Sterling Partners Equity Advisors
Portfolio Commentary
Summer 2020

Kevin E. Silverman, CFA

Pandemic Parallels

Here we are three months later, still all immersed in what I feel safe to say is the weirdest time in all of our lives. The total damage to persons and property has yet to be tallied and may not be fully measurable for a long time.

Our small-cap strategies are down a lot although less than our benchmark year to date, and there is performance detail later in this letter. But by one measure, the total value of the S&P 500, the damage looks modest, which seems odd to a lot of people, and we did some homework on that also further on in this letter.

A lot of things seem a bit upside down and in the midst of a permanent shift. Interest rates were once too high, now too low, same for inflation. Trains, planes and buses, now bad. World trade was good, now only medium. Deficits used to matter a little more. Record collections and office buildings were once useful. Personal savings rates in particular are acting oddly. After decades of being too low, now some economists are concerned they are too high.

According to Moodys.com, the savings rate jumped to unprecedented levels as a March 2020 to May 2020 decline in personal consumption expenditures (PCE) of $1.36 trillion and an identical $1.36 trillion year-over-year gain in personal disposable income both made their way into a $2.76 trillion increase in savings, which is roughly 20% of annual PCE. It's also a tad larger than the $2.3 trillion of support the Fed has pumped in over the past few months, maybe half of which is included in the disposable income number. Who doesn't like free markets, but the Fed has learned from the past and is creating "liquidity" until people can get back to work. In that sense, big government spending to stop a threat, more typically in wartime, has been seen as expansionary for a long time and it may be the case again. And if inflation is a side effect, it's good timing from current near zero levels.

While some economists are concerned about a liquidity trap caused by indifference between holding cash vs. low-yielding bonds, history suggests that a time of job disruption is a creative time as weak returns and idle labor can drive innovation. This time, because there is more fresh powder than usual seeking better risk adjusted investment returns than offered by current yields, there's a case that we are on the front end of a very productive entrepreneurial period. Modern factors like knowledge and communication are now nearly free even while college and real estate are the most expensive they've ever been.

The recent savings rate spike may simply be the beginning of a period of freed up capital thinking about how to redeploy to best use. Suddenly to many around the world, the expense of commuting, the office space and the infrastructures that have built up around them have proven to be at least partially unnecessary. A lot of the wealthiest in society have all just been taught they can save the time and effort of going to the bank or the store. New more efficient habits that are historically slowly adopted over a generation have just been universally adopted in 3 months. That change opens some doors.

In the near term, the economic aftermath of the 1918 pandemic is a hazy guide to our future *(Federal Reserve Bank of St. Louis, November 2007)* because just as the economy was recovering from the effects of the 1918-19 flu, 2.6 million WW I service personnel were returning to civilian life. To make matters worse, the young Fed began raising rates, a mistake repeated in the Great Depression. The loss of life in the 1918 pandemic was terrible, with over 650,000 American deaths out of a 100 million population, primarily within the prime ages of 21-49, the prime years of life and economic contribution. Given how terrible the loss of life was, it's surprising the admittedly sparse economic data isn't worse.

