Punch

Small Cap Commentary
Fourth Quarter, 2020

Overview

The fourth quarter of 2020 was one for the record books, as the Russell 2000 Index of small cap stocks posted its single best quarter ever, rising 31.4%. This performance exceeded both the S&P 500 Index of large cap stocks (+12.1%) and the popular NYSE FANG+ Index (+16.9%).

For the year, the Russell 2000 Index returned 19.9%, also ahead of the S&P 500 Index return of 18.4%. After lagging large caps for the entire year, at some points meaningfully, small cap stocks pulled ahead in the last month of the year. 2020 was the second consecutive year of gains in excess of 20% for small caps.

Attribution

The Punch Small Cap Strategy returned 31.1% in the fourth quarter, trailing of the benchmark return of 31.4%. Our underperformance was primarily the result of sector allocation, while security selection was a contributor to total return.

For the year 2020, the Punch Small Cap Strategy lagged its benchmark, with a 15.6% total return compared to 19.9% for the Russell 2000 Index. Both security selection and sector allocation were detractors for the year.

The most glaring performance factor in the small cap market in 2020 was the significant and unprecedented outperformance of growth stocks compared to value stocks (+34.6% vs. +4.6%), although this trend reversed itself in the fourth quarter when value outperformed growth (+33.3% vs. +29.6%). Many of the companies that gained the most attention were direct beneficiaries of the global pandemic and the resulting government lock-down orders around the world this year. Fueled by near-zero interest rates, many of these beneficiaries went from irrational valuations before the pandemic to absurd valuations today.

While we do not focus exclusively on value, we do have a concerted value bias. We want to own businesses that are high quality and can grow over time, but we seek to acquire companies when their share prices are depressed. Coming into 2020, our opinion was that the popularity of growth stocks was overextended; today it appears to be more stretched than even during the tech bubble of 1999-2000. As growth stocks have outperformed recently, we have chosen not to participate in the

Annualized Performance as of 12/31/2020 *(net of fees)*

	Q4 2020	1 Year	3 Years	5 Years	10 Years	Since Inception*
Punch Small Cap	31.1%	16.1%	9.1%	11.8%	11.2%	10.5%
Russell 2000 Index	31.4%	19.9%	10.2%	13.3%	11.2%	9.0%

**Inception date is 3/31/2002. Figures over one year are annualized.*

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See disclosures at the end of this commentary performance derby in an effort to control risk. We are hopeful that the fourth quarter marked a turning point in this cycle and, as the economy normalizes and interest rates rebound over the coming years, these factors may become tailwinds for our strategy.

Bottom Contributors to Return

During a strong quarter for the markets, longtime holding **LendingTree, Inc. (TREE, $3.6 billion market cap)** was the largest detractor from performance. As a reminder, LendingTree is an online platform that connects consumers with access to various financial products including mortgage loans, credit cards, auto loans, and insurance quotes. Despite posting better than expected results in the quarter, shares traded lower after the company released a disappointing outlook for the fourth quarter.

Bottom Contributors: Fourth Quarter 2020

Holding	Average Weight	Total Return	CTR** (bps)
LendingTree Inc.	0.90%	-10.79%	-11
Select Energy Services Inc.	0.11%	-11.20%	-5
Phibro Animal Health Corp.	1.09%	12.29%	9
Franchise Group Inc.	0.24%	10.22%	10
Spok Holdings Inc.	0.79%	8.85%	11

***CTR represents the contribution to total return in basis points. Contribution data is reflective of a representative account in the Punch Small Cap Equity Strategy.*

Throughout the pandemic, lenders' hesitancy to extend credit to consumers has impacted the business. Some banks are waiting to issue loans until they have a better understanding of the ultimate impact that COVID-19 will have on consumers. LendingTree has diversified into offerings like mortgages, auto and student loans, and insurance, so they can more efficiently connect borrowers with willing lenders. Additionally, the company's mobile offering has continued to attract new consumers because the platform makes accessing services easy and convenient. We believe LendingTree's diversified portfolio coupled with strong secular trends driving personal finance to digital channels position the company well to navigate the near-term headwinds.

