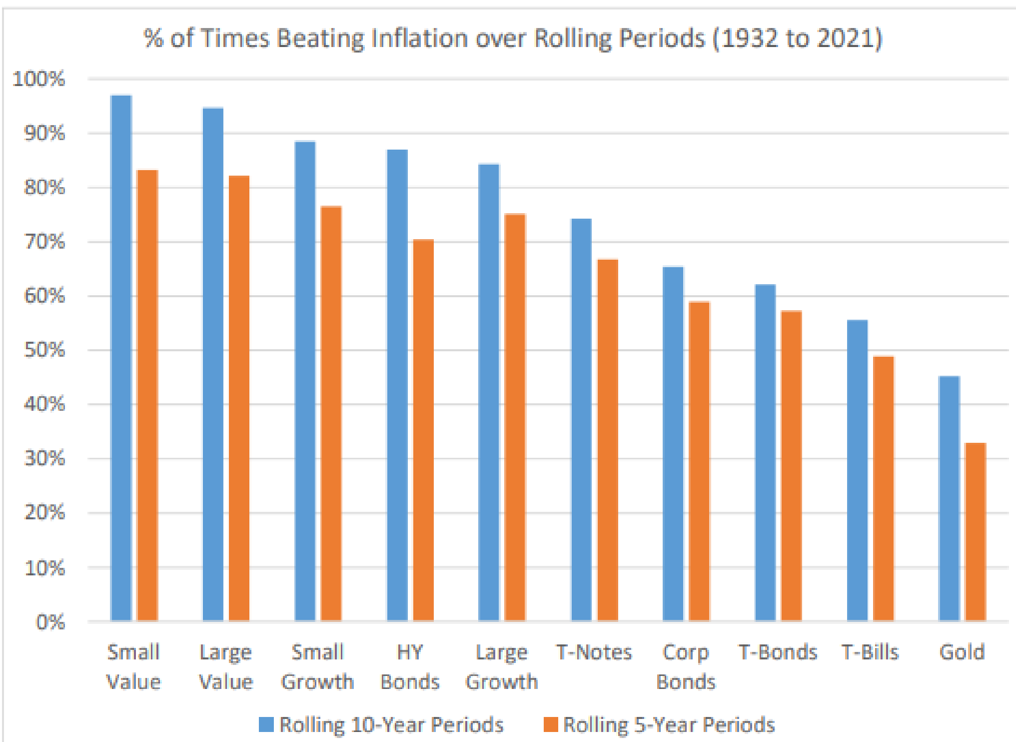
Q12022 ESG SMID VALUE OPPORTUNITIES STRATEGY UPDATE

By Adam Peck

Equity markets sold off this quarter, driven by the Russian invasion of Ukraine, continued high inflation readings and the market's anticipation of what the Federal Reserve will do to combat inflation. We are happy to say that if higher inflation is indeed here to stay, history tells us (going back to 1932) that the best area of the market to be in is Small Cap Value (SCV). As seen in the chart below by Furey Research Partners (FRP), SCV has beat inflation over 95% of all rolling 10-year periods, better than any other equity asset class, even better than gold. Contrary to popular belief, gold is actually the worst inflation hedge.

Fig. 7. **Over 5- and 10-year rolling periods, nothing has beat inflation more often than small-cap value**



Source: FRP, FactSet, Morningstar; as of 12/31/21

Value stocks outperformed growth stocks in the quarter with the Russell 2500 Value Index declining 1.5% compared to the Russell 2500 Growth which was down 12.3%. The Riverwater ESG SMID Value strategy slightly underperformed its benchmark, the Russell 2500 Value Index, this quarter. The largest driver of this underperformance was in our healthcare and industrial sectors. The weakness centered around three stocks: Charles River Labs (CRL), Quest Diagnostics (DGX) and Builders Firstsource (BLDR). We think the healthcare names, CRL and DGX, are just giving back some of the tremendous gains they racked up during the pandemic. Builders' weakness mainly stems from fears that higher mortgage rates will negatively affect the housing market. Even with mortgage rates rising to the highest level in years, we remain bullish on the homebuilding industry given the deficit of homes in the US which resulted from a decade plus of underinvestment in new housing.

Surprisingly, the Energy sector was a positive relative contributor to the portfolio. It is not easy to find companies in the energy space that meet our criteria for investment, but Renewable Energy Group (REGI) did, given that, as its name implies, it is a producer of renewable energy. We originally invested in REGI in 2021 and then added to our position early in the first quarter of 2022 when it traded in the $40s. REGI received an all-cash offer from Chevron for $61.50 per share at the end of February. In early April, we replaced REGI with another energy company. We have high expectations and look forward to discussing that name in our next letter. Additionally, strong energy returns were driven by CNX Resources (CNX), our best performing stock. CNX is a beneficiary of higher natural gas prices which are up on the Russian invasion of Ukraine.

