

RAW Transcript -Q2 2024 Webinar | August 8, 2024

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00:02:37.130 --> 00:02:39.290

Matt Drvaric: Thank you all for joining. We will begin momentarily.

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00:03:10.010 --> 00:03:15.779

Matt Drvaric: Good afternoon. This is Matt Davarik. Thank you for joining us and welcome to the river water partners, Q. 2, 2,024. Webinar.

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00:03:15.800 --> 00:03:25.239

Matt Drvaric: All participants will be in. Listen only mode to review the agenda for the call. Today. Adam Peck, our co-founder and chief investment officer, will discuss performance for the strategies

4

00:03:25.390 --> 00:03:28.149

Matt Drvaric: and share a case for small cap allocation.

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00:03:28.300 --> 00:03:32.700

Matt Drvaric: Cindy Bolan, our director of responsible investing, will review engagement activity.

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00:03:32.850 --> 00:03:40.230

Matt Drvaric: After today's presentation there will be an opportunity to ask questions. If you are at your computer, please submit your question in the questions chat box

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00:03:40.260 --> 00:03:43.009

Matt Drvaric: located at the bottom of your webinar control panel.

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00:03:43.340 --> 00:03:47.120

Matt Drvaric: Please note this event is being recorded and a replay will be made available.

9

00:03:49.750 --> 00:03:56.439

Matt Drvaric: River water partners was founded in 2,016 in Milwaukee as a dedicated small cap, responsible investing manager.

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00:03:56.820 --> 00:04:05.879

Matt Drvaric: We are proud to be a signatory to the United Nations principles of responsible investment. The certified D corporation certified women owned and 100% employee owned. Firm

11

00:04:10.770 --> 00:04:19.519

Matt Drvaric: competitive strategy is about being different. It means deliberately choosing a different set of activities to deliver a unique mix of value.

12

00:04:19.820 --> 00:04:21.100

Matt Drvaric: Michael Porter.

13

00:04:21.260 --> 00:04:22.859

Matt Drvaric: Harvard Business School, Professor

14

00:04:24.720 --> 00:04:31.699

Matt Drvaric: River Water was founded on the premise to be deliberately different in the approach of integrating Esg factors into small cap analysis.

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00:04:31.820 --> 00:04:38.949

Matt Drvaric: The pursuit of integrating these factors has shaped a unique and unapologetic approach to analyzing companies and designing portfolios.

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00:04:39.210 --> 00:04:46.239

Matt Drvaric: This was never considered to be the easy path, and we believe that the results achieved prove what Meta studies have confirmed.

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00:04:46.280 --> 00:04:50.279

Matt Drvaric: Esg integration does not negatively impact returns.

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00:04:50.640 --> 00:04:54.299

Matt Drvaric: Fiduciaries are required to put the interest of their clients before their own.

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00:04:54.590 --> 00:04:58.590

Matt Drvaric: It was with the fiduciary standard in mind that we crafted our permission

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00:04:58.620 --> 00:05:02.659

Matt Drvaric: to make the world a better place by growing wealth through sustainable investing.

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00:05:03.050 --> 00:05:08.180

Matt Drvaric: Through this lens all investments are viewed with the expectation that the businesses making

22

00:05:08.330 --> 00:05:14.359

Matt Drvaric: that the businesses making the world better are delivering a unique mix of value for which they will be rewarded.

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00:05:14.600 --> 00:05:21.929

Matt Drvaric: The unique, the unique mix of value is a combination of financial return, societal benefit and means to mitigate potential risk.

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00:05:25.540 --> 00:05:31.369

Matt Drvaric: Investors in all roles of portfolio design aspire to build diversified non-correlated portfolios.

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00:05:31.450 --> 00:05:35.479

Matt Drvaric: The status quo for an active manager is returns above a benchmark.

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00:05:35.660 --> 00:05:46.679

Matt Drvaric: Rivermore does not accept the status quo. The sustainable value. Strategy has developed exceptional risk, adjusted return metrics and believes in investing beyond returns by designing portfolios that make the world a better place.

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00:05:46.750 --> 00:06:00.029

Matt Drvaric: As a boutique founder led firm that deeply cares about the results we produce produce. We elected to pursue nontraditional thinking in an effort to generate returns that are different from our peers and redefine high quality.

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00:06:00.220 --> 00:06:12.370

Matt Drvaric: Our integrity is more important than crafting than another generic strategy. We are proud of these results, and have just started the journey. I invite you to join us in thinking differently and learn about our balanced approach to responsible investing.

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00:06:12.540 --> 00:06:16.190

Matt Drvaric: Adam will review the strategy's performance and portfolio position.

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00:06:16.350 --> 00:06:17.140

Matt Drvaric: Adam.

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00:06:18.170 --> 00:06:27.710

Adam Peck: Thank you, Matt, and good afternoon to everyone, so I'll cover both our small cap strategies. Then I'll give my thesis on. Why, we think it's small caps time to shine.

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00:06:27.830 --> 00:06:44.519

Adam Peck: I'll note that there's a lot going on since quarters and historic small cap run, and then a massive unwind in the uncarried trade. I'm happy to answer any questions in the QA. As it relates to the current quarter, but I'll be sticking to the past quarter for the vast majority of our prepared remarks.

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00:06:44.810 --> 00:06:47.739

Adam Peck: Okay, so let's get started here. We have our top 5

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00:06:47.970 --> 00:06:54.570

Adam Peck: for the sustainable value strategy for the 5 were top holdings last quarter. The only new entrant is Vico.

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00:06:55.140 --> 00:07:00.599

Adam Peck: which vaulted into the second largest decision in strong, year-to-date performance driven by AI.

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00:07:01.140 --> 00:07:06.699

Adam Peck: That, of course, the only company that was not a repeat. It dropped out due to weak relative performance.

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00:07:06.990 --> 00:07:13.620

Adam Peck: All of the top 5 have grown to be here as the average position. Size starts at 3%.

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00:07:13.890 --> 00:07:25.279

Adam Peck: Modine is now our largest holding. Its success was driven by both internal execution and positive end markets. Modine has improved its operational focus

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00:07:25.300 --> 00:07:29.900

Adam Peck: which has resulted in significantly higher margins across its 2 segments.

