DISTILLATE CAPITAL

2021 Q3 Letter to Investors: Expanding Valuation Premiums

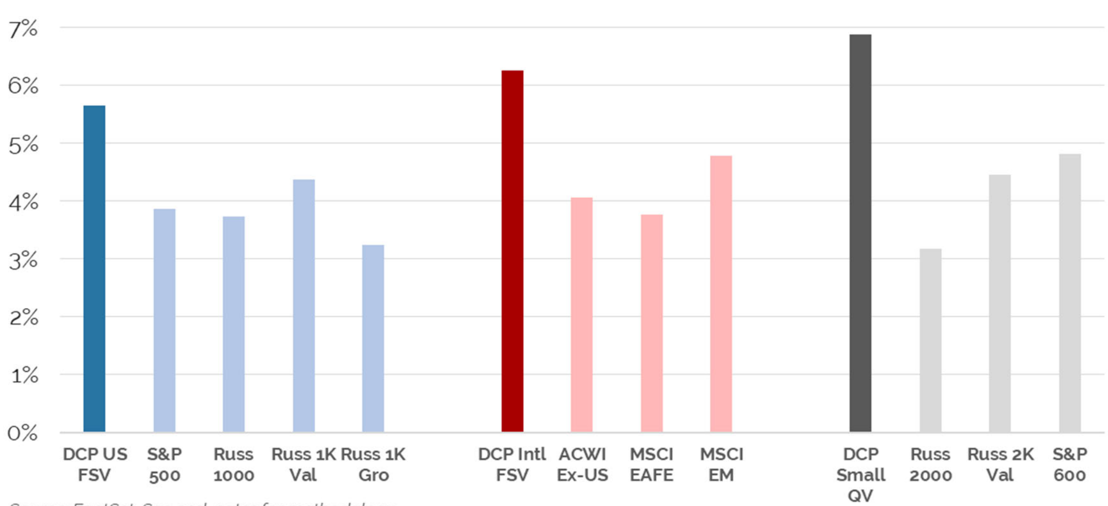
Strategy Description

Distillate Capital's U.S. and International Fundamental Stability & Value (U.S. FSV & Intl FSV) strategies seek to outperform over the long-term by investing in stocks that are more fundamentally stable, less levered, and more attractively valued. Distillate's Small Cap U.S. Quality and Value (U.S. SQV) seeks to do the same by focusing valuation and indebtedness.

Performance Summary: The U.S. and International Fundamental Stability & Value strategies returned -1.49% and -7.06% on a net of fees basis for the quarter, respectively. The U.S. portfolio lagged its S&P 500 benchmark by around 2.1% in the quarter, causing the year-to-date performance to trail that benchmark by around 2.2%. The international portfolio likewise lagged its benchmark, the iShares MSCI ACWI ex-US ETF, in the quarter, and year-to-date performance is trailing the benchmark by a more substantial 6.6% after outperformance of around 8.0% last year (See **Figures 2 & 3** on the following page). Annualized returns net of fees for the U.S. and International strategies remain ahead of their primary benchmarks by around 1.3% and 1.0%, respectively, since inception. Distillate's U.S. Small Cap Quality & Value strategy lagged the iShares Russell 2000 ETF and iShares Russell 2000 Value ETF benchmarks modestly in the third quarter, but year-to-date net-of-fee performance of 25.83% remains well ahead of both the broader small-cap and value benchmark returns of 12.28% and 22.69%. Since-inception performance also remains solidly ahead of each benchmark by around 6.9% and 10.4% on an annualized net-of-fee basis (See **Figure 4** on the following page).

Valuation Summary: With a backdrop of strong equity performance and certain areas of the market appearing extremely richly valued, we continue to believe that it remains important to be disciplined on valuation and to employ a methodology that is efficacious in an asset-light economy where accounting distortions have rendered many traditional valuation measures less relevant. **Figure 1** highlights how our strategies compare to a variety of benchmarks on the basis of consensus-estimated next-twelve-month free cash flows relative to enterprise value (EV). The large valuation premium for each strategy over its primary benchmark reflects both the wide dispersion in valuations in the market as well as the depressive impact of some very richly valued stocks on benchmark valuations. That valuation premiums of our strategies increased sharply in recent months suggests that lagging price gains versus benchmarks were a function of the multiples of owned stocks not keeping pace with the overall market rather than fundamental erosion, with the implication being that there is an attractive opportunity set moving forward.

Figure 1: Next-Twelve-Month Estimated Free Cash Flow to Enterprise Value



Source: FactSet, See end-notes for methodology.

Performance Charts: **Figures 2 through 4** show annual and 2021 year-to-date performance for Distillate's U.S. and Intl. FSV strategies and its U.S. Small Quality Value (U.S. SQV) strategy versus their respective benchmarks since inception.

Figure 2: Performance of Distillate's U.S. FSV Strategy (through 9/30/2021)

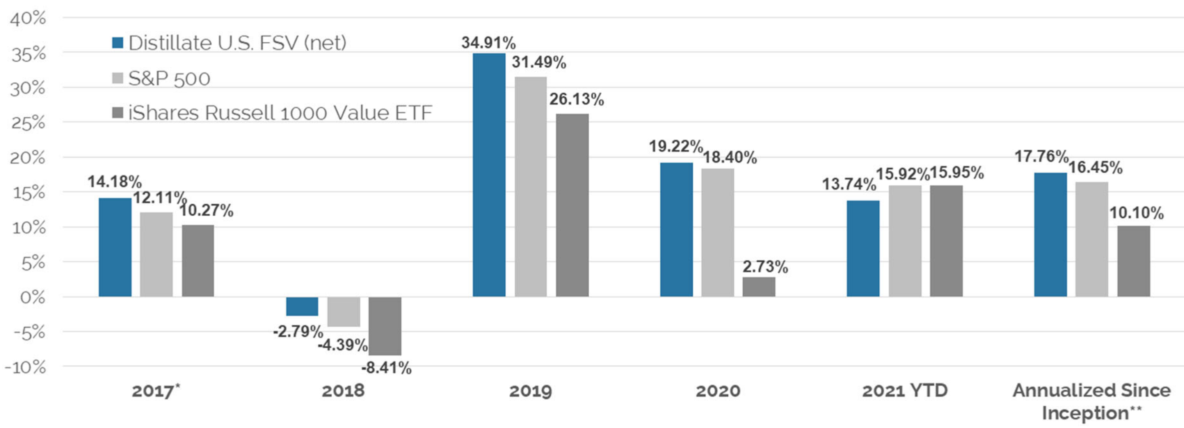


Figure 3: Performance of Distillate's International FSV Strategy (through 9/30/2021)

