

# 15 for 15: A US SMID retrospective



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**Mark Sherlock**  
Lead Manager  
US Small and Mid-cap team

Sustained outperformance by any fund manager is rare, but over a decade and a half of involvement in the US small- and mid-cap Strategy at Federated Hermes, Mark Sherlock has consistently generated market-beating alpha<sup>1</sup>. Read our Q&A to understand what makes him tick as an investor and how the market has evolved since he started managing money.

### Track record 28/02/2009 - 29/02/2024

Net annualised return: Net relative cumulative outperformance:

**15.0%** **61.1%**

Outperformed every calendar year that the Russell 2500 has produced a negative return on a net and gross basis.

Beta:	0.93
Information ratio:	0.29
Sharpe ratio:	0.82
Sortino ratio:	1.34
Tracking error:	4.36

Volatility benchmark: Volatility strategy:

**18.77** **17.87**

Source: Federated Hermes as at 29 February 2024. Performance shown is the Federated Hermes US small- and mid-cap Strategy in US\$, net of fees. Benchmark: Russell 2500. **Past performance is not a reliable indicator of future returns.** The information shown is supplemental to the GIPS © compliant composite report.

## 1. When did you join Federated Hermes and what were you doing before?

Initially qualifying as an accountant with PwC, I joined Hermes (from the Rio Tinto pension scheme) to focus on European small and mid-cap companies in 2005. I transitioned to the US Small and Mid-cap team in 2009, taking over as Lead Manager in 2012, where I have been ever since! AUM managed, initially coming in at US\$200m, now stands at around US\$3bn.

## 2. What's your investment philosophy? What makes you tick as an investor?

My investment philosophy can best be described as patient: 'The tortoise beats the hare'. We typically eschew fashionable stocks, preferring to look for below the radar, multi-year compounders, often in quite unglamorous parts of the market. This is a conscious approach which discourages new capital (competition) to be drawn in, consequently superior returns can be achieved over an extended period.

We focus on companies with a durable competitive advantage, as defined by barriers to entry, typically with strong balance sheets and good cashflow. A virtuous circle can occur when cashflows are deployed to strengthen existing barriers, which in turn generates additional cashflow – this can persist for many years and result in market caps rising substantially.

I was fortunate – if you can call it that – to experience first-hand and at an early stage in my career the downside of investing in businesses of lesser quality: leveraged, low-barriers businesses are cheap for a reason and many do not last for long! Downside protection is crucial, with the absolute loss of capital the key risk in investing: self-evidently (but a fact often overlooked...) if you lose half your money in a stock, it has to double from there to get back to where it was – that can really affect your long-term returns. 'The first rule of compounding: never interrupt it unnecessarily'. Warren Buffett

## 3. What if anything has changed in the past 15 years, either in terms of the Strategy or the investment backdrop? What has stayed consistent and what has evolved?

The investment landscape has changed significantly over the last 15 years, during which we have seen the continued rise of passive investing, the very strong performance of growth stocks, the dominance of mega-cap tech and the narrowing of the large cap market.

More broadly, globalisation has begun to give way to onshoring – and technology, which was historically confined to its own distinct sector, now permeates throughout the index. This includes everything from the challenges of multi-

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channel retailing to the adoption of Software as a service (SaaS) business models to the current opportunities offered by adoption of artificial intelligence (AI).

AI is rightly a hot topic for the market, and we believe it will yield very significant productivity gains for companies across the market cap spectrum over the next decade and beyond. The consideration of non-financial factors has also become more of a focus – certainly our assessment of the sustainability of a business is additive in our assessment of its quality and likely future success.