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00:07:30.260 --> 00:07:37.139

Adam Peck: It's also a big beneficiary of the AI boom as they manufacture Hvac equipment for data centers.

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00:07:37.280 --> 00:07:40.949

Adam Peck: Modine has been our most levered AI player across the portfolio.

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00:07:41.560 --> 00:07:48.090

Adam Peck: The top 5 have been in the portfolio for a number of years. Icf and pharmack were purchased in 2,020,

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00:07:48.250 --> 00:07:53.050

Adam Peck: Luminara and Vico in 2022, and Modena in 2,023,

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00:07:53.190 --> 00:08:10.890

Adam Peck: I'll also say, as I look through the portfolio. 25% of our holdings have been owned for more than 5 years. This points to our efforts to find quality companies that we can own for long periods of time. Obviously, as long as the valuation and outlooks remain compelling.

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00:08:12.590 --> 00:08:20.389

Adam Peck: So here we've got our sector weights, and I'll remind everyone we try to stay within 5% of our benchmark and have a hard and fast limit at 10.

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00:08:20.460 --> 00:08:29.679

Adam Peck: Today the largest underweights are in materials and consumer discretionary, both at a 4.9% underweight. Largest overweight is in tech at 8.6

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00:08:30.070 --> 00:08:36.259

Adam Peck: the technology overweight has grown. It was our top performing sector. This quarter, driven by Vico and Amcor.

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00:08:36.510 --> 00:08:41.639

Adam Peck: we have 6 companies in the sector, and only one has a weight above 4%.

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00:08:41.870 --> 00:08:47.070

Adam Peck: 4 of the 6 have stronger to date relative performance versus the rest of the portfolio.

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00:08:47.410 --> 00:08:49.259

Adam Peck: We like all 6,

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00:08:49.400 --> 00:08:55.889

Adam Peck: but are also cognizant that we're approaching our 10% limit, and so may opportunistically trim as the year unfolds.

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00:08:58.190 --> 00:09:05.660

Adam Peck: So here I'll start with the PE ratio. We're just slightly higher than our benchmark. It's hard to get the aggregate data.

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00:09:05.740 --> 00:09:21.200

Adam Peck: but I would guess the Russell benchmark PE is skewed by not including a number of unprofitable companies. We know 40% of the Russell. 2,000 holdings are not profitable. Every company we own is forecasted to be profitable. This year

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00:09:21.390 --> 00:09:27.660

Adam Peck: we're higher on a price to cash flow basis, but I believe a good chunk is driven by one or 2 holdings that are undervalued on assets

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00:09:27.820 --> 00:09:33.809

Adam Peck: and traded high price to cash, flow metrics. Limanera, a top holding would be one example.

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00:09:34.040 --> 00:09:46.590

Adam Peck: luminara. So Luminara also skews our forward PE as it trades at around 50 times, earnings again, what matters for Luminara is the value of the real estate and water rights, not the current cash flows.

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00:09:48.310 --> 00:09:53.440

Adam Peck: So this quarter's outperformance, again, can mainly be attributed to stock selection.

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00:09:53.930 --> 00:09:55.670

Adam Peck: particularly in tech

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00:09:55.790 --> 00:10:01.009

Adam Peck: technology. Outperformance was widespread. Among our 6 holdings. As I just mentioned.

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00:10:01.760 --> 00:10:06.769

Adam Peck: the standouts and technology were Vico and Amcor. Both companies are in the semi space.

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00:10:06.810 --> 00:10:19.699

Adam Peck: You can think of both. As the picks and shovels of AI AI cannot happen with without advanced chipsets and advanced chipsets cannot be manufactured without the test and measurement equipment

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00:10:20.130 --> 00:10:22.579

Adam Peck: at both Vico and Amcorp provide.

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00:10:22.980 --> 00:10:29.940

Adam Peck: Both companies meet our 3 pillars, and as a compare trade, get less than half the valuation of well-known AI companies like Nvidia.

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00:10:30.820 --> 00:10:34.110

Adam Peck: Our top sector detractors were led by industrials.

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00:10:34.140 --> 00:10:40.080

Adam Peck: which last quarter was our best performance. Sector under performance in utilities and financials, was a minimum

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00:10:40.860 --> 00:10:42.330

Adam Peck: on the stock side.

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00:10:42.520 --> 00:10:44.480

Adam Peck: Adcor was our worst performer.

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00:10:44.550 --> 00:10:59.139

Adam Peck: It was a top 3 performer last quarter so easy. Come, easy go. But really, since we 1st bought it in 2,020. It's been a standout performer. As a reminder. We trim the position over a year ago, after the position grew outsized.

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00:10:59.370 --> 00:11:12.609

Adam Peck: Adcor manufactures, electrical products for commercial buildings, it still trades at a ridiculously low valuation, as the market does not believe they can maintain elevated margin and return structures that have been in place since Covid.

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00:11:13.750 --> 00:11:17.830

Adam Peck: Now, over the last 12 months we've beaten the benchmark, all driven by stock selection.

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00:11:18.080 --> 00:11:26.559

Adam Peck: sector allocation has been a slight detractor. The top contributors, Modine and Vico, have been discussed. The top detractor has been Iridium.

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00:11:27.350 --> 00:11:32.500

Adam Peck: which, as a Communications company, has driven that sector to be the worst relative performance

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00:11:34.220 --> 00:11:59.860

Adam Peck: headquarters, and the position represented less than 1% of aum. We still hold on to the position as it's attractively valued. A high single digit. Free cash flow. There are catalysts which could move the stock higher, but our conviction in the catalyst are not as high as they once were given a severed satellite phone opportunity. It is possible a satellite phone opportunity could rise again, and with that I pass it back to Matt.