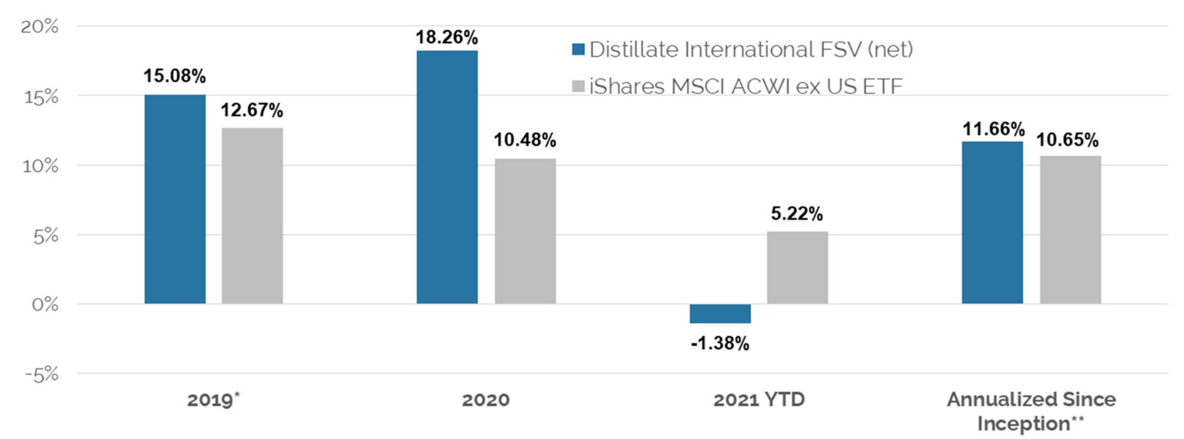
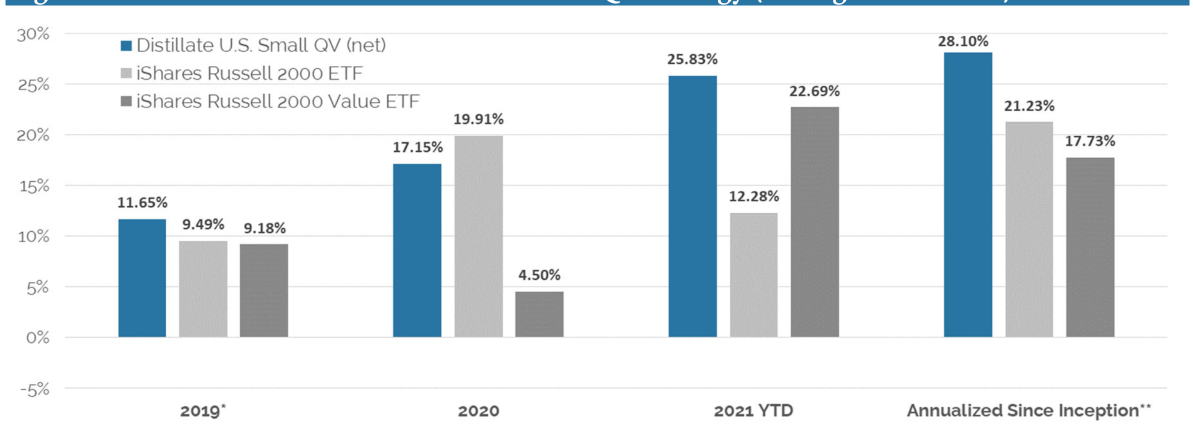


Figure 4: Performance of Distillate's U.S. Small QV Strategy (through 9/30/2021)



* Strategy inception of 5/31/2017 to 12/31/2017 for US FSV; 1/31/2019 to 12/31/2019 for INTL FSV; and 3/31/2019 to 12/31/2019 for US SQV.
** Strategy inception of 5/31/2017 for US FSV; 1/31/2019 for INTL FSV; and 3/31/2019 for US SQV.
Sources: U.S. Bank, iShares.com. Please see important performance disclosures at the end of this document.

Valuation & Quality vs. Indexes

As we highlighted last quarter, we believe that the valuation and quality charts on the following pages depict the most relevant metrics for evaluating our strategies and for understanding how they differ from comparable indexes.

Starting with valuation, **Figure 5** compares next-twelve-month estimated free cash flows to enterprise value and highlights substantial valuation premiums for each of Distillate's strategies compared to their relevant benchmarks. This measure is slightly different from the normalized free cash flow yield methodology that we use to value individual stocks, but is straight-forward and comparable across a variety of benchmarks. In addition to looking at a snapshot of current free cash flow valuations, it is useful to look at how this measure has trended over time. **Figure 6** shows the same metric for the Russell 1000 Value and Russell 1000 Growth benchmarks since forward estimates became reliably available in 2009. Somewhat counterintuitively, the figure shows that the growth index offered the more attractive free cash flow yield for much of the past decade, inverting only recently. In this context, the lagging performance of traditionally measured "value" benchmarks like the Russell 1000 Value is sensible and could (and likely should) be attributed to the fact that they didn't offer very much value versus the alternatives. The chart also depicts the same valuation metric for Distillate's U.S. FSV strategy since inception in 2017 and shows that its valuation has consistently been more attractive than either benchmark.

