Lazard
Global Small Cap Equity

1Q20
Strategy Review

Market and Strategy Highlights

- Global small cap equities suffered one of their worst quarters ever as the MSCI World Small Cap Index fell 30.1%, significantly worse than the 21.1% drop in large caps.
- The growth style headwind stretched to new extremes, a reflection of the fact that value stocks as a group are more cyclically oriented.
- Defensive sectors uniformly outperformed while cyclicals lagged. Japan outperformed while the UK and Canada lagged.
- Energy stocks fell more than 60% on shocks to both supply and demand.
- While the portfolio slightly outperformed, it was within the context of a highly correlated and largely indiscriminate sell-off. We expect the long-term pattern of performance to continue.

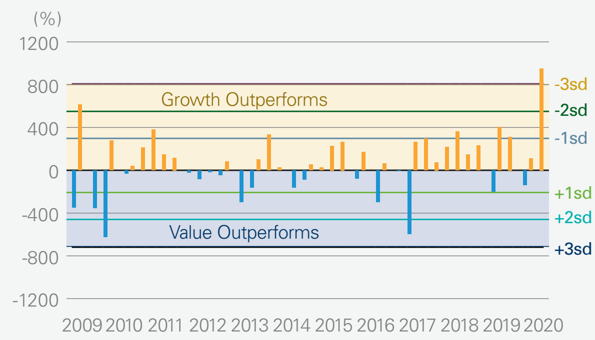
Market Insights

As we entered the year, investors had high expectations that corporate profits would start growing again in the wake of the positive geopolitical developments that had calmed uneasy markets in the fourth quarter of 2019. The US and China had reached a significant Phase 1 trade deal in December 2019, removing a significant source of uncertainty from the daily headlines. A decisive election in favor of the Conservative Party in the United Kingdom created a date certain for Brexit: 31 January. Global central banks, which drove valuations and stock prices higher by loosening policy in 2019, were expected to be supportive.

Then, a novel coronavirus, now called COVID-19, started spreading in the Chinese city of Wuhan. By March, the virus was a pandemic, and optimism was a difficult thing to come by. The available data suggests the new coronavirus is more infectious and more deadly than a typical flu. As of 31 March, there were more than 823,000 confirmed cases worldwide, and 175,000 of them were in the US, more than in any other country. Many countries have issued strict lockdowns. France, Germany, Italy, India, and Spain have issued sweeping orders to their residents to stay inside as much as possible (or, in the case of India, to simply stay inside no matter what), and most Americans are subject to some kind of limitation on travel, movement, or gathering.

In the short term, social distancing techniques are clearly having a material impact on economic activity that will be damaging for company financial metrics and economic data over the next few months. Equity markets all over the world have declined sharply on fears about global recession amidst COVID-19 contagion. International equities were no exception. The MSCI World Small Cap Index fell 30.1% in the first quarter, significantly more than large caps, where the MSCI World Index fell 21.1%. Despite their already historic valuation discount to growth equities, value stocks took a disproportionate hit, as they are more cyclically oriented. For the quarter, the MSCI World Small Cap Value Index underperformed the MSCI World Small Cap Growth Index by nearly 10%, a difference that is more than 3 standard deviations from the average disparity between the two styles (Exhibit 1).

Exhibit 1
Growth Outperformed by an Unprecedented Amount
MSCI World Small Cap Value vs. MSCI World Small Cap Growth



As of 31 March 2020

Quarterly total returns. Standard deviation does not include most recent period.

The performance quoted represents past performance. Past performance is not a reliable indicator of future results. The indices mentioned are unmanaged and has no fees. One cannot invest directly in an index. All data is in USD.

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Source: Lazard, FactSet, MSCI

The virus created a demand shock for oil markets, but the commodity markets suffered an additional blow due to the disintegration in March of supply agreements between Russia and Saudi Arabia. The two countries agreed in 2016 to work together to manage oil prices in the face of the dramatic rise in US shale oil production. Recently, Russia refused to cut production along with Saudi Arabia to prop up prices. Instead, both countries ended up increasing production. The confluence of the two events created a perfect storm that sent oil prices tumbling, with Brent crude down more than 60% as of 31 March.