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00:12:03.180 --> 00:12:25.759

Matt Drvaric: Sam performance, for the strategy is presented here and offers competitive performance across each period as a reminder. We have launched the founders class the It vehicle for this strategy at a 10 million minimum, for up to 5 plans at 48 basis points alongside Sei. As the vendor offering documents are available on request. I will note that the new with the new marketing rule, the returns presented

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00:12:25.760 --> 00:12:33.209

Matt Drvaric: are on the net. A fee basis, represent 1% for retail clients and institutional fee schedule is available.

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00:12:33.300 --> 00:12:35.290

Matt Drvaric: Adam will walk through our micro strategy.

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00:12:36.230 --> 00:12:37.470

Adam Peck: Thanks, Matt.

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00:12:37.990 --> 00:12:45.200

Adam Peck: so coming up, we've got our top 5, for the micro. 4 or 5 are here last quarter, with Lamace edging up 1st business bank.

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00:12:45.460 --> 00:12:48.900

Adam Peck: The make was the second largest positive contributor to

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00:12:49.150 --> 00:12:51.309

Adam Peck: performance in the Quarter.

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00:12:51.730 --> 00:13:02.740

Adam Peck: The micro universe has been exceedingly frustrating over the last few years. The space has been weak, as many micros are unprofitable, and also many of the companies with debt have loading right structures.

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00:13:02.800 --> 00:13:07.149

Adam Peck: We think in many instances the baby is being thrown out with the bath water.

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00:13:07.480 --> 00:13:16.429

Adam Peck: It's telling that our 2 largest holdings have both hired investment banks to consider strategic alternatives, techno glass and lemona.

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00:13:17.050 --> 00:13:25.909

Adam Peck: It is always hard to handicap event driven outcomes, but I'd say the odds are better than 50 50 that at least one of the companies will consummate a deal before your end.

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00:13:26.090 --> 00:13:34.850

Adam Peck: I will say we would not be disappointed if a deal or 2 does not transpire, as we see long runways for value creation. In both companies

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00:13:36.120 --> 00:13:41.399

Adam Peck: our largest underweight isn't consumed discretionary. If using the Russell 2,000 as a benchmark.

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00:13:41.490 --> 00:13:50.369

Adam Peck: our consumer exposure is mass, though, as we are exposed in the communication space to the consumer. With Marcus. Marcus owns hotels and movie theaters.

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00:13:50.390 --> 00:13:54.880

Adam Peck: We're becoming more bullish on a better movie slate with the strike ending.

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00:13:55.180 --> 00:14:04.540

Adam Peck: And Covid no longer keeping moviegoers at home. We doubled down on our movie exposure this month and look forward to sharing details in our next update.

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00:14:06.700 --> 00:14:16.239

Adam Peck: Here you can see our metrics are fairly in line with the benchmark, the Russell 2,000, I would note. We do consider the Russell Russell micro as our main benchmark.

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00:14:16.490 --> 00:14:19.769

Adam Peck: A weighted average market cap would be in line with the Russell micro

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00:14:19.910 --> 00:14:20.890

Adam Peck: benchmark.

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00:14:21.460 --> 00:14:29.519

Adam Peck: I think it's very important to note that every company in the portfolio is profitable. The last time I looked less than 50% of Russell

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00:14:30.563 --> 00:14:34.159

Adam Peck: of the Russell Benchmark companies were proper

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00:14:35.240 --> 00:14:41.320

Adam Peck: looking at 3 months attribution. We outperform both the Russell 2,000 and the Russell Michael Cap

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00:14:41.450 --> 00:14:51.320

Adam Peck: stock selection drove majority of the outperformance. The aforementioned Vico was the top contributor for the strategy. Our top detractor was parion.

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00:14:51.780 --> 00:14:58.940

Adam Peck: Parian provides digital advertising solutions to brands agencies and publishers.

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00:14:59.380 --> 00:15:11.969

Adam Peck: Pairing was impacted when their largest customer Microsoft revised the relationship between the 2 companies by excluding a number of pairings, publishers from Bing's search marketplace.

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00:15:12.210 --> 00:15:24.240

Adam Peck: We were comfortable with sticking in the stock. After speaking with management, and thinking there was a margin of safety and parents roughly 480 million dollar netcast position, which is where the stock was.

100

00:15:24.350 --> 00:15:30.740

Adam Peck: However, the cast position didn't provide the downside protection we had anticipated, and hence the poor return

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00:15:31.960 --> 00:15:40.709

Adam Peck: over the last year the strategy has underperformed the Russell. 2,000 does also underperform the micro benchmark, but by a margin of about 5%.

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00:15:40.730 --> 00:15:44.860

Adam Peck: Vico again, was the top contributor. Over the last year

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00:15:45.260 --> 00:15:51.260

Adam Peck: Harvard Bio has been the top detractor. They actually just reported earnings this morning

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00:15:51.630 --> 00:16:00.430

Adam Peck: the bad news continues as they lowered guidance on weak end markets, specifically, contact research organizations and weakness out of Asia and the EU

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00:16:00.900 --> 00:16:06.170

Adam Peck: right now. The last I looked before the webinar started, the stock was up 6 and a half percent.

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00:16:06.260 --> 00:16:10.639

Adam Peck: So being up 6 and a half percent on bad news, I think, is a good sign.

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00:16:11.010 --> 00:16:13.319

Adam Peck: The CEO did outline a path

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00:16:13.410 --> 00:16:22.919

Adam Peck: to end market improvement and said, based on operational improvements and new products. They could grow in the face of flat and markets.

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00:16:23.550 --> 00:16:32.339

Adam Peck: More detail on stocks bought and sold, as well as deep dives on new names, please reference our latest quarterly letters which are available on our website.

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00:16:35.800 --> 00:16:36.710

Adam Peck: Hey, Pam?

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00:16:36.710 --> 00:16:42.729

Matt Drvaric: Performance for the micro strategy is presented here against the Russell. 2,000. Keep in mind the Russell Micro cap. Index.

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00:16:42.990 --> 00:16:45.259

Matt Drvaric: fit due to licensing issues.

113

00:16:45.320 --> 00:16:51.529

Matt Drvaric: We do not show that net a fee returns are based on the highest fee schedule and can be applied at 1% for retail clients.

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00:16:51.720 --> 00:16:57.000

Matt Drvaric: Adam, take it away and talk about why small caps are poised to outperform.

