ANCHOR
CAPITAL ADVISORS LLC

Small Cap Value
Portfolio Commentary
As of June 30, 2021

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Market Review

As vaccination rates climb, more states fully reopen, and a sense of returning to normalcy is beginning to take hold, we continue to see the U.S. equity markets respond positively during the second quarter. After a sharp rebound in small cap stocks from last November, we saw the markets transition to large cap stocks with a tilt to growth during the quarter. The S&P 500 was +8.6%, followed by Russell Mid Cap at +7.5% and finally Russell 2000 at +4.3%.[i] Technology, Communication Services, and Real Estate led the second quarter after being laggards the prior six months.[ii] The value trend is in place and we expect to see continued leadership from the Energy, Financials, and Materials sectors. The cyclical rally appears to be slowing down as the recovery and markets are shifting from early to mid-cycle. In the mid-cycle stage, we expect that the markets will broaden, quality companies will be more desirable, and stock picking will come into focus. These attributes benefit Anchor's portfolios as we believe quality performs well over market cycles.

Financial results reported in April and May were strong as companies benefitted from the economy reopening, additional government stimulus, unemployment benefits, and pent up demand for goods and services.[iii] Many companies were able to reduce costs during the pandemic, which has helped drive strong earnings growth. However, on recent earnings calls, we have consistently heard about rising costs - including higher input to freight and labor costs. Management teams have warned that earnings may not be as robust going forward due to these increased costs. They have also indicated they are trying to pass these costs, where possible, through to the end consumer.[iv]

When the pandemic hit, companies - many of which employ just in time systems- automatically reduced inventories in anticipation of a slow rebound. A hurricane in Louisiana, a deep freeze in Texas and the Suez Canal jam compounded supply chain issues. As the economy has recovered very quickly there have been shortages of a number of goods and freight costs have soared. On top of that, additional stimulus and unemployment benefits appear to have had the unintended consequence of making it less attractive for people receiving those benefits to return to work. Thus, many retailers and restaurants are having to raise wages to attract workers. Many states are suspending the additional unemployment benefits and hopefully the labor situation will improve. We believe that the shortages will be rectified over the next several quarters.

All of these factors combined have translated into a rise in the rate of inflation not seen since August of 2008. In April and May, we saw consumer price index (CPI) 12-month percentage growth of 4.2%[v] and 5%[vi], respectively. For context, the Federal Reserve (Fed) has a dual mandate to keep full employment and stable prices – with a current inflation target that averages 2% over time.[vii] We suspect that the growth seen in more speculative activities has been fueled in part by liquidity provided by the government.

Performance Overview

The Anchor Capital Small Cap Value Portfolio underperformed the Russell 2000 Value Index in the second quarter.

On a relative basis, the Portfolio benefitted the most from security selection in the Technology, Health Care, and Utilities. Security selection in Industrials and Consumer Discretionary, as well as an underweight allocation to the Energy sector were the greatest detractors from performance.

Quarterly Attribution Highlights[x]

Sector - Top 3 Contributors	Sector - Bottom 3 Detractors
Technology	Consumer Discretionary
Health Care	Industrials
Real Estate	Basic Materials

Security - Top 5 Contributors	Avg. Weight %	Contribution %	Security - Bottom 5 Detractors	Avg. Weight %	Contribution %
Perficient, Inc. (PRFT)	3.32%	1.02%	Aterian Inc (ATER)	1.73%	-1.29%
Harrow Health, Inc. (HROW)	2.10%	0.65%	Gibraltar Industries, Inc. (ROCK)	2.23%	-0.41%
National Storage Affiliates Trust (NSA)	2.05%	0.49%	Bank of Marin Bancorp (BMRC)	1.50%	-0.30%
Open Lending Corporation Class A (LPRO)	2.17%	0.44%	BWX Technologies, Inc. (BWXT)	2.12%	-0.25%
UFP Technologies, Inc. (UFPT)	2.73%	0.38%	eXp World Holdings, Inc. (EXPI)	0.92%	-0.19%