Also notable in **Figure 6** is the recent uptrend in the U.S. FSV strategy yield versus either benchmark. **Figure 7** makes this comparison more directly by plotting the spread of Distillate's U.S. FSV strategy's free cash to enterprise valuation yield over that of the S&P 500. While Distillate's strategy has consistently offered a valuation premium to the overall market, the spread is currently the highest on record. We believe this reflects a widening dispersion of valuation opportunities in the market and, in particular, the impact of the rich valuations of several mega-cap companies.

This same analysis is applied to Distillate's International FSV strategy in **Figure 8** on page 5, with the valuation of the market, Distillate's strategy, and the spread all shown together. Again, the gap between Distillate's strategy and the broader index is extremely wide, albeit over a shorter time horizon given the strategy's inception in 2019. While this spread can be somewhat variable from month-to-month, it has increased by roughly 30% since the end of last year from 1.7% to 2.2% currently. That this valuation spread to the market increased substantially this year amid lagging price performance suggests that the price weakness is due to relative valuation compression rather than a deterioration in underlying fundamentals of stocks held. While we cannot predict the timing of a reversion in the trend, the continuation of the underlying production of free cash flow creates optionality for the companies producing it.

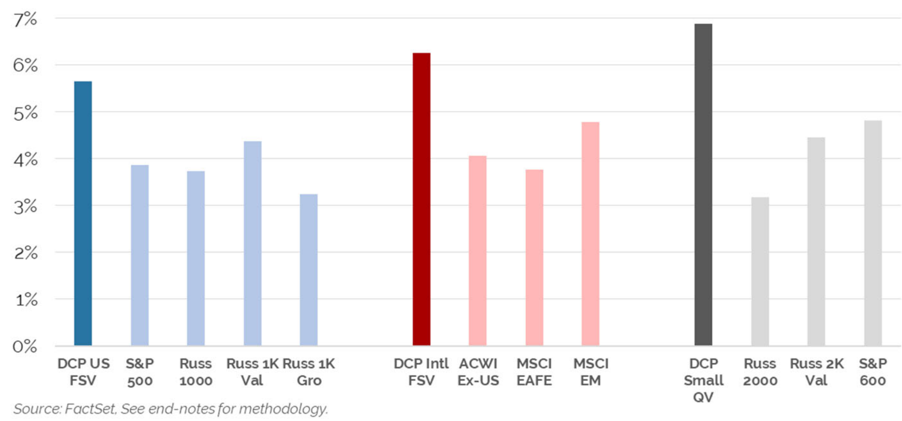
Figure 9 looks at fundamental stability by assessing the through-cycle variability of cash flows, with a higher score equating to greater stability. It is the same metric used for stock selection in the FSV strategies. The greater stability available through stock selection versus benchmark in our estimation are meaningful. The small cap strategy does not employ a stability overlay since we have found this metric to be less useful in the small cap space where companies tend to have shorter histories and much less stability in general.

Figure 10 measures leverage in the form of total debt relative to normalized consensus estimates for earnings before interest, taxation, depreciation, and amortization (EBITDA). Leverage for the U.S. FSV strategy is not that differentiated from the S&P 500 or Russell 1000 Growth benchmarks where many mega-cap companies with little debt have a significant impact on the overall level of indebtedness. The goal of employing a leverage limit is not necessarily to have less leverage than the overall index, but to select stocks that will preserve capital in challenging economic environments. Capital preservation is a critical element to generating good long-term returns and each element of our process – a focus on stability, leverage, and valuation – contributes to that goal. Internationally, leverage is higher in the benchmark than it is domestically and the international FSV strategy is more differentiated in this regard. Lastly, leverage is very high among small cap companies despite the fact that the fundamentals for these companies are more volatile and they are thus less able to support higher debt burdens. We believe this is a key risk among smaller companies and an attribute that is crucially different for our small cap strategy.

Given this backdrop, the benefits of stock selection currently, in our estimation, are noteworthy. The fact that the growth benchmark outperformed the value benchmark at a time that it was actually less expensive suggests to us that value really never stopped working despite the lagging performance of traditional "value" benchmarks. But after outperforming significantly, the growth index now looks very expensive. While the value benchmark is at long last less expensive than the growth index, our strategy is significantly more attractively valued than either and does not come with higher leverage, lower stability or the sector concentration risks that we see in the value benchmarks. Second, while the international benchmark is now slightly less expensive than the U.S. large-cap benchmark, Distillate's international strategy is substantially more attractively valued it and offers a portfolio of stocks that have much greater fundamental stability and less leverage. While "home bias" is strong and understandable given the long and significant out-performance of the U.S. versus International stock markets, we believe there are meaningful opportunities now outside the U.S. that deserve consideration. Finally, small-cap stocks are highly leveraged and in the case of the Russell benchmarks, fairly expensive after a significant run. Leverage and valuation may pose risks to small cap investors going forward and are key points of differentiation for Distillate's small cap Quality Value strategy.

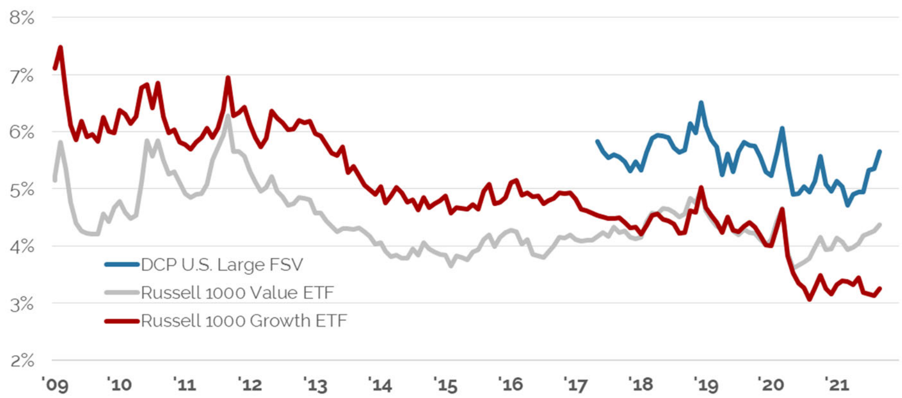
Valuation: Figure 5 shows the current valuations for Distillate's U.S. and International Fundamental Stability and Value (FSV) strategies and its U.S. Small Quality and Value versus various benchmarks. **Figure 6** looks at how the U.S. FSV valuation has compared to the iShares Russell 1000 Growth and Value ETF benchmarks over time. **Figure 7** shows the valuation of Distillate's U.S. FSV strategy compared to the S&P 500 benchmark.

