

## Quarterly Portfolio Commentary – Second Quarter 2021

### Clifford Capital Focused Small Cap Value Portfolio

#### Summary of the Focused Small Cap Value Portfolio Composite Historical Return\* (unaudited)

	2 <sup>nd</sup> Quarter 2021	Year-to-Date	1-year Return	3-year, annualized	5-year, annualized	Since Inception**
Portfolio, gross <sup>1</sup>	6.60%	32.48%	90.77%	12.51%	16.18%	16.23%
Portfolio, net	6.37%	31.92%	89.07%	11.47%	15.11%	15.16%
Russell 2000 <sup>®</sup> Value, total return	4.56%	26.69%	73.28%	10.27%	13.62%	13.84%

\* Individual account performance may differ slightly from the overall Composite.

\*\* April 1, 2016

We hope this letter finds you well and enjoying the summer months. We have been thankful as life is moving closer to normal and as the worst of the pandemic seems to be behind us today. We are grateful for your investment with Clifford Capital Partners and thank you for your support.

The Clifford Capital Focused Small Cap Value Portfolio (“the Portfolio”) experienced a positive quarter, performing ahead of its benchmark for the last three months and for the year-to-date period. While we are always focused on long-term results, a six-month return over 30% is welcome, and we see continued long-term promise for our strategy, given the current valuations of the Portfolio today. The Portfolio’s Deep Value stocks were again the strongest performers during the quarter and even though it’s the smaller of the two sleeves of our strategy, Deep Value has been the primary driver of the Portfolio’s outperformance over the recent past and since inception. We continue to believe our Deep Value stocks are particularly attractive in today’s environment and the Portfolio’s weighting in them remains well above average as of June 30.

As we mentioned in our last quarterly letter, we are beginning to see incrementally more value in our Core Value watchlist, and our Core Value weighting increased slightly during the quarter. Given uncertainty about the pace of economic recovery, the lingering effects of the virus (and its mutations), and how much deep value strategies have outperformed recently (leading some investors to take profits and/or question the sustainability of the rally), we would not be surprised to see Core Value’s relative performance results improving soon. We still believe, however, that our Deep Value companies remain very compelling long-term investments today, given that they are recovering well fundamentally and trade at unassuming valuations (especially when compared to major market indices).

Our investment decisions and portfolio weighting decisions are all based on our long-term views of the individual stocks we hold, with a focus on each investment’s Key Thesis Points™, which are a handful of long-term catalysts for fundamental improvement that we’ve identified through our research efforts. We believe the formula of owning stocks that trade at attractive valuations coupled with long-term catalysts that should improve their fundamental results is a compelling way to generate strong long-term results. Even after a strong recent period of performance, we think the Portfolio is still attractively valued today and well-positioned to continue generating attractive long-term results.

<sup>1</sup> Portfolio, gross return represents the performance results for the Focused Small Cap Value composite including the reinvestment of dividends and other account earnings and are net of transaction costs, but do not reflect the effect of advisory fees, which would lower performance. Portfolio, net return includes the deduction of advisory fees, reflects the reinvestment of dividends and other account earnings and are net of transaction costs. Past performance does not guarantee future results.

The benchmark for the Focused Small Cap Value composite is the Russell 2000<sup>®</sup> Value index. This index is a capitalization-weighted index which measures the performance of Russell 2000 index companies, respectively with lower price-to-book ratios and lower forecasted growth values. Index returns include the reinvestment of dividends (total returns). Performance of the composite and the index may not be comparable due to differences amongst them including, but not limited to, risk profile, liquidity, volatility and asset composition. An investor cannot invest directly in an index. Moreover, index performance does not reflect the deduction of advisory fees, transaction fees, and other expenses.

## **Market Observations**

In our last letter, we briefly discussed how long-term interest rates in the U.S. had increased significantly, attributable to worries about higher inflation and the potential for the Fed to raise interest rates. In the second quarter, those worries began to abate and interest rates meaningfully declined. This is microcosmic of why we refrain from basing our investment decisions on macroeconomic happenings. Even though the actual economic data did not change very much (and arguably supported those worries), investor expectations—as reflected in interest rate movements and stock market leadership—changed significantly. As such, an analyst striving to stay ahead of macroeconomic conditions must both: a) accurately forecast the macroeconomic condition; and b) accurately forecast what investor behavior and expectations will be based upon the new macroeconomic condition. This is a tall order for anybody without a magical crystal ball, in our view.

