

April 2022

Small Cap Quarterly Perspectives

A Double Whammy

After a massive run during 2021, 2022 started out with a double whammy which consisted of geopolitical worries as Russia invaded Ukraine, along with the anticipation of higher rates as the Fed tries to battle inflation. Both meaningfully impact the economy as Ukraine produces a significant amount of grain, among other commodities, and a high level of interest rates likely changes risk appetites and curtails discretionary spending. In addition, the ugly and tragic headlines impact consumer confidence which has additional ripple effects throughout the economy. That being said, while tragic and attention-grabbing, past geopolitical events have generally been digested by investors, and after a modest drawdown, the market has historically moved forward. We may have begun to see some signs of this behavior in the last few weeks of the quarter.

Resilience

While the market has moved lower, the economy thus far has continued to recover from the COVID-induced pullback. We see this trend in corporate earnings, unemployment rates, TSA checkpoint travel numbers, and restaurant dining data. Higher interest rates and higher commodity prices will undoubtedly have an impact. Still, when we look at our companies' financials and listen to their quarterly conference calls, we see a balanced take with most companies continuing to report strong demand for their products. While they are often experiencing cost pressure, they are managing it reasonably well. Our broad view is that most of these headwinds are temporary rather than permanent, and after a period of adjustment, a new run rate will be achieved.

Value vs Growth Tug of War Continues

We saw a risk appetite shift this quarter as higher volatility, the prospect of higher rates, and stretched valuations drove investors to move out of more speculative pockets of the market. As a result, value stocks outperformed growth stocks during the quarter. We expect that additional air could come out of certain pockets of the market. Still, we are also seeing some new opportunities arise in stocks that may be experiencing unjust selling pressure. The opportunity to evaluate high-caliber companies that are now trading at attractive valuations is extremely exciting!

Staying Vigilant

As we noted last quarter but wished to reiterate, we are continually examining our portfolios and our convictions to ensure that we hold stocks trading at material discounts to our conservative assessments of their worth. We continue to confirm that our portfolios remain composed of high-caliber companies at discounts to the market and have been excited to uncover some new opportunities this quarter that have been shaken loose by the recent market volatility.

Active Management Continues To Matter

It matters what you own, and active management provides an opportunity for future success. Passive management, on the other hand, buys more of those companies that have already more than fully recovered and represent a disproportionately large weight of the indices. We continue to have a positive long-term view on small caps and expect an environment like this one to remain advantageous to our philosophy and process. It has never been more critical than it is today to focus on stock selection using a time-tested and consistent approach.

Sincerely,

The Cornerstone Investment Team

Past performance does not indicate future results. As with all investments, the possibility for profit is accompanied by the risk of loss.