Quarterly Transactions

Purchased	Sold
MVB Financial Corp (MVBF)	First Financial Bancorp (FFBC)
Nicolet Bankshares Inc (NCBS)	

Purchases

MVB Financial Corp (MVBF) is a holding company for a bank based in Fairmont, West Virginia. It primarily lends to commercial and retail customers in North Central West Virginia and Northern Virginia. We believe MVBF has a long-term history of strong asset quality and has a forward-thinking approach to Fintech that should help it deliver consistent above-average growth over the next several years. Historically, MVBF had opportunities to grow loans 10-20% per year but did not have the deposits to profitably support that level of growth. Management moved towards fintech as a way to get low cost deposits that are in many case non-interest bearing. MVBF partnered with fintech and hospitality/gaming companies to be the deposit holder behind the partners' technology. MVBF owns relationships with a majority of the top hospitality/gaming companies, such as DraftKings, FanDuel, Penn National, and Credit Karma.

This deposit growth has been with a non-interest-bearing focus. In 2020, non-interest-bearing deposits increased 157% year-over-year and represented 36% of total deposits, up from just 22% in 2019 and 8% in 2015. The evolving deposit mix has been driven by the continued success of the deposit acquisition strategies discussed above, including Fintech deposits. Gaming and hospitality deposits were up 198% over the last year with overall fintech deposits up 255%. As a result of the increase in non-interest-bearing deposits, MVBF's net interest margin has expanded more than 50 bps over the last 5 years during a time when many banks have seen their NIMs compress significantly. MVBF is now the 21st ranked bank in the U.S. by number of deposit accounts. Over the last 5 years, it has grown its assets at a compound annual growth rate of 13%. Growth has not come at the expense of profitability either, with net income growing at 24% annually over the same period.

Also notable, the company has high inside ownership with Management and the Board owning ~14% of the shares. MVBF's CEO, Larry Mazza, is the 2nd largest shareholder with 4.7% ownership.

Nicolet Bankshares Inc (NCBS), founded in 2000, is a full-service community bank serving northeast and northcentral Wisconsin, operating in 12 counties through 36 branches. NCBS is a high-quality community bank still led by its co-founders and with a history of good lending and business decisions, growing to be the 2nd largest Wisconsin-based bank in just 20 years. Nicolet has done that without entering the State's two largest markets, Madison and Milwaukee, instead opting to focus on the northern two-thirds of the state where they can dominate the local market share. Banking in this part of the country is relationship driven and Nicolet has built strong relationships due in part to being an active member of its communities. The overall operating environment is also less competitive in these areas thanks to disinvestment by the large banks who are focused more on cutting costs than gaining market share.

NCBS has a commercial focus with ~50% of its loan portfolio in C&I and Owner-Occupied CRE, with the existing loan book also representing a diversity of industries. Credit metrics in Wisconsin are perpetually among the top in the country and are especially favorable in the northern two-thirds of the state. Unemployment is historically very low and the people in the area are notorious for their work ethics. Because of this and NCBS's conservative credit culture and strong underwriting, Nicolet has averaged net charge-offs to average loans of just 0.04% over the last 5 years. The bank also never lost money during the Global Financial Crisis.

While Wisconsin has a relatively low growth economy, NCBS feels confident they can grow loans organically at mid-single digit rates for the near future. However, Nicolet is not reliant solely on organic growth, proving to be a proficient acquirer, successfully closing five accretive M&A transactions since 2013. The company recently announced two new accretive acquisitions in 2021, which will take the asset base from $4.5bn today to more than $7.5bn. We believe NCBS has a long runway to continue acquiring smaller banks in an accretive manner and was our primary attraction to the stock. Finally, as an added bonus, NCBS also has a growing and diversified fee income base, which has grown at a 26% CAGR over the five years, helped in part due to its now $1.3bn mortgage servicing portfolio and RIA with ~$3.6bn in AUM. All of this coupled with a cheap valuation made this a very attractive investment to us.

