MARKET REVIEW

U.S. equities continued their ascent in the third quarter, with the S&P 500 Index posting a 9% gain. Small-cap stocks (defined as the Russell 2000 Index) climbed 5%, illustrating the broad-based nature of the rally. The gains in the quarter would have been greater were it not for a pullback in September on concerns that a rise in COVID-19 cases (largely associated with back-to-school openings) could hinder the pace of the economic recovery.

Each of Cambiar’s domestic strategies performed well in the quarter relative to their primary benchmarks, widening their year-to-date (and longer timeframe) excess return differentials. Given the portfolios’ emphasis on quality and downside protection, we were encouraged that the bulk of the 3Q alpha was sustained in the September drawdown. Cambiar remains focused on consistent execution in the underwriting of new positions, maintenance of existing holdings, and selective avoidance of industries/companies that do not meet our investment criteria.

Growth vs. Value – Still Going...

Once again, growth stocks outpaced their value counterparts in the quarter – prompting the Energizer Bunny reference from the early 1990s. The Russell 1000 Growth Index gained 13.2% in 3Q and has now returned 24.3% in 2020. In contrast, the Russell 1000 Value Index gained 5.6% in the quarter and has a year-to-date return of -11.6%. The YTD spread of 3600 basis points is the widest divergence on record – including the dotcom bubble in the late 90s. The market’s preference for all things growth may not yet be at euphoric levels, but when stocks rally by 50% (e.g., Tesla, Apple) after announcing a stock split – we have to be getting close. At a minimum, clients who embrace the concept of buy low/sell high should consider a rebalance to their value allocations, given the high multiples now assigned to many growth companies.

Recognizing that our clients have likely reached a level of fatigue with the value vs. growth narrative that has dominated this cycle, Cambiar would argue that this dynamic grows in relevance each day these spreads continue to widen. There is no question that the pandemic accelerated a number of trends that favor growth stocks. But there are logical limits to prices, no matter how strong the underlying fundamentals. Financial gravity is a very real investment concept, despite the growth at any price behavior that has currently overtaken the market.

The sentiment around value stocks could not be much worse than it is today. Despite the extended out-of-favor status currently ascribed to value, Cambiar continues to believe that buying companies using a price-sensitive approach remains a key variable to compounding capital over time. If outperformance is a function of exceeding expectations, shouldn’t one be inclined to look in areas where expectations are low? The key here is to avoid the false positives that often accompany a process that is overly enamored by low valuations. A traditional low Price/Book philosophy was successful in the industrial age but has been less effective as the world transitions to a digital economy. Cambiar’s relative value discipline seeks companies that are trading at reasonable valuations – but we attempt to avoid value traps by prioritizing quality over statistically cheap stocks. Quality can take on various meanings; Cambiar attempts to remove subjectivity by evaluating metrics such as leverage, free cash flow, and return-on-equity/return-on asset metrics. We then determine an appropriate price level to attach to these attributes, with the goal of providing both a margin of safety as well as an attractive upside return over a forward 1-2 year timeframe.
The Cambiar Large Cap Value (LCV) portfolio outpaced the Russell 1000 Value Index in the third quarter, a by-product of positive stock selection and allocation decisions (e.g., abstention in Energy). The LCV strategy seeks to outperform in a variety of market environments, which has certainly been the case over the past three years. As the below table illustrates, the portfolio has performed well in both up and down markets, as well as on a risk-adjusted basis:

Trade activity in the quarter was comprised of four new purchases and four sales. There were no notable changes to aggregate exposures, with Industrials, Technology, Financials and Healthcare continuing to represent the four largest sectors in the portfolio. The team continues to maintain a healthy pipeline of investment candidates, resulting in competitive capital allocation discussions (i.e., a good problem to have).

While Cambiar continues to emphasize company-specific fundamentals to drive the buy/sell process, there is no shortage of macro cross-currents to also consider. Topics such as the vaccine timeline, potential for additional fiscal stimulus, cyclical vs. secular inflation, and the upcoming Presidential election are all part of the team dialogue. The objective is to consider all potential factors that can influence the investment thesis, while properly filtering the more pertinent inputs from the ‘noise’ that we cannot predict.

