

Kennedy Capital Management LLC

Micro Cap Commentary 4th Quarter 2023

Market Review

The Russell Microcap[®] Index increased 16.06% in the fourth quarter of 2023, as investor sentiment turned toward the potential impact of interest rate cuts and slowing inflation in 2024. This dramatic change in expectations precipitated a significant rebound in every sector except for Energy during Q424, which declined 3.23% yoy due to weakening international demand and increased production from non-OPEC countries. The best performing sector in the quarter was Financials (up 22.96%), which was supported by the potential for improvement in valuations of bank securities portfolios and the continued stabilization of deposit bases. As a reminder, the regional banking crisis in the spring of 2023 was triggered by investors' fears related to the sustainability of bank deposit franchises and the risk that banks may be forced to liquidate securities portfolios at significant discounts. These risks appear significantly diminished as we enter 2024.

Performance Recap

The KCM Microcap Composite increased 14.62% (gross of fees) and 14.36% (net of fees) in Q4, underperforming the Russell Microcap[®] Index by 144 basis points (gross) and 170 basis points (net). Both stock selection (103bps) and sector allocation (70ps) were relatively equal in terms of relative underperformance. Overall, the Materials sector was the best relative performer, adding 45 bps to performance, while Health Care was our largest laggard (63 bps deduction). The bulk of the underperformance in Health Care was tied to our underweight position a biotechnology company acquired at a significant premium. For 2023, the Microcap strategy increased 13.52% (gross of fees) and 12.53% (net of fees), outperforming the Russell Microcap[®] Index by 419bps (gross) and 320bps (net), respectively. Additional performance information is included in the table below.

	1 Year	3 Years	5 Years	10 Years	Since Inception
Gross	13.52%	8.97%	13.21%	10.44%	14.88%
Net	12.53%	8.10%	12.21%	9.42%	13.81%
Index	9.33%	0.61%	8.56%	5.79%	6.50%

Data as of 12/31/2023

Outlook

While 2023 felt like a year heavily focused on macro events, with a particular focus around interest rates and inflation, we were pleased with how the year unfolded for the Microcap strategy. We expect continued volatility as market participants debate macro