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00:16:57.980 --> 00:17:06.240

Adam Peck: Great. Okay? So it, may, we put in parentheses finally, be a time for small caps to shine.

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00:17:06.460 --> 00:17:09.050

Adam Peck: Everyone knows the code, even a broken clock

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00:17:09.060 --> 00:17:10.740

Adam Peck: is right twice a day.

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00:17:11.111 --> 00:17:25.899

Adam Peck: Here we have a picture of a broken clock that can't even be right twice a day, and I refer to this as small cap investors calling a bottom, and maybe it's more me calling a relative bottom for small caps. In January of 2023,

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00:17:26.050 --> 00:17:40.609

Adam Peck: in January 2023, we titled a piece, David versus Goliath. Why, small caps will slay market giants in 2023. Clearly I was wrong, and I was wrong again for the 1st 6 months of 2024

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00:17:40.670 --> 00:17:45.540

Adam Peck: as a value investor we're very much known usually for being too early.

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00:17:45.955 --> 00:17:50.800

Adam Peck: That this piece spoke to why, we thought small caps were poised to outperform large caps again.

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00:17:50.930 --> 00:18:01.640

Adam Peck: when we wrote this piece in 23 small caps had been underperforming for roughly 12 years. So I had not been calling for small caps to perform for 12 years, but post that piece.

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00:18:01.660 --> 00:18:07.089

Adam Peck: Obviously large caps went on on a huge run, and we know even the Meg. 7.

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00:18:07.160 --> 00:18:14.119

Adam Peck: Not only did it crush small caps, it also crushed the 493 other stocks in the S. And P. 500

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00:18:15.170 --> 00:18:17.770

Adam Peck: so I'll share again

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00:18:17.920 --> 00:18:23.330

Adam Peck: more than a later. Why, we think now is the time to increase your small kind of exposure. But

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00:18:23.698 --> 00:18:33.259

Adam Peck: I could obviously be wrong in the short term, but I'll wager with anybody over a 5 or 10 year timeframe. I totally believe small caps will outperform, and

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00:18:33.270 --> 00:18:36.300

Adam Peck: if you're willing to make a bet, put it in the chat

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00:18:36.490 --> 00:18:38.410

Adam Peck: before I get into

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00:18:39.300 --> 00:18:43.018

Adam Peck: it, though I think this is a very instructive slide.

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00:18:43.800 --> 00:18:55.880

Adam Peck: as to what's going on with the Mag. 7, the S. And p. 500 in small caps, and this shows the largest stock in the S. And P. 500 going back to 1,987. So it's always going to be whatever the largest stock was.

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00:18:56.480 --> 00:18:59.580

Adam Peck: and it's it's market cap in relation to

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00:18:59.780 --> 00:19:00.620

Adam Peck: the Russell

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00:19:00.850 --> 00:19:09.700

Adam Peck: and Hope Pre covid historically averaged about, I'd say 30 ish percent of the Russell's value post covid.

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00:19:10.080 --> 00:19:12.549

Adam Peck: a lot of concentration. And

136

00:19:13.170 --> 00:19:14.300

Adam Peck: today

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00:19:14.410 --> 00:19:16.180

Adam Peck: we're at the end of the last quarter.

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00:19:16.320 --> 00:19:37.230

Adam Peck: Microsoft represented 115% of all small caps. So, Microsoft, worth more than the entire market. Why do I bring this up? Well, quite interesting. Given,

what's actually just happened in the most recent quarter July was, we saw a huge small cap rally in July, and some weakness in the Mag. 7. And so I think

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00:19:37.550 --> 00:19:46.120

Adam Peck: what could happen is, if you just get a little bit of money coming out of the Mag. 7. If just a little bit finds its way into small caps, you can get large runs.

140

00:19:46.630 --> 00:19:50.109

Adam Peck: and rarely has it ever been this bad for small caps on

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00:19:50.160 --> 00:19:54.680

Adam Peck: a relative return basis. So the next chart.

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00:19:55.247 --> 00:19:58.229

Adam Peck: shows the second quarter's return relative

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00:19:58.480 --> 00:20:13.169

Adam Peck: to the S. And p. 500. This the Russell 2,000 relative return relative to the S. And P. 500. Going back since 1,979. You can see we're in the 90 bottom, 93% of all quarterly returns, which is is pretty bad

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00:20:13.300 --> 00:20:16.479

Adam Peck: on top of that. If you just look at small caps

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00:20:17.132 --> 00:20:20.159

Adam Peck: going back just about a hundred years

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00:20:20.670 --> 00:20:34.209

Adam Peck: the last quarter was also about the 93rd percentile worst out of all quarters going back 100 years. So it's been a terrible small cap market on a relevant basis.

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00:20:35.020 --> 00:20:38.370

Adam Peck: What happens after you're in a terrible small cap market

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00:20:38.920 --> 00:20:50.129

Adam Peck: well, on the next slide you can see. Just start. Well, starting on the right hand side, just so you can see exactly what the relative returns are. For the Russell.

149

00:20:50.420 --> 00:21:04.279

Adam Peck: It was a minus 13.6% under performance. Last time it was this, bad was 1998. So quite a while since micro caps or small caps were this bad? But what happens? Post? So now, moving?

150

00:21:04.698 --> 00:21:06.590

Adam Peck: To the left hand side.

151

00:21:07.680 --> 00:21:31.039

Adam Peck: the average of all the really bad quarters seen on the right was is a negative 9.5% average small caps on average. Then we're down 13 versus S and P. Down 4. What what happens? Looking forward? Well on a relative basis for the forward quarter. Small caps beat by 5.8 and, more importantly, over a long time period, the forward year. Small caps outperformed by 16.8% on average.

152

00:21:31.391 --> 00:21:40.330

Adam Peck: You can see, it's it's it's not perfect. It's positive 66% of the time, and 63. But I will. I will take those for

153

00:21:42.120 --> 00:21:43.880

Adam Peck: I will take that

154

00:21:45.710 --> 00:21:48.650

Adam Peck: So to illustrate this in a different way.

