

# Mid Cap Strategy

3Q:23



## MISSION STATEMENT

At QSV Equity Investors we strive to deliver a smoother ride in good markets and bad, seeking to help our clients reach their long-term investment goals by setting clear expectations and through investment in high-quality small and mid cap value stocks.

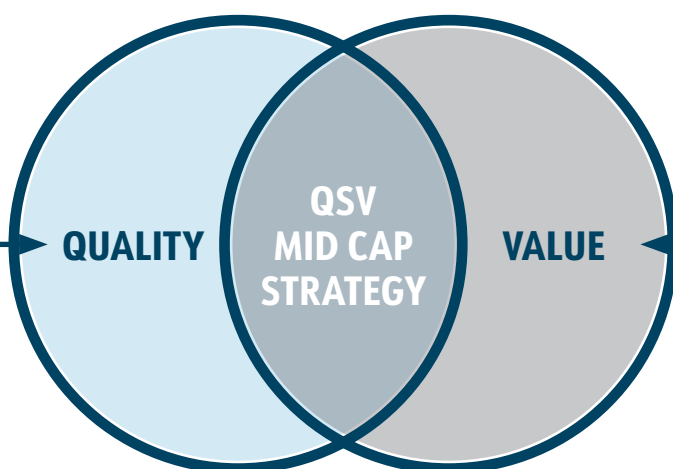


## INVESTMENT TEAM

QSV's investment team has navigated markets together for more than 25 years. Jeff Kautz and Randy Hughes founded QSV (formerly Ballast Equity Management) in 2016 and worked together previously at Perkins Investment Management, a subsidiary of Janus Henderson. While there, Jeff held roles including Portfolio Manager, CEO and Chief Investment Officer and Randy held the roles of Director of Research and Analytics and Equity Analyst. QSV is 100% employee owned and fosters a culture that marries independent thought with collaboration. Employee-owners invest alongside the clients of the firm in each of its strategies.

**QSV Quality Bias:** Invest in companies exhibiting strong balance sheets, stable and growing cash flows and returns on invested capital (ROIC) well in excess of their cost of capital (WACC).

Strong financial characteristics are sustained through the presence of a durable competitive advantage allowing the companies to drive economic profits well into the future.



QSV purposefully acts like business owners, focusing on a company's intrinsic value and blocking out day-to-day price moves.

QSV believes that buying wealth-creating businesses at discounts to intrinsic value will offer our clients stability, with less volatility and lower drawdowns, pursuing our goal to create long-term wealth.

# STRATEGY

**OBJECTIVE** QSV Equity Investors (QSV) Mid Cap Strategy strives to deliver a smoother ride in good markets and bad, seeking to outperform the Russell Mid Cap Value Index and Russell Mid Cap Index with less risk over a full market cycle.

**OVERVIEW** QSV Mid Cap Strategy invests with conviction in 50-70 high quality companies which can deliver high returns on invested capital, well in excess of their cost of capital, sustained through strong, durable competitive advantages. Identification and selection of these companies is supported by proprietary Quality Scores and fundamental research. QSV is patient and will only add a company to the Mid Cap Strategy when its stock can be purchased at a reasonable valuation.

**PROCESS** QSV employs a research and screening process that includes four distinct steps:

 SCREENING	 QUANTITATIVE ANALYSIS	 QUALITATIVE ANALYSIS	 VALUATION
QSV screens a universe of over 3000 small and mid cap stocks by charting the ratio of Enterprise Value to Invested Capital relative to the Return on Invested Capital for the companies. Investors should be willing to pay more for a business that earns high returns on capital; QSV only considers those that appear undervalued.	QSV ranks stocks in its universe according to its proprietary Quality Rankings Model, using factors that identify companies with strong financial flexibility, stable and growing cash flow and stable and improving profitability metrics. QSV focuses on stocks with Quality Rankings in the top two quintiles of its universe.	QSV believes strongly that high returns on capital are maintained and defended through proven, durable competitive advantages, such as economies of scale, strong intangible assets, high switching costs, network effects and cost advantages. QSV professionals carefully assess the durability of each business's competitive advantages.	QSV strongly believes that valuation plays a vital role in successful investing. Forecasting future economic profits and capital allocation decisions allows QSV to answer its primary question: "Does the company create wealth for investors over time?"