The second largest detractor during the quarter was **Phibro Animal Health Corporation (PAHC, $786 million market cap)**. We took an initial position in this provider of livestock nutrition and animal health products in the summer of last year believing that the company has a portfolio of high-quality products and significant growth opportunities in emerging markets.

The African Swine Fever outbreak in 2019 pressured sales and had driven their shares lower. Phibro has more recently been affected by COVID-19, as developing countries struggle with meat production and consumption. (However, the most recent quarter showed promise with improving demand.) Despite these two unfortunate events, management has invested into new products that we expect to become meaningful to sales in the coming years. We believe the company is set up to return to attractive growth and normalized margins as economies reopen and new product rollouts gain traction. Valuations across the peer group today are substantially higher than Phibro's, and we believe investors are giving little credit to this under the radar stock given its recovery opportunity.

Commercial furniture manufacturer **Kimball International, Inc. (KBAL, $442 million market cap)** was the third largest detractor after announcing a large acquisition of commercial furniture designer and manufacturer, Poppin, Inc., simultaneously with its third quarter results. Kimball has been hit especially hard by the pandemic, as two of its three customer verticals are commercial offices and hospitality. The company decided to use a majority of its cash to acquire Poppin under the expectation that the new business will be a growth driver and Kimball can leverage Poppin's digital platform across existing brands.

We believe the acquisition provides an opportunity for Kimball to diversify its customer base and quickly add new technology to help the company through the pandemic. With its net cash balance now largely spent, the combined business has elevated risk and opportunity in the coming years. Since speaking with management and conducting due diligence post acquisition, we are comfortable with the Poppin acquisition and will be monitoring its integration closely in the coming quarters.

Top Contributors: Fourth Quarter 2020			
Holding	Average Weight	Total Return	CTR** (bps)
B. Riley Financial Inc.	5.12%	78.71%	353
Etsy Inc.	4.89%	46.27%	222
Sleep Number Corp.	2.86%	67.37%	167
Green Brick Partners Inc.	3.95%	42.61%	162
Callaway Golf Company	4.37%	25.44%	108

***CTR represents the contribution to total return in basis points. Contribution data is reflective of a representative account in the Punch Small Cap Equity Strategy.*

Top Contributors to Return

B. Riley Financial, Inc. (RILY, $1.1 billion market cap) was the Punch Small Cap Strategy's top performing investment during the quarter. B. Riley is a diversified financial services platform with operations across capital markets, retail liquidations, and valuations and appraisals. During the quarter, the company benefitted from strength across most of its business lines but especially from its capital markets division. As a result of the strength, B. Riley pre-released results reporting that it expects to generate earnings per share of approximately $4.20 in the fourth quarter and $5.25 for the year (compared to the stock's year end closing price of $44). The company remains under the radar with zero analyst coverage, and insiders remain the largest shareholders owning over 20% of the company. We think B. Riley will continue to see tailwinds across several of its verticals. It also has a demonstrated track record of deploying capital into attractive opportunities. It remains a top holding for the Punch Small Cap Strategy.

Sleep Number Corporation (SNBR, $2.3 billion market cap) was another top contributor in the quarter. The company is a leader in the premium mattress market and benefitted from consumers renewed interest in upgrading their home furnishings. As a vertically integrated retailer, Sleep Number was well-positioned to sell both online and in its own stores meeting customers where they were comfortable. Health and wellness trends continue to benefit Sleep Number. In addition, it has room to grow its market share to drive future growth, and the company is building from a stable level of business thanks to its loyal customer base (over 40% of its revenue comes from repeat purchases and referrals). We believe the company remains an attractive investment opportunity.