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00:21:49.029 --> 00:21:58.379

Adam Peck: If we look at the next slide, if you look at long term, returns. And so this is annualized. 10 year returns for small versus large.

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00:21:58.780 --> 00:22:05.930

Adam Peck: And right now, over the last 10 years, large has beaten small by 5.9% on a relative basis.

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00:22:05.980 --> 00:22:09.160

Adam Peck: What's interesting is if you go back to last 100 years.

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00:22:09.890 --> 00:22:20.189

Adam Peck: This is about the maximum underperformance on a 10 year rolling time period. It happened 3 previous times. You can see in 2,000 around the early nineties, and again in 1,956.

159

00:22:21.060 --> 00:22:45.999

Adam Peck: If you flip that over the maximum outperformance for small is kind of similar. So you know, small was great. With a 10 year time period ending around 2,009 again in the mid eighties, have fantastic, which is about a 10 year beat, and then in the forties was beating in the high single digits. So both large and small, typically outperform by the same amount when they hit their peaks.

160

00:22:47.670 --> 00:23:09.700

Adam Peck: if we go to the next slide you'll see what happens after those really terrible relative performances, and what you can see here is after you hit minus 5% when looking 10 years forward, just in the short term forward one year, small beats by 6 forward 2 years by 12, and forward 3 by 21.7.

161

00:23:10.271 --> 00:23:12.779

Adam Peck: So why does this occur?

162

00:23:13.428 --> 00:23:16.571

Adam Peck: Well, I believe, though, everything is cyclical.

163

00:23:17.260 --> 00:23:35.690

Adam Peck: and we show that's a locality in the next slide. You can see cycles here, for small versus large can go anywhere from 6 years to 16. The longest large cycle lasted 16. So yes, could this cycle go on for a couple more years? It is possible.

164

00:23:35.700 --> 00:23:48.909

Adam Peck: but if you take a long term horizon, as all investors should in the equity market. Again, if you look out 3, 5, or 10 years, I wholeheartedly believe small will be large.

165

00:23:49.600 --> 00:23:51.690

Adam Peck: So what has actually driven.

166

00:23:52.134 --> 00:24:03.049

Adam Peck: This divergence, and I think if people had to guess most would say, Oh, well, large has had better earnings, because earnings growth is what drives, returns.

167

00:24:03.646 --> 00:24:31.759

Adam Peck: And that has clearly been the case. Large has done better in 2023 and 2024. But if you look at the last 13 years of underperformance. For small it's actually not true, and that is the green bars. So if you look at the Green bar for the Russell, it has increased earnings at a rate of about 8% compared to the S and P. At roughly, a 7% growth rate. So large small has had better earnings growth than large.

168

00:24:31.840 --> 00:24:34.260

Adam Peck: What they haven't had is multiple expansion

169

00:24:34.690 --> 00:24:41.530

Adam Peck: of largest outperformance. The vast mass majority of the outperformance is due to a change in the valuation.

170

00:24:41.600 --> 00:24:50.320

Adam Peck: so is it is receiving higher multiples on the same earnings, and they have slightly higher dividend pans.

171

00:24:50.871 --> 00:24:56.739

Adam Peck: So when you look at the past 13 years. Again, of underperformance. It's not, too.

172

00:24:56.830 --> 00:25:01.850

Adam Peck: to fundamentals. It's due to a change in investors, perception of what the fundamentals are worth.

173

00:25:02.080 --> 00:25:11.859

Adam Peck: and a different way to look at this on the next slide. Is how it's trended that that differences trended over time. And what you can see here is in

174

00:25:12.000 --> 00:25:13.970

Adam Peck: green is that relative

175

00:25:14.400 --> 00:25:33.130

Adam Peck: earnings discrepancy. And so anything above one small is doing better than large and is consistently had better earnings, growth and large again, just it's been tough in the last 18 to 24 months, but still beating large by roughly 50%. The problem has been relative valuation which has just continually been

176

00:25:33.370 --> 00:25:37.509

Adam Peck: heading downward. And again, as I believe that everything is.

177

00:25:37.630 --> 00:25:43.190

Adam Peck: it's cyclical. I think we're getting close to the bottom on a relative value basis.

178

00:25:45.810 --> 00:25:56.289

Adam Peck: So you can. Make the argument. Another way is to look at valuation on a relative basis. And this actually shows the Russell 2,000

179

00:25:56.970 --> 00:26:01.380

Adam Peck: ex biopharma, which includes a number of loss makers

180

00:26:02.250 --> 00:26:03.810

Adam Peck: which are unprofitable.

181

00:26:03.910 --> 00:26:05.907

Adam Peck: And you can see that relative.

182

00:26:06.758 --> 00:26:17.209

Adam Peck: earnings. On average, I'm sorry. Relative valuation on average is about 165%. So small typically has a higher multiple again, because it has more growth.

183

00:26:17.250 --> 00:26:27.780

Adam Peck: So it usually is priced better but the one standard deviation line is the red and the green. I don't have the 2 standard deviation line, but we are getting pretty close on

184

00:26:27.890 --> 00:26:57.630

Adam Peck: the lowest relative valuation for small versus large. Again, excluding loss makers. Could we get to levels that we saw in 99, 2,000? It's possible. That would require about another 14% decline in the relative valuation. But what I'll also note is it? It happened for a very brief amount of time, I'd say 6 months to get that low, and then it it snapped right back. So from a valuation basis. Small is very, very attractive.

185

00:27:01.330 --> 00:27:09.600

Adam Peck: So why am I optimistic? That this valuation discrepancy should reverse? Well again, if you look in the the upper left

186

00:27:09.989 --> 00:27:14.569

Adam Peck: in dark blue, is the Russell. 2,000 light blue is the S. And P. 500

187

00:27:15.010 --> 00:27:19.749

Adam Peck: small caps have not been keeping up with large earnings. Growth, because.

188

00:27:20.938 --> 00:27:23.930

Adam Peck: mainly, I believe, small caps

189

00:27:24.170 --> 00:27:26.500

Adam Peck: have a little bit more depth than large.