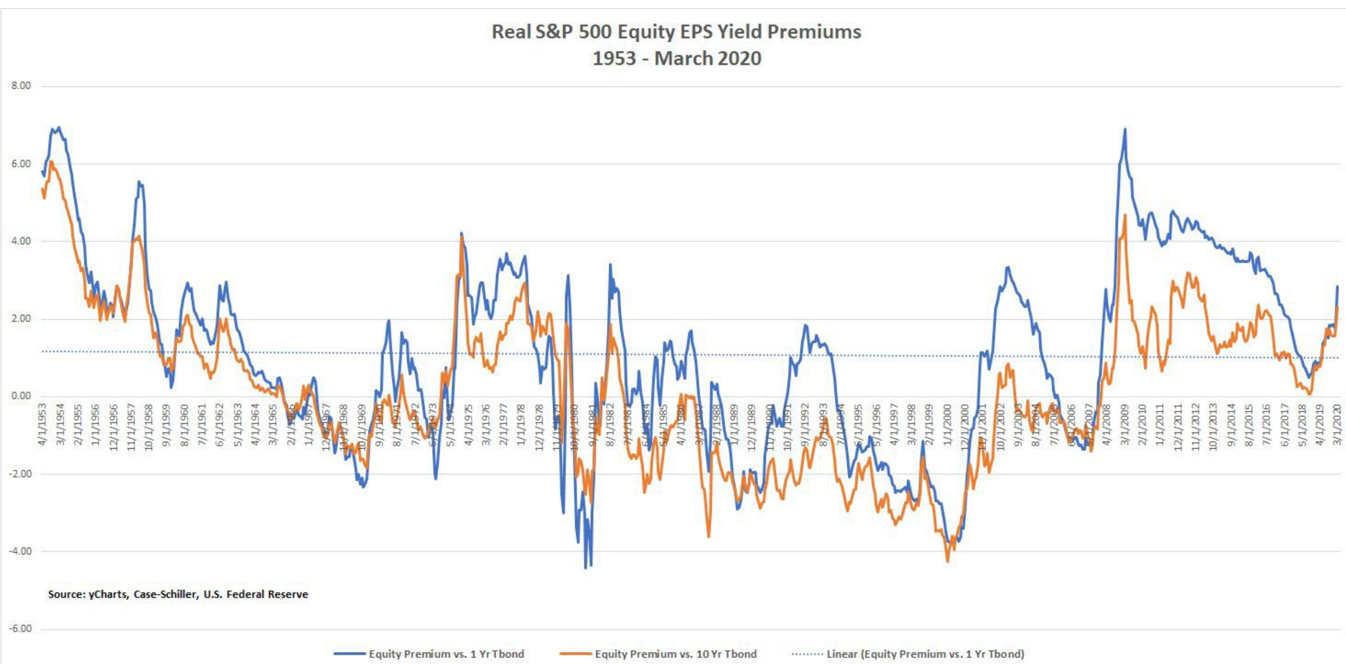
According to "The Economic Almanac for 1946-47", published by the National Industrial Conference Board (NICB), unemployment rose from 1.4% in 1919 to a peak of 11.7% in 1921, a level already surpassed in the current pandemic. The NICB also estimates that National Income doubled from $29 billion in 1915 to $61 billion in 1920, and specifically 14% growth 1917, 12% in 1918 and 10% in 1919, all positive and all better than we are likely to see for 2Q 2020, mostly due to final spending on WW I industrial equipment. But with returning service personnel and rising unemployment, the country was soon in a post-war recession, with the National Industrial Conference Board estimating that National Income fell to $49 billion in 1922, a drop of nearly 20% in two years.

As now, the market didn't like the approaching pandemic, with the stock market down 31% in the 12 months ended November 1917. But by July 1919, the trailing 12-month return was a positive 26% as the pandemic wound down. But by then, the returning soldiers caused a labor glut that created the 1921 recession. The market as usual saw it coming and by December 1920 the trailing 12-month return was negative 24%, the worst it got. Once the labor glut was absorbed, the Roaring Twenties ensued.

Market Valuation

So aside from the quick market recovery paralleling 1919, why is our market P/E so high and should we be worried about it? Are excessively optimistic views finding their way into not just quarterly letters but also P/E multiples? This letter is getting a little long, but here's what we found. Using YCharts' data on Case-Schiller's Cyclically Adjusted P/E, basically Price divided by average 10-year EPS, and 10-year and 1-year constant maturity government securities, we calculated the Real Earnings Premium since 1953. That graph is below:

High P/E's are the math of low interest rates, and so low earnings yields and bond yields are the result of low inflation. This equity yield data doesn't suggest to me that the current valuation is too high in the face of a pandemic, but rather attractively priced. The 6/30/2020 real earnings yield of roughly 3% on the S&P is above the average posted since 1953, reminiscent of 1962 and 1982, both the beginning of bull runs.



These comments are just part of what we think about every day. While this environment is new, in some way all environments are new. As students of economics and equity valuation, we continue to work hard to make our best estimates of the value of public companies and their potential contribution to our clients' investment returns. Thank you for your interest in Sterling Partners Equity Advisors.