We sold Verso Corp (VRS) this quarter, given they also received an all-cash offer (see last quarter's letter). Three other names were also sold in the quarter, all for different reasons. We sold Amerco (UHAL) because we felt it was a Coronavirus beneficiary (lots of people moving) and they were having issues buying new equipment. We thought there was better opportunity elsewhere in companies that could benefit more as the economy emerges from COVID (like Spirit AeroSystems – to be discussed below). SVB Financial Group (SIVB) because it was too successful. We purchased the stock early in the pandemic when it had a sub $10B market capitalization. It more than tripled for us and became a large cap stock so we felt it prudent to reinvest into a smaller company. Lastly, we sold Levi Strauss & Co. (LEVI) as we found another consumer discretionary company that we felt had more potential. We took a small loss on LEVI.

During the quarter we trimmed one holding, added to four existing holdings, and purchased four new names. We trimmed Atkore (ATKR) when it became an outsized position given its tremendous performance over the last year.

We added to the aforementioned REGI in January before it got bought out. We also increased our positions in Infusystems (INFU), a health care holding, and two utilities – Pinnacle West (PNW) and NorthWestern Corp (NWE). Infusystems sold off because a large contract that they expected to be signed was delayed. We also liked that they were reinvesting in their business because of a large and growing opportunity. That investment had upfront costs before revenues hit, resulting in earnings that were not as strong as the market expected. Both issues are temporary, and we think the market is being too near-sighted.

When we sold positions and looked for reinvestment opportunities, we thought it made sense to add to our utility holdings. As the markets climbed over the last two years the utility names have lagged and both positions shrank in size. We made both full positions again.

We bought four new names in the quarter. The first, Spirit AeroSystems (SPR), designs and manufactures commercial aerostructures like wings and the fuselages. SPR was hit hard by the 737 Max trouble at Boeing and then the pandemic shutdowns. After three tough years of headwinds (no pun intended) it looks like SPR is poised to again benefit from increased 737 Max production. We expect this will push the company back to a free cash flow positive position. As travel comes back and 737 Max production reaches 41 planes a month, margins should grow and eventually exceed pre-pandemic levels. We think this will allow SPR to pay down debt raised during the pandemic, which will benefit equity holders like us. On the ESG side, Spirit's entire 12 million square foot facility in Wichita is fully powered by a nearby wind farm.

We started a position in AZZ Inc. (AZZ), which has a galvanizing and an infrastructure solutions business. After years of market underperformance, AZZ is rightsizing their portfolio towards greater profitability and higher rates of growth. They are a mini conglomerate with two non-synergistic businesses. They have announced a sales process for their infrastructure solutions business and recently made a large acquisition in the metal coatings business. We think that the sale of their infrastructure business will enable the company to realize much improved margin structure. As a pure play coatings company, we believe it should also be granted a higher valuation multiple comparable to peer coatings companies. AZZ published their inaugural ESG report for 2021 and has committed to "growing their business in a sustainable and socially responsible manner."

We exited our position in LEVI and deployed the capital directly into Crocs (CROX), a manufacturer of casual footwear. The world is split 50/50 on Crocs; you either hate them or love them. Whether you hate or love the shoe, we believe it is hard to hate the stock! CROX has had double-digit growth and trades at a valuation of about 7x this year's earnings per share. Casual attire and footwear were clearly a beneficiary during the pandemic and their improved earnings reflects this. However, the stock sold off sharply with concerns around recent consumer spending habits. In late 2021, CROX acquired Hey Dude, a young footwear company with a strong brand recognition for its core demographic. The purchase of Hey Dude is immediately accretive to CROX earnings and greatly diversifies their product offering. We doubt you will hate the look of Hey Dude. On the ESG front, we particularly like that CROX is making progress towards becoming a net zero emitter by 2030.

(Disclosures and chart showing ESG SMID Value Strategy Largest Contributors and Detractors on next page).

ESG SMID Value Strategy
Largest Contributors and Detractors - Q1 2022

5 Best - Absolute Contribution				
Ticker	**Company**	**Average Weight**	**Contribution**	
CNX	CNX Resources	4.02%	1.62	bps
REGI	Renewable Energy Group	3.10%	1.07	bps
SNEX	StoneX Group	3.12%	0.59	bps
FMC	FMC Corporation	2.64%	0.50	bps
CFR	Cullen/Frost Bankers Inc.	4.65%	0.44	bps
	5 Best Total	**17.53%**	**4.22**	**bps**

5 Worst - Absolute Contribution				
Ticker	**Company**	**Average Weight**	**Contribution**	
CIEN	Ciena Corporation	4.72%	-1.18	bps
BLDR	Builders FirstSource, Inc.	3.14%	-0.89	bps
CRL	Charles River Laboratories Intl, Inc.	2.24%	-0.67	bps
THRM	Gentherm Inc.	3.10%	-0.57	bps
JLL	Jones Lang LaSalle	3.95%	-0.47	bps
	5 Worst Total	**17.15%**	**-3.78**	**bps**

Disclosures:

Reader should not assume that investments in the securities identified were or will be profitable. Timing differences of purchases and sales may have a modest impact on the actual contribution numbers presented. The holdings identified do not represent all of the securities purchased, sold, or recommended. The calculation's methodology along with details on all holding's contribution to the overall account's performance during the measurement period are available upon request. Past performance does not guarantee future results.