Kennedy Capital Management LLC

Extended Small Cap Commentary
3rd Quarter 2023

At the risk of sounding like a broken record, we saw many of the same themes from the first half of the year continue to exert their influence during the third quarter of 2023. These included overall market concerns about inflation, the path of Fed policy remaining "higher for longer" and the ongoing debate between hopes for soft landing or fears of a real economic slowdown, indicated both by economic data and significant switches in market positioning. Summer quarters often feature market participants having less conviction as they look for economic or policy direction, which can become exacerbated due to investors being on vacation and volumes being lighter overall. In 2023, these impacts seemed magnified, and we think led to a market much less willing to discount company-specific future improvements, instead more focused on short term sentiment swings. These can be particularly challenging conditions for small cap stocks, which often trail their larger peers over the summer. We continue to believe that the effects of the Fed's steep tightening program are yet to be fully realized, as they are still working their way through the economy. We likewise expect time is still needed to uncover and take advantage of the opportunities these delayed effects likely create. As we work through concerns about the pace of economic slowing, the eventual impacts to employment, and the lagged effects of higher costs of capital, we do believe that the conditions are forming for a sustainable market cycle to take hold, offering strong potential for single stock differentiation to come to the forefront.

Factors at Work in Q323

The third quarter of 2023 appeared to be meaningfully driven by sentiment, as hopes or expectations for a plateau in Fed policy ran alongside economic data that sometimes suggested otherwise. The continued rise in long-term rates, while re-steepening the yield curve somewhat, indicated higher rates were likely for a longer window of time impacting rate sensitive areas of the market (both in equities and bonds). Much like the AI effects of the prior quarter, these broad and sometimes monotonic factors imply a sentiment driven regime. Until there is a little more rate policy clarity from the Fed, we expect the market to remain susceptible to outsized positioning and sentiment inflections.

The market modestly faded overall during the third quarter; after a rally in the month of July, stocks largely declined over the remainder of the quarter. We believe that many participants remain worried about the Fed's tightening stance and whether that will push the U.S. into a recession, but the market continues to often be playing along with the notion that strong employment data in particular could signal an elusive "soft-landing." It remains our view that the Fed is likely to follow through on its present course and hold short-term rates steady for some time. We expect lagged tightening effects to continue working their way into earnings, economic forecasts, and market valuations. In the real economy, we can see indications of rising stresses – increasing consumer costs (fuel prices), mortgage rates at fifteen year highs, consumer savings down, and credit card delinquency rates rising.

In a quarter dominated by these macro effects, we observed less value given to individual stock differentiation, even during earnings season (although we did see a substantial amount of downside asymmetry in post-result stock reactions). As we approach the reporting season for Q3 results, we are anticipating finding opportunities where fundamental results are better than the stocks would suggest following Q3 drawdowns. We're watching for milestones indicating how well the market has calibrated expectations around business volumes, pricing or cost pressures, and especially how company-specific outlooks for the rest of 2023 and into next year will be revised. Choppy trading is likely to be present as the market sorts between single stock performance and overall sentiment and momentum, and we look for company-specific signals to get stronger as the market more fully digests any impacts of economic slowing and the potential for a new cycle.

For the third quarter of 2023, the Russell 2000® Value Index (R2V) finished at -2.96%. Extended Small Cap returned -4.19% (gross of fees) and -4.34% (net of fees) for the quarter, trailing the R2V by -1.23% (gross of fees) and by -1.38% (net of fees). Relative performance was solid through earnings season and August, with pockets of weakness during the quarter seen primarily as macro forces came to the fore. Attribution across sectors in Q323 was relatively balanced, as the portfolio saw positive contributions from Financials, Utilities, and Health Care, with negative contributions from Communication Services, Energy, and Information Technology. Selection was the larger component of overall attribution, although we did observe meaningful allocation effects in areas including Energy and Health Care. Additional performance information is included in the table below.

	1 Year	3 Years	5 Years	10 Years	Since Inception
Gross	7.10%	14.98%	4.38%	7.63%	12.51%
Net	6.40%	14.23%	3.70%	6.91%	11.61%
Index	7.84%	13.32%	2.59%	6.19%	9.02%

Data as of 9/30/2023

Outlook

We wrote last quarter that the momentum of the market seemed focused primarily on Fed policy, fading inflation, and slowing economic growth, meaning that the evaluation of stock-specific forecasts could take a secondary role into the fall. That was largely the case, but as we enter earnings season, we'll again watch for signs of greater confidence around 2023 revisions and especially any forecasts into 2024. We think that resiliency of profitability and any company-specific capacity for growth will be rewarded and believe as the economic cycle progresses that the market and individual stocks will start showing better response to underlying fundamentals.