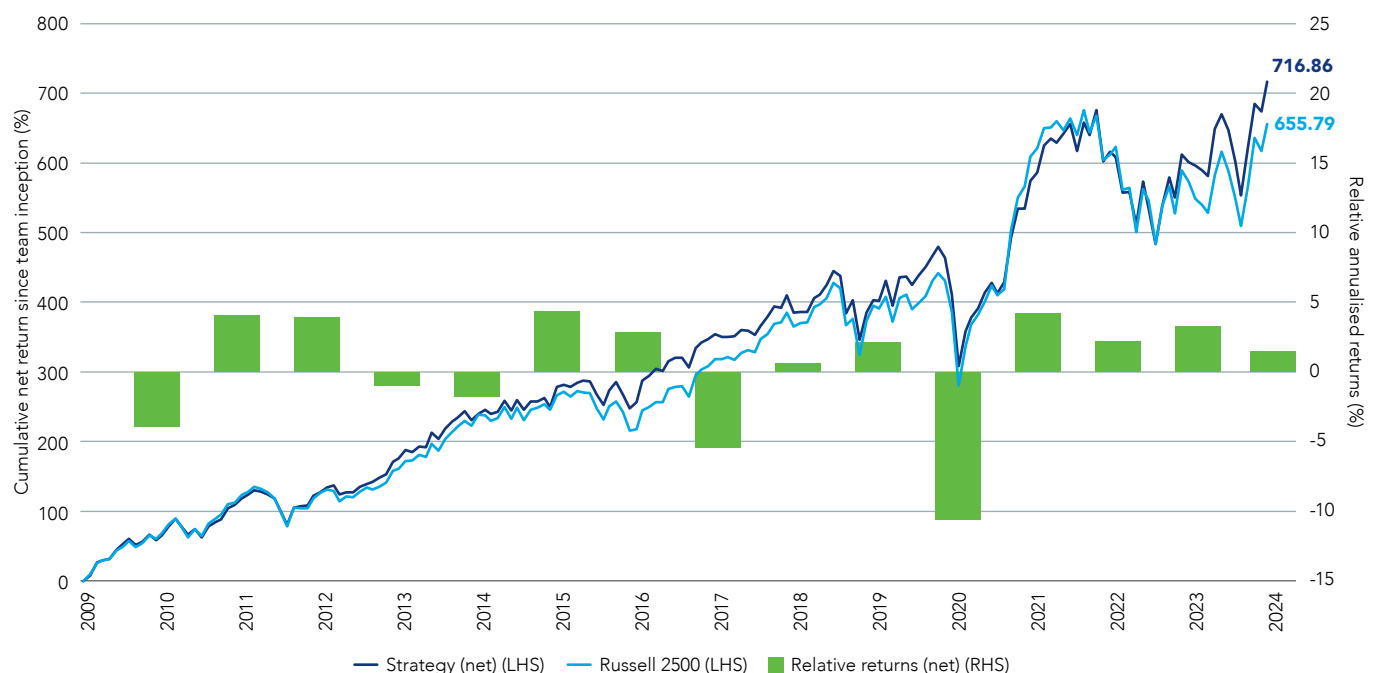
Yet certain things remain the same – not least the opportunity offered by the market to generate strong risk-adjusted returns. Cashflow remains king for the optionality it, quite literally, affords. The importance of quality remains a constant – during periods of economic or market turbulence it's these businesses that can take advantage of more peripheral or highly levered competition: 'Never let a good crisis go to waste,' as Churchill once said! As does the importance of patience and resisting the urge to overtrade.

#### 4) It's unusual to manage a US strategy from outside the US. Have there been any challenges associated with this?

It hasn't represented any real problems so far, and, as our track record suggests, we have access to enough information to make the right calls about the companies in which we invest. Perhaps, if anything, it's something of a benefit to be removed from the 'white noise' of Wall Street, making it easier to make better long-term decisions.

Another unusual aspect of the Strategy is the longevity of the team with the PMs having worked together for more than a decade. Over that time, we've witnessed so many different markets and economic conditions – think of the changes of president in the White House, for instance, or the impact of a global pandemic – and it's a credit to the stability of the team that we're still investing profitably and finding opportunities to create alpha.

Figure 1: 15 years of relative net performance



Source: Federated Hermes as at 29 February 2024. Performance shown is the Federated Hermes US small- and mid-cap Strategy in US\$, net of fees. Benchmark: Russell 2500. **Past performance is not a reliable indicator of future returns.** The information shown is supplemental to the GIPS® compliant composite report.