At a sector level, Cambiar’s holdings in the Industrials sector were a notable value-add in the quarter.
Industrial companies are positively correlated to forward economic growth considerations, which have certainly been somewhat of a moving target due to the pandemic. The LCV portfolio has sought to invest in companies that have the potential for secular tailwinds, and are therefore less affected by quarter-by-quarter growth fluctuations. Examples include logistics, automation, and sustainability. Individual outperformers in the quarter were United Parcel Service (UPS) and Trane Technologies. UPS has benefited from the ongoing surge in high e-commerce volumes, which translated into strong top-line gains. The market was also pleased with the increased focus on profit and returns that were relayed by the company’s new CEO. HVAC manufacturer Trane also re-rated in the quarter on strong earnings results. An uptick in demand for residential air conditioning and commercial air quality systems have been positive earnings catalysts for the company. Cambiar trimmed both positions in response to the recent price gains, but believe both companies continue to offer attractive upside potential.

Cambiar’s non-participation in Energy was an additional performance tailwind relative to the index, as the Energy sector sold off in concert with the 3Q decline in oil prices. The pain in negative compounding can be seen in the quarterly and year-to-date benchmark returns for the Energy sector thus far in 2020: -51% (1Q), +32% (2Q), -20% (3Q), and -48% (YTD). Cambiar continues to monitor the sector for potential opportunities, but we remain on the sidelines for now.

The Technology sector remains a standout performer for the LCV portfolio thus far in 2020, and stock selection was again positive in the third quarter. Bright spots included the portfolio’s semiconductor positions, which are the arms dealers to the suppliers of upcoming fifth-generation (5G) devices. The performance contribution from Technology was somewhat mitigated by relative underperformance in Consumer Discretionary and Healthcare. Restaurants, gaming/lodging companies, and retailers performed well in the quarter – Cambiar’s lower allocation to this outperforming sector subsequently detracted from return. Within Healthcare, Gilead was a notable standout to the downside; the stock declined on a delay in the company’s rheumatoid arthritis drug and Gilead’s announced acquisition of Immunomedics. Disciplined capital stewardship is a key attribute Cambiar seeks in all of our holdings. On this basis, the price paid for Immunomedics was extremely generous. Upon review, Gilead was liquidated from the portfolio.

In a reversal from 2Q, Cambiar’s holdings in Financials trailed the index and were detracted from performance in the quarter. The sector has lagged the broader equity market in 2020, with overhangs that range from pandemic-induced debt write-downs and a weak lending environment to lax money laundering compliance controls and elevated catastrophe claims. AIG and Citigroup posted disappointing returns in the quarter, triggering a review that resulted in both positions being sold. For AIG, the investment had simply incurred too much thesis drift since our initial attachment in early 2018. Although the company had made progress on improving profitability in some segments, COVID-19 losses will result in yet another transition year for AIG. Citigroup similarly had an inconsistent return pattern over our holding period, and the accelerated change in CEO that was announced in the quarter led to concerns about the potential for additional setbacks. Given the pipeline of new ideas, the liquidations were made in favor of companies with clearer upside cases.
The Cambiar Small-Mid Cap Value (SMID) portfolio posted a solid gain for the third quarter, extending the strategy’s year-to-date performance advantage vs. the Russell 2500 Value Index. The excess return in the quarter was a function of positive stock selection, with Cambiar generating above-benchmark returns in eight out of nine sectors in which the portfolio was invested. The team’s continued focus on companies that can provide a margin of safety was evident during the market selloff in September, as the strategy was able to hold up considerably better than the benchmark.

