

## Q4 2024 - Small Cap Value Quarterly Update

Portfolio Manager Evan Fox, CFA provides an update on the fourth quarter for our Small Cap Value strategy.

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Hi, this is Evan Fox, one of the portfolio managers on Pzena's Small Cap Value products. Uh, we just finished 2024, which ended with a pretty volatile quarter, as we saw stocks generally—and particularly small stocks—do well in November with the election results, but then almost all of that performance reversed in December as we pulled into the end of the year. We continued a trend that we've seen throughout the course of the year, and for quite a few years, of small caps underperforming their large-cap peers, and we saw, uh, value underperforming growth in that backdrop. And we—for the quarter, we underperformed the value benchmark just slightly.

When you look at what some of the top contributors were, uh, the top sectors were financials and healthcare. The top individual name was Genesco, which is a company in the retail space. They own Journeys, which is really a mall-based, uh, teen-targeted shoe retailer. Uh, they also own Johnston & Murphy, which makes the men's dress shoes that I'm wearing right now, and they own Schuh, which is a shoe retailer in the UK. This is one that's been under quite a bit of pressure, but what we saw is that same-store sales turned positive off of pretty easy comps, and with how depressed the valuations were, the stock did incredibly well. They've also done a nice job of improving their product assortment and, uh, diversifying some of the suppliers that they have.

Another top contributor was Bread Financial. This is a company that makes private-label credit cards, and there's been a lot of concerns over the course of the last year that there could be caps on late fees and other regulatory actions. What we've seen is that the industry, and Bread, have done a nice job of creating a lot of offsets in order to deal with that and still be just as profitable, even if some of these regulatory, uh, changes occur. But also, with the election results in November, the—the odds of some of the, uh, some of these regulations going into effect went down substantially, and the stock did very well.

On the detractor side, the biggest detracting sectors were industrials and basic materials. Uh, one of the notable names is Jeld-Wen, which is a window and door manufacturer. This is one where it was weak in the quarter on a couple different things. One was that we've just had general housing weakness, and they also did lose, uh, one retailer customer who's trying to import windows. It's interesting because this is not something we've really seen happen in the market—just the nature of importing glass from China—and we will see how it works, but there is a good chance that it ends up failing, and we'll see if they end up coming back over time. The other thing that happened is, there's been a lawsuit for a number of years between Jeld-Wen and one of their customers that ultimately led to Jeld-Wen being forced to divest, uh, one of their facilities. The court then took over that process and ended up selling the facility for a price that was incredibly depressed versus what it was worth, which is very disappointing, and we're working through that.

Another stock that detracted was Olin. This is a chemical company that makes chlor alkali—that means they make caustic soda and chlorine—and they use it for a wide range of end applications. We've seen end demand being very depressed, and this is really driven by a range of just macro expenditures. But then we also had them deal with hurricane damage, and then one of their customers announced that they're vertically integrating and adding some of their own capacity. The stock was down on that, and again, it's one where there is risk of the market being more competitive with more capacity opening, but we're also at a very depressed level. And because Olin has been the player to take out a lot of capacity and reduce their utilization, when volumes do recover, they're really going to be the ones to see that operating leverage on the way up.

In terms of notable portfolio actions, we had quite a few tweaks that we were making, but I want to call out particularly a new name that we added to the portfolio. Uh, this is the company Envista, which is a leading dental products manufacturer. They're especially big in dental implants and in orthodontics. What's interesting about the dental space is that it's been particularly depressed over the last couple years with just the macro environment, because a lot of the expenditures are discretionary. And so as interest rates have gone up, as, uh, consumers have tighter budgets, they've actually spent less on their teeth. When you combine that macro pressure with Envista's own, uh, portfolio—they're skewed to some of the higher-priced procedures that have been under pressure—but also, they've invested quite a bit in the last few years in clear aligners. This is the orthodontics where it's basically clear bite plates that you use rather than putting full braces on. And they've lost money the last few years as they've invested in it, but they should turn break-even soon. And so when you combine some of the overall market pressures that the industry has faced with their earnings growth and their turnaround as some of their investments come into profitability, it's a quite attractive opportunity that we're seeing today.

Uh, when you look at how we've funded this and some of our other buys, we've trimmed back some of our financials that have done well, and we exited a few of our names, including Gap—the retailer that owns Gap, Banana Republic, Athleta, and Old Navy. We also trimmed and sold out of Belden, a signal transmission company, as well as Interface, a company that makes carpet tiles for offices.

So in closing, as we move into 2025, the backdrop for small-cap performance has been challenged. There have been eight years in a row that small caps have underperformed their large-cap peers, but we're also at extreme valuation differences. And so as we look at it, we see opportunity for earnings growth going forward, but more importantly, the valuation disconnect between small caps and large caps is at historically wide levels. So we feel very optimistic for the relative performance opportunities as we go into 2025.

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