PMV Month In Review

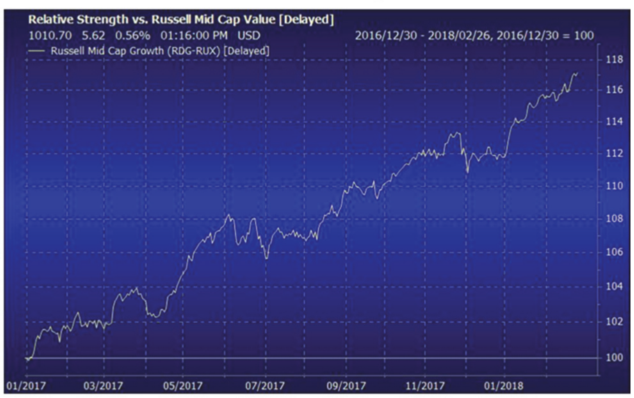
February 2018

Macro

Inflation was February's focus; trade appears to be the focal point as we enter March.

The markets finished broadly lower in February (S&P, Russell 3000, NASDAQ, DJIA all down 2%-4% for the month) on the heels of a 10% correction from January 26-February 8, which was driven by inflationary and interest rate concerns. However, the markets have recovered somewhat in the last two to three weeks and remain modestly positive YTD. One aspect of the selloff, which seemed to defy typical patterns, was the quick, uniform nature of the decline. Candidly, given the >200% spike in the Chicago Board Options Exchange Volatility Index (VIX), we would have expected growth and momentum stocks to take larger hits in such a market environment. But this was not the case, as stock correlations approached 1.0 and growth, value, momentum, etc. all declined approximately the same amount. In fact, looking at the chart below, November was the only meaningful change in market sentiment/price action, while large cap and growth style indices continue to exhibit market leadership (spread between large cap growth and small cap value >800 bps YTD). Despite the style headwind, the Mid Cap PMV strategy has benefitted from a return of volatility to the markets, with significant intra-day swings still prevalent.

Russell Mid Cap Growth Relative Strength vs. Russell Mid Cap Value



Source: FactSet

Longer-term, we continue to believe recent market and economic dynamics (rising rates, tax reform, growth vs. value mean reversion) could serve as a relative performance tailwind for our PMV discipline in 2018. While inflation was February's focus, trade and tariffs appear to be the focal point as we enter March with the Trump Administration leaning toward a protectionist policy agenda. While it is difficult to predict the ultimate outcome, from a stock level, we do not own any material stocks or true industrials, so we believe our portfolio is fairly immunized. In fact, very few names in the portfolio have any steel or aluminum input costs. The few that do (Borg Warner, Snap On and National Oilwell) all have pricing power, technology, and switching costs embedded which should help them protect margins. Ultimately higher costs hurt companies without pricing power, which is one of the reasons our quality focus and discipline tends to benefit in increasingly inflationary environments.

Earnings

Portfolio widens YTD lead vs. index with one of the strongest earnings seasons in recent memory.

The Mid Cap PMV portfolio extended its lead vs. the Russell Midcap Value Index last month due to a combination of 1) continued positive Q4 earnings, 2) increased market volatility, and 3) the announced buyout of CSRA, Inc. by General Dynamics. All-in-all, this has been one of the strongest earnings seasons the portfolio has seen in years. Of course, we are not alone in this regard as EPS reports have been strong across the universe. However, the absence of negative reports in the portfolio, coupled with much higher guidance for EPS in FY'18 has definitely helped to support our stocks during some volatile markets of late. Overall, the average stock holding in Mid Cap PMV revised its 2018 EPS guidance 8% higher compared to year-end. The primary trends & themes we have observed include:

- Higher EPS guidance based on lower corporate tax rates in 2018
- Higher corporate spending based on lower tax rates (investing for the future)
- Pricing increases to offset rising costs (raw material costs, tight transportation markets, higher wages) = coming inflation
- Ongoing gap (pun intended) between GAAP earnings and adjusted earnings

This last trend continues to bother our conservative nature, as management teams seem more intent than ever to present their results in the best possible light, with all kinds of non-recurring adjustments and add-backs. The overall concern is that 2018

(continued from page 1)

guidance has been provided at a time of CEO optimism, and all these increased investments ultimately lead to more supply and competition which limit corporate profit margins in late 2018 & 2019. Ultimately, we believe much of the tax savings being baked into guidance today will ultimately be shared with suppliers, customers, employees, etc. as excess profits get competed away over time. This is one of the reasons we believe our quality focus will benefit on a relative basis.

