

# Kennedy Capital Management LLC

## Micro Cap Commentary 3rd Quarter 2023

### Market Review

The Russell Microcap<sup>®</sup> Index declined 7.93% in the third quarter of 2023, as investors focused on the risks associated with the rapid rise in interest rates. Companies with meaningful exposure to big ticket capital projects and those with higher corporate debt levels have become increasingly out of favor. We continue to see inventory destocking in certain sectors weigh on demand, but many companies have been able to navigate this phenomenon effectively.

The only sector in the Russell Microcap<sup>®</sup> with a positive return in the quarter was Energy, which gained 18.50%, largely driven by the appreciation in oil prices. The other 10 sectors all declined, with Information Technology (down 18.09%) and Health Care (down 17.37%) the biggest laggards. Banks delivered a slightly positive return in the quarter, up 1.28%.

### Performance Recap

The KCM Microcap Composite declined 7.68% (gross of fees) and 7.89% (net of fees) in Q3, outperforming the Russell Microcap<sup>®</sup> Index by 25 basis points (gross) and 4 basis points (net). Both stock selection and sector allocation were largely immaterial on a relative basis in the quarter, as favorable stock selection in Industrials (+98 bps) was offset by Communication Services (-38 bps), Health Care (-37 bps) and Real Estate (-37 bps). On an overall basis, the Industrials sector was the best relative performer, adding 130 bps to performance, while Consumer Discretionary weighed (51 bps deduction). For 2023 year-to-date, the Microcap strategy has declined 0.96% (gross of fees) and 1.62% (net of fees), outperforming the Russell Microcap Index by 484 bps and 418 bps, respectively. Additional performance information is included in the table below.

	1 Year	3 Years	5 Years	10 Years	Since Inception
<b>Gross</b>	7.97%	14.55%	6.50%	9.96%	14.28%
<b>Net</b>	7.06%	13.62%	5.55%	8.93%	13.22%
<b>Index</b>	-1.35%	4.85%	0.23%	5.25%	5.76%

Data as of 9/30/2023

### Outlook

On balance, our conversations with management teams during the third quarter were positive. With the exception of a few industries, opportunities for growth exist, companies continue to take

actions to drive operational improvements, and labor and supply chain constraints are either being dealt with more effectively or are in fact lessening.

The rapid rise in interest rates, however, has caused equity investors to turn increasingly bearish. We have managed through cycles before and have experienced situations where the market reacts to a coming economic slowdown more quickly than is visible to industry participants. We think there is a distinct possibility that this may in fact be the situation the US economy is facing today.

Confidence in our portfolio comes from key areas of exposure where we anticipate little slowdown (commercial aerospace stands out given the preceding period of underinvestment) and from the company-specific drivers of value creation that we tend to focus on with stock selection. As we highlighted last quarter, a more difficult demand backdrop can force difficult decisions at companies that lead to the value-enhancing restructuring actions or turnaround efforts that we gravitate to as we source new ideas.

As always, we thank you for your support, and please don't hesitate to reach out with any questions or concerns.

Sincerely,

Christian J. McDonald, CFA®  
Portfolio Manager

Sean McMahan  
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The Micro Cap Composite invests primarily in micro cap companies (market cap generally in line with Russell Microcap® index market caps) which have strong intrinsic value. For comparison purposes the composite is measured against the Russell Microcap® 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.

Performance returns are presented gross and net of investment advisory fees and include the reinvestment of all income. Gross of fee returns reflect the deduction of transaction costs and custodian fees but do not reflect the deduction of investment advisory fees. Net of fee performance is calculated using gross returns less the actual applicable annual management fee applied monthly. **Past performance is not indicative of future results.** A client's return will be reduced by the advisory fees as described in Form ADV Part 2A and other expenses incurred by the account. For example, an annual advisory fee of 1% compounded quarterly over 10 years will reduce a gross 14.44% annual return to a net 13.32% annual return. Form ADV Part 2A is available upon request.

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The Russell Microcap<sup>®</sup> is used as the benchmark. The Index is unmanaged and represents total returns including reinvestment of dividends. The benchmark is used for comparative purposes only and generally reflects the comparable risk or investment style of the Firm's strategy. The investment portfolios underlying the Index are different from the investments in the portfolios managed by the Firm. Certain accounts may also use other benchmarks not listed in the GIPS composite report. The Verification and Performance Examination Report does not cover the benchmark returns included in the GIPS composite report.