Policymakers have been quick to grasp that they must step in aggressively to not only provide liquidity to markets, but also to help fill the demand gap for millions of workers whose jobs disappeared overnight when social isolation restrictions went into place. Central banks all over the world have acted aggressively to increase liquidity in the financial system by cutting rates, implementing (or re-starting) quantitative easing, and creating new credit facilities. Governments have also announced unprecedented fiscal stimulus measures, in sharp contrast to the global financial crisis, when monetary stimulus was the primary tool for fighting the economic slowdown. Several European governments are reimbursing private companies for workers' salaries so the workers keep their jobs and paychecks and the companies keep afloat until restrictions are lifted. In the US, a fiscal package worth more than $2 trillion extends unemployment benefits and offers cash payments to individual households and loans to small businesses and large corporations alike.

The big uncertainty now is just how long the pandemic lasts and how severe it becomes. Markets are seesawing between concerns about the virus and its implications and hopes that the world is one step closer to bringing it under control. In this environment, stocks didn't always act the way one might expect. Some "defensive" stocks failed to protect, and Japanese stocks outperformed as the country avoided the kinds of major outbreaks that hit in many other countries.

Portfolio Insights

Being underweight in the UK and Asia ex-Japan helped performance this quarter. Having moved higher in the fourth quarter on the resolution of Brexit uncertainty, British small caps gave up their big gains in the first quarter. Our stock-picking in real estate also boosted performance. For most of our portfolio, the relative vulnerability to COVID-19 was the driving factor in determining which stocks outperformed and which stocks underperformed. The cyclical bent of stocks in Asia ex-Japan made them particularly susceptible to the COVID-19 demand shock, for example. Meanwhile, the drastic decline in oil prices in the first quarter—driven partly by lower demand in the face of stay-at-home orders—made our overweight to energy-sensitive Canada a liability. Finally, we are underweight consumer staples and healthcare, where we don't find valuations compelling. However, given the defensive nature of those two sectors, they outperformed in the COVID-19 sell-off. Given the sweeping influence the pandemic has had on performance, the portfolio management team has done an extensive mapping exercise to assess exposure within the portfolio. Please see the Outlook section for a more detailed discussion of this effort.

Positives

Teamviewer AG sells software that allows users to connect to and control remote devices such as personal computers, smartphones, or smart objects (Internet of Things). The German software-as-a-service provider has a robust and very defensible position in the industry, thanks to an established customer base and unique free-to-paid business model. The full core software is free to non-commercial users, but can detect when users shift to commercial use and target them for payment. (The company tracks the number of devices each account services, how often it is used, etc., to make the determination.) In addition, the company has shifted to a subscription-only model, allowing investors substantial insight into potential future revenues. Some 80% of billings next year are subscription renewals, pointing to a sticky, resilient model. The software has been installed on 2 billion devices since creation in 2005 and is currently active on 340 million devices, with 370,000 paid subscriptions. The resiliency of its business model and subscriber base helped propel Teamviewer's outperformance in the first quarter, as did a good report in the early part of the quarter. In January, the company gave markets a positive pre-announcement of strong billings growth of 41%. The Americas was a standout region, with billings growth of 56% where the enterprise product is gaining traction. Profitability is best in class among SaaS providers and we believe their strategy of investing more at this land-grab stage will compound the company's advantages in the long term.

Japan Lifeline is a medical equipment and trading company that specializes in cardiology-related equipment. A growing number of medical procedures, new products, and expansion into new markets are driving the company's growth. The company must develop more overseas sales expansion to grow its multiple. The company operates with a five-year rolling plan for achieving attractive growth and margin targets and only includes products already scheduled for launch in marketing materials. The balance sheet is strong, with nearly zero net debt. Like Japanese companies and the healthcare sector overall, the stock outperformed. We expect improved profitability over the next 23 years, but we will be patient in the near term, as some surgical procedure demand will be delayed due to prioritization of COVID-19 patients.