Figure 5: Next 12-Month Free Cash Flow to Enterprise Value



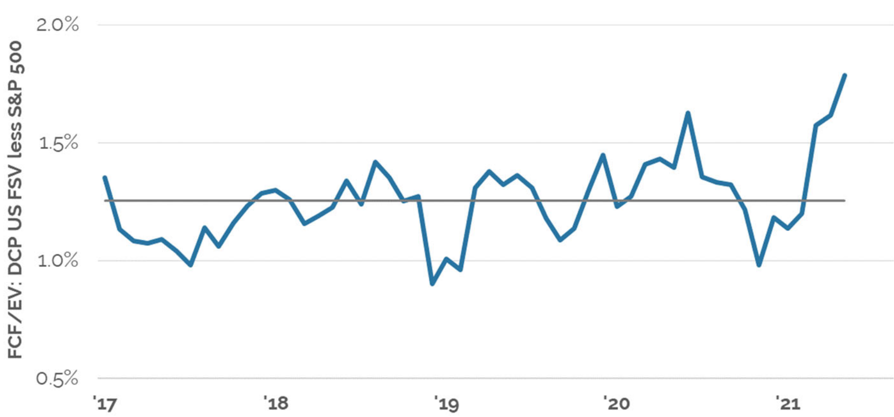
Source: FactSet, See end-notes for methodology.

Figure 6: Next 12-Month Free Cash Flow to Enterprise Value Over Time



Source: FactSet, See end-notes for methodology.

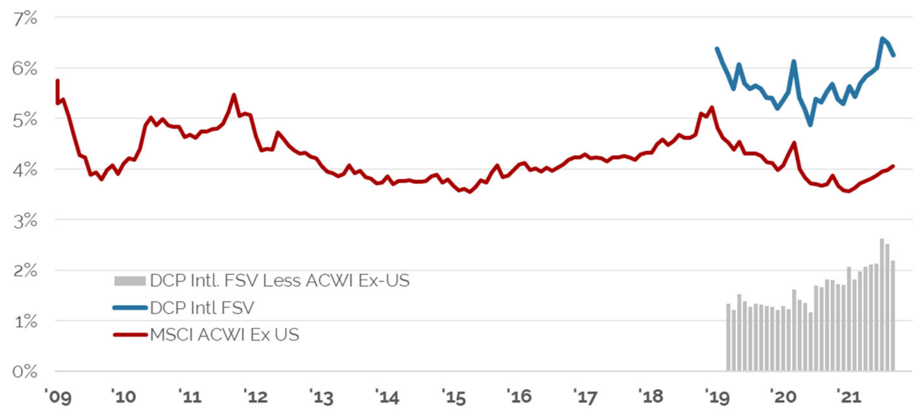
Figure 7: Next Twelve-Month Free Cash Flow to Enterprise Value Spread for Distillate's U.S. FSV Strategy Over the S&P 500 Benchmark



Source: FactSet, See end-notes for methodology.

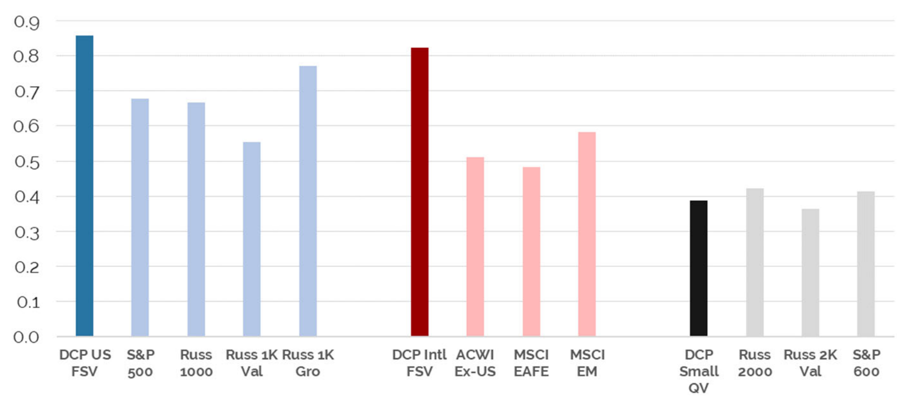
International Valuation Comparison & Quality Charts: **Figure 8** highlights the valuation of Distillate's International FSV strategy versus its benchmark. **Figures 9 & 10** show the cash flow stability and leverage metrics for all of Distillate's strategies versus their various benchmarks.

Figure 8: Next 12-Month Free Cash Flow to Enterprise Value for Distillate's International FSV Strategy vs. the MSCI ACWI Ex-US ETF



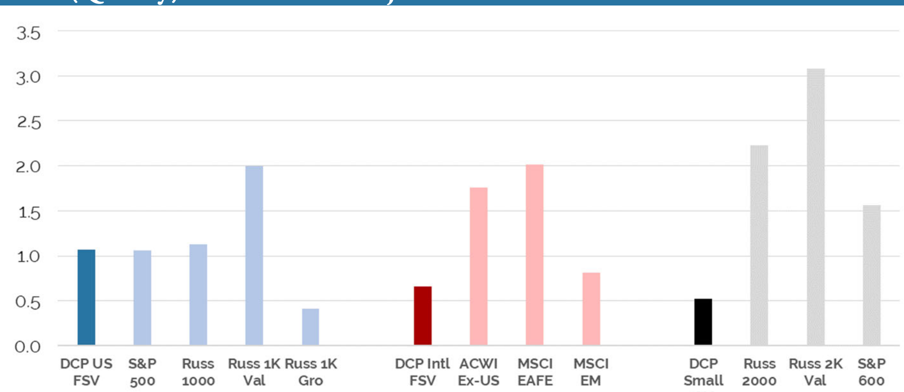
Source: FactSet. See end-notes for methodology.