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Sterling Small-Cap Value Diversified
2Q 2020 Summary*

Listed from highest to lowest contribution within the performance category

Top Performers	Bottom Performers
1. Green Dot Corp.	1. Enova International, Inc.
2. Glu Mobile Inc.	2. L.B. Foster Co.
3. Patrick Industries, Inc.	3. Criteo S.A.
4. Middleby Corp.	4. Regional Management Corp.
5. Papa John's Intl Inc.	5. The Pennant Group, Inc.

Sterling Small-Cap Value Focus
2Q 2020 Summary*

Listed from highest to lowest contribution within the performance category

Top Performers	Bottom Performers
1. Green Dot Corp.	1. The Pennant Group, Inc.
2. Glu Mobile Inc.	2. L.B. Foster Co.
3. Middleby Corp.	3. Oshkosh Corp.
4. Papa John's Intl Inc.	4. Enova International, Inc.
5. Patrick Industries, Inc.	5. Regional Management Corp.

Top Performers

Green Dot Corp. (GDOT)
Sterling Small-Cap Value Diversified
Sterling Small-Cap Value Focus

Green Dot is a consumer financial services company, providing a range of reloadable prepaid debit cards and cash reload processing services to both institutional and Individuals with a mission to provide a full range of affordable and accessible financial services to customers.

Green Dot's management believes that the long-term strategy will remain intact despite the impact of COVID-19 but has taken precautions by reducing expenses and drawing down the full $100 million available under its revolving credit facility.

We own the stock on the thesis that the company will continue to gain market share with its no real estate, low-cost model and that customers will increasingly gravitate to the convenience of online commerce.

Glu Mobile Inc. (GLUU)
Sterling Small-Cap Value Diversified
Sterling Small-Cap Value Focus

Glu Mobile is a leading creator of mobile games. With a diverse portfolio of original and licensed IP titles including Covet Fashion, Deer Hunter, Design Home, Diner DASH Adventures, Disney Sorcerer's Arena, Kim Kardashian: Hollywood and MLB Tap Sports Baseball.

Glu Mobile recorded strong Q1 revenue and bookings growth year-over-year of 15% including record bookings from Design Home. The company raised full year 2020 bookings guidance to the range of $490-500 million with a successful launch of Disney Sorcerer's Arena and Tap Sport Baseball.

We continue to believe in the economics of the video game space over the long-term, but on this one, both the valuation and direction of the evolving fundamentals will limit our exposure as we monitor management as it executes its strategy.

Patrick Industries, Inc. (PATK)
Sterling Small-Cap Value Diversified
Sterling Small-Cap Value Focus

Patrick Industries is a manufacturer and distributor of components and building products for the recreational vehicle, manufactured housing, marine and industrial markets. Our thesis on PATK is again a view that leisure is in a long cycle of gaining share of the economy as Patrick Industries is a supplier for multiple recreational vehicle companies.

Patrick lost production days and had a negative impact from COVID-19 but started the year with positive momentum with all their segment end markets. During the quarter, PATK took steps to contain costs by leveraging their high variable cost business model to manage through these uncertain times.

We see PATK as a beneficiary of entrenched favorable trends in recreational vehicles and marine markets and we will be patient while the management team executes on their strategic plan.

Middleby Corp. (MIDD)
Sterling Small-Cap Value Diversified
Sterling Small-Cap Value Focus

Middleby Corporation is a global leader in the foodservice equipment industry. The Company develops, manufactures, markets and services a broad line of equipment for the commercial foodservice, food processing, and residential kitchen industries.

Middleby Corporation is a new addition to our portfolio although we've long admired the consistently good returns generated by the business. We believe that leadership will manage well through this global pandemic. Management has indicated actions to ensure uninterrupted service to customers and goals of reducing cost structure for expected revenue declines. Historically most of its sales are replacement and upgrades in conjunction with new menu initiatives and operational improvement. During this pandemic, MIDD will focus on supporting transitions to more delivery, drive-through and carry-out business in addition to workplace safety.