FTI Consulting is a US consulting company with a strong bankruptcy and restructuring business, both of which are somewhat countercyclical. The company has been executing its strategy well, taking marketing share from other firms. Their two best sectors for distressed advisory work are energy and retail, which continue to face significant turbulence. The crown jewels are the restructuring and strategic communications (#MeToo, data breaches, and executive scandals) businesses, which together comprise 40% of profits. Another 50% comes from litigation consulting and economic consulting, which is more tied to mergers and acquisitions. The company continued its string of strong quarterly reports relative to consensus when it reported fourth-quarter earnings early in the new year. It also set the stage for future growth as newly hired consultants ramp their billable hours. The balance sheet ended the year with positive net cash. The company has authorized $500 million in share buybacks, and we believe repurchases will indeed ramp higher. We think guidance for FY20 is achievable and the countercyclicality of the business should help in a difficult economic climate.

Real Estate. With the exception of Aroundtown (a German diversified real estate investment trust [REIT] with residential exposure), our stock selection in the sector was positive. Altus (Canadian real estate consulting services), Americold (US cold storage), National Storage

(US self-storage), and PS Business Parks (US multi-tenant flexible office and industrial), all contributed positively to performance within the sector. Real estate should prove more defensive in an economic pullback, but certain sub-industries such as retail or residential may prove more vulnerable than originally thought amid the global economic shutdown.

Negatives

Marcus Corp is a movie theater and hotel owner/operator based in the US Midwest. The hotel assets are the legacy of an 80-year-old family business, and the firm owns some classic hotels such as the Pfeister in Milwaukee, the Intercontinental in Milwaukee, and Grand Geneva in Lake Geneva, Wisconsin. However, most of its earnings come from movies. It aims to outperform the US movie market by driving attendance and offering more food, rather than only by raising prices as the bigger theater chains have. The three national theater chains own about 50% of US movie screens—5,000-7,000 each, compared to 1,100 for fourth-place player Marcus. Marcus likes to own its own theaters so it can quickly remodel or reformat to add features such as 3-D capabilities or reclining seats. Marcus spent significantly on remodeling over the past few years, and capex is expected to fall going forward as those projects wind down. The company is now in a good position to consolidate the many 100-screen companies that are too small to interest the Big Three, but still meaningful to the No. 4 player. Still, COVID-19 has had an outsized effect on this stock, and we continue to monitor and evaluate our holding.

US Foods is the second-largest competitor in a very fragmented food service distribution market in the US. Its 28,000 employees serve approximately 300,000 operators via 70-plus distribution centers, a customer mix distributed fairly equally among independent restaurants, healthcare, and hospitality end markets. Restaurants represent nearly 50% of revenue. We initiated a position early in the quarter based on the company's high and improving financial returns, synergies from recent acquisitions, and historically defensive revenue stream. However, the stock has suffered disproportionately of late due to the nature of the COVID-19 pandemic and the significant impact on many of its customers. Recognizing these headwinds, coupled with the leveraged balance sheet, we sold the stock as a growing number of global shutdown orders went into effect.

Spinmaster, a toy company based in Canada, has been a long-term holding in the portfolio. The company has exhibited consistent growth over the years and has become more diversified over the last few years—no single toy represents more than 20% of sales. We appreciate the company's status as a third supplier to the two large US competitors, Mattel and Hasbro. Management has innovative brand development, has executed highly complementary acquisitions, and uses customer insights to shape strategy. The company can drive margins through scale and owned content. The business model is capital-light: A third party manufactures most of the toys, and the company only has one factory that it received as part of an acquisition. Short-term and long-term compensation for management is tied in part to the business' free cash flow. The stock underperformed in the quarter after announcing results that were below expectations—profit margins were down 400 basis points in 2019. We believe the weakness was driven by external factors and one-time internal issues. Supply chain issues forced the company to step up promotional activity, which in turn cut into gross margins. We expect margins to rebound. The risks are well understood and the stock trades at an inexpensive valuation of less than 8x EV/EBITDA, a large discount to competitors. The balance sheet is net cash positive. The company continues to gain market share, and we continue to appreciate the long-term model. We added to the stock during the COVID-19 sell-off.