Figure 9 (Quality): Distillate's Cash Flow Stability Score



Source: FactSet. See end-notes for methodology.

Figure 10 (Quality): Net Debt to Adjusted EBITDA



Source: FactSet. See end-notes for methodology.

Performance

U.S. Fundamental Stability & Value (U.S. FSV)

Year-to-date, Distillate's U.S. FSV strategy is trailing the S&P 500 benchmark by around 2.2% after leading it by almost 3% in the first quarter of the year. Momentum among the most expensive stocks in the second and third quarters was the primary driver of relative performance. Since the end of the first quarter, while the S&P 500 price is up around 12%, chip-maker Nvidia is up 64%, Salesforce is up almost 40%, and Microsoft and Tesla are each up almost 30%. The free cash flow yields on next-twelve-month consensus estimates relative to market cap for those stocks are 1.9%, 2.0%, 2.8%, and 0.6%, respectively. Other richly valued stocks like Shopify, ServiceNow, and Snowflake have risen around 30% to 45% over the same period and are now collectively worth $409 billion against consensus-estimated next-twelve-month revenues of just $14.5 billion and free cash flows of slightly under $3 billion – an aggregate free cash flow yield of 0.7% and price-to-sales ratio of 28x vs. comparable figures of 4.3% and 2.8x for the S&P 500.

Among owned positions, Viatris, Cigna, and Jazz Pharmaceuticals were the weakest performers year-to-date with negative contributions to relative performance of around -0.3%, -0.3%, and -0.2%. United Rentals, Applied Materials, and Fortinet were the largest year-to-date positive contributors to relative performance against the S&P 500. By sector, the underweight in financials, where leverage tends to limit the portfolio weight, was a 0.7% drag versus the benchmark. The underweight in energy, where high cash flow volatility and leverage make many of the stocks look unappealing from a risk point of view, detracted another 0.6%. As a reminder, sector weights are driven by bottom-up stock selection and reflect the attractiveness of the stocks within the sector on the basis of free cash flow valuation and quality.

International Fundamental Stability & Value (Intl. FSV)

After outperforming the iShares MSCI ACWI Ex-US ETF benchmark by around 8% last year, the International FSV strategy's year-to-date total return of -1.38% lagged the benchmark by around 6.6% through the first three quarters of this year **(See Figure 2)**.

Chinese stocks have been a substantial drag on relative performance. Our holdings in any region are capped to 150% of the benchmark region weight, with the intention of limiting our exposure to particular regions and countries. Nonetheless, sharp declines in several Chinese holdings impacted by government policy changes resulted in a 3% drag to relative performance year-to-date. Strong performance of financial stocks, and bank stocks in particular, also contributed to our shortfall versus benchmark. As a reminder, high leverage, low stability, and lacking free cash flows will limit ownership in financials in our Intl FSV strategy. In general, sector weights should not have an outsized impact on performance for the strategy over time, as is the goal with the U.S. strategy. That said, the strategy's general aversion to owning bank stocks for the reasons noted above will lead to an underweight in this industry which is much larger in the international benchmark than it is domestically. The international strategy may therefore vary in performance on a quarter-to-quarter basis more than is the case domestically if bank stocks are rising or falling sharply. Over time, given the goal of protecting capital, we believe the general lack of exposure to balance-sheet-driven financials makes sense and we believe this to be especially true internationally where many banks are captive to local governments and not necessarily run for the benefit of shareholders. Last worth noting, the portfolio has lagged the benchmark by roughly 2 percentage points due to performance in the metal and mining industry. This resulted from an underweight in certain mining and steel stocks that have risen sharply this year. Those stocks have a legacy of volatile fundamentals, and several are also financially levered and therefore not constituents in our portfolio. Our objective is that the performance drag that may come from not owning such stocks in a rising market will be more than offset by the capital preservation benefit of avoiding them during periods of distress.

We are disappointed with the extent of this year's underperformance and that it has offset the very strong relative gains from last year. Still, we are encouraged by the wide valuation premium at present and continue to firmly believe that focusing on leverage and financial stability are crucial to preserving capital and limiting losses, allowing capital to compound at better than market returns over the long run.

U.S. Small Quality & Value (U.S. SQV)

Performance for Distillate's U.S. SQV strategy lagged modestly in the third quarter relative to the iShares Russell 2000 ETF and iShares Russell 2000 Value ETF benchmarks, but remains very strong on a year-to-date basis with relative gains over those respective benchmarks of more than 13% and 3%, respectively, net of fees. Top contributors year-to-date include PBF Energy, Signet Jewelers, Consol Energy, ArcBest Corporation, and Ultra Clean Holdings, which added around 1.5%, 1.5%, 1.0%, 0.6%, and 0.6% to relative performance, respectively versus the Russell 2000 benchmark. The largest detractors from relative performance in the first three quarters of 2021 included several unowned "meme" stocks such as AMC Entertainment and GameStop, which after declining more recently are still up around 1,700% and 1,000% respectively through the third quarter, and combined to weigh on relative performance by almost a full percentage point.