190

00:27:26.940 --> 00:27:37.950

Adam Peck: and and by and large they have a lot more floating rate debt. And so when the fed. Increased interest rates that disproportionately hurt small versus large.

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00:27:39.170 --> 00:27:41.300

Adam Peck: If you look to 2025

192

00:27:43.130 --> 00:27:58.039

Adam Peck: Wall Street is looking for small caps to increase their earnings 28% versus large up only 13 and change. And again, I think if the fed does start to become accommodative, the odds of small being being large, increase tremendously.

193

00:27:58.690 --> 00:28:08.070

Adam Peck: likewise same factor on sales not as large, of a discrepancy, but still a street is looking for larger sales growth out of small versus large and

194

00:28:08.150 --> 00:28:27.760

Adam Peck: data that already proves small is on the upswing from an earnings. Growth basis is the chart on the bottom that shows the percentage of companies with upward revisions in current year earnings for small has been 15% of all companies versus only 7% for the S. And P. 500,

195

00:28:28.670 --> 00:28:30.469

Adam Peck: so to wrap it all up

196

00:28:30.809 --> 00:28:59.520

Adam Peck: what are? Well, I guess. Well, to wrap it all up, why do I think Small is poised to outperform over the next 3, 5, 10 years. Well, relative returns are cyclical, and we're we gotta be getting close to the end. After 13 plus years. Valuations are definitely attractive on a relative basis and relative earnings. Outlook is good, Matt referenced at the beginning. The quote from Michael Porter, and that you know to really be great, we have to be differentiated. I thought this was cute

197

00:28:59.874 --> 00:29:08.029

Adam Peck: way to wrap things up as I I referenced the the broken clock this is, you know, an exam from probably

198

00:29:08.610 --> 00:29:21.327

Adam Peck: I don't know kindergarten or 1st grade whenever kids learn how to tell time. And you know this this little suit he took a differentiated approach to answering the question which is is how we think about things. So we we

199

00:29:21.780 --> 00:29:28.799

Adam Peck: we're bullish on small caps, and think we are perfectly positioned to outperform over the long term, and with that I will pass it over to Cindy.

200

00:29:31.680 --> 00:29:35.359

Cindy Bohlen: Thank you, Adam, and thank you. Everyone for joining us today.

201

00:29:35.510 --> 00:30:00.639

Cindy Bohlen: Today, I'd like to share some highlights of river waters engagement activities during the second quarter as a reminder. The second pillar of our responsible investment process is engagement with companies about starting the sustainability journey and improving their efforts relating to Esg. Factors that are material to their business. It also includes proxy voting.

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00:30:02.020 --> 00:30:11.240

Cindy Bohlen: In April, Adam Matt and I met with tanner dos, investor relations of Black Rifle Coffee Company at their headquarters in Salt Lake City.

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00:30:11.390 --> 00:30:31.570

Cindy Bohlen: We were given a tour, and we discussed the Company's mission history and strategy. We also sampled the delicious coffee. We were pleased to learn about the company's responsible sourcing of coffee, beans, as well as its mission, to bring excellent coffee and opportunity to veterans, police officers and 1st responders

204

00:30:31.760 --> 00:30:49.610

Cindy Bohlen: as a public Benefit corporation. Black Rifle has received formal affirmation of its multi stakeholder focus. Therefore we suggested they begin

storytelling and we shared a few exceptional sustainability reports for them to use as a guide

205

00:30:49.880 --> 00:31:09.450

Cindy Bohlen: as a beverage company. We suggested that Black Rifle also consider giving attention to water, energy and waste stewardship in its operations. We recommended connecting with the Water Council for Water stewardship advice. Once a water risk analysis has been completed.

206

00:31:09.710 --> 00:31:15.100

Cindy Bohlen: will monitor for progress, and we do stand ready to help if they need it.

207

00:31:16.830 --> 00:31:26.120

Cindy Bohlen: The research team also had the opportunity to tour the plexus headquarters and its Nina and Appleton manufacturing plants. In April

208

00:31:26.140 --> 00:31:50.900

Cindy Bohlen: we met with Todd Kelsey, CEO, Oliver Heem, chief operating officer, Sean Harrison investor relations to discuss current business trends. We also met with Megan Schleicher, director of Esg. To discuss plexus's current sustainability priorities. Many of the top sustainability practices they they highlighted for us were evident during our visit

209

00:31:50.900 --> 00:31:58.690

Cindy Bohlen: things like implementation of waste streams, management to recycle nearly all packaging parts, etc.

210

00:31:58.890 --> 00:32:13.220

Cindy Bohlen: Attainment of an 11.9% energy intensity, reduction via the use of skylights and also sensors to adjust the led lighting in the building based on the level of incoming sunlight

211

00:32:13.660 --> 00:32:22.900

Cindy Bohlen: implementation of workplace standards that assure worker safety and fair treatment, as well as growth and development in their careers at plexus

212

00:32:23.370 --> 00:32:36.459

Cindy Bohlen: formalization of a supplier code of conduct and human rights policy to ensure that labor and natural resources are sourced responsibly throughout the supply chain

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00:32:36.960 --> 00:32:59.600

Cindy Bohlen: and completion of a water risk, assessment and design of systems to improve water flows at manufacturing sites. One of Plexus's manufacturing sites is located in Guadalajara, Mexico, which is a high water stress area. This makes it extremely important that plexus implements stewardship of water used at that site.

214

00:33:00.080 --> 00:33:07.739

Cindy Bohlen: Therefore we reintroduced plexus to the Water Council to help inform. Best practice related to water.

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00:33:08.240 --> 00:33:14.680

Cindy Bohlen: Importantly, Plexus also formalized its design for environment service, offering

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00:33:14.740 --> 00:33:25.309

Cindy Bohlen: this offering seeks to design products and their manufacturing processes for circularity by using lower virgin material content.

217

00:33:25.350 --> 00:33:29.250

Cindy Bohlen: reducing greenhouse gas emissions of end products.

218

00:33:29.450 --> 00:33:32.230

Cindy Bohlen: using recycled packaging.