Ingevity is a US specialty chemical company. It is the industry leader in producing activated carbon, which is used to control passive emissions from motor vehicles. (Passive emissions escape from the gas tank when the car is idle.) The company has both intellectual property that specifies how to size pores precisely for contaminants and a well-established service model. In the very challenging auto market, they still raise prices 1%-2% annually. They also have a pavement business making a warm-mix asphalt that can be applied in thinner layers and that does not need to be hot, allowing customers to extend the application seasons. The stock underperformed in the quarter due to its cyclical orientation and end-market exposure. Better pavement technologies somewhat offset a difficult patch in oil field technologies and industrial specialties, but results were nonetheless weaker than expected. The company also lost a patent case that would have kept an importer from bringing a competing product into the country. The case is still working its way through the courts, and there should be no impact on the Ingevity business in the short term. If the final ruling is consistent with the preliminary ruling, we believe the ultimate impact would be a small one in 2023 or 2024. We believe the stock is a cyclical compounder, with favorable regulatory drivers increasing demand for its products, and that investors are pricing in more concern around this issue than is warranted.

Outlook

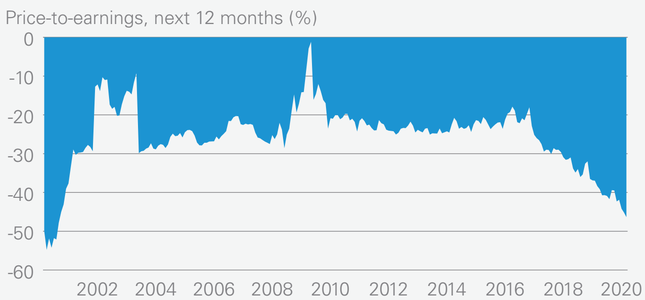
In the short-to-medium-term, the progress and policy reaction to COVID-19 will likely drive the performance of every asset class, including global small caps. So far, policymakers have been aggressive with both monetary and fiscal initiatives, which could benefit value cyclicals in the long run. While it is tempting to compare the current crisis to the last one, they are quite different. Central banks were ultimately able to control the global financial crisis by pumping massive amounts of liquidity into the system. COVID-19 is not a financial crisis, but rather a profound, sudden demand shock the likes of which the world has never seen, in which millions of people are losing their jobs and millions more are at home, rather than out spending money. While maintaining cash flow is necessary, it is not enough. Policymakers must also make up for the missing demand in the economy and keep out-of-work people as financially sound as possible to avoid a feedback loop that leads into a prolonged recession when the threat of the novel coronavirus passes.

If policymakers successfully bridge the demand gap, it is possible that the global economy can recover relatively quickly once the spread of the virus is under control. Markets are waiting eagerly for a treatment, a vaccine, or simply news that the rate of new infections seems to be slowing in a hard-hit country. Any new developments on this front are likely to continue to drive price movements.

Going forward, we expect numerous material negative earnings revisions, particularly in cyclical areas (Exhibit 2). The performance differential between value and growth stocks has been a headwind to our relative value investment philosophy, in which we invest in companies with an attractive trade-off between financial productivity and valuation. Yet, despite this headwind, relative performance was broadly in line with our benchmark. However, we believe the widening gap between the two styles is creating long-term relative value opportunities in both defensive and cyclical value stocks, while reducing opportunities in tech and other expensive cyclicals that have held up relatively well.

Exhibit 2
International Value Stocks Are Trading at a Historic Discount to International Growth

MSCI World Value Index vs. MSCI World Growth Index



As of 31 March 2020
Source: FactSet, MSCI

While central bankers and governments are doing everything they can to ensure liquidity, we still feel that highly levered companies are risky in an environment that has investors seeking safety at all costs. We have also seen in our own holdings that certain industries and sub-industries are particularly vulnerable to the particular nature of this unprecedented demand shock. To that end, we have completed an extensive mapping exercise to assess the vulnerability of each industry to COVID-19 factors (Exhibit 3), similar to an earlier exercise to rate industries on their cyclical versus defensive orientation. Just as we did in that exercise, we then applied the ratings to our holdings in order to assess our overall exposure to the pandemic and its after-effects. Here are the three categories into which we have divided stocks:

- **Group 1**: These industries and sub-industries are the most resilient to the forces shaping the COVID-19 economy. Demand for their services is relatively inelastic—think of utilities, internet-based businesses, and some areas of media content such as video gaming. Thus, while they may have sold off due to broader investor fears, the underlying businesses in these industries are usually relatively unharmed by the pandemic.
- **Group 2**: These industries are moderately stressed by social isolation measures, travel advisories, and other pandemic-related changes to the way people must live now. The franchise values of businesses within these industries have not changed in many cases, but their immediate cash flow and circumstances have.
- **Group 3**: These industries are highly cyclical in nature (energy, financials, automakers) and have been hardest-hit by the sudden drop in demand. However, these stocks will likely rebound the fastest once the spread of COVID-19 can be brought under control.

