Kennedy Capital Management, Inc.

Extended Small Cap Commentary
2nd Quarter 2022

Following a macro-driven environment in the first quarter of 2022, which included exogenous impacts like the invasion of Ukraine, we had anticipated the potential for somewhat better visibility into the economic path looking forward in the second quarter. We instead experienced a quarter that featured rapid shifts in the assessment of inflationary pressures, Fed policy, and the durability of the economy. As a result, positioning, de-risking, and other nonfundamental drivers continued to be the major factors determining individual stock movements throughout much of the quarter and even to some extent during earnings season. We continue to believe that the primary undercurrent remains a market that is wrestling with inflationary expectations, the ultimate profile of Fed positioning and the downstream impacts of policy decisions, and – in Q2 especially – significant consternation about the economic cycle, which is moving at a very rapid pace.

Factors at Work in Q222

We believe that the second quarter saw an extension and amplification of the market's rising concerns about a sustainably higher inflationary environment and whether the Fed is prepared to address that inflation, in a way not required for decades, in order to prevent inflation from becoming untethered to actual economic conditions. Global concerns arising from the Ukraine invasion and resultant impacts to global commodities exacerbated inflationary expectations, especially earlier in the quarter, but as worries about economic demand destruction began to take hold, some expectations saw reversals later in the quarter. We continue to believe that inflation in many bottlenecked or supply-constrained areas is likely to become disinflationary (as some retailers are now starting to report excess inventories) once supply chains adjust and the surplus of stimulus spending fades. Labor costs appear to be a key area that could determine just how durably overall inflation remains at a higher level than we've seen for the past couple decades. We would expect other significant areas, such as housing, automotive, and fuel costs to potentially exhibit some natural slowing both as the result of Fed policy impacts and a slackening of demand as economic expectations adjust. We therefore believe that while the Fed will continue to pursue a hawkish policy, there are likely also several corrective factors to slow inflation over the course of the year.

During the second quarter, while we still observed at least some signs of better individual stock performance through earnings season, overall results across most areas of the market continued to be dominated by multiple compression, which drove the negative market returns. Later in the quarter, we observed what we think could be the start of a ratcheting down of economic expectations, which is likely to take the form of earnings revisions in the summer earnings season. We believe that this will be an important gauge of how aggressively the market has "priced in" any amount of potential forward economic pain. The annual reconstitution of the Russell Indexes included a few meaningful sector- and industry-group level adjustments (notably, a significant decrease to Energy and increases to Consumer, Financials, and Health Care within the Russell 2000®

Value Index) which we think led to some exaggerated movements exiting the second quarter and entering the third.

Given the increasing concerns around inflation and the economy, overall equity returns were negative over Q222, with the Russell 2000® Value Index (R2V) finishing down approximately -15.28%. Extended Small Cap returned -15.31% (gross of fees) and -15.45% (net of fees) for the quarter, slightly behind the R2V by -0.03% (gross of fees) and -0.17% (net of fees). Relative performance was again strongest through earnings season, especially in April, with weakness during the quarter primarily in May as macro forces took over. Attribution across sectors in Q222 was somewhat bifurcated, as the portfolio saw positive contributions from Consumer Discretionary, Communication Services, and Health Care, with negative contributions from Financials, Energy and Utilities. While selection is generally the larger component of overall attribution, allocation and selection effects were relatively balanced in the second quarter, which was unsurprising given the magnitude of overall returns and some differences in sector weightings, for example within Utilities.

Outlook

With the market now transitioned almost fully a focus on both the positioning of the economic cycle and the impact of Fed policy actions on inflation and slowing economic growth, the evaluation of stock-specific forecasts has taken a secondary role. We will see if that changes during the upcoming earnings season, and if there is more differentiation between those forecasts based on perceived durability, profitability, or other factors. As we move through this economic cycle at what feels like an accelerated pace, we believe at some point the market and individual stocks will show better response to underlying fundamentals. That may require some level of market assessment that the forward economic path is more visible in order to fully manifest, but that could begin to take hold as we start to discount prospects into 2023.

