Small Cap Value – 1Q2025

Hi, I'm Evan Fox, one of the portfolio managers on Pzena Investment Management's Small Cap funds. We just finished the first quarter of 2025, and it's been a pretty extreme start to the year, as we've already seen so much uncertainty with tariffs, with the economic implications of that, and what that's doing to really the whole global economy.

When you look at what's been going on so far, we've really seen that in this period of uncertainty, small caps have continued to underperform, continuing a trend that, to be honest, we've seen for fourteen years in a row now. And what we also saw in terms of value is that while within large cap, value actually held up much better than growth, within small cap, value did slightly better but with much less of a differentiation. During this period, we did underperform our benchmark a bit in the first quarter.

When you look at what really drove some of the performance, the sectors that were under the most pressure, unsurprisingly, are consumer discretionary and industrials. These are two sectors that are both impacted by recessionary concerns and tariffs more broadly. A couple of the individual biggest detractors I'll touch on: Adient, a seat manufacturer for automobiles, as well as Genesco, a retailer.

So Adient is a leading manufacturer of seats for cars. What's notable about this is that typically the seats are actually completed near where the original equipment manufacturer—where Ford, GM, or anyone else—is located. So from a net importing perspective, a lot of the tariff impact is really driven by the decisions that the OEM has made. They do have some components, such as some of the metalwork that goes into the seats, that they make in Mexico, and there's been a lot of discussions of what's going on there. What I will say is there are really a couple elements of tariffs: one is the ability to put it through, but the other is the impact on pricing. And I think what we're really seeing here is that they should be relatively well positioned to pass it on to their customers, but what we don't know at this point is if those prices are put through to the end consumers, will demand come down substantially, which is a broader issue for automobile sales globally and especially in the U.S.

The other one is Genesco, which owns Journeys, the mall-based teen shoe store. They also own Johnston & Murphy, which is mainly men's shoes as well as other products. This is a stock that was actually a top contributor in the fourth quarter, as after a period of weakness, same-store sales improved and there was a lot of optimism. We actually trimmed quite a bit of the position, and then this quarter, sure enough, they said, "We don't have that much visibility into 2025," which is to be expected because, to be honest, teens buy shoes and other products especially at the back-to-school season and the holiday season, so it's very loaded to the last few months of the year. The stock fell pretty dramatically, and we actually took the opportunity to buy back a portion of what we had sold earlier in the quarter.

When you look at what was positive and what contributed to performance, the only sector that was actually positive was technology, and that was led by Concentrix, which was the top individual contributor. This is a contact center operator—if you're outsourcing your call center, your online chat, or anything else. They have operations around the world, in the U.S. but also in the Philippines and Costa Rica and other countries like that. The short thesis on this, and the reason that it's been an opportunity for us, is people have been afraid that artificial intelligence will get rid of the need for this, and that structurally we're going to see declines in this industry. In reality, what we saw during the quarter was a continuation of what we've been seeing over the last year or two: more and more of their customers have already implemented AI—over 50% of their customers have done so—and they're actually still growing. Now it's low single-digit growth, but the very fact that they're able to say that, even as customers are going to AI and putting in those implementations, their sales are still growing, really was well perceived by the market, and the stock was up pretty significantly right after that news.

The other biggest contributor was a life insurance company, CNO Financial, and this is a company that just gave better-than-expected results. They've been chugging along pretty well for quite a while with better underwriting results than expected, and they actually just gave new midterm ROE targets that were higher than they're earning today, which led to the stock going up.

In terms of portfolio actions, we added a new name, Robert Half. They're a leading provider of staffing and consulting services. They especially focus on the finance and accounting fields, and they have one division, Protiviti, that's particularly well positioned to take share from some of the bigger accounting firms because they're able to leverage some of their lower-cost labor to more efficiently serve those clients, and it's been growing pretty rapidly over time. The stock's been trading down as we've had low job turnover throughout the economy and a weak staffing market more generally, but we were able to take advantage of that weakness.

When you look at some of the source of funds, we fully exited AXIS Capital, which is a Bermuda-based property and casualty insurer, where we've seen quite strong pricing in the insurance market over the last year, and the stock's done quite well. And we also trimmed CNO Financial, one of the top contributors I mentioned earlier.

As we continue into the second quarter, this continues to be a particularly challenged market. We've already seen more color as to the tariffs, although it does seem that every day there's more evolution as to what's going on there, and markets have been down more broadly. This is really the kind of opportunity that we take advantage of as value investors, because we're looking to see which things we've had overreactions for, and by being patient investors that can work our way through it and really take advantage of that, we're excited for what could be coming in the coming months and years.