Exhibit 3
COVID-19 Exposure: Portfolio vs. Benchmark

	12/31/2019		3/31/2020		Benchmark
COVID Group	Portfolio (%)	Benchmark	Portfolio (%)	Benchmark	Q1 Performance
1	33.4	36.9	40.1	41.0	(22.7)
2	26.1	23.3	26.5	24.8	(26.3)
3	37.7	39.1	31.5	34.2	(39.3)

We used these categorizations to assess the overall exposure of the portfolio to COVID-19 risks and adjusted our holdings accordingly in the last few weeks of the quarter. We reduced our underweight to resilient Group 1 stocks dramatically (-3.5% to -0.9%), moderately reduced our overweight to Group 2 stocks (+2.8% to +1.7%), and moderately increased our underweight to cyclical Group 3 stocks (-1.4% to -2.7%). For more specifics on the stocks we bought and sold in each group, please see the next section.

It's important to stress, however, that the mapping exercise is only a starting point in how we assess our individual holdings. We are well aware that high-quality businesses in Group 2 in particular may be temporarily undervalued as a result of indiscriminate selling. We remain cautious about adding highly cyclical stocks at present, without a clear sense of how long the current demand shock will last. However, depending on the duration of the crisis, and valuation levels, we may start to consider these stocks at a later date.

In this extremely volatile market, we believe it is important to be careful when making changes to the portfolios, which in our view are already well positioned for the long term. With that said, our trading activity has focused on areas where we believe extreme price moves have created good relative value opportunities. It is important to note that most value stocks are not defensive and most defensive stocks are not value. Currently, inexpensive valuations for more cyclically oriented businesses, coupled with extreme uncertainty for the global economic outlook, suggest a balanced portfolio is most prudent.

We will continue to monitor economic and financial data as the virus moves sequentially through Asia, Europe, and the United States. We believe the nature and speed of the market recovery depends almost entirely at this point on how long the virus continues to disrupt the global economy and how effective fiscal and monetary policy is at bridging the demand gap.

New Buys

Adaptive Biotechnologies (COVID Group 1), based in the US, is a leader in the rapidly developing market for immunotherapies. The company believes that there is a roughly $50 billion addressable market between the end markets of life sciences research, clinical diagnostics, and drug discovery. We believe that we are in the early innings of this innovative approach to medicine and that Adaptive will be one of the eventual winners. Adaptive is partnering with companies on the cutting edge of technology, such as Genentech and Microsoft. We take a longer view of the company's valuation, using a sum-of-the-parts analysis. Adaptive has current revenue and milestone-based revenue, as well as a large potential pipeline and a large net cash position to fund future growth. We believe the company will deliver on its large pipeline opportunity and that the share price will ultimately confirm our sum-of-the-parts valuation.

Arcadis (COVID Group 3) is a Dutch global engineering company with a relatively even mix of businesses: environmental services, "smart" buildings, water management and purification, and infrastructure. Making client firms more sustainable accounts for the overwhelming majority of revenues, and public-sector customers represent half of group sales. Arcadis' new chief executive has been pushing through a major operational and financial revamp, and the improvements in group profitability, cash flow, and balance sheet strength have become increasingly evident. The company has streamlined its portfolio, implemented markedly tighter project review and approval procedures, and developed and refined systems monitoring for decentralised operations. The business is somewhat linked to the direction of the global economy, and thus, results are very likely to weaken this year. We believe the decline in share prices during the first quarter reflected the market's recognition of this likelihood. In response to the pandemic, Arcadis' management prudently announced an array of initiatives to cut costs and preserve cash, and we believe the group's financial liquidity and balance sheet are resilient enough to withstand the COVID-19 crisis and return to growth when it fades.

