CI SEGALL BRYANT & HAMILL
ASSET MANAGEMENT

The Return Advantage of High ROIC Investing

With a backdrop that includes Federal Reserve (Fed) rate hikes, near record yield curve inversion, softening economic data, and tightening bank lending standards, we believe companies with high and improving return on invested capital (ROIC) are well positioned to navigate this type of economic and market regime.

Our Small Cap Core investment approach is based on the belief that ROIC and its byproduct, free cash flow, are the most important drivers of long-term outperformance in the small-capitalization universe. Companies with high ROIC generate returns on capital in excess of the cost of capital. These returns indicate the company's ability to sustain a competitive advantage.

High ROIC During Fed Rate Hike Cycles

Over time, stocks of high ROIC companies have delivered excess relative returns during periods of monetary tightening. **Exhibit 1** below highlights how companies with high ROIC levels have performed in the last six Fed rate hike cycles.

High ROIC names (as defined by the top quartile of securities within the Russell 2000® Index) have generated alpha relative to the Russell 2000 in five of the six cycles. While acknowledging history may not repeat—and that each of these cycles had its own unique set of circumstances—the relationship between this quality characteristic and returns may prove informative.

Exhibit 1: High ROIC Names Have Generated Alpha in Five of the Past Six Fed Rate Hike Cycles

Performance of High ROIC Companies During Periods of Monetary Tightening

Period	Dec 1986 – Feb 1989	Feb 1994 – Feb 1995	June 1999 – May 2000	June 2004 – June 2006	Dec 2015 – Dec 2018	March 2022 – May 2023
Russell 2000 Top ROIC Quartile Return	25.09	1.32	11.12	30.40	27.79	-6.03
Russell 2000 Return	17.52	-6.13	12.63	24.38	24.32	-12.93
Fed Funds Rate Change	3.50	3.00	1.75	4.25	2.25	5.00
Starting Fed Funds Rate	5.88	3.00	4.75	1.00	0.25	0.25
Ending Fed Funds Rate	9.38	6.00	6.50	5.25	2.50	5.25
Rate Hikes	17.00	7.00	6.00	17.00	9.00	10.00
Length of Cycle (# Months)	26	11	10	24	36	13

Source: FactSet, Russell, Federal Reserve. ***Past performance does not guarantee future performance. It is not possible to invest directly in an index. Indexes are unmanaged and do not incur fees and expenses.***