We own the stock on the thesis that the company will continue to gain global market share with its portfolio of niche brands in the foodservice equipment industry and proven management leadership to execute well through all business cycles. We are pleased to own this very high-quality company at a once in a decade valuation.

Papa John's International Inc. (PZZA)
Sterling Small-Cap Value Diversified
Sterling Small-Cap Value Focus

Papa John's is one of the world's largest pizza delivery & carry out companies with 5,343 system-wide company owned & franchise stores located in 49 countries.

Not only is pizza delicious, cheap and fast, but it may have also been a savior for many during this global pandemic as Papa John's kept its doors open in North America and most markets during the COVID-19. Papa John's reported a Q1 2020 increase of 5.3% over the prior year for system-wide North American comparable sales. As cities continue to see spikes in more COVID-19 cases, we believe that PZZA will benefit as a reliable food option.

We like the delivery pizza business as a fast way to get hot food to a customer and service only gets better with the use of technology. Management recently restructured the C-Suite and Board to make strategic changes to complete with others in the industry. We look forward to seeing this team execute on their plans.

Bottom Performers

Enova International, Inc. (ENVA)
Sterling Small-Cap Value Diversified
Sterling Small-Cap Value Focus

Enova is a provider of online financial services to non-prime consumers and small businesses, providing access to credit powered by its advanced analytics, innovative technology, and world-class online platform.

Enova's management believe that its flexible online lending platform enabled the company to adapt rapidly to the market conditions driven by the COVID-19 pandemic. ENVA is focused on supporting their existing customers and reducing originations to address risks in the current environment. Our thesis on Enova is that digital transactions will continue to move toward a dominant share of the financial industry, with a low-cost, high-service model.

L.B. Foster Company (FSTR)
Sterling Small-Cap Value Diversified
Sterling Small-Cap Value Focus

L.B. Foster is a manufacturer and distributor of transportation and energy infrastructure products and services with locations in North America and Europe.

FSTR had a decrease of 14% in the quarter with the difficult market conditions caused by COVID-19. On the positive side, L.B. Foster's backlog did increase during the quarter. Management indicated at the end of Q1 that the Rail Products and Services and Construction Products segments were experiencing steady proposal activity and continuation of planned products.

We believe that the company's strong product slate will gain market share over the long run as infrastructure spending both in transportation and energy drives stable growth. We expect management will use free cash flow to reduce debt and to improve EBITDA margin and ROI. At the current price, we believe FSTR offers an attractive long-tern return.

Criteo S.A. (CRTO)
Sterling Small-Cap Value Diversified

Criteo is an online advertising platform designed to deliver advertising across all channels. Our thesis is that advertising spending will continue to migrate to online and mobile from TV, and Criteo is positioned to benefit from that continuing migration.

Criteo looks like a compelling value at 3-4 times forecasted EBITDA. It's cheap because there is a view that the technology Criteo uses to identify potential customers for clients is losing its competitive advantage in the face of rising regulation and closer scrutiny by Google. Quarter over quarter revenue declines have been slightly down as the company evolves its ability to present ads. We believe all evidence points to Criteo's continuing ability to maintain market share in its niche. We continue to monitor this name very closely and are intrigued by the opportunity perhaps to have purchased it at a tremendous bargain, but time will tell.

Criteo did end the quarter with $437 million in cash, up $18 million from the prior quarter. Criteo added over 110 new clients and maintained client retention at close to 90% for all solutions. In the quarter, Criteo launched Criteo Partner, its global partnership program for reseller agencies.

Regional Management Corp. (RM)
Sterling Small-Cap Value Diversified
Sterling Small-Cap Value Focus

Regional Management is a diversified consumer finance company providing loan products primarily to consumers with limited access to consumer credit from banks, thrifts, credit card companies and other traditional lenders.

Regional Management increased its provision for credit losses in the first quarter from the prior-year period due to adding an allowance for credit losses related to the expected economic impact from the COVID-19 pandemic. Management believes that its omni-channel approach to servicing its customers by providing them with multiple avenues to make payment will help through this difficult time. In addition, Regional Management had strengthened its balance sheet and improved its underwriting quality over the past several years in anticipation of a reversion of the credit cycle.