Carlisle Companies (COVID Group 2) is a diversified industrial company that we view as near best in class in terms of financial productivity. The company operates in multiple business lines, but the commercial roofing markets makes up the largest portion of the business at some two-thirds of sales. Carlisle is a dominant player in commercial roofing, with as much as 50% share in certain product lines. Re-roofing activity drives that particular business line, making it less exposed to the more cyclical forces that guide the pace of new construction. The second-largest business is called Interconnect Technologies, which manufactures specialized wiring and cable products, as well as connectors and related products. This segment has heavy exposure to commercial aerospace and does add some risk to the thesis, but we still view CSL as less cyclical overall than most SMID industrials. Carlisle's free cash flow historically has been well in excess of net income, and the strong balance sheet offers a potential cushion in a downturn.

Digital Garage (COVID Group 1) is a Japanese developer and holding company for digital and internet-based businesses. The company operates across three key areas: online advertising, cashless payments, and venture capital/incubation investing. The company's cashless payments business began to grow rapidly as the Japanese government promoted the development of digital payments ahead of the 2020 Olympics, and it continues as online transactions gain currency at a time when many shoppers are effectively housebound. The business line has significant room for growth, given that Japan's cashless payment penetration is still just 20%. Meanwhile, the online advertising business has recovered from last year's pullback, and game advertising should benefit if social isolation measures result in people playing more video games, as one might expect. As for Digital Garage's venture capital business, it focuses on internet applications related to the company's own operations. The company has a net cash balance sheet, stable cash flow, and high capital efficiency with 15% to 20% returns on equity (ROE). The sell-off in March presented an attractive opportunity to add this company, with its long-term structural growth profile, to the portfolio.

Grid Dynamics (COVID Group 1) is a US-listed technology company offering digital transformation services primarily to the consumer retail, technology, and financial sectors. The company's projects are critical for their clients, helping them to enhance their operations to fit a more digital and technologically advanced world. We believe that digitalization will continue to be a fast-moving trend for all companies in all sectors, and that Grid Dynamics will be a beneficiary of that trend. The company's offerings are in complex, premium sectors that employ a global, highly educated workforce. While the company's customer base is highly concentrated, it is adding new customers, and some existing customers have entered a high-growth phase. Grid has top-end organic growth, a solid margin profile, and net cash on its balance sheet, and we believe that as it continues to diversify its customer base, the stock should begin to trade in line with its peers.

Industrial & Infrastructure Fund Investment Corp IIF (COVID Group 2) is a Japanese real estate investment trust (J-REIT) that invests in industrial (logistics, storage, manufacturing, R&D facilities) and infrastructure (data centers, power generation, transportation) properties. IIF's investment manager is Mitsubishi Corp.–UBS Realty Inc., a 51%/49% joint venture between Japan's leading general trading company and the asset management arm of UBS AG. Because the fund is not sponsored by a development company like most J-REITs, it may partner with a diverse group of companies due to its corporate real estate (CRE) solutions capabilities. Japanese companies are increasingly mindful of capital efficiency and ROE, and they increasingly express that awareness by leasing property instead of spending capital on land and buildings—a trend that obviously benefits IIF. Sixty percent of their assets are in greater Tokyo, 23% in greater Osaka, and 3% in greater Nagoya. We expect the trust to invest ¥25 billion a year on average, with most of that spending going to logistics facilities, for which there is ongoing demand, and manufacturing facilities and facilities related to research and development. To source manufacturing and R&D facilities, we expect IIF to combine Mitsubishi Corp's relationships with its own CRE capabilities. Their CRE model allows IIF to participate in development projects and helps them acquire properties below their appraised value. The fund has a track record of stable distribution per unit growth and attractive returns compared to others in the sector. Return on capital upside is limited, but the steady growth in net asset value and the 3%-4% dividend yield have produced reasonable returns with defensive characteristics. The J-REIT sector performed poorly in the first quarter as traditional investors such as regional banks faced losses from overall market weakness and sold their positions to lock in gains ahead of the end of the fiscal year on 31 March. When the stock traded at a dividend yield of 5% compared to its normal range of 3.5%, we established a position to take advantage of both the defensive characteristics and steady growth potential.

NIC Inc. (COVID Group 1) is a US provider of digital government solutions. NIC primarily focuses on developing state government websites used for processing payments for such things as drivers' licenses and vehicle registration renewals, taxes, outdoor recreational licenses, and professional licenses. Much of the company's revenue is recurring, and it has a long track record of driving organic growth even during recessionary periods. The transition from face-to-face to online transactions should continue or even accelerate during this pandemic period, and we think NIC is uniquely suited to benefit from this trend. The company has a net cash balance sheet and should generate free cash flow equal to or greater than net income. We initiated positions in March after an initial sell-off in the stock which brought valuations down below 18x 2021 estimated earnings (ex $3 per share in net cash).