219

00:33:32.580 --> 00:33:36.889

Cindy Bohlen: in extending product life by making service easier

220

00:33:37.090 --> 00:33:40.739

Cindy Bohlen: and optimizing end of life. Material capture.

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00:33:41.680 --> 00:33:51.050

Cindy Bohlen: Plexus believes that its focus on material Esg factors offers benefits for all stakeholders, including shareholders, and we agree.

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00:33:53.420 --> 00:34:00.250

Cindy Bohlen: The second quarter generally brings the majority of company annual shareholder meetings and proxy votes.

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00:34:00.540 --> 00:34:10.979

Cindy Bohlen: river water votes, all proxies in alignment with our proxy voting guidelines, which favour management and shareholder proposals that align with our Esg. Views.

224

00:34:11.120 --> 00:34:19.189

Cindy Bohlen: When we vote against a company, we write to the board of directors explaining our rationale and inviting dialogue.

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00:34:19.820 --> 00:34:28.910

Cindy Bohlen: During this proxy season, as in most voting seasons, most of our votes against management fall in the area of governance.

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00:34:29.010 --> 00:34:38.469

Cindy Bohlen: sound governance kind of seemingly the often neglected stepchild of Esg is really paramount to successful value. Creation by business

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00:34:39.090 --> 00:34:45.270

Cindy Bohlen: given that we invest in the small and mid cap space. It's not uncommon for companies to be founder led.

228

00:34:45.290 --> 00:34:49.389

Cindy Bohlen: This often means that the CEO is also the chair of the board.

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00:34:49.810 --> 00:35:02.719

Cindy Bohlen: We share information about why separation of the chair and CEO roles is best practice, and suggest that a lead independent director be appointed as a good start towards separation of the roles.

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00:35:04.070 --> 00:35:14.040

Cindy Bohlen: Smaller companies are also more likely to have staggered boards, often to protect against unsolicited bids to acquire the company or gain board control.

231

00:35:14.520 --> 00:35:20.539

Cindy Bohlen: best practice and better outcomes really support board members standing for election. Each year

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00:35:20.770 --> 00:35:30.130

Cindy Bohlen: we received a response to one of our letters to the board of a Portfolio company on this topic, stating that the Board will take it up in the New Year.

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00:35:31.750 --> 00:35:41.080

Cindy Bohlen: We believe that all stakeholders, including shareholders, are rewarded when companies generate superior returns on their invested capital.

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00:35:41.240 --> 00:35:49.240

Cindy Bohlen: Therefore we suggest that companies use return on invested capital as a long-term incentive compensation. Metric.

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00:35:49.620 --> 00:35:51.310

Cindy Bohlen: One of the portfolios.

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00:35:51.340 --> 00:35:59.569

Cindy Bohlen: Portfolio companies we wrote to on this topic, responded to our letter, stating that the Board will take up the question.

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00:35:59.740 --> 00:36:10.990

Cindy Bohlen: Another initiated dialogue with us to describe their current attention, to return on investor capital, and why it uses other benchmarks for incentive comp.

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00:36:11.030 --> 00:36:15.799

Cindy Bohlen: They said the Compensation Committee would revisit return on invested capital in the future.

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00:36:16.220 --> 00:36:28.529

Cindy Bohlen: Finally, one item that's been finding its way onto ballots is the exculpation from fiduciary duty of care which removes liability for an officer's breach of his or her duty of care.

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00:36:28.560 --> 00:36:41.940

Cindy Bohlen: Delaware law now allows this practice to be adopted into corporate bylaws with shareholder approval. We vote against these proposals, as we believe they are not in the best interest of stakeholders.

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00:36:44.756 --> 00:37:05.769

Cindy Bohlen: In the Quarter River water signed on to the 2,024 global investor statement to governments on the climate crisis, encouraging a whole of government approach to implement policies in line with countries nationally determined contributions, and a 1 and a half degree

242

00:37:05.770 --> 00:37:18.509

Cindy Bohlen: scenario per the Paris agreement. Remember, countries have committed to this. And so this letter was intended to have them work toward their promises.

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00:37:18.980 --> 00:37:27.190

Cindy Bohlen: recognizing common but differentiated responsibilities and respective capabilities between emerging and developed economies

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00:37:27.200 --> 00:37:32.119

Cindy Bohlen: will accelerate private sector action and large scale investment.

245

00:37:32.340 --> 00:37:35.949

Cindy Bohlen: And given that climate change is the crisis of our day.

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00:37:35.990 --> 00:37:46.580

Cindy Bohlen: We recognize that Ngos nonprofits and corporations need strong governing systems to work toward this coordinated and meaningful progress forward.

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00:37:46.900 --> 00:37:50.269

Cindy Bohlen: The Government's role is really crucial for success.

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00:37:51.930 --> 00:38:06.340

Cindy Bohlen: Finally, river water signed onto the Unpri statement from the private financial sector to Member States negotiating the internationally, legally binding instrument to end plastic pollution.

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00:38:06.600 --> 00:38:10.320

Cindy Bohlen: This is one of the United Nations top goals. For 2024.

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00:38:11.000 --> 00:38:38.370

Cindy Bohlen: The statement was drafted by the unep for financial institutions, the Pri, the finance for Biodiversity Foundation business Coalition coalition for a Global Plastics Treaty, the Dutch Association of Investors for Sustainable Development and Cdp, it's endorsed by 160 financial institutions representing over 15 and a half trillion in combined assets.

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00:38:39.020 --> 00:38:43.009

Cindy Bohlen: According to Earth. Overshoot day for 2024

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00:38:43.060 --> 00:38:55.909

Cindy Bohlen: plastic overshoot day is projected to occur on September 5, th marking the point when plastic waste produced surpasses the planet's waste management systems

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00:38:56.130 --> 00:38:57.740

Cindy Bohlen: in 2024,

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00:38:57.780 --> 00:39:06.989

Cindy Bohlen: 220 million tons of plastic will be created, and nearly 70 million tons of plastic will end up in nature.