Portfolio Changes & Valuation

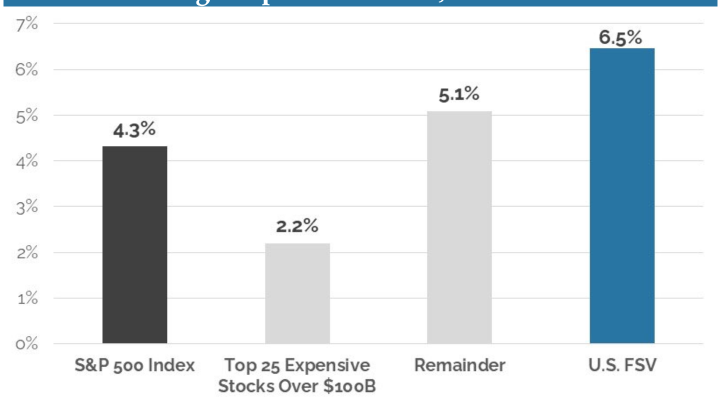
U.S. Fundamental Stability & Value (U.S. FSV)

After rebalancing, the weighted average free cash flow yield to market cap for the U.S. FSV strategy is 6.5% versus a comparable 4.3% for the S&P 500, and the free cash flow to enterprise value yield is 5.7% vs. 3.9%.[1] Both metrics are at a record premium since the strategy's May 2017 inception. We believe this record premium reflects both a wide dispersion in valuation opportunities as well as the depressive impact of several large richly valued stocks on the overall market. This latter point is evident in **Figure 11** which contrasts the free cash to market cap yield of Distillate's U.S. FSV strategy with that of the S&P 500. The figure shows the large downward pull of the most expensive 25 stocks with market values over $100 billion, which collectively have a free cash yield of just 2.2%. If those stocks are removed from the analysis, the free cash yield on the remainder rises to 5.1%. This highlights the valuation risk of some of the mega-cap stocks in the market today, as well as the valuation benefit that can come simply from avoiding them.

In addition to the valuation premium to the market, Distillate's U.S. FSV strategy also enjoys significantly more stable long-term fundamentals, as evidenced by the higher fundamental stability score in **Table 1**. The same table shows that the FSV strategy has a comparably low level of indebtedness to the market, though this metric excludes a number of financials where forward estimates for EBITDA are not available and so likely flatters the index figure.

Distillate's U.S. FSV strategy is avoiding several large richly valued stocks that are driving the overall S&P 500 free cash yield lower.

Figure 11: Free Cash to Mkt Cap Yield for the S&P 500, 25 Large Expensive Stocks, & Distillate's FSV



Source: FactSet, 10/15/2021
Stocks without estimates are excluded and the index re-weighted

Distillate Capital's U.S. FSV Strategy is less expensive, more fundamentally stable, and less levered than the S&P 500.

Table 1: U.S. FSV Portfolio Characteristics*

	U.S. FSV	S&P 500
Free Cash Yield to Mkt Cap[1]	6.5%	4.3%
Free Cash Yield to EV[1]	5.7%	3.9%
P/E[2]	17.4	28.9
Fundamental Stability[3]	0.86	0.68
Leverage[4]	1.07	1.13

*as of 10/15/2021

Sector Changes: the largest sector change was a 3% reduction in financials which outperformed in the quarter. Offsetting this was a 2% increase in consumer discretionary, which has lagged. Sector weights reflect the opportunity set at a stock level and are not driven by any top-down decisions. The opportunity set presently favors the industrials and health care sectors where valuations look attractive, and leans away from financials and communications. The consumer staples weight has also been rising recently after underperformance of many stocks in that sector (**See Table 2**). The table also highlights the impact of several key stocks (Amazon, Tesla, Apple and Microsoft) that can distort headline sector comparisons.

Sector weights are driven by bottom-up stock selection which currently favors the Industrials and health care sectors versus the S&P 500 Index.

Table 2: U.S. FSV Portfolio Characteristics*

	U.S. FSV	S&P 500
Communication Services	4.6%	11.0%
Consumer Staples	7.5%	5.7%
Consumer Discretionary	13.7%	12.5%
Ex Amazon & Tesla	*13.7%*	*6.8%*
Energy	1.0%	2.9%
Financials	2.9%	11.5%
Health Care	21.5%	12.8%
Industrials	21.9%	8.1%
Information Technology	22.0%	27.8%
Ex Apple & Microsoft	*22.0%*	*15.8%*
Materials	4.1%	2.5%
Real Estate	0.8%	2.6%
Utilities	0.0%	2.4%

*as of 10/15/2021

[1] Free Cash Yield to Market Cap and Enterprise Value (EV) are based on the next-twelve-month free cash flow estimates relative to market capitalization and EV, which adds Distillate's proprietary measure of indebtedness. Stocks without estimates in the are excluded and the remaining names are reweighted based on those exclusions.
[2] P/E is based on consensus estimates for next-twelve-months and excludes P/Es over 250 and under 0 to avoid the distortion from outliers.
[3] Fundamental stability is Distillate Capital's proprietary measure of through-cycle cash flow stability with a higher value indicating greater stability.
[4] Leverage is based on Distillate Capital's proprietary measure of indebtedness which looks at the ratio of adjusted net debt to an adjusted measure of forecast Earnings Before Interest, Taxation, Depreciation, and Amortization (EBITDA.)

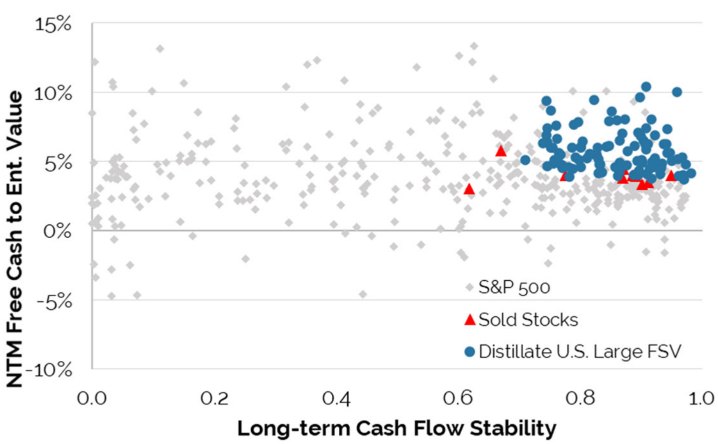
Sells: The largest exited positions were Oracle, which outperformed significantly, and Texas Instruments and Honeywell, which were roughly flat versus the market in the quarter but were edged out for inclusion by other stocks that became even more attractively valued.

