

Q3 2022 ESG LARGE VALUE STRATEGY UPDATE

By Kirk Fox

Large cap equities continued their decline in the quarter, marking the third straight quarterly decline this year. The Riverwater ESG Large Value Strategy is benchmarked to the Russell 1000 Value Index, which declined more than 6% but the Large Cap portfolio was able to outperform. Our focus on high quality companies and management teams along with a slight tilt towards more defensive-oriented companies drove the outperformance.

The market continues to digest the inflation outlook and is concerned with how far the Federal Reserve will have to go to reduce inflation to their stated 2% goal. The main two elements the market is struggling with are the duration of inflation (how long it will take to be controlled) and what the long-term impact of higher rates will be. Will the economy just slow or will we enter into a recession? This uncertainty around inflation and economic resilience has created a volatile market. This is evidenced by 35 market moves of more than 2% or more so far in 2022. It is fair to say the market does not like uncertainty. In the face of this volatility, we are steadfast in our process; continue to manage with a focus on superior businesses run by exceptional managers, and always look to pay a fair price.

Top Contributors

Our top five contributors to outperformance in Q3 2022 came from five different sectors: technology, energy, consumer staples, financials, and industrials. Notable outperformers during the quarter were First Solar (FSLR) and Constellation Energy (CEG). FSLR was our top performer during the quarter due to strong demand along with the recent passage of the Inflation Reduction Act (IRA). CEG, a nuclear energy provider, benefited from its stability of energy supply while global energy prices have become anything but secure and stable.

Top Detractors

Our top detractors during the quarter were slightly more concentrated along sectors with two names coming from healthcare along with utilities, consumer discretionary and financials. Our detractors during the quarter were more broad-based vs. our gains. Our detractors declined mostly due to macro factors rather than individual equity fundamentals with the exception of GSK which gave conservative guidance. We sold GSK during the quarter (see Sales below).

Purchases:

Zebra Technologies (ZBRA) was purchased in the Large Cap portfolio, having grown into a large cap company from its original place in the SMID portfolio. ZBRA designs, manufactures, and sells a broad range of products serving the Automatic Identification and

Data Capture (AIDC) industry, including barcode/label specialty printing, supplies/consumables, and rugged mobile computers. Supply chain “optimization” importance has elevated across industries and benefits are being realized throughout the value chain. Technology advancement applied to mobility, data capture, and real-time accessibility to the data will continue to drive adoption, fueling low double-digit revenue growth for ZBRA. The management team has executed extremely well, and the company has begun to focus on ESG during the past several years. We believe ZBRA will drive long-term value creation for its customers and our clients.

We also bought Fiserv (FISV) this quarter. FISV engages in the provision of financial services technology and operates through the following segments: Merchant Acceptance, Financial Technology, and Payments and Network. FISV core payments and merchant acceptance business is highly profitable and very sticky once installed. Additionally, we believe FISV has some undervalued assets within the business that can be monetized in the future; the largest being Clover, which serves as a POS system for commerce. On the macro front, FISV benefits from higher inflation because the payment volume will increase, helping earnings growth stay solid.

During the quarter, we also added to our position in Porsche Automobil Holding (POAHY), The family holding company that retains a controlling position in Volkswagen and Porsche. POAHY trades at a large discount to its peers and is trading below the value of its two holdings, Volkswagen and the newly spun out and independent Porsche Group. After Porsche was IPO’d on September 29, it was worth \$27B to POAHY, but the stock market only values POAHY at \$18B. We think the market will eventually ascribe the appropriate value and therefore think there is, at a minimum, 50% upside in the stock.

Sales

Haleon plc (HLN) was sold from the portfolio. The separation of GSK Consumer Healthcare from GSK (formerly GlaxoSmithKline) formed Haleon, and shares were received in July 2022 by virtue of the portfolio owning shares in GSK. HLN focuses 100% on consumer health brands. While we were interested in the company’s stated goal to grow 4-6% organically, we were concerned about the high level of debt put on the company as part of the merger agreement.

AT&T (T) was also sold during the quarter due to the increase in competition among the wireless carriers that appears to be ramping up significantly. Also, inflation and supply chain disruptions have depressed margins, and the progress in launching new fiber installations and 5G has been costly and slow. AT&T’s debt could come under more scrutiny by investors with the macro backdrop deteriorating and rates rising.

Several stocks were sold to realize tax losses, given the market's extreme sell-off: Charles River Labs (CRL), GSK (GSK), and Teradyne (TER). All will be considered as potential portfolio candidates again.

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

**ESG Large Value Strategy
Largest Contributors and Detractors – Q3 2022**

5 Best - Absolute Contribution

Ticker	Company	Average Weight	Contribution
FSLR	First Solar, Inc.	1.61	88 bps
CEG	Constellation Energy	1.84	56 bps
SJM	J.M. Smucker	4.47	17 bps
RF	Regions Financial	2.94	14 bps
PCAR	PACCAR Inc.	3.22	5 bps
5 Best Total		14.08	180 bps

5 Worst - Absolute Contribution

Ticker	Company	Average Weight	Contribution
PFE	Pfizer, Inc	4.34	-66 bps
GSK	GSK plc ADR	1.67	-64 bps
EXC	Exelon	3.33	-62 bps
POAHY	Porsche Automobil	2.99	-49 bps
FISV	Fiserv, Inc	1.61	-43 bps
5 Worst Total		13.94	-284 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.