Start Date	End Date	Product Net Annual Return	Benchmark Annual Return
28-02-2023	29-02-2024	16.48	12.25
28-02-2022	28-02-2023	-2.02	-5.42
28-02-2021	28-02-2022	6.24	0.40
29-02-2020	28-02-2021	31.91	45.90
28-02-2019	29-02-2020	1.61	-1.80
28-02-2018	28-02-2019	3.59	6.36
28-02-2017	28-02-2018	6.82	11.17
29-02-2016	28-02-2017	27.35	31.75
28-02-2015	29-02-2016	-5.74	-13.30
28-02-2014	28-02-2015	11.27	8.24
28-02-2013	28-02-2014	23.19	29.97
29-02-2012	28-02-2013	21.41	15.17
28-02-2011	29-02-2012	4.17	1.45

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## Schedule of Rates of Return and Statistics

Composite: **Federated Hermes US Equity Small & Mid Cap**  
Index: **Russell 2500**  
Periods Ending: **31 Dec 23**

	Returns (%)		
	Composite Gross Return	Benchmark	Composite Net Return
Q4 23	11.93	13.35	11.72
1 Year	21.63	17.42	20.72
3 Years (Annld)	8.18	4.24	7.37
5 Years (Annld)	12.81	11.67	11.96
10 Years (Annld)	9.42	8.36	8.60
15 Years (Annld)	13.97	12.66	13.13
20 Years (Annld)	11.00	9.08	10.18
Nov-87 - Dec-23 (Annld)^^	12.18	11.04	11.36

	Annualised Returns (%)									
	Composite Gross Return	Composite Net Return	Benchmark Return	*Composite 3-Yr Std Dev	*Benchmark 3-Yr Std Dev	Number of Portfolios	**Dispersion	Composite Assets (mil)	Firm Assets (bil)	
2014	6.12	5.33	7.07	10.60	11.67	<5	N/A	1,174.9	38.9	
2015	2.16	1.40	(2.90)	12.25	12.42	<5	N/A	1,405.7	28.0	
2016	21.31	20.40	17.59	12.67	13.67	<5	N/A	1,492.2	28.9	
2017	12.24	11.40	16.81	11.43	12.13	<5	N/A	1,550.6	34.5	
2018	(8.75)	(9.44)	(10.00)	13.36	14.10	<5	N/A	1,372.7	32.0	
2019	30.90	29.92	27.77	14.13	14.58	<5	N/A	1,677.9	40.2	
2020	10.23	9.40	19.99	22.11	24.21	<5	N/A	1,446.8	585.7	
2021	23.28	22.35	18.18	20.35	22.48	<5	N/A	1,926.1	634.2	
2022	(15.56)	(16.20)	(18.37)	23.16	25.16	<5	N/A	834.1	627.4	
2023	21.63	20.72	17.42	19.76	20.15	<5	N/A	1,038.5	720.0	

^^Represents composite inception period. See page 2 for additional notes to the schedule of rates of return and statistics.

\*Represents the 3-year annualized standard deviation for both the gross composite and the index returns. Statistic is used to measure the volatility of composite returns.

\*\*Standard deviation is calculated using gross returns. Standard deviation is not applicable (N/A) for any period if fewer than five accounts are in the composite for that period. (See footnote 5)

The composite includes all discretionary portfolios following the US Small & Mid Cap strategy run by the Federated Hermes Small & Mid Cap Equity team (London Office) and has an inception date of 1 November 1987. The objective of the strategy is to achieve long-term capital appreciation. The benchmark is the Russell 2500 Index, which is designed to measure the equity market performance of the small to mid-cap segment of the U.S. equity universe, commonly referred to as "SMID" cap. The Russell 2500 Index is a subset of the Russell 3000 Index. The benchmark is market-cap weighted and rebalanced on a quarterly basis. The return is calculated on a total return basis gross of withholding tax. This composite was created in December 2006. Performance shown for 1987 is for a partial period starting 1 November 1987. Federated Hermes claims compliance with the Global Investment Performance Standards ("GIPS®") and has prepared and presented this report in compliance with the GIPS® standards. Federated Hermes has been independently verified for the period of January 1, 1992, through September 30, 2023. The verification report is available upon request. A firm that claims compliance with the GIPS® standards must establish policies and procedures for complying with all the applicable requirements of the GIPS® standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS® standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report. Since inception the management fee schedule for this strategy was 0.90% per annum for the first USD 25mln, 0.80% per annum for the next USD 25mln and 0.70% per annum thereafter. As of 1 January 2014, the management fee schedule for this strategy is 0.75% per annum. Gross of fees returns have been calculated gross of management/custodial fees and net of reclaimable withholding taxes, but after all trading commissions.

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