Buys: The largest buys were Blackrock (BLK), Micron (MU), Lam Research (LRCX), and TJX (TJX). Each of these stocks underperformed in the previous quarter such that their relative valuations improved to warrant inclusion in the portfolio.

Summary of Holdings vs. the Benchmark: Similar to what we have done in the past, one way to visualize the current portfolio versus the benchmark, as well as the recent changes, is to look at scatter plot of all of Distillate's FSV holdings versus those in the benchmark with valuation on the vertical axis and free cash flow stability on the horizontal axis (**See Figure 12**). The index stocks in grey are scattered across both axes, while FSV's stocks (blue circles) are clustered to the upper right where attractive valuations and high levels of fundamental stability converge. Positions that were sold (red triangles) generally shifted to the left or fell below this cluster, but could also have been exited if debt levels exceeded the threshold for inclusion. New purchases are included among the owned stocks.

Distillate's holdings are clustered where attractive valuations and high levels of stability converge while benchmark stocks are more scattered.

Figure 12: Valuation vs. Stability for all Stocks in the S&P 500 vs. Distillate's Large Cap FSV Strategy



Source: FactSet, Reflects 10/5/21 rebalancing

International Fundamental Stability & Value (Intl. FSV)

After rebalancing, Distillate's International FSV strategy offers a higher free cash flow yield both to market cap and EV and has substantially more stable fundamentals and less leverage than the index (**See Table 3**). The international FSV strategy is thus significantly differentiated from its benchmark not just on valuation, but critically on quality as well.

Like its domestic counterpart, Distillate Capital's International FSV Strategy is less expensive, more fundamentally stable, and less levered than the benchmark All Country World Ex U.S. (ACWI-EX US) Index.

Table 3: International FSV Portfolio Characteristics*

	Intl. FSV	ACWI Ex-US
Free Cash Yield to Mkt Cap[1]	7.0%	5.1%
Free Cash Yield to EV[1]	6.3%	4.1%
P/E[2]	16.2	22.9
Fundamental Stability[3]	0.82	0.51
Leverage[4]	0.66	1.76

*as of 10/15/2021, see footnotes on previous page.

Changes & Regional Weights: The international methodology was recently adjusted to eliminate ownership of Chinese stocks listed on U.S. exchanges in preference for Hong Kong traded shares. This was done given concerns about the Variable Interest Entity (VIE) ownership structure of Chinese stocks listed on U.S. exchanges as American Depository Receipts, or ADRs. Stock of the Chinese company Baidu, for example, was previously owned through an ADR with the ticker BIDU, but was swapped for the Hong Kong traded shares with the ticker 9888-HK. Relating to this change, the regional limit to the portfolio's holdings in China, which is set to be no more than 50% greater than the ACWI Ex-U.S. weight, is limited to only Hong Kong traded stocks and will exclude China-domiciled companies listed only as ADRs. The maximum regional weight for China following this methodology is approximately 13%, which is only slightly ahead its 12% weight in the ACWI Ex-US benchmark.

The largest sales in the quarter were the Chinese E-commerce giant Alibaba, Japanese chemical conglomerate Shin-Etsu, and the Dutch exchange operator Euronext. While Alibaba is still attractively valued, it is not as attractively valued as other Chinese names after the significant sell-off that has occurred in that region. Alibaba was therefore sold to make room for other Chinese stocks within the limits of the regional weight. Shin-Etsu and Euronext both outperformed in the quarter and Euronext crossed over the leverage threshold for inclusion. The largest new positions to the portfolio were British consumer goods giant Unilever, Chinese internet technology company NetEase, and Swiss luxury goods company Richemont. All three underperformed last quarter.

Region weights after the quarterly rebalance are fairly well matched with the ACWI Ex-U.S. benchmark. Japan is the largest overweight at 18% vs. 15% for the benchmark and reflects increasingly attractive valuations there. Europe is a modest underweight partly due to a high index weight in balance-sheet-driven financials and somewhat reflective of valuation. The China weight is roughly in line with the benchmark due to the regional limit of 150% of the tradable universe there (**See Table 4**).

Regional weights reflect bottom-up stock selection but are limited to 150% of the benchmark to limit geographic concentration risk.

Table 4: International FSV Portfolio Region Weights*

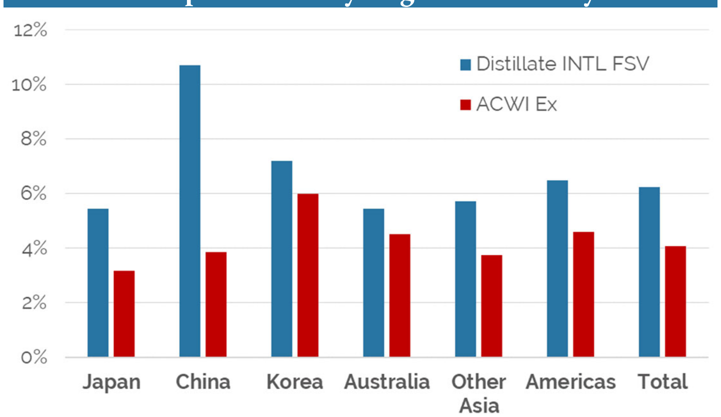
	Intl. FSV	ACWI Ex-US
Europe	39.9%	42.7%
Japan	17.7%	14.6%
China (incl. Hong Kong)	12.4%	11.9%
Asia Ex China & Japan	16.7%	18.2%
Americas	13.3%	9.6%
Middle East & Africa	0.0%	3.1%

*as of 10/15/2021 and based on headquarter location using FactSet data.

Beyond region weights, we thought it would be useful to look at valuation differences by region to examine at how much of the overall valuation premium is due to any particular geography. **Figure 13** depicts the free cash flow to enterprise value yield on next twelve month estimates for several key regions and countries and shows that the valuation of Distillate's portfolio significantly exceeds that of the benchmark in each. This demonstrates that the portfolio achieves its valuation premium to the market not by investing in cheaper stocks in any one region, but instead in a diversified way across regions and countries. The wide valuation gap in China highlights both the very attractive opportunity set there after the recent sell-off as well as the importance of considering leverage. There are many stocks in China that look very cheap on traditional valuation metrics but are saddled with very high levels of debt and so appear both very risky and unattractively valued on the basis of free cash flow to enterprise value. We believe this to be a crucial consideration in trying to capitalize on recent weakness in that market and its longer-term opportunities.