Online marketplace **Etsy, Inc. (ETSY, $22.4 billion market cap)** is a poster child beneficiary of the change in consumer habits due to COVID-19. Etsy achieved triple-digit revenue growth as people turned to Etsy while shopping at home. While a portion of the revenue growth came from pandemic-related needs (like masks), we believe Etsy will continue to benefit from the increased attention its platform garnered. Consumer habits likely changed permanently due to the events of 2020, and customers realized Etsy can be used for a wider variety of goods. Investors kept buying the stock, and its stock price rose five-fold from its March lows. The company's addition to the S&P 500 Index (a first for the Punch Small Cap strategy) also led to a significantly broader investor base.

Portfolio Activity

In the fourth quarter, we added two new positions and exited three, bringing the total number of positions to 44. Portfolio turnover in 2020 was 27%.

We generally review all small cap spin-offs because of behavioral opportunities typically associated with these transactions. We often see selling pressure from funds which, due to their mandates, are not able to own the spun company, making the shares artificially cheap. **Arcosa, Inc. (ACA, $2.7 billion market cap)** was spun from Trinity Industries, Inc. (TRN, $3.0 billion market cap) in November 2018. Arcosa is an infrastructure conglomerate with businesses in construction products, energy equipment, and transportation products. We have been following ACA since the spin and took a position in the fourth quarter.

Spin-offs are usually made up of the less desirable assets of a company and may have excess debt on the balance sheet. In the case of Arcosa, Trinity released high-quality assets with a low-debt balance sheet. Another distinctive aspect to Arcosa was that half of the board of directors from TRN left to be on the newly formed ACA board. In its relatively short life as an independent public company, Arcosa management has proven their ability to execute on organic and inorganic initiatives. We like

ACA because it has demonstrated its ability to shift from a complex business to a more simple one. As a result, it should get more investor attention and perhaps, along with it, a higher multiple.

In prior commentaries, we have discussed our use of a "red team" and a "green team" as part of our research process. In this effort, half of our investment team argues the bull case for a stock, and the other half argues the bear case. This practice has proved to be a significant gatekeeper for the portfolio. We ran **Franchise Group, Inc. (FRG, $1.3 billion market cap)** through our "red team/green team" diligence, and it resulted in our taking a position in the company. FRG rolls up asset-light businesses in the retail sector with value-pricing dynamics and franchise potential. Given the contrarian nature of retail today, Franchise Group has plenty of acquisition opportunities, and the company has strong cash flow characteristics to support them. Management owns 30% of the company and is taking a "private equity approach" to cost reductions. We believe, over time, growth in FRG's operations will help drive a franchise multiple for the stock and a higher valuation for shareholders. While we wait for franchise operations to develop, management has committed to growing the dividend, currently at 4.81%. Our red team/green team approach led us to believe we have few reasons not to own this stock, and we are optimistic about the outcome.

We exited three positions in the fourth quarter. The first, in early October, was **BioSpecifics Technologies Corp. (BSTC, $550 million market cap)**, a profitable pharmaceutical licensing firm with relatively new management and a strong balance sheet. It's main licensing partner, Endo Pharmaceuticals (ENDP), acquired the company in October for $88.50 per share in cash. While the acquisition premium was meaningful, we were disappointed in the outcome, as we thought that the company was poised for significant growth in the years ahead.

In November, we exited energy services firm **Select Energy Services, Inc. (WTTR, $600 million market cap)** on deteriorating fundamentals in the business with a poor near-term outlook. We initially invested in the company in 2018 because we believed that the company's core water infrastructure services had competitive barriers to entry and that new customers and contracts provided for meaningful growth opportunities. The company also had no net debt and a thoughtful management team. As the global pandemic of 2020 upended the energy industry, we believe that Select fared better than many but has still had its business and prospects for growth permanently impaired.