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00:39:07.120 --> 00:39:24.800

Cindy Bohlen: The purpose of this statement is to demonstrate support from the financial sector for an ambitious international, legally binding instrument to end plastic pollution and to set out what a robust agreement would include from the perspective of the financial sector

256

00:39:24.890 --> 00:39:30.990

Cindy Bohlen: efforts at individual companies like those we highlighted earlier at plexus are not enough

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00:39:32.050 --> 00:39:52.239

Cindy Bohlen: to conclude river waters. Asset management team invests in companies that generate high returns on invested capital, the measure of the value they're creating for society. While responsibly using society's physical, human, and financial resources, that value creation is recognized by the market

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00:39:52.240 --> 00:40:02.589

Cindy Bohlen: in the form of higher shareholder returns. And this is how river water seeks to fulfill our mission, to make the world a better place by growing wealth through sustainable investing.

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00:40:02.630 --> 00:40:03.510

Cindy Bohlen: Thank you.

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00:40:08.860 --> 00:40:15.910

Matt Drvaric: Thank you for the update on the strategies, Adam and Cindy, and for highlighting the engagements of the quarter. At this time we welcome any questions

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00:40:18.330 --> 00:40:20.490

Matt Drvaric: we did receive a question earlier

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00:40:20.560 --> 00:40:23.420

Matt Drvaric: is a current topic in the market today.

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00:40:23.520 --> 00:40:32.730

Matt Drvaric: What do you believe is the most misunderstood thinking around Esg investing today. And you know specifically for us, maybe, as it relates to small cap.

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00:40:34.920 --> 00:40:36.111

Adam Peck: Cindy, you want to start.

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00:40:36.350 --> 00:40:47.660

Cindy Bohlen: Yeah, sure, I can go with that first.st So I mean, I think generally the most misunderstood topic is the idea that superior return generation

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00:40:47.660 --> 00:41:08.670

Cindy Bohlen: is inconsistent with a focus on sustainability factors. And we actually believe. And we've seen this in our own portfolio companies and in results of meta studies that actually, the opposite is true. A focus on material factors of any sort, including environmental, social and governance ones.

267

00:41:08.670 --> 00:41:25.599

Cindy Bohlen: really have the potential to materially impact the financial outcomes for companies. So we think that they are materially, or they're inextric, inextricably combined. That you cannot have superior outperformance without

268

00:41:25.680 --> 00:41:32.079

Cindy Bohlen: at least considering the material Esg. Factors that can affect a company.

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00:41:32.150 --> 00:41:33.749

Cindy Bohlen: Adam, did you want to add.

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00:41:37.660 --> 00:41:44.110

Adam Peck: Yeah, I will. And Cindy answered it perfectly. I I think the only thing I would add is

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00:41:44.650 --> 00:41:48.990

Adam Peck: that we believe the companies that

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00:41:49.260 --> 00:41:51.460

Adam Peck: realize that

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00:41:51.760 --> 00:41:54.610

Adam Peck: Esg factors are important.

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00:41:55.320 --> 00:41:59.209

Adam Peck: I think, indicates that they're better managers.

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00:42:00.435 --> 00:42:01.450

Adam Peck: And

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00:42:01.530 --> 00:42:03.599

Adam Peck: I think that's why you you

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00:42:03.740 --> 00:42:05.699

Adam Peck: don't have a performance

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00:42:06.137 --> 00:42:08.849

Adam Peck: headwind. When you look at these factors.

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00:42:09.050 --> 00:42:17.218

Adam Peck: And there was a report that just came out of the Wall Street Journal in the CEO section like a week ago.

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00:42:17.610 --> 00:42:24.505

Adam Peck: again. This is the Wall Street Journal that that was looking at a study that looked at the number of

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00:42:25.020 --> 00:42:32.749

Adam Peck: responsible jobs for each company, and found that those companies that had more employees dedicated to sustainability

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00:42:33.040 --> 00:42:40.670

Adam Peck: beat the average company across a number, and actually have them. The article here across, beat the average by a number of factors.

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00:42:41.417 --> 00:42:47.749

Adam Peck: Which included customer satisfaction, employee engagement, innovation, financial strength, overall effectiveness. So

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00:42:48.010 --> 00:42:55.659

Adam Peck: you know, I believe environmental social governance is to totally intertwined with companies, operational strategic

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00:42:56.890 --> 00:43:00.380

Adam Peck: goals and and paths. And so

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00:43:01.388 --> 00:43:05.150

Adam Peck: I there, I think there is a large misperception

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00:43:05.837 --> 00:43:12.359

Adam Peck: in the market today. About what it actually is and how it actually impacts companies.

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00:43:15.830 --> 00:43:17.040

Matt Drvaric: Thank you. Have a big

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00:43:17.100 --> 00:43:19.290

Matt Drvaric: Cindy. Are those all the questions at the time

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00:43:19.310 --> 00:43:30.919

Matt Drvaric: to conclude the call? We are passionate about small cap, responsible investing and believe these factors are crucial to help minimize portfolio volatility through maintaining positions in superior businesses that endure market cycle.

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00:43:31.050 --> 00:43:48.499

Matt Drvaric: We welcome your consideration as a manager. Additional data on the strategies can be found in investment. Morning star investment metrics, Psn. Wilshire and Calend databases. If you have additional questions or would like to speak directly with a member from our team. Please contact me. We look forward to talking with you again next quarter. Enjoy the balance of summer.

292

00:43:51.240 --> 00:43:52.180

Adam Peck: Thanks. Everyone.

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00:43:52.180 --> 00:43:53.140

Cindy Bohlen: Thank you.

294

00:44:04.770 --> 00:44:06.321

Adam Peck: Okay. Everyone's on.

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00:44:08.060 --> 00:44:08.830

Cindy Bohlen: Okay.

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00:44:09.290 --> 00:44:09.869

Adam Peck: You know what.

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00:44:09.870 --> 00:44:11.899

Cindy Bohlen: Done everybody. I thought it was great.

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00:44:12.200 --> 00:44:12.900

Adam Peck: Yeah.

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00:44:14.810 --> 00:44:15.940

Matt Drvaric: Good to keep doing them.

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00:44:19.000 --> 00:44:19.520

Adam Peck: Are you?