Even though we've been stock investors for a long time, and we shouldn't be surprised anymore, we still remain fascinated that market perceptions seem to change overnight, such as what we observed in June when the Fed revealed that several of its leaders believed that interest rates may need to be raised sooner than originally expected. At face value we think this could have been viewed as an indicator of higher long-term interest rates and the Fed acting more cautiously in the face of rising inflation (both positives, in our view, for Value stocks). The stock and bond market reaction, however, suggested the opposite and Value stocks underperformed and interest rates declined after the Fed announcement.

We won't speculate on the reasoning behind the market's movements, but we are reminded of Benjamin Graham's timeless metaphor of Mr. Market – a skittish fellow who sometimes acts peculiarly. We believe there's simply a lot of uncertainty that remains in the world today and Mr. Market is prone to changing his mind every now and then. Our job is to take advantage of his mood swings when they lead to investment opportunity.

At Clifford Capital, we focus our research on individual companies and the fundamental long-term drivers (Key Thesis Points™) of their businesses that we think will catalyze their results above investor expectations. While it is true that macroeconomic forces can affect these companies (and we strive to be aware of potential macro risks and exposures), we aim to build a diversified portfolio of stocks where the fundamentals of each company matter more to our overall portfolio than any particular macroeconomic outcome. This is usually referred to as a “bottom-up” process where stocks are selected individually, based on their own merits.

Our high-conviction bottom-up process may result in the Portfolio being out of step with the market at times when Mr. Market is “in a mood”, but we believe it's a prudent way to outperform over the long-term.

## **We Think This is a Particularly Good Time to Own Small Caps**

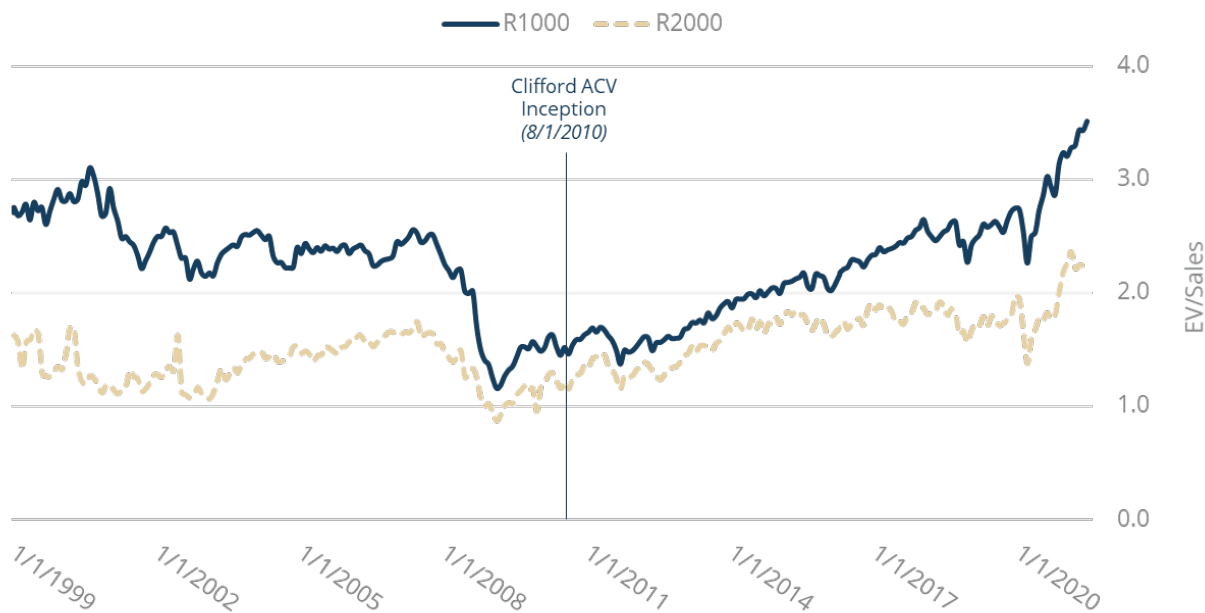
Following up on a concept we discussed in our last commentary, Clifford Capital's philosophy/process is predicated on purchasing ownership stakes in businesses when their stocks are out of favor, trading at what we believe to be attractively low valuations (a good leading indicator, in our view, of strong future returns), after also having identified Key Thesis Points™ that we believe will catalyze fundamental improvement for each company we invest in. When we do this, we think the odds are in our favor for a favorable outcome.

In today's market our team continues to find the greatest numbers of these types of opportunities in smaller companies and among Deep Value stocks (most of which are smaller as well). Given that Clifford Capital's flagship strategy is an all cap value strategy, where we invest in companies of all sizes, we think we have a good idea of where the best values lie in the U.S. stock markets because we can essentially “go anywhere”. The “anywhere” we're attracted to the most lately has been in smaller-cap stocks and we think small cap value stocks are the single most attractive subset of the stock market today. As such, we're bullish on the prospects for the Portfolio.