The SMID Value portfolio seeks to outperform in a variety of market environments, with an emphasis on downside protection via a bias towards attributes such as profitability, stable margins/returns, and low leverage. Given that the past three years have included periods of both strong up markets and steep drawdowns, this timeframe would be a useful mile marker to gauge how the strategy has performed. As the below table illustrates, the portfolio demonstrated a high degree of efficacy vs. the index – performing well in both up and down markets, as well as on a risk-adjusted basis:

<table>
<thead>
<tr>
<th></th>
<th>3Q 2020</th>
<th>YTD</th>
<th>1 Year</th>
<th>3 Year</th>
<th>5 Year</th>
<th>10 Year</th>
<th>Since Inception</th>
</tr>
</thead>
<tbody>
<tr>
<td>SMID Value (gross)</td>
<td>7.3%</td>
<td>-8.8%</td>
<td>-1.3%</td>
<td>7.1%</td>
<td>9.6%</td>
<td>12.2%</td>
<td>12.8%</td>
</tr>
<tr>
<td>SMID Value (net)</td>
<td>7.1%</td>
<td>-9.2%</td>
<td>-1.9%</td>
<td>6.4%</td>
<td>8.9%</td>
<td>11.5%</td>
<td>12.1%</td>
</tr>
<tr>
<td>Russell 2500 Value</td>
<td>3.5%</td>
<td>-18.4%</td>
<td>-12.6%</td>
<td>-2.7%</td>
<td>4.7%</td>
<td>8.0%</td>
<td>8.3%</td>
</tr>
</tbody>
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Source: Morningstar. Data is trailing 3-year, as of 9.30.20

Returning to the quarter, there was wide dispersion in small-mid sector returns – thus providing an opportunity for active managers to add value from both stock selection and allocation decisions. Outperforming sectors included Consumer Discretionary, Materials, and Communication Services, while Financials, Utilities, and Technology lagged. After showing signs of a recovery in the second quarter, energy stocks slumped.
in 3Q, and comprised the worst-performing sector. The headwind in Energy goes beyond 2020, as this sector has now lagged the broader small-mid market over the past three years by a wide margin.

Trade activity in the quarter consisted of seven new purchases and five liquidations. The incoming positions spanned a variety of sectors, including Industrials, Healthcare, and Real Estate. With the purchases of Alaska Air and Lamb Weston Holdings, Cambiar has been selectively attaching to companies that are positively correlated to a reopening of the physical economy. Alaska Air is a well-managed regional airline that has a strong balance sheet and should benefit from any uptick in leisure travel. As the leading producer of frozen potato products (i.e., French fries), Lamb Weston is an indirect (and higher quality) play on a recovering food service industry. Cambiar views both companies to offer an attractive reward-to-risk profile over a forward two-year timeframe.

The portfolio’s positive stock selection during the quarter was most evident in Financial Services; the portfolio further benefitted from an active underweight allocation in the sector. The outperformance in the sector came from Cambiar’s non-bank holdings. Synchrony Financial was a notable bright spot in the quarter, as the private label credit card provider has done a reasonable job generating growth and building partnerships with recognizable brands such as Amazon, Lowe’s and PayPal. The gains in Synchrony helped to offset weakness in East West Bancorp and PacWest Bancorp – both of which posted modest losses in the quarter.

The SMID portfolio’s Healthcare positions have been a meaningful contributor to the strategy’s outperformance over the past one- and three-year periods, and this positive stock selection continued in the third quarter. Diagnostics and research company Charles River Laboratories (CRL) was a notable bright spot, as the stock gained almost 30% in the quarter. An uptick in biotech funding and the increased potential for permanent outsourcing of preclinical and early-stage trials to CRL provide a high degree of forward earnings visibility and the potential for additional margin expansion. Cambiar trimmed the position in response during the quarter, while continuing to maintain exposure to the company.

Additional drivers to Cambiar’s outperformance in the quarter were above-benchmark returns in the Technology sector and continued non-participation in Energy. The SMID Value portfolio also generated solid returns in the Real Estate sector. Disruptions in cashflow and potential tenant defaults within the REIT space have resulted in heightened investor apprehension; yet these concerns have also created opportunities in the sector. Cambiar has identified a number of high-quality operators whose business outlook we believe should be only notionally affected by the environment relative to the multiple compression incurred by their stock prices.

