Kennedy Capital Management LLC

Extended Small Cap Commentary
4th Quarter 2022

In many respects, and for many investors and market observers, 2022 is perhaps a year best put into the rear-view mirror; challenging absolute equity returns and little help from the fixed income side of many investment portfolios left some room to be desired. To turn the year, without our usual practice of reflecting on the passing year to consider what it can tell us about the upcoming one, would however seem to deprive us of some insight into what the market's assessment might be of a changing economic picture and, perhaps more importantly, what it might reward if those changing market conditions were to bear new leadership. We have just witnessed yet another year with significant macro-driven market impacts; however, the effects of the Fed's steep tightening program on both the economy and the market will take time to be fully realized and to divulge all of the opportunities that they have created. We think that the shape of economic slowing, the impact to employment, and the effects of higher costs of capital are all key questions to consider when looking into 2023, and, while informed by 2022's market dynamics, are more pertinent to the task at hand.

We remind our readers that the Extended Small Cap portfolio is built both with and for persistence; it is designed to find things that the market isn't seeing quite yet, primarily by identifying companies with the potential to improve their businesses that are undervalued or overlooked. We think that when business differentiation is strong, the portfolio's company-specific nature, micro cap exposure, and emphasis on potential business improvement tends to shine through. At other times macro effects can dampen those factors, particularly when they come to dominate investment decisions and money flows across the market. We'd assert that 2022 had no shortage of macro impacts, but we'd also observe that these usually provide mis-pricings and discounted entry points for businesses that fit our investment objectives.

Factors at Work in Q4 and 2022

As we noted in our last letter, each successive quarter over 2022 felt like an extension and amplification of the market's concerns about a sustainably higher inflationary environment and the calibration of the Fed's true endpoint on its aggressive tightening regime. The market has been marked by significant multiple compression and punctuated by sharp rallies on sentiment changes that maybe the Fed will pivot from that hawkish stance. In this environment, with heightened sensitivities and exacerbated by relatively low trading volumes, uncertainty and hesitation from many fundamentally driven funds, and with larger amounts of marginal flows from macro and momentum traders, the market has been very susceptible to exaggerated positioning and sentiment inflections. We expect these kinds of dynamics to perhaps last for a couple of quarters as clarity on the Fed's end goals and the durability of the U.S. economy in the face of that policy takes hold.

As we saw in the third, the fourth quarter was marked by a rally over its first half, followed by fading through the closing month of the year. The underlying driver of that seesaw action appears to be a market alternately concerned about the Fed's aggressive tightening stance and its commitment to fighting inflation (which risks pulling the U.S. into a potentially sharp recession), to one seeing relief as positioning or momentum highlights a path towards relaxing that stance. Fundamentally, we still see elevated measures of inflation and it is our view that the Fed is likely to follow through on its present course and hold short terms rates for some time, which may have meaningful lagged effects not fully priced into earnings, economic forecasts, or market valuations.

While dominated by these macro effects, we did observe some signs of individual stock performance, and as usual particularly during earnings season. Until the market is a little more settled around the forward trajectory of Fed policy, we expect to see choppy trading and potentially countervailing forces between company-specific performance and overall market sentiment and momentum. We do, however, continue to look for those company-specific signals to improve as the market further evaluates the impacts of economic slowing and the potential for a new cycle.

We often see fourth quarter rallies in small cap stocks, and even with the intra-quarter volatility, Q422 delivered just that. The Russell 2000® Value Index (R2V) finished up +8.42%. Extended Small Cap returned +7.43% (gross of fees) and +7.26% (net of fees) for the quarter, behind the R2V by -0.99% (gross of fees) and -1.16% (net of fees). Relative performance was again solid through earnings season, with weakness during the quarter seen primarily as macro forces came to the fore. Attribution across sectors in Q422 was relatively balanced, as the portfolio saw positive contributions from Health Care, Consumer Staples, and Communications Services, with negative contributions from Financials, Industrials, and Information Technology. Selection was the larger component of overall attribution, although we did observe some allocation effects in areas including Energy, Health Care, and Industrials.

For 2022 in total, the Russell 2000® Value Index posted negative returns of -14.48%. Extended Small Cap returned -17.19% (gross of fees) and -17.73% (net of fees), underperforming the R2V by -2.71 % (gross of fees) and -3.25% (net of fees). Attribution was also fairly broad for the year as a whole, with positive contributions from Communications Services, Health Care, and Consumer Staples, and negative contributions from Energy, Information Technology, and Consumer Discretionary. Selection was the larger component of overall attribution, although we did observe meaningful allocation effects in areas including Energy, Health Care, and Information Technology. Additional performance in included in the table below.