Finally, in December, we exited communications services provider **SPOK Holdings (SPOK, $230 million market cap)**. Our investment in the company dates to 2016 and our original thesis was that, as the leading provider of paging services in the U.S., SPOK management was milking its legacy cash cow business to invest in new, higher-growth communications software products that would be sold to its existing customer base of large hospitals. We believed that this transition was underappreciated by investors and that the market value of the company did not appropriately reflect the value in these new products. Unfortunately, mismanagement of the growing software business, along with years of significant investment in new products, has led to disappointing results, and we have lost confidence in management's ability to pivot the business. Despite involvement from several activist investors and an outside bid for the company in early 2020, entrenched management has fended off shareholder efforts to create value and instead remains focused on continuing its current failed strategy.

Conclusion

Mark Twain once remarked that "history doesn't repeat itself, but it often rhymes." While 2020 stands alone in in the annals of modern history with little historical precedent, aspects of this era do not look all that different than past episodes for investors. One such "rhyme" is the performance of small cap stocks before, during, and after the economic recession of 2020.

Going into 2020, large cap stocks had outperformed small cap stocks for over ten years. In the twelve months leading up to February 2020 (the official start date of the current recession according to the National Bureau of Economic Research), large cap stocks delivered a total return of 21.4% compared to only 9.2% for small cap stocks, and in the three years before the recession, large cap stocks returned more than twice that of small caps (49% compared to 23%).

In 2020, pressured by recession fears and COVID uncertainty, smaller companies bore the brunt of declines because they tend to be more cyclical, less diversified businesses. They also did not benefit as directly as larger companies from Federal Reserve intervention during this recession.

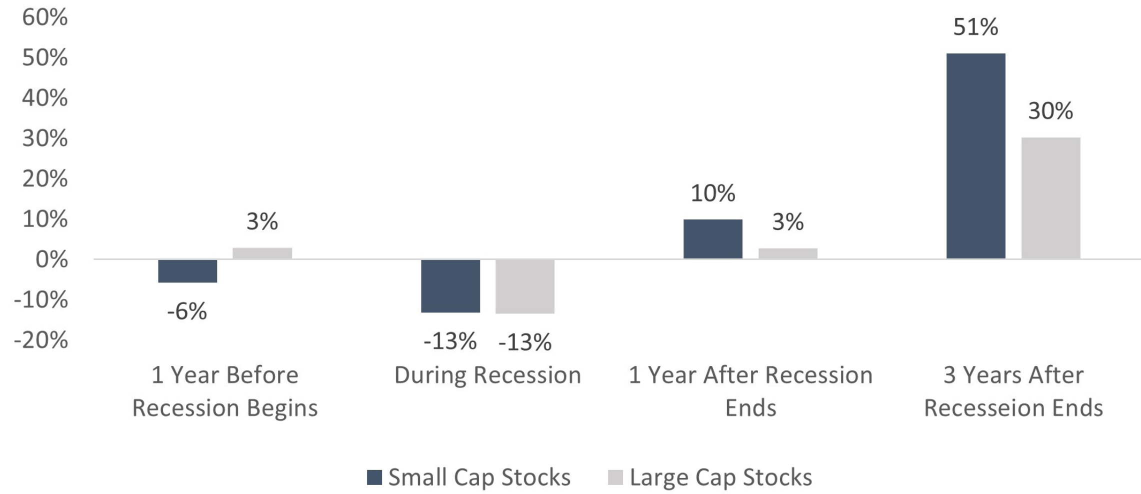
It was not until the fourth quarter that this relative performance improved dramatically, and by December 31st, small cap indexes had completely closed the gap. In the fourth quarter alone, small cap stocks more than doubled the return of large caps (+31% vs. +12%). For the full calendar year, the Russell 2000 Index of small cap stocks produced a total return of 19.9% compared to the S&P 500 Index's return of 18.4%. While small caps entered the year as one of the worst-performing asset classes, they exited as one of the best.