Detractors from performance came from cash drag and exposure (or lack thereof) in Consumer Discretionary and Communication Services, as both sectors posted strong returns in the quarter. Cash levels are simply a by-product of the discipline, and should be expected to vary in the low single-digit range over time. Within the Discretionary sectors, Cambiar has been admittedly more conservative in our exposures – a function of the competitive backdrop (e.g. Amazon effect) and consumer spend rates, given elevated unemployment levels and lack of additional fiscal stimulus. Our team continues to mine the sector for differentiated investment opportunities that meet our purchase criteria.

The SMID Value strategy reached its ten-year anniversary during the quarter, and Cambiar is pleased with the track record we have compiled over this timeframe. Looking ahead, we continue to view the small-mid asset class as a key ‘sweet spot’ for active management – i.e., quality companies that are often overlooked as a result of their smaller market capitalizations, yet possess strong operating characteristics within their respective industry verticals that can translate into excess returns over a market cycle.
The Cambiar Small Cap Value (SCV) strategy continued its positive performance momentum in the third quarter, and is now ahead of the Russell 2000 Value Index by a wide margin on a year-to-date basis. The excess return in the quarter was largely achieved during the market sell-off in September, as the SCV portfolio’s quality bias enabled Cambiar to protect capital to a greater extent than the benchmark.

The Cambiar team has worked hard over the past three years to achieve a more consistent profile for the types of companies we seek to own on behalf of our clients in the SCV strategy. The emphasis is on companies that demonstrate high margins, steady free cashflow, and a structural product and/or advantaged market position. It is our view that prioritizing such attributes at the company level should result in a portfolio return stream that can provide downside protection in market declines as well as participation in up markets. The metrics in the below table help to quantify these qualitative efforts:

<table>
<thead>
<tr>
<th></th>
<th>Cambiar Small Cap Value (g)</th>
<th>Russell 2000 Value Index</th>
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<tbody>
<tr>
<td>Alpha</td>
<td>7.30</td>
<td>-</td>
</tr>
<tr>
<td>Beta</td>
<td>0.98</td>
<td>1.00</td>
</tr>
<tr>
<td>Tracking Error</td>
<td>5.40</td>
<td>0.00</td>
</tr>
<tr>
<td>Sharpe Ratio</td>
<td>0.17</td>
<td>-0.08</td>
</tr>
<tr>
<td>Information Ratio</td>
<td>1.40</td>
<td>-</td>
</tr>
<tr>
<td>Up Capture</td>
<td>122.20</td>
<td>100.00</td>
</tr>
<tr>
<td>Down Capture</td>
<td>83.80</td>
<td>100.00</td>
</tr>
</tbody>
</table>

Source: Morningstar. Data is trailing 3-year, as of 9.30.20

Portfolio buy/sell activity included three new purchases and two liquidations. Cambiar made a ‘swap’ in the Technology sector, with the sale of Vishay and purchase of Diodes. Both companies provide specialized semiconductors called power discretes that are used in a wide variety of products and applications. Power
discrete semis are benefiting from increased content in electric vehicles, industrial automation, and consumer digital devices. Cambiar views Diodes to be the higher quality option between the two companies, and used the September pullback to high-grade our exposure. In aggregate, portfolio construction continues to emphasize balance and diversification, while Cambiar remains willfully benchmark-agnostic (although aware of notable deviations).

Active management can add value relative to an index via stock selection and sector over-/underweight decisions. The SCV portfolio registered positive contributions on both fronts in the Financials sector during the quarter. Cambiar has benefited from maintaining less relative exposure to Financials over the past few years, choosing to reallocate capital to higher conviction holdings across the portfolio. Within the sector, participation has been geared to industries such as insurance, an area of the market that Cambiar believes to offer higher earnings visibility. Reinsurance Group of America (RGA) is one such example — the company moved higher after reporting a significant earnings beat and increase in book value. Given the strength in the company’s core business, Cambiar anticipates additional upside to the 0.5x BV multiple that is currently assigned to this high quality company. Additional exposure in the sector includes a select number of small-cap banks that we view to have lower-risk profiles, strong capital ratios and consistent profitability metrics.