Sales

First Financial Bancorp (FFBC) is a bank headquartered in Cincinnati, Ohio. It provides consumer and commercial banking products and services, investment and insurance products. We sold FFBC on valuation as the stock has appreciated year to date and we believe there are more compelling opportunities for investment in the banking industry.

Outlook

The Fed is in an interesting spot because they want the economy to fully recover and get to full employment, but they do not want inflation to get out of control.[xi] This is controlled by the Fed raising interest rates.[xii] If the Fed raises rates too early then the economy could stall out, and if the Fed waits too long then the rampant inflation could impact economic growth.[xiii] In addition, the Fed is cautious in telegraphing any interest rate increases so the markets do not sell off. The Fed has said that they are happy to let inflation run a little hot, but based on the June Fed meeting they are expecting to have two interest rate increases in 2023.[xiv] The interest rate increased quickly for the 10 Year Treasury Bond, from 0.90% at the end of 2020 up to 1.7% at one point, and is now hovering around 1.5%.[xv] We expect that interest rates will grind higher as the year progresses and the economic recovery takes hold.

President Biden's proposed infrastructure plan, which is currently being negotiated, is meant to fix aging infrastructure, support the continued build out of electric vehicle charging stations, fund solar and wind projects and build out broadband for rural America.[xvi] Funding this plan requires an increase in corporate and personal taxes to currently unknown levels. In looking at our holdings, we are monitoring the impact a potential tax increase from 21% to as high as 28% could have on businesses. The proposal also includes an increase in the capital gains tax rate.[xvii] For many investors that would be a significant and impactful change. Our ability to construct portfolios of securities we can hold over multiple market cycles remains critical.

As the global economy reopens and we see strong GDP growth, especially in emerging markets, we expect that value will continue to perform well. We anticipate there will be demand for value parts of the market like industrials, energy, and materials. Generally, a strong economic recovery benefits banks, as interest rates rise and loan growth increases. As mentioned earlier, we expect that the markets will broaden, quality companies will be more desirable, and stock picking will come into focus. These attributes benefit Anchor's portfolios as we believe quality performs well over market cycles. We continue to look for high quality companies that can manage through the business cycle and have the ability to grow. Our research process allows us to identify strong businesses and the COVID-19 selloff gave us the opportunity to buy these companies at a discount to intrinsic value. We now have to be patient as the market realizes the earning potential for our portfolio companies. We are excited about the holdings in our portfolios and we believe we are well positioned going forward.

[i] FactSet financial data & analytics; Charting
[ii] Ibid.
[iii] https://www.morganstanley.com/ideas/excess-savings-fiscal-spending-boosts-economy
[iv] https://www.wsj.com/articles/companies-weigh-price-increases-other-options-as-costs-rise-11621243807
[v] https://www.cnbc.com/2021/05/12/consumer-price-index-april-2021.html
[vi] https://www.nytimes.com/2021/06/10/business/consumer-price-index-may-2021.html
[vii] https://www.chicagofed.org/research/dual-mandate/dual-mandate#:~:text=What%20is%20the%20dual%20mandate,longer%2Drun%20goals%20and%20strategies.
[viii] eVestment Analytics, see model disclosures below.
[ix] FactSet financial data and analytics; Attribution
[x] FactSet financial data & analytics; Attribution
[xi] https://www.cnbc.com/2021/03/20/the-fed-can-fight-inflation-but-it-may-come-at-a-cost.html
[xii] Ibid.
[xiii] Ibid.
[xiv] https://www.cnbc.com/2021/06/16/fed-holds-rates-steady-but-raises-inflation-expectations-sharply-and-makes-no-mention-of-taper.html
[xv] FactSet Data & Analytics, Charting
[xvi] https://www.npr.org/2021/04/01/983470782/by-the-numbers-bidens-2-trillion-infrastructure-plan
[xvii] Ibid.

For a complete listing of all strategies contact Anchor Capital Advisors LLC (617) 338-3800.