Portfolio Activity

New purchase of Loews

Overall the portfolio continues to be somewhat defensively positioned with a healthy cash balance and many business models that should prove resilient in the face of future market volatility. Our recent purchase of Loews would be an example of such a stock. The sum-of-the-parts discount widened to 31% in the market selloff, creating the entry point needed in early February. Loews is a conservatively-managed conglomerate with $2.7 billion in net cash and a business mix driven by a steady specialty/ property insurance business (CNA is 60% of value). The stock trades at a significant discount to PMV and even to its publicly-traded holdings. The company owns significant assets in hotels, packaging, and energy pipelines. Their high-end Loews hotels are growing organically (EBITDA +14% in Q4) with group business at 50% of total and an increasingly attractive Universal partnership. The new CEO at CNA Financial continues to make progress with better underwriting and cost controls. Loews also stepped-up company stock buybacks in Q4 and YTD'18, and we were happy to put capital to work alongside this value-driven management team.

On a final portfolio note, we did swap out of Archer Daniels and into Ingredion. While most of our swaps are driven by valuations, occasionally a quality upgrade at the same price is available. Such was the case with INGR. Both stocks trade at the same multiple of 8.5x EBITDA, and both companies operate in agricultural businesses. Although ADM has cost and scale advantages in the processing, transport and storage of crops, the firm has been unable to grow its specialty business and remains captive to the ag cycle with low margins. INGR on the other hand has grown its specialty business over the years to 29% of revenues and 50% of profits through organic means and smart acquisitions. The firm's ROIC has been improving consistently and we expect this to continue in the years ahead. Over time we expect the stock's valuation multiple to expand as the mix shift continues to improve.

To reach a representative for your region, please contact:

U.S. West Region (AK, AR, AZ, CA, CO, HI, IA, ID, IL, KS, LA, MI(UP), MN, MO, MT, ND, NE, NM, NV, OK, OR, SD, TX, UT, WA, WI, WY):
Joel Dykman (608) 609-4141 jdykman@reinhart-partnersinc.com
U.S. Southeast Region (AL, DC, FL, GA, KY, MD, MS, NC, PR, SC, TN, VA, WV):
Christopher Rhyne (336) 817-8206 crhyne@reinhart-partnersinc.com
U.S. Northeast Region (CT, DE, IL, IN, MA, ME, MI, NH, NJ, NY, OH, PA, RI, VT)
Christopher Hodges (443) 326-1875 chodges@reinhart-partnersinc.com
Director, Institutional Client Services (MI):
Rick Plawecki (248)-330-6363 rplawecki@reinhart-partnersinc.com

Chicago Board Options Exchange Volatility Index (VIX): an unmanaged index calculated from options on the S&P 500 Index and is supposed to reflect the market expectation of the index's annualized 30-day volatility. The volatility measured by the VIX reflects both the possibility of upside movements as well as the possibility of downside movements. An investment cannot be made directly to an index.

Russell Midcap Value Index: an unmanaged index that measures the performance of those Russell Midcap companies with lower price-to-book ratios and lower forecasted growth values. An investment cannot be made directly to an index.

Russell 3000 Index: an unmanaged index that measures the performance of the 3,000 largest U.S. companies based on total market capitalization. An investment cannot be made directly to an index.

Reinhart Partners, Inc.
1500 W. Market Street, Suite 100
Mequon, WI 53092
262-241-2020
www.reinhart-partnersinc.com