We own the stock on the thesis that the company will continue to gain market share and lower costs on easy-to-understand loan products and customers will move to the convenience of online commerce and lower costs for lenders.

The Pennant Group, Inc. (PNTG)
Sterling Small-Cap Value Diversified
Sterling Small-Cap Value Focus

The Pennant Group is a holding company of operating subsidiaries that provide healthcare services through 65 home health and hospice agencies and 53 senior living communities located throughout the United States.

Pennant Group did not perform well versus other holdings despite strong operational results as the company continues to finish its spin-out related transition and confronts the impacts of the global pandemic. Pennant Group plans to capitalize on opportunities to expand its business during this time with a strong balance sheet and compelling accretive acquisition opportunities.

This business benefits from the aging demographics of the U.S. population, a thesis we have long invested in, providing a broad spectrum of skilled nursing and assisted living services, physical, occupational and speech therapies, home health and hospice services and other rehabilitative and healthcare services.

Oshkosh Corporation (OSK)
Sterling Small-Cap Value Focus

Oshkosh is an integrated global industrial designing, manufacturing and servicing company across a broad range of access equipment, commercial, fire and emergency, military and specialty vehicles.

Oshkosh Corp reported lower revenue by 9.75% in Q1 2020 which was expected with the global economic shutdown from COVID-19. In addition to the lower sales in the access equipment segment, backlog in the access equipment was also lower at the end of the period. Some of this revenue decline was offset by the Defense segment. Oshkosh has a strong balance sheet and the ability to weather this storm for the long-term.

We’ve owned the stock for a long time with the basic thesis that the company is a world class competitor in several large stable markets with entrenched competitive advantages. A long period of recovery has demonstrated the skill of OSK management, and the stock has performed nicely in the recent years.

Sterling Partners Equity Advisors
Small-Cap Strategy Performance
Periods Ending June 30, 2020

Sterling Small-Cap Value Focus**	Jun '20	QTD	YTD	One Year	Three Years	Five Years	Seven Years	Ten Years	Since Incep 6-30-2001
Sterling SCV Focus (Gross)	3.33%	30.77%	-10.79%	-8.87%	2.48%	5.16%	7.84%	11.85%	10.00%
Sterling SCV Focus (Net)	3.25%	30.47%	-11.19%	-9.74%	1.47%	4.13%	6.78%	10.75%	8.92%
Russell 2000 Value Index	2.90%	18.91%	-23.50%	17.48%	-4.36%	1.26%	3.99%	7.83%	6.56%

Sterling Small-Cap Value Diversified**	Jun '20	QTD	YTD	One Year	Three Years	Five Years	Seven Years	Ten Years	Since Incep 12-31-2006
Sterling SCV Diversified (Gross)	3.27%	25.04%	-12.85%	-7.02%	4.52%	7.20%	9.40%	11.70%	7.43%
Sterling SCV Diversified (Net)	3.18%	24.76%	-13.24%	-7.90%	3.50%	6.15%	8.33%	10.61%	6.37%
Russell 2000 Value Index	2.90%	18.91%	-23.50%	-17.48%	-4.36%	1.26%	3.99%	7.83%	3.62%

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*Highest and Lowest Performers were calculated by Sterling Partners Equity Advisors using data available for the holding's contribution to composite performance taking into account its composite weight, on an annualized basis.

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Information relating to the Russell 2000 Value Index ("Russell Index") is provided for illustrative purposes only. SPEA does not purport to implement the same strategy as the Index. The Index provide general market data that serves as a point of reference to compare the performance of the Sterling Small-Cap Value Focus and Sterling Small-Cap Value Diversified Composites with the performance of other products that make up a particular market. The Index do reflect the expenses associated with management of an actual portfolio, the actual cost of investing in the instruments that comprise it or other fees. No representation is made that any benchmark or index is an appropriate measure for comparison. SPEA makes no representation that any benchmark or index is an appropriate measure for comparison. SPEA makes no representation that the information related to the Index is accurate or complete.

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