Over the past thirty years, the U.S. economy has experienced four recessions: 1990-91, 2001, 2007-09, and 2020. In the twelve months before the onset of each of these recessions, large cap stocks outperformed small caps in each instance by an average of over 8%. During recessions, all stocks tend to decline in value, although small cap stocks have historically declined slightly less. The stock market tends to be forward-looking, and part of this performance may be explained by investors anticipating an end to the recession before it officially ends.

Perhaps most interestingly, small cap stocks tend to continue their outperformance in the twelve months after a recession officially comes to a close. In all three historical episodes since 1990, small caps had a total return that was 7% better than large caps (9.9% average return compared to 2.8%) during the following year. Over the three years subsequent to the end of a recession, small caps continued to outperform large caps, and by a wide margin (20% on average). As the economy repairs itself, these smaller companies benefit disproportionately from the rising tide of economic activity and access to capital markets.

Over long periods of time, small cap stocks have historically produced superior returns to large cap companies, albeit with higher levels of volatility. Having just gone through a cycle where small cap stocks produced inferior returns for several years, history may be indicating brighter days ahead.

Performance of Small and Large Cap Stocks
Before, During, and After Recessions since 1990



Average Total Return of Small and Large Cap Stocks Around Recessions Since 1990				
	Twelve Months Before Recession	During Recession	Twelve Months After Recession	Three Years After Recession
Large Cap Stocks	2.9%	-13.4%	2.8%	30.3%
Small Cap Stocks	-5.7%	-13.1%	9.9%	51.1%
Small Cap Relative Performance	-8.6%	0.3%	7.1%	20.8%

**Large Cap Stocks represented by the Russell 1000 Index. Small Cap Stocks represented by the Russell 2000 Index*

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Composite performance is shown net of fees and brokerage commissions paid by the underlying client accounts. Certain client accounts have directed us to reinvest income and dividends, while others have directed us to not reinvest such earnings. As such, performance data shown includes or excludes the reinvestment of income and dividends as appropriate, depending on whether the account has directed us to reinvest income and dividends. Past performance is no guarantee of future results, and investing in securities may result in a loss of principal.

Please refer to the attached Composite Profile and Schedule of Performance for information regarding Punch & Associates' compliance with GIPS® standards.

The reference to the top five and bottom five performers within the Punch Small Cap Equity Strategy portfolio is shown to demonstrate the effect of these securities on the strategy's return during the period identified. Punch & Associates calculated this attribution data using a representative institutional client account which: 1) imposed no material restrictions related to investments made; and 2) was fully invested in the Punch Small Cap Equity Strategy during the entire time period shown. The holdings identified do not represent all of the securities purchased, sold, or recommended for advisory clients during the period of time shown. Past performance does not guarantee future results; therefore, it should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities in this list. Please contact Punch & Associates at andy@punchinvest.com or (952) 224-4350 to obtain details regarding our calculation methodology or to obtain a list showing every holding's contribution to the overall strategy's performance during the period of time shown.

We compile company specific information referenced in this commentary from a variety of sources including SEC filings, quarterly and annual reports, conference calls, conversations with management teams, and Bloomberg LP.

Any benchmark indices shown are for illustrative and/or comparative purposes and have only been included to show the general trend in the markets in the periods indicated. Such indices have limitations when used for comparison or other purposes because they may have volatility, credit, or other material characteristics (such as number and types of securities or instruments represented) that are different from those of the Composite and/or any client account, and they do not reflect the Composite investment strategy or any other investment strategies generally employed by Punch & Associates. For example, the Composite, or a particular client investment portfolio will generally hold substantially fewer securities than are contained in a particular index. *Inception of the Punch Small Cap Equity Strategy was March 31, 2002. **CTR represents the contribution to total attribution.