While we presented some Growth vs. Value charts last quarter to show the large valuation spread between the two major styles of investing, the chart below is illustrative of the long-term valuation spreads between larger and smaller companies. It compares the Enterprise Value to Sales<sup>2</sup> ratio (“EV/Sales”) of the Russell 1000 index (*proxy for all U.S. large cap stocks*), and the Russell 2000 index (*proxy for U.S. small cap stocks*) since the beginning of 1999 (during the “Internet Bubble”).

The EV/Sales ratio compares the value of an entire firm (market cap plus net debt) to its sales over the past 12 months. While simple, we think the EV/Sales ratio is one of the few ‘apples to apples’ valuation metrics that is useful to compare almost all companies. Additionally, since Enterprise Value includes a company’s entire capital structure (all equity and debt) this metric is also a simple way to answer the question of “what is the valuation today of the entire company (or index of companies) per dollar of sales?”

**Large Cap Valuations Higher Now than the Internet Bubble – and a Widening Spread to Small Caps**  
**EV/Sales of the Russell 1000<sup>3</sup> & Russell 2000<sup>4</sup> Indices**  
*January 1, 1999 – June 30, 2021*



*Source: Bloomberg as of June 30, 2021*

As shown in the chart above, large cap stocks have consistently traded at a valuation premium to small cap companies and in recent years that valuation spread has widened as we believe large caps have been much more in favor with market participants (especially compared to the small cap value subset of the small cap universe). During the Internet Bubble in 1999/2000, spreads were similarly wide. We also note that the absolute value of this metric is historically high today for both indices, but especially for large caps.

As the Internet Bubble peaked and popped, the Russell 2000 outperformed the Russell 1000 by about 63% from January 1, 1999 – July 31, 2010 (Clifford Capital’s inception), which was reflected by narrowing valuation

<sup>2</sup> Ratio of a company’s or index’s current Enterprise Value (market capitalization plus short and long-term debt minus cash) to its sales over the prior 12 months as of the date of the analysis.

<sup>3</sup> The Russell 1000® Index is a capitalization-weighted index which is designed to measure performance of the largest 1000 companies in the Russell 3000® Index. Numbers presented include the reinvestment of dividends (total return). An investor cannot invest directly in an index. Moreover, index performance does not reflect the deduction of advisory fees, transaction charges, and other expenses.

<sup>4</sup> The Russell 2000® Index is a capitalization-weighted index which is designed to measure performance of the smallest 2000 companies in the Russell 3000® Index. Numbers presented include the reinvestment of dividends (total return). An investor cannot invest directly in an index. Moreover, index performance does not reflect the deduction of advisory fees, transaction charges, and other expenses.

spreads over that time. Since then, through June 30, 2021, the Russell 1000 has outperformed the Russell 2000 by about 83% and spreads have widened again.

We do not think valuation spreads alone are a clear buy or sell signal, but we do believe that it is a supportive data point of why it's easier to find investment bargains amidst smaller companies today, relative to larger ones. We also believe large cap stocks trade at historically high valuations today – a time to be more cautious with them, in our opinion, and we would expect the valuation spread to normalize over time, which is another way of saying we expect smaller companies to outperform larger ones.

As we reflect upon the combination of what we believe to be: 1) high valuation ratios for large caps; 2) historically high spreads between large- and small-cap stocks; and 3) attractive absolute valuations for many smaller “value” companies, we feel very bullish today about the Portfolio’s prospects compared to the rest of the U.S. stock market.

We believe our investment philosophy and process is disciplined, repeatable, and effective over the long-term and we are encouraged by the value we see in our individual stocks today. While we recognize results will not always be favorable and Mr. Market may continue to change his mind from time to time, we think the Portfolio is well positioned to produce solid long-term results.

#### **Final Comments**

Thank you for your investment with Clifford Capital. We believe the Portfolio still trades at an attractive discount as of June 30, 2021, based on our analysis. We will continue to focus on building long-term wealth through disciplined portfolio management.

Sincerely yours,

Ryan Batchelor, CFA, CPA  
Principal and Portfolio Manager  
Clifford Capital Partners, LLC

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*Any return estimates are subject to actual known and unknown risks, uncertainties, and other factors that could cause actual results to differ materially from those projected. As with any investment strategy, there is potential for profit as well as the possibility of loss. Clifford Capital Partners, LLC does not guarantee any minimum level of investment performance or the success of any index portfolio or investment strategy. All investments involve risk and investment recommendations will not always be profitable. Past performance does not guarantee future results.*