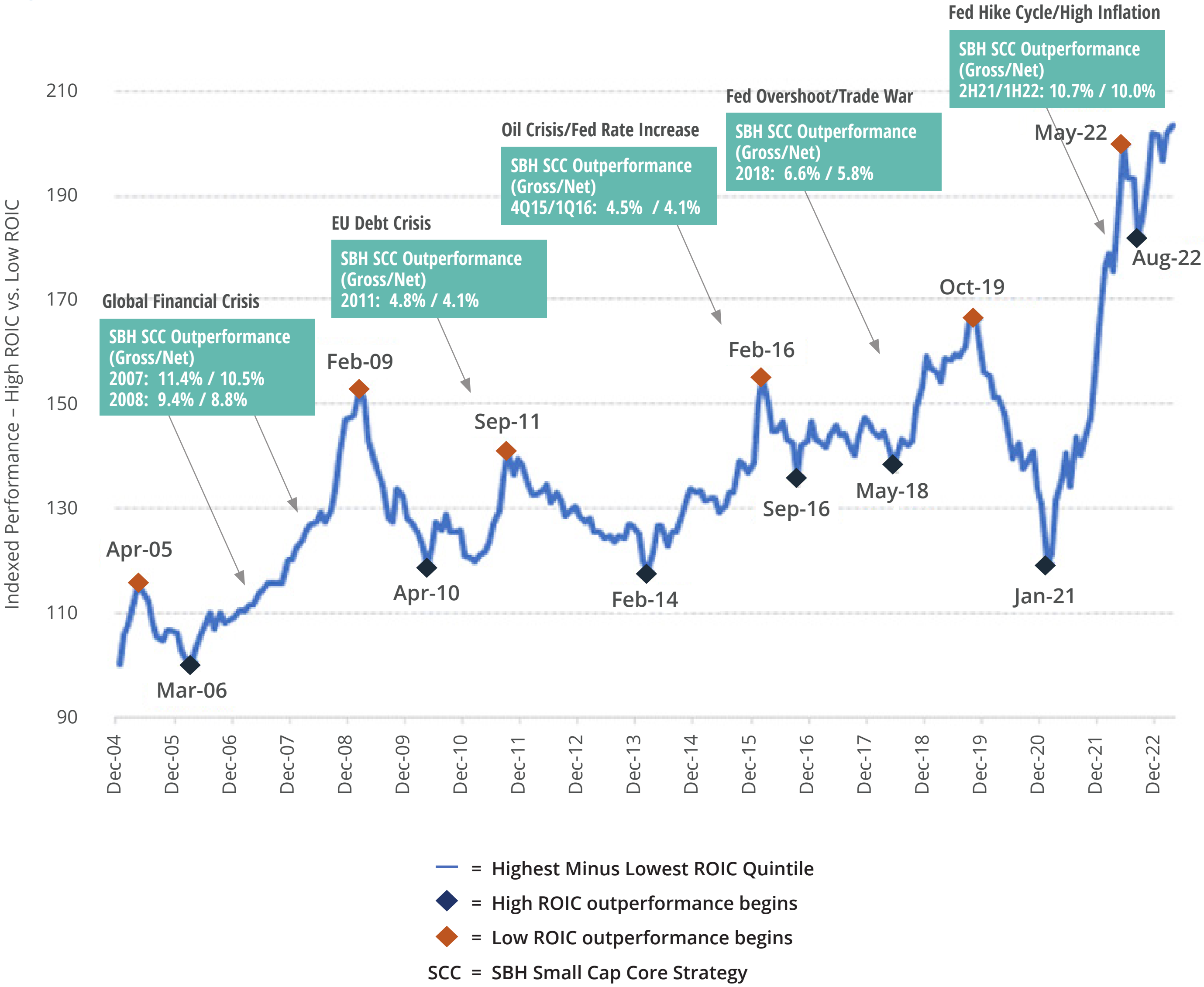
High ROIC Outperforms in Periods of Market Stress

Given the consistent focus on ROIC within the Small Cap Core strategy, we have examined the performance of high ROIC stocks versus low ROIC stocks in market sell-offs dating back to the Global Financial Crisis (GFC). As illustrated in **Exhibit 2**, the market consistently prefers (and rotates to) high ROIC companies in times of market stress.

From the GFC (2007-2009) to the more recent Fed hike cycle/high inflation (2H21/1H22), high ROIC companies have outperformed the low ROIC companies relative to the Russell 2000 in nearly every market correction. As such, the Small Cap Core strategy has historically exhibited attractive downside protection in periods of market stress and capital preservation in times of uncertainty.

Exhibit 2: High ROIC Companies Outperform in Periods of Market Stress

Highest Minus Lowest ROIC Quintiles



Data as of 3/31/23. Source: Furey Research Partners and FactSet. Small Cap ROIC quintiles are reconstituted annually and based upon trailing 3-year average ROIC for companies between $200M and $5B market cap. Performance is calculated as a capped average performance for stocks in each quintile. The chart depicts the cumulative difference between the discrete monthly returns for the top minus bottom ROIC quintiles. ***SBH outperformance is presented gross and net of fees. Past performance cannot guarantee future results. All investments involve risk, including the possible loss of capital.*** *Benchmark is Russell 2000® Index. Index performance does not reflect the expenses associated with the management of an actual portfolio or other fees. One cannot invest directly in an index. For illustrative purposes only.*

SBH Small Cap Core

A Differentiated Approach to ROIC Small Cap Investing

Our Small Cap Core philosophy is based on four key pillars that, when combined, are designed to generate excess returns. Our experienced small cap equity investment team seeks companies that generate high or improving levels of ROIC, serve niche markets with defendable competitive advantages, are guided by strong management teams, and trade at attractive reward-to-risk ratios.

Our Small Cap Core is available in the following investment vehicles:

- Separate Account
- Collective Investment Trust (CIT)
- Mutual Fund: Retail (SBHCX) Institutional (SBASX)

To learn more about SBH Small Cap Core, please reach us at (800) 836-4265 or contactus@sbhic.com.

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