## 3Q:23 COMMENTARY

Q3 2023 was difficult for U.S. equities as the reality that “higher for longer” truly will mean higher interest rates for longer gelled in the minds of investors. The Federal Reserve is intent on fighting inflation and seems committed to keeping rates high and conditions tight for the foreseeable future, causing concerns over the impact on the economy. Economic growth and interest rates impact smaller companies more than large, and small caps experienced a double digit drop from their July peak through the quarter-end.

**QSV Mid Cap** outperformed the Russell Mid Cap Value and the Russell Mid Cap Indexes before fees. The net return lagged the Russell Mid Cap Value Index while exceeding the Russell Mid Cap Index. Security selection in Consumer Discretionary and Industrials companies helped relative performance, while selection in Financials and Real Estate businesses detracted.

### MID CAP TOP CONTRIBUTORS

Outsourced payroll and human capital management provider **TRINET GROUP, INC. (TNET)** was the leading contributor to performance in the quarter. Increasing use of technology, digitization of the HR function, employment growth in new industries and increasing geographic decentralization of the small and medium-sized business workforce all create favorable trends for TNET. TNET has competitive advantages relative to its peers that include its scale and the efficiencies offered through the consolidation of its operating units on a single technology platform. TNET generates returns on invested capital of 28% and shares are at a discount to our estimate of intrinsic value.

Shares of **APA CORPORATION (APA)** gained more than 20% during the quarter on rising oil prices, contributing to the results of QSV Mid Cap. APA produces oil and gas with operations in the U.S., Egypt and the United Kingdom, and exploration activities offshore in Suriname. APA generates strong free cash flows and is committed to returning 60% to its shareholders, primarily through share repurchases, dividends and paying down its debt.

### TOP 10 HOLDINGS<sup>1</sup>

	% Weighting
Booz Allen Hamilton Holding Corporation Class A	3.09%
TriNet Group, Inc.	2.66%
Broadridge Financial Solutions, Inc.	2.64%
Akamai Technologies, Inc.	2.50%
West Pharmaceutical Services, Inc.	2.50%
APA Corporation	2.43%
FLEETCOR Technologies, Inc.	2.33%
Tyler Technologies, Inc.	2.22%
Laboratory Corporation of America Holdings	2.20%
Core Laboratories Inc.	2.15%
<b>TOTAL</b>	<b>24.72%</b>

### PERFORMANCE

	4Q:22	1Q:23	2Q:23	3Q:23	1 Year	3 Year (Ann)	5 Year (Ann)	Annual Total Return (since inception) 6/30/16
QSV Mid Cap (Gross) <sup>3</sup>	9.03%	5.28%	4.09%	-4.32%	14.32%	10.75%	8.57%	10.73%
QSV Mid Cap (Net) <sup>3</sup>	8.76%	5.02%	3.84%	-4.55%	13.21%	9.68%	7.52%	9.65%
Russell Mid Cap Value <sup>2</sup>	10.45%	1.32%	3.86%	-4.46%	11.05%	10.98%	5.18%	7.22%
Russell Mid Cap <sup>2</sup>	9.18%	4.06%	4.76%	-4.68%	13.45%	8.09%	6.38%	9.03%

## 3Q:23 COMMENTARY – CONTINUED

### MID CAP TOP DETRACTORS

**MASIMO CORPORATION (MASI)** fell on poor financial results and lowered future guidance. Results were impacted by issues that included lower hospital volumes, elevated channel inventory levels, and hospital labor inflation that is impacting capital equipment demand. MASI is a medical technology company which develops, manufactures, and markets non-invasive vital sign monitoring devices and offers consumer audio products. The integration of its acquisition of Sound Audio has continued to present challenges to the business and we exited the position in favor of higher conviction businesses.