Steris (COVID Group 2) is a medical device company listed in the US and headquartered in Ireland that leads the world in producing sterilization equipment. Steris has created a suite of sterilization offerings that service a wide range of hospital, medical device, and pharmaceutical companies. Those customers order not only the tools that sterilize equipment, like endoscopes, but also the preventive sterilization products, recurring consumables, and equipment maintenance services. Steris' competitive advantage is both its technological advantages and all-encompassing offerings. While COVID-19 may delay capital-related revenue, we took advantage of the equity market sell-off to start a position in this high-quality business at an inexpensive valuation. We believe the company's business model is normally fairly defensive, with roughly 75% recurring revenue and a strong balance sheet.

Stillfront Group AB (COVID Group 1) is a Swedish video game developer with pure online global distribution. This puts the company in a good position to withstand the challenges of the COVID-19 crisis, but even before that, the company benefited from consumers increasingly preferring in-home entertainment. The company has a 33% profit margin (EBIT), ROE of 31%, and revenue growth of 49%, half of which is organic. The company's strong balance sheet will enable it to make acquisitions, thus helping to consolidate the very fragmented mobile gaming segment. Stillfront has an impressive track record in making and integrating acquisitions that should help in this process. Its most recent US-based acquisition has several top-grossing game franchises internationally and contributes a significantly larger base of active users and higher profitability to the company. We expect profits to rise further in the coming years, thanks to cost synergies from other studios Stillfront is likely to acquire, higher efficiency through improved use of live operations within its games, an ability to allocate products across more channels, and positive operational effects from greater scale. Stillfront has a highly entrepreneurial culture and extremely sophisticated data analytics capabilities, which helps management make nimble, effective decisions on both investments and allocating the marketing budget.

Trend Micro (COVID Group 1) is a cybersecurity company founded in 1988 in the US. Building on success with antivirus products in Japan, the company established its headquarters there and went public in 1998. It is the world's third-largest antivirus software company, with a large share of the enterprise market in Europe, Japan, and the US, as well as a large share of the individual market in Japan. Trend Micro sells user protection products in the mature markets for on-premises and antivirus solutions and hybrid infrastructure protection (HIP) products for the growth market of cloud and anti-cyberattack solutions. The migration of enterprise IT infrastructure to the cloud requires more complex cyber-security solutions, but enterprises are increasingly interested in reducing the number of vendors. Trend Micro is one of the few companies providing solutions matched to customers' particular needs, depending on where they are in the process of transitioning to a cloud infrastructure. The company has been able to maintain enterprise relationships as its customers' needs evolve. The amount of data and the need for system-related cybersecurity measures are constantly growing and should accelerate further. Many workers are doing their jobs from home at the moment, which in turns creates a need for more cloud-based solutions for a large portion of the work force. They generate steady cash flow, and the balance sheet has no debt and significant assets in cash or other liquid investments. ROE has been steady at 15%, supported by a high payout ratio of 70%. The COVID-19 sell-off presented a unique opportunity to establish a position in this company at very attractive valuations.

WPT Industrial (COVID Group 2) is a Canadian-listed REIT. The company focuses on acquiring and maintaining assets that house large, high-quality, multinational tenants. The company's occupancy rate is higher than 99%, with a diversified tenant base. Its top five customers include General Mills, Unilever, and Amazon. The company also boasts an attractive dual combination of long-dated debt maturities and lease expirations. Shortly afterward, when WPT announced a transformative deal that increased its US footprint and required capital, we bought the shares. As investors realize that WPT has a high-quality diversified US asset base, we believe that the shares will rerate in line with its US peers.

Sales

Brink's Company (COVID Group 1) is a US-based global leader in the movement of cash and valuable goods via armored trucks. We thought of the company as a mispriced asset. We had begun trimming the stock early in the year, as it had reached our valuation target and the Argentina business posed an incremental risk to earnings. We ultimately sold the entire position before the COVID-19 pullback.