	1 Year	3 Years	5 Years	10 Years	Since Inception
Gross	-17.19%	7.36%	4.87%	10.59%	12.87%
Net	-17.73%	6.66%	4.18%	9.86%	11.96%
Index	-14.48%	4.70%	4.13%	8.48%	9.28%

Data as of 12/31/2022

Outlook

With the market remaining focused almost solely on the economic cycle and the impact of Fed policy actions on inflation and slowing economic growth, the evaluation of stock-specific forecasts in our view continues to take a secondary role. We will continue look for signs of that changing in the upcoming earnings season, as we expect more attention to focus on 2023 forecasts and the perceived resilience of profitability and any company-specific capacity for growth. As we continue to move through this economic cycle, we believe the market and individual stocks will start showing better response to underlying fundamentals. That may require a market assessment that the forward economic path towards a recovery is more visible, but as prospects for 2023 are discounted, it could begin to take shape.

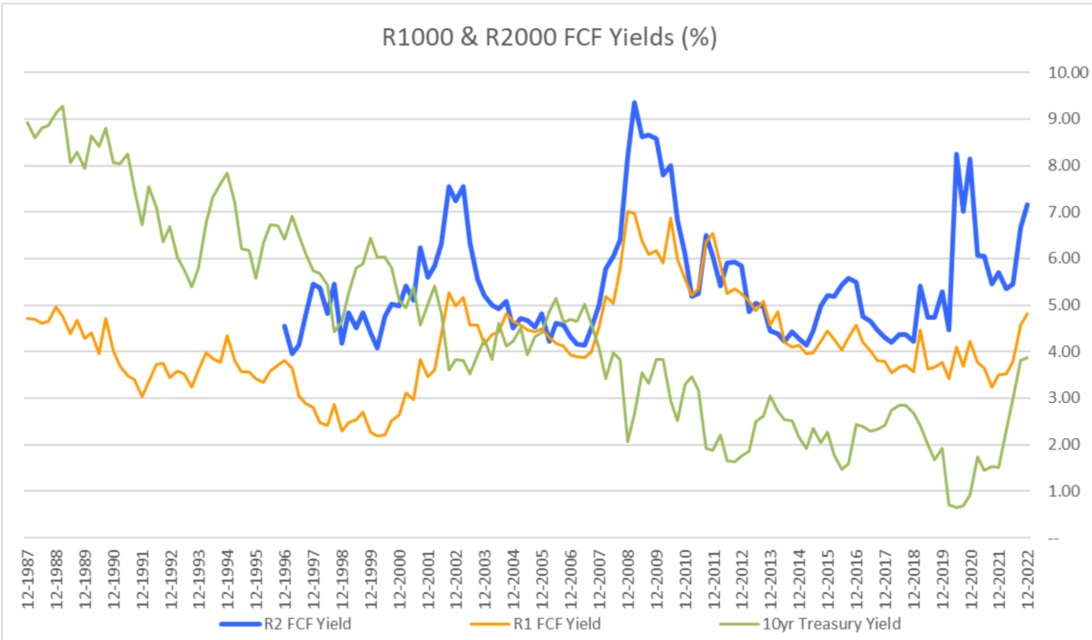
Looking into 2023, we see the Fed continue to wrestle with inflation, driving impacts that will be felt by both the economy and the markets. Economic measures continue to be solid, benefitting from strong but waning fiscal impulses and elevated activity levels and overall employment, even if that is also fading. We believe that there will be significant and lagging impacts from the tightening of financial conditions by the Fed to be seen in these measures over 2023. The markets, on the other hand, are trying to reconcile all of these inputs to arrive at a cohesive set of economic expectations. We read many calls from market observers for a severe slowdown or recession, and from those arguing for a soft landing. To us, the true driver between the two appears to be employment, a result of a multitude of decisions made in the real economy by businesses about how to position into that perceived economic slowing. The longer the Fed maintains what is seen as a restrictive policy, the stronger the impulse will be to curb hiring and the greater the chances for recession. From a real economy perspective, and as we can see in our usual chart below, we still think on a cash flow basis that even as Treasury yields have increased, on a relative basis there is support for equities, and we'd again note the continued wide gap between small and large caps.

We remain mindful of the effects of macro positioning but continue to expect company-specific opportunities to be available. We see strong potential for leadership changes as we look through the cycle, based on the new range of rates, debt costs, and a focus that may shift more towards efficiency and returns. We therefore continue to seek opportunities within small cap and value stocks, our optimism based on three things: low relative valuations against longer term business potential (even under potentially stressed scenarios), what looks to us like a broad set of investment ideas starting to open up, and the underlying conditions of recovery within the economy ahead. 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. 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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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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