RIVERWATER PARTNERS

Q3 2022 ESG SMID VALUE STRATEGY UPDATE

By Adam Peck, CFA

It was a Jekyll and Hyde quarter. Our benchmark, the Russell 2500 Value Index, rose over 13% by mid-August only to give it all up and then some by quarter's end. The index ended the quarter down 4.5%. We outperformed for the quarter but are down - in line with our benchmark - on a year-to-date basis. The drivers of some of the significant up and down moves this past quarter explain why we have not met our expectations to outperform in a bear market.

As the market rallied to begin the quarter, the strategy lagged by a significant amount. Meme stocks got a second wind with Bed Bath & Beyond Inc. (BBBY) leading the way. The stock traded at $4.71 on July 1 and peaked at $23.08 on August 16th. The stock rose 390% in the first six weeks of the quarter, despite having major liquidity issues. (The stock peaked on the exact same day as the market, interestingly enough.) Bed Bath & Beyond ended the quarter at $6.09 – down 74% in the second half of the quarter.

We think our significant underperformance in the first half of the quarter was likely driven by lower quality companies like BBBY driving index returns. In the second half of the quarter our quality bias drove significant outperformance as markets - and lower quality companies - declined.

We feel comfortable with how the portfolio is currently positioned. We do not have any large sector bets as we are within a 5% weighting compared to our benchmark for all but one sector, Real Estate. There, we are underweight by 7%. On severe down days the strategy has recently had very good downside capture. If the markets continue their descent, we are hopeful we can continue to outperform. Having said that, we expect and hope that the markets will soon find a bottom.

Top Detractors

The worst performers in the quarter were InfuSystem Holdings (INFU) and Hannon Armstrong (HASI). InfuSystem Holdings is a healthcare company whose main business is the supply and servicing of infusion pumps for cancer treatment at home. They expanded their offering to service hospitals through a contract they closed with GE Medical. There were high expectations for the large GE contract; however, delays in its finalization pushed out revenues, and the market did not like the temporary pauses in growth. The company had invested heavily for the growth, raising its cost structure, and resulting in lower earnings in the near-term.

We think the long-term investment will pay off and the management team is as bullish as ever, though cognizant that they did a poor job in guiding the street. We sold a portion of our holding for a tax loss but will likely buy back as we believe the GE contract issues are indeed temporary.

Hannon Armstrong was the second worst performer. We sold Hannon Armstrong early in the quarter after a short report indicated that there were potential undisclosed related party transactions and weaknesses in accounting methods that put into doubt the earnings power of the company. Management did not respond to these issues to our satisfaction. All financial companies are built on trust. If there is any hint of a lack of trust the fall for financials can be swift.

Top Contributors

The top contributors in the quarter were First Solar (FSLR) and Crocs (CROX). First Solar designs, manufactures, and sells solar panel modules which convert sunlight into electricity. FSLR is the largest solar manufacturer in the US and primarily competes with Chinese produced products that use forced labor. The stock went on a nice run after Congress passed the Inflation Reduction Act (IRA) which incents domestic manufacturing.

Crocs bucked the prevailing trend this quarter and went up. There were no positive macro drivers and there was also nothing new on a company level. We think it was just a case of a stock getting too oversold. The stock hit a peak of $177 per share last year in November and bottomed out in the high $40s in early July. The management team has maintained confidence in their earnings guidance of around $10 per share in 2022. When the stock got down to below 5x earnings there were evidently more buyers than sellers.

Sales

We had multiple companies that were bought out in the first half of the year, and we sold a couple of companies that had outsized performance and grew to be too large. As Q3 2022 progressed, we took the opportunity to take tax losses with the market weakness to offset the earlier gains. We took losses in Euronet Worldwide, InfuSystem Holdings, Pathward Financial, and QuidelOrtho Corp. It is possible we may reinvest in these same companies, or we may replace them with more attractive ideas depending on where the market goes over the near-term.

Earlier in the quarter, we sold Hannon Armstrong Sustainable Infrastructure (HASI). New information that came out in a short report indicated there were potential undisclosed related party transactions and weakness in accounting methods that put into doubt the earnings power of the company. Management did not respond to these issues to our satisfaction and so we thought best to part ways.

Additions

In the quarter, we added to several existing holdings and bought one new name. National Retail Properties (NNN) is a triple net lease REIT that invests in free standing retail properties across the US. NNN has a strong capital allocation track record and a 32-year history of consecutive dividend increases. Today the dividend yield is 5.3%. NNN is more of a defensive REIT as it avoids retail categories most susceptible to e-commerce threat. With no mall or strip exposure. NNN has a healthy portfolio with 99.2% current occupancy, a weighted average remaining lease term of 10.6 years, and has had only 3.7% of leases expire through 2023. As a triple net lease, NNN is not responsible for maintenance, taxes, or insurance so it is difficult to influence the tenants on ESG efforts, but they do track energy use and emissions through scope three reporting.

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

ESG SMID Value Strategy
Largest Contributors and Detractors – Q3 2022

5 Best - Absolute Contribution				
Ticker	**Company**	**Average Weight**	**Contribution**	
FSLR	First Solar, Inc.	2.94	161	bps
CROX	Crocs, Inc.	2.47	62	bps
IRDM	Iridium Communications	4.17	57	bps
ICFI	ICF International	4.43	57	bps
CFR	Cullen/Frost Bankers	4.95	51	bps
	5 Best Total	**18.96**	**388**	bps

5 Worst - Absolute Contribution				
Ticker	**Company**	**Average Weight**	**Contribution**	
INFU	InfuSytem Holdings	2.67	-81	bps
HASI	Hannon Armstrong	.47	-79	bps
NWE	NorthWestern Corp.	3.13	-61	bps
JLL	Jones Lang LaSalle Inc.	3.19	-52	bps
LOPE	Grand Canyon Education	3.54	-50	bps
	5 Worst Total	**13.00**	**-323**	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.