**ETSY INC. (ETSY)** detracted from performance during the quarter. Etsy markets differentiated products through its “House of Brands” which includes Esty.com, Reverb, and Depop. Competitive advantages include the diversity of its offerings, a strong base of active buyers and sellers, and productivity tools it offers sellers. Despite these advantages, with rising fuel prices, the resumption of student loan payments, and a shift by consumers to “experiences” over goods, we believe there are better opportunities for our investors, thus we exited the position during the quarter.

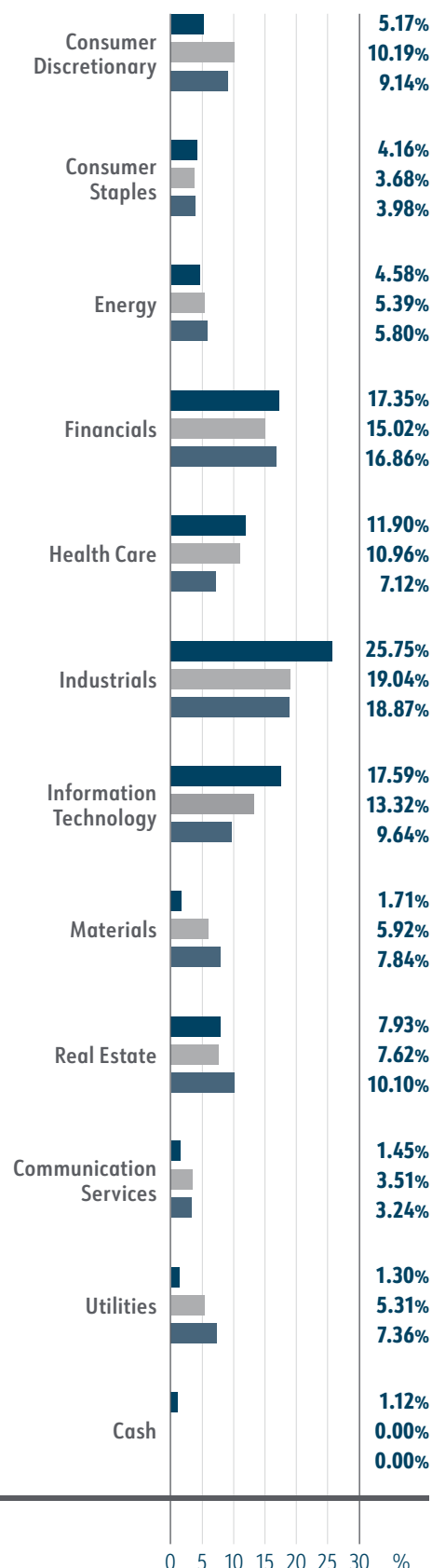
### MID CAP PORTFOLIO ACTIVITY

Turnover during the quarter was higher than usual as QSV took opportunities to upgrade its portfolio. As noted above, **ETSY (ETSY)** and **MASIMO (MASI)** were exited for business performance reasons. **A.O. SMITH (AOS)**, **CINTAS (CTAS)**, and **ROSS STORES (ROST)** were sold for valuation reasons and **MID-AMERICA APARTMENT COMMUNITIES (MAA)** was sold to allocate to better ideas. New positions were initiated in digital services provider **AMDOCS (DOX)**, nitrogen producer **CF INDUSTRIES (CF)**, LabCorp spin-out **FORTREA HOLDINGS (FTRE)**, GPS-enabled hardware and software provider **GARMIN (GRMN)**, **MATCH GROUP (MTCH)**, elevator and escalator manufacturer **OTIS WORLDWIDE (OTIS)**, and **WATERS (WAT)**, a provider of liquid chromatography and mass spectrometry products.

