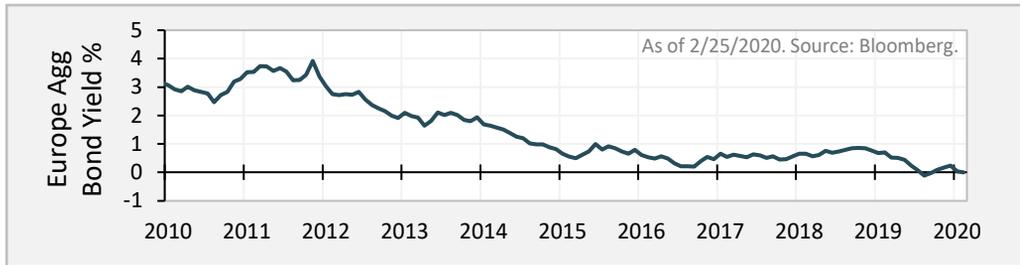


Source: Bloomberg. Indices: Russell 2000 Value, Russell 2000, Russell 2000 Growth, MSCI ACWI ex USA, Russell 1000 Value, MSCI EM, Russell 3000, Russell 1000, MSCI Momentum, MSCI ESG Leaders, Russell 1000 Defensive, MSCI Low Volatility, Russell 1000 Growth. Private Equity: S&P Global Market Intelligence LBO Multiples.

3 key trends that helped inflate this bubble are summarized below. Value stocks are typically on the other side of these trends and stand to benefit the most should the trends reverse, or at least normalize to lesser extremes.

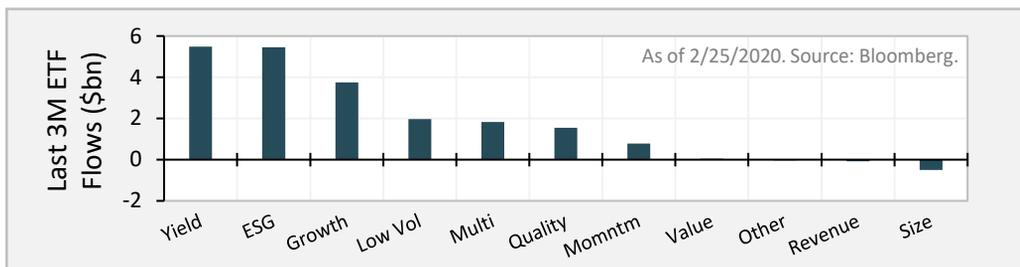
Central banks pushing global yields negative

This heavily propped up secular growth/tech and defensive sectors



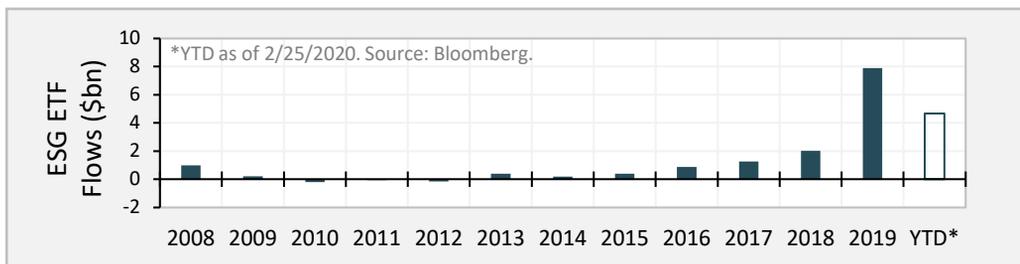
Growth of passive, smart beta strategies

Flows funneled into smart beta strategies with high holdings overlap, amplifying momentum effect on mega cap, low vol, growth/tech



Growth of simplistic ESG schemes

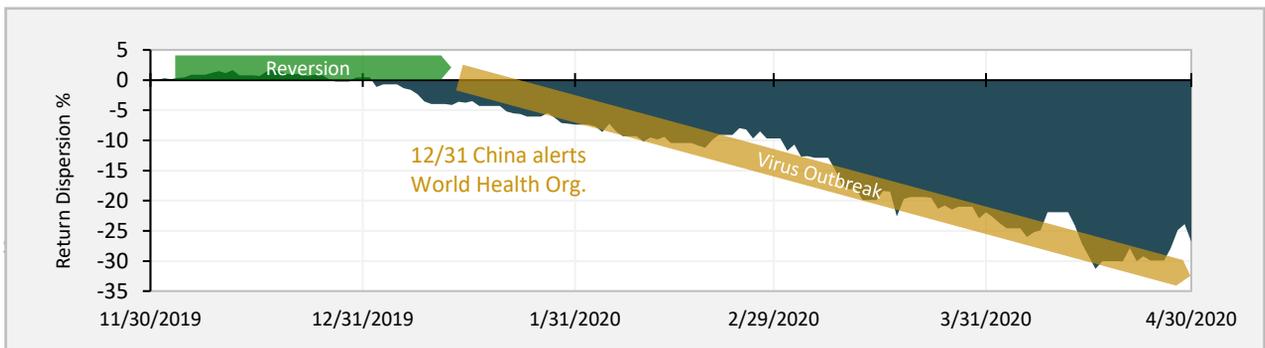
Continuation of crowding trends, funneled into low vol/mega cap/tech/etc.



The coronavirus epidemic initially shut down markets across the globe.

As economies start to slowly reopen and adapt to a “new normal”, we believe this trend favors value stocks going forward. Revenues of most value stocks have been impacted by the pandemic shutdown, and thus have traded down to significantly lower valuations. After this unprecedented shutdown, we believe value stocks will have extremely low bases for which to show significant improvement going forward and thus driving return potential. In our view, it is important to study balance sheets as companies have raised higher levels of debt to survive the temporary shutdown. If cash flow improvement is not significant, it may lead to prolonged business loss. However, during this pandemic, highly speculative biotech companies scrambling for the first COVID-19 vaccine have skyrocketed and software companies benefitting from telecommuting trends have dominated the performance landscape.

Small Value vs Large Growth Return Dispersion: 12/1/19 – 4/30/20



In conclusion, we believe small cap value stocks are primed to recover as valuation multiples have reverted to long term 2010-2020 levels. The pandemic has confirmed many themes that have worked over the last 10 years to push the market to extremes not seen since 2000. Investors should not lose sight of what we believe determines true value for a company; the tenants of cash flow. A bubble collapse may also be imminent as interest rate, momentum, and smart beta trends have inflated low volatility, growth, technology, and defensive factors to unsustainable levels.

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