Punch & Associates Investment Management Inc.
Punch Small Cap Composite
Performance as of 6/30/2019

Punch

	Annual Performance History			3-Year Standard Deviation		As of December 31st			
Year	Gross of Fees	Net of Model Fees	Benchmark[1]	Composite[2]	Benchmark	Composite Accounts	Composite Assets (mil)	Firm Assets (mil)	Dispersion[2]
2009	32.78%	31.52%	27.17%	20.88%	24.83%	264	$86.0	$340.4	3.28%
2010	18.88%	17.79%	26.85%	23.19%	27.69%	273	$104.2	$395.6	1.03%
2011	0.80%	-0.12%	-4.18%	20.44%	24.99%	281	$104.8	$475.6	0.66%
2012	20.12%	19.07%	16.35%	17.15%	20.20%	290	$152.3	$613.6	0.63%
2013	42.64%	41.53%	38.82%	13.49%	16.45%	323	$267.6	$832.7	0.47%
2014	-0.23%	-1.07%	4.89%	12.61%	13.12%	333	$266.3	$905.7	0.25%
2015	0.52%	-0.38%	-4.41%	15.46%	13.96%	335	$256.2	$938.1	0.65%
2016	20.96%	19.84%	21.31%	17.20%	15.76%	353	$308.7	$1,101.0	0.50%
2017	12.93%	11.92%	14.65%	16.36%	13.91%	380	$357.0	$1,241.6	0.32%
2018	-9.88%	-10.79%	-11.01%	16.40%	15.79%	387	$293.5	$1,157.8	0.53%
2019 (through 6/30/2019)	16.97%	16.43%	16.98%	N/A	N/A	N/A	N/A	N/A	N/A

	Annualized Performance History		
Period	Gross of Fees	Net of Model Fees	Benchmark[1]
1 Year	-5.48%	-6.45%	-3.31%
3 Year	12.82%	11.75%	12.30%
5 Year	7.62%	6.64%	7.06%
Since Inception (3/31/2002)	11.00%	9.96%	8.20%

[1] The Russell 2000 Index is the Composite's benchmark. The returns of this index do not include any transaction costs, management fees or other fees.

[2] 3-Year Standard Deviation and Dispersion calculations for the composite are based on gross of fee returns.

Notes:

1. Punch & Associates Investment Management, Inc. (Punch) claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Punch has been independently verified for the periods from April 1, 2002 through June 30, 2019. Verification assesses whether (1) the Firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the Firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The Small Cap Composite has been examined for the periods from April 1, 2002 through June 30, 2019. The verification and performance examination reports are available upon request.
2. Punch & Associates Investment Management, Inc. (Punch) is an investment adviser registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940.
3. The Punch Small Cap Composite was created December 31, 2005 and includes discretionary, fee paying accounts over $100,000 invested in the firm's Small Cap strategy (Strategy). The Strategy invests in small cap companies that are typically between $250 million and $2 billion in market capitalization. The Strategy is benchmarked to the Russell 2000. The Strategy has been open since firm inception (March 31, 2002). Accounts are removed from the composite for cash flows exceeding 10% of the account's monthly beginning market value.
4. The portfolio returns for the period are based in U.S. dollars and reflect the reinvestment of dividends and other earnings. After June 30, 2018 net of fee performance was calculated by deducting one quarter of one percent from each quarter's gross performance and geometrically linking the resulting returns. Prior to June 30, 2018 net of fees performance figures are reflective of quarterly gross of fee returns minus actual investment fees paid by the underlying accounts in the composite for the period. The dispersion of the annual returns of the Composite is measured by the asset-weighted standard deviation method. Only portfolios that have been managed for the full year have been included in the annual dispersion calculation of the Composite. The three-year annualized ex-post standard deviation measures the volatility of returns for the Composite and benchmark over the preceding 36-month period. Punch's policies for valuing portfolios, calculating performance, and preparing compliant presentations and a list of composite descriptions are available upon request.
5. Punch has updated the historical performance results provided in this presentation to more precisely illustrate composite performance based on revised accounts' composite membership exit dates. For more information about the revisions and performance update, please contact us.
6. Past performance is not an indication or a guarantee of future results. Investments are subject to risk and may lose value.