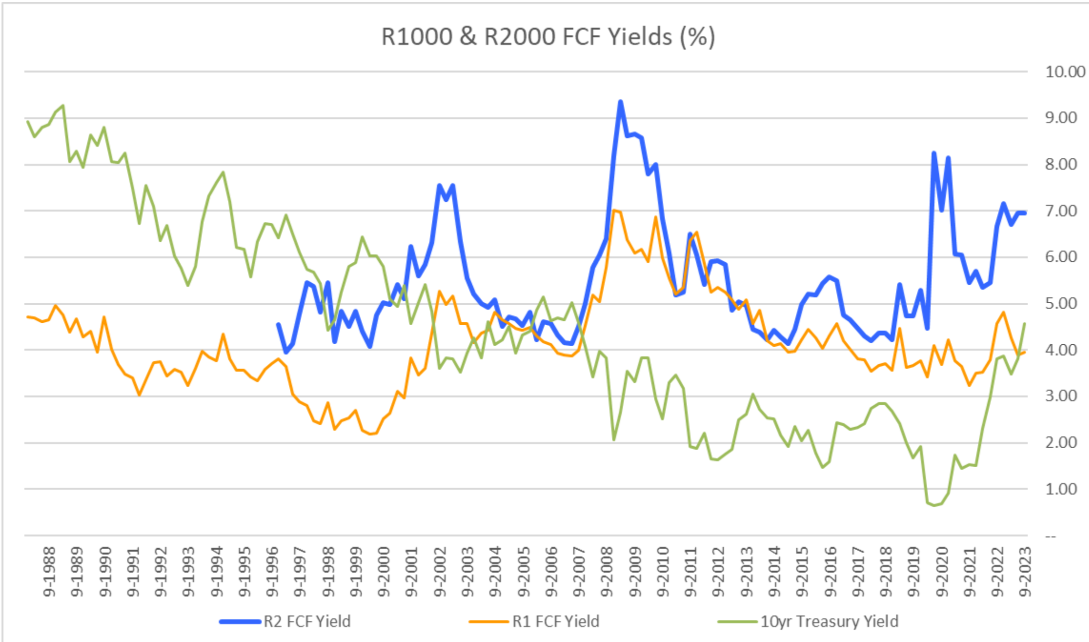
We still expect an elevated rate environment for more than a couple of quarters. Likewise, we believe that there are significant and lagging impacts forthcoming from the rapid tightening of financial conditions. Effects began to appear in regional banks earlier in the year and we anticipate other businesses will feel some impact as well. The longer we have a restrictive policy, the more likely that hiring slows, and the greater the chances for recession. As the landscape develops, we anticipate many investment opportunities to present themselves in companies with strong or improving business models and compelling valuations that the market can recognize and reward.

As we can see in our usual free cash flow chart below, Treasury yields have continued to climb and have closed the gap to large caps. We'd again note the wide spread between small and large caps, which we think supports a bullish small cap view exiting this economic turbulence. While we remain mindful of the effects of macro positioning, we expect company-specific opportunities to be more plentiful in the quarters ahead, with the potential for leadership changes based on a new range of rates, debt costs, and a focus that may shift more towards efficiency and returns. Our process and experience tell us that attractive investment opportunities arrive during periods of uncertainty and volatile or bearish sentiment. We thus continue to seek them out within small cap and value stocks, our optimism based on three things: the availability of low relative valuations against longer term business potential (even under potentially stressed scenarios), what looks like a broadening set of investment ideas starting to open up, and the underlying conditions of recovery within the economy ahead. We are increasingly focused on how these factors likely play out over the next year.

We continue to wish you, your families and stakeholders good health and safety. 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.

FCF Yield for each of the R1000 and R2000 indices represents the total free cash flow (FCF) of the components of the index divided by the total market capitalization of those components. It is a measure of the cash flow provided by the businesses represented in each index and is presented for comparison to the cash flow (yield) provided by current 10-year U.S. Treasury bills.

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The Extended Small Cap Composite invests in companies with a low relative P/E and price/book valuation. Such companies generally exhibit relatively lower analyst coverage and institutional ownership than other comparable companies in the Russell 2000® Value Index. The U.S. Dollar is the currency used to express performance.

Composite specific data provided within this presentation has been calculated from accounts that are discretionary as defined in this paragraph. The assets shown are derived only from discretionary accounts. Non-discretionary accounts, as defined by KCM, are accounts that are not included in the composite due to one or any combination of the following criteria: there were significant cash inflows or outflows within the account; the account's asset level did not meet the minimum requirement to remain in the composite; the account assets are managed by others using our non-discretionary model. The temporary removal of such an account occurs at the beginning of the month and the account re-enters the composite the month after the criteria has been met.

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The Russell 2000® Value Index measures the performance of small-cap value segment of the U.S. equity universe. It includes those Russell 2000® companies with relatively lower price-to-book ratios, lower I/B/E/S forecast medium term (2 year) growth and lower sales per share historical growth (5 year) . The Russell 2000® Value Index is constructed to provide a comprehensive and unbiased barometer for the small-cap value segment. The Index is completely reconstituted annually to ensure new and growing equites are included and that the represented companies continue to reflect value characteristics.

The Russell 2000® Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000® Index is a subset of the Russell 3000® Index representing approximately 7% of the total market capitalization of that index, as of the most recent reconstitution. It includes approximately 2000 of the smallest securities based on a combination of their market cap and *current index membership. The Russell 2000® is constructed to provide a comprehensive and unbiased small-cap barometer and is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true small-cap opportunity set.*

The Russell 1000® Index measures the performance of the large-cap segment of the US equity universe. It is a subset of the Russell 3000® Index and includes approximately 1,000 of the largest securities based on a combination of their market cap and current index membership. The Russell 1000 represents approximately 93% of the US market. The Russell 1000® Index is constructed to provide a comprehensive and unbiased barometer for the large-cap segment and is completely reconstituted annually to ensure new and growing equities are included.

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