Distillate's international holdings are cheaper across regions.

Figure 13: Next Twelve Month Estimated Free Cash to Enterprise Value by Region & Country



Source: FactSet

U.S. Small Quality & Value (U.S. SQV)

Small cap stocks have rebounded solidly with enormous price gains propelling indexes to levels well above records prior to the pandemic. Resultingly, valuations now look significantly richer, particularly in the headline Russell 2000 index. This was evident in **Figure 5** which contrasted valuations across all of Distillate's strategies and key benchmarks. Fortunately, there is a wide range of valuations within this segment of the market and a very attractive set of opportunities below the surface of the more expensive headline numbers. Distillate's small cap strategy is therefore able to compile a portfolio of stocks that is still very attractively valued at a next-twelve-month estimated free cash flow yield to enterprise value of 6.9% compared to just 3.2% for the Russell 2000 and 4.4% for the Russell 2000 Value (**See Table 5**).

Leverage is also very elevated among small cap stocks and is another key risk to consider. Distillate's small cap strategy looks to avoid this and after rebalancing has a leverage ratio of 0.4 which is significantly differentiated from the very elevated 2.2 and 3.1 figures of the Russell 2000 and Russell 2000 Value benchmarks (**See Table 5**). Given more volatile underlying cash flows, small cap stocks in general would be expected to have less debt than their large cap peers, yet the opposite is true and leverage looks like a key risk to avoid in the small cap space.

Distillate's U.S. Small Cap Quality & Value strategy is more attractively valued and less indebted than its Russell 2000 and Russell 2000 Value benchmarks.

Table 5: Small Cap QV Characteristics*

	SQV	Russell 2000	Russell 2000 Value
Free Cash Yield to Mkt Cap[1]	8.0%	4.5%	6.6%
Free Cash Yield to EV[1]	6.9%	3.2%	4.4%
P/E[2]	13.5	29.2	21.8
Leverage[4]	0.52	2.23	3.08

*as of 10/15/2021, see footnotes on page 7.

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Distillate claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Distillate has been independently verified for the periods June 1, 2017 through November 30, 2018. The verification report is available upon request. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.

To receive a GIPS compliance presentation and/or our firm's list of composite descriptions please email your request to __info@distillatecapital.com__.

The U.S. Dollar is the currency used to express performance. Returns are presented net of management fees and include the reinvestment of all income. For non-fee-paying accounts, net of fee performance was calculated using a model management fee of 0.39%, which is the highest investment management fee that may be charged for this composite. For accounts calculated with a per share, net-of fee NAV, gross performance was calculated by adding back the unitary fee associated with that fund. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

The investment management fee schedule for the composite is 0.39%; however, actual investment advisory fees incurred by clients may vary.

The U.S. Fundamental Stability & Value composite seeks to distill a starting universe of large cap U.S. equities into only the stocks where quality and value overlap using Distillate's proprietary definitions. Its goal is to achieve superior compounded long-term returns by limiting downside in periods of market stress, while still providing strong performance in up markets. This composite was created in May 2017.

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__Free Cash Flow__ refers to a company's operating cash flow, less its capital expenditures.

__Enterprise Value__ refers to a company's market capitalization plus its net debt balance.

__Free Cash Flow to Enterprise Value Yield__ refers to a company's or group of companies' free cash flow divided by the company's (or companies') Enterprise Value, with a higher resulting ratio indicating a more attractive valuation.

__Normalized Free Cash Yield (or Distilled Cash Yield)__ refers to the firm's proprietary valuation measure that looks at estimated, adjusted free cash flow relative to a company's adjusted enterprise value. References to historical stocks that ranked well using this methodology refer only to these stocks' historical valuation and not their inclusion in any actual or hypothetical strategies/accounts managed by Distillate Capital Partners LLC.

__Long-term Fundamental Stability__ is Distillate Capital's proprietary measure of through-cycle cash flow stability with a higher value indicating greater stability.

__Methodology note for Figures 1, 5, 6, 7, 8, 11, & 13:__ free cash flow (FCF) figures reflect consensus estimates of next-twelve-months (NTM) FCF in comparison to enterprise value (EV) for the relevant portfolio/strategy or benchmark. Stocks without data are excluded and portfolios are reweighted accordingly. Stocks with FCF/EV values of greater than 50% or less than -20% have been eliminated to avoid distorting overall averages. __For Figures 9 & 10,__ stocks without data are excluded and portfolios are reweighted accordingly and stocks with leverage values of greater than 20 or less than -5 have been eliminated to avoid distorting overall averages. All data is as of 10/15/2021.

The __S&P 500 Index__ is an index of roughly the largest 500 U.S. listed stocks maintained by Standard & Poor's. The __iShares Russell 1000 Value ETF__ is an investable benchmark used as a proxy for its underlying index, the __Russell 1000 Value Index__, an index of U.S. listed stocks that possess attractive valuation as measured FTSE Russell. The __iShares MSCI ACWI Ex-US ETF__ is an investable benchmark used as a proxy for its underlying index, the __MSCI ACWI ex USA Index__, an index managed by MSCI representing large and mid cap stocks outside of the U.S. The __iShares Russell 2000 ETF and iShares Russell 2000 Value ETF__ are investable benchmarks used as a proxies for the underlying indexes of the __Russell 2000 Index__ (an index of U.S. listed small cap stocks) and the __Russell 2000 Value Index__ (an index of U.S. listed small cap stocks that possess attractive valuation as measured FTSE Russell).

Indices are not available for direct investment. Investment in a security or strategy designed to replicate the performance of an index will incur expenses, such as management fees and transaction costs, which would reduce returns.

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