### OUR FOCUS ON THE LONG TERM

Investors began the last quarter on an optimistic note, while bullishness faded in September. Strength of the consumer continues to be touted as a positive for the economy, as are strong employment and rising labor participation rates. Yet credit card debt is high and student loan payments are again due. Persistent inflation and higher interest rates will also weigh on the consumer as well as on corporate earnings. The Financial Times notes that 30% of the debt of Russell 2000 companies is variable rate debt, presenting risks to lower quality, more leveraged businesses.

### SECTOR EXPOSURE^



QSV Mid Cap<sup>1</sup>

Russell Mid Cap<sup>2</sup>

Russell Mid Cap Value<sup>2</sup>

## 3Q:23 COMMENTARY – CONTINUED

At this stage in the market cycle, we believe that QSV's style of investing and our investors should do well. Late cycle investing favors the lower volatility stocks of quality businesses, those that have limited debt, high interest rate coverage and strong free cash flows. Selectivity is important and opportunities abound in small to mid-cap stocks that have been overlooked in the narrow market that dominated the first half of the year. Investors will also do well to check their asset allocation; the mega-cap led markets of 2023 have left many portfolios in an unbalanced state and shifts in allocations may be due.

### PORTFOLIO CHARACTERISTICS

	QSV Mid Cap	Russell Mid Cap	Russell Mid Cap Value
Active Share		92.62	94.76
Number of Securities	57	814	701
Weighted Average Market Cap (MM)	15,655.20	21,563.85	20,433.71
Median Market Cap	14,382.65	9,322.96	9,094.01
Dividend Yield	1.40	1.86	2.28
ROIC	16.47	6.61	6.13
Debt/Capitalization	45.47	52.25	50.76
EV/EBITDA	18.73	31.69	15.64

### RISK METRICS

	QSV Mid Cap	Relative to Russell Mid Cap	Relative to Russell Mid Cap Value
Annualized Alpha (RF=10-year Treasury)		0.22	0.36
Beta		0.87	0.82
Up Capture		89.30	91.80
Down Capture		92.42	89.66
Standard Deviation*	16.24	18.32	18.86
Information Ratio		0.39	0.61
Sharpe Ratio	0.57	—	—

\*Standard Deviation is shown for the QSV Strategy and each respective Index.



For more information, please call  
**844.322.5527** or visit **qsvequity.com**

WE THANK OUR CLIENTS AND INVITE OTHER LIKE-MINDED INVESTORS TO CONTACT US IF WE MAY BE OF SERVICE.

## DISCLOSURES

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No client or potential client should assume that any information presented should be construed as personalized investment advice. Personalized investment advice can only be rendered after engagement of the firm for services, execution of the required documentation, and receipt of required disclosures. Investing carries risk of loss. You should consider the strategy's investment objectives, risks, charges and expenses carefully before investing.

<sup>^</sup> Sector classifications are generally determined by referencing the Global Industry Classification Standard (GICS<sup>®</sup>) and exclude cash. GICS was developed by and/or is the exclusive property of MSCI, Inc. and Standard & Poor's Financial Services LLC (S&P). GICS is a service mark of MSCI and S&P.

<sup>1</sup> Top ten holdings, sector weights and portfolio characteristics for the QSV Mid Cap Strategy are taken from the model portfolio.

<sup>2</sup> The QSV Mid Cap Strategy is compared to the Russell Mid Cap Indices as they are widely used benchmarks for mid capitalization securities. An investment with QSV Equity Investors (QSV) should not be construed as an investment in a program that seeks to replicate, or correlate with, these indices. Market conditions vary between the QSV products and these indices. Furthermore, these indices do not include any transaction costs, management fees and other expenses, as do the QSV products. Lastly, QSV may invest in strategies and positions that are not included in these indices.

<sup>3</sup> QSV Mid Cap returns are for the QSV Mid Cap Composite. Net returns are calculated assuming the maximum advisory fee of 100bps is deducted from the quarterly gross composite return from inception through June 30, 2020. Starting July 1, 2020, actual fees charged are used to calculate net performance. Returns are net of both advisory fees and transaction costs. All dividends are assumed to be reinvested. The reporting currency is USD.

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