Brixmor Property Group (COVID Group 3) is a US shopping center REIT. The stock was a successful investment in the portfolio and the valuation had risen to reflect the steady grocery anchor tenant base as well as the repositioning of the portfolio under new management. With significant exposure to the COVID demand shock and a valuation that was no longer supportive, we sold the stock in favor of WPT Industrial.

Carel Industries (COVID Group 2) is an Italian-based manufacturer of control systems for HVAC and refrigeration units. The stock had been a solid performer, and the valuation had reached our target. We began selling the stock late in 2019 and finished early in 2020.

Consun Pharmaceutical Group (COVID Group 1) is a leading Hong Kong-based provider of prescription and over-the-counter medicines for the Chinese market. We sold the stock very early in the year, as the fundamentals had not matched our expectations, and used the proceeds to fund other ideas.

Equiniti Group plc (COVID Group 1) is a UK payment and administrative engine for public and private organizations. After several quarters of misexecution, weak cash flow generation, and a stretched balance sheet, we began selling the stock in late 2019 and finished our remaining small position in early 2020.

FLIR Systems (COVID Group 2) is a US provider of thermal imaging systems. We had owned the stock for multiple years and it had been a solid performer for the portfolio. After several quarters of significantly beating consensus, expectations grew too high, and the company was unable to continually beat them. We sold the stock early in the COVID pullback with valuation no longer supportive of the thesis.

GMO Internet (COVID Group 1) is a Japanese provider of internet infrastructure services such as advertising, payment processing, and security systems. The company also operates one of the largest online retail currency trading platforms. GMO Internet also has exposure to the cryptocurrency market, which has introduced outsized volatility to share price performance. On a sum-of-the-parts valuation, Digital Garage offered much more attractive valuations for similar exposure to the payment processing space, without the cryptocurrency volatility.

SAIA (COVID Group 3) is a US regional provider of less-than-truckload transportation services. We bought and sold the stock within the quarter. We purchased the stock early in the year with the view that industry tonnage was bottoming, and combined with internal company initiatives, that would result in outsized earnings growth and improving financial productivity in the coming years. Saia historically had priced loads at discounted levels relative to the competition, but in recent years more disciplined pricing and operational improvements resulted in higher profits. We felt that with additional tonnage and greater density, the company would be able to further leverage the high fixed cost model and expand EBIT margins. The stock held up well relative to the initial phase of the COVID pullback and we used that relative outperformance to sell the stock. As the US economy shifts into recession mode, we concluded that Saia would not be able to continue on its trajectory and would likely see margins decline.

Tapestry (COVID Group 3) owns and operates the US luxury brands Kate Spade and Coach. Our thesis hinged on a turnaround story, given improving margins at Kate Spade and steady cash flow from Coach. The pandemic impairs our thesis, as falling demand and store closures could put stress on the balance sheet.

TMX Group (COVID Group 1) is the Canadian-listed stock exchange group of Toronto and Montreal. The stock had outperformed and reached our valuation target. Consensus expectations have caught up to our projections, and costs will be more difficult to cut going forward.

Toromont Industries (COVID Group 2) is the Canadian-listed dealer of Caterpillar equipment. We began reducing our position in Toromont prior to the COVID pandemic in order to upgrade the quality of our cyclical exposure with a position in Carlisle Companies.

US Foods (COVID Group 2) is the second-largest competitor in a very fragmented food service distribution market in the US. Its 28,000 employees serve approximately 300,000 operators via more than 70 distribution centers, with a customer mix relatively equally distributed between independent restaurants, healthcare, and hospitality end markets. Restaurants overall represent nearly 50% of revenue. We initiated a position early in the quarter based on the company's high and improving financial returns, synergies from recent acquisitions, and a revenue stream that has historically held up well in downturns. The stock suffered due to the nature of the COVID-19 pandemic and the significant impact on many of the company's customers. Recognizing the impact of these headwinds, coupled with the leveraged balance sheet, we sold the stock as the global shutdown expanded.

Zenkoku Hosho (COVID Group 2) is a Japanese provider of credit guarantees for residential mortgages. The company has been a long-term holding in the portfolio and benefited from low unemployment rates and declining credit costs. The potential for this these two trends to change has increased given the current pandemic, and we exited the position to make room for a more defensive real estate-related position.

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Important Information

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