Another positive contribution to performance in 3Q was generated by Cambiar’s holdings in the Real Estate sector. The sector has incurred significant capital flight on fears of payment lapses by tenants that have been negatively impacted by the pandemic. While rent collections in the sector are down, higher quality operators have not seen a material drop relative to expectations. Within the SCV portfolio, Essential Properties Realty Trust (EPRT) gained 25% in the quarter (vs. -3% for average real estate company) as the company posted solid earnings and adjusted funds from operations (AFFO). The company also reported a strong realized gain on sold properties — which has been another concern (i.e., a drop in property values). The REIT sector has been a good example of where a rigorous due diligence process (and the willingness to take a non-consensus view) can add value.

Additional value-adds in the quarter included positive stock selection in Technology as well as the continued avoidance of energy stocks. Cambiar’s higher allocation to tech stocks is in response to the number of unique businesses that exist in the sector. While the larger-cap FAANG stocks have rallied sharply in 2020, small-cap tech companies remain reasonably valued — thus providing an attractive reward-to-risk opportunity. Within the Energy sector, Cambiar’s ongoing aversion has been beneficial to performance. Given the low price deck for oil and levered balance sheets for many participants in the sector, we would not be surprised if the energy patch incurred an uptick in bankruptcy filings. The removal of these marginal companies may be the necessary reset the sector needs to attract capital.

Consumer Discretionary stocks rallied strongly in the quarter, continuing their rebound that began in the second quarter. Although Cambiar’s holdings in the sector performed well, the portfolio’s lower exposure to discretionary stocks (6% vs. 12% for the index) was a relative performance headwind. In contrast to the ‘all clear’ signal that investors appear to assign the sector, Cambiar remains cautious on our outlook for industries such as retail, restaurants and related discretionary end markets.

One sector where stock selection trailed the index was Industrials, as Parsons Corporation and Healthcare Services Group posted modest losses in the quarter. Cambiar views the investment cases for both companies to be intact — thus no change to our outlook. Similar to the Tech sector, Industrials covers a wide span of end markets. Cambiar’s holdings in the sector include freight logistics, water infrastructure, a temp staffing company and a defense/consulting services provider.

Year-to-date we have been pleased with how the strategy has navigated an unprecedented market environment. We continue to maintain a bias toward highly profitable businesses that have a record of durable free cash flow generation and low leverage. This period has been a reminder that companies that possess these characteristics are capable of offering downside mitigation in choppier conditions but still possess the ability to keep pace in a stronger market environment.

Small-cap companies continue to trade at a meaningful disconnect to their large-cap counterparts, with the year-to-date performance divergence now at historically high levels. While we cannot predict if and when this valuation gap will close, Cambiar has taken advantage of the market’s seeming indifference towards small caps to establish positions in a number of unique businesses that we believe to offer a combination of earnings upside and multiple expansion over a forward 1-2 year timeframe.
As we transition to the final quarter of 2020, the trajectory for U.S. equities will continue to be heavily dictated by the COVID-19 pandemic and its continued duration. Any news flow on the efficacy/availability of a vaccine and related treatment protocols would be a welcomed event – for the broader public as well as the equity markets. We believe a breakthrough will almost certainly have a disproportionately positive impact on value stocks, which have been largely overlooked in the market’s strong preference for growth.

The upcoming Presidential election presents an additional unknown to stocks, although the accompanying volatility may be dampened should Congress agree to a second fiscal stimulus package.

Regardless of the environment, Cambiar remains focused on high quality companies that can manage (if not grow) through the current uncertainty. Our team will continue trying to use the elevated market volatility to our advantage by focusing on what the storm throws onto our laps, vs. throwing ourselves into the storm.

We hope you and your families remain safe, and we appreciate your continued confidence in Cambiar Investors.

LOOKING AHEAD

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