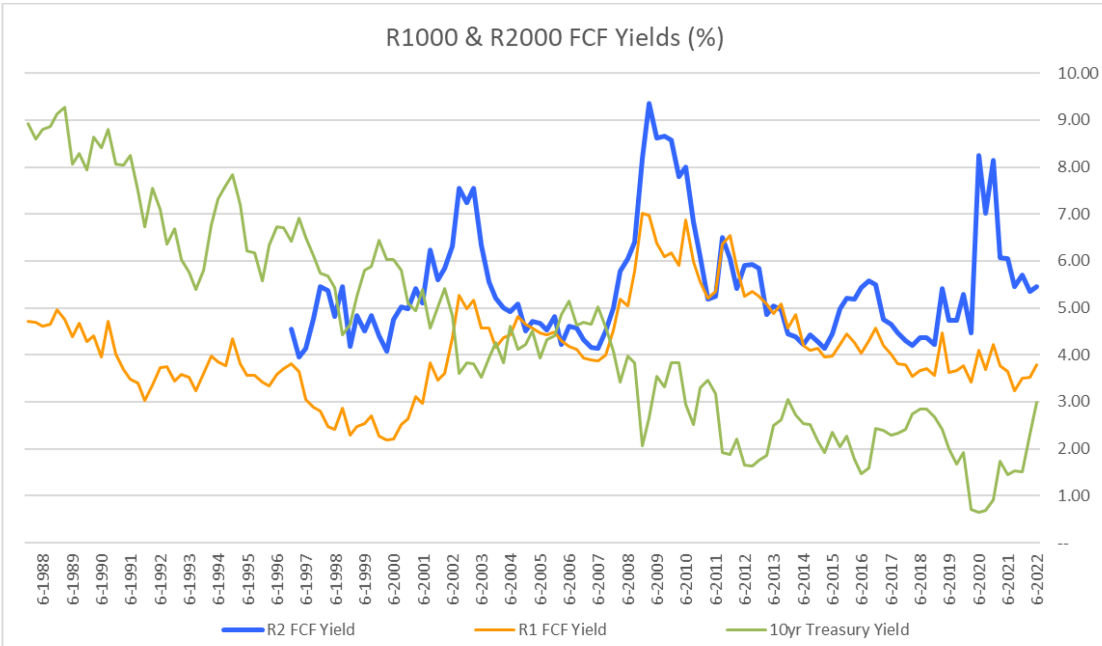
We therefore continue to expect factors at work in the back half of 2022 to likely include some components of company-specific levels of revenue and earnings growth, as well as policy changes and how those might influence long-run economic expectations (growth and inflation, both here and abroad), geopolitical tensions, and the upcoming midterm elections. It does feel a little like the market believes the economic cycle is running at a very rapid pace, so we are watchful for cycle impacts. As shown in our usual chart below, we still think on a cash flow basis that rates offer support for equities, even as Treasury yields have increased meaningfully, and we would again note the continued wide gap between small and large caps.

We remain mindful of macro rotations but continue to expect company-specific opportunities to be available. We likewise continue to seek opportunities within small cap and value stocks, based on three things: low relative valuations against longer term business potential in many areas, even under potentially stressed scenarios, the still broad set of opportunities that we are finding in terms of investment ideas, and the underlying conditions of opportunities within the economy and low absolute rates, all of which are broadly favorable to small cap valuations. We remain vigilant to see how these factors play out over the year.

We continue to wish you, your families and stakeholders good health and safety. While the pandemic seems to be receding for now, we continue to hope for a steady improvement in the months ahead. We deeply appreciate your interest and support.

Sincerely,

Michael Bertz, Ph.D., P.E., CFA®	Sean McMahon	Rob Van Bergen, CFA®
Portfolio Manager	Assistant Portfolio Manager	Assistant Porfolio Manager



Source: FactSet Research Systems Inc.

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Free Cash Flow Yield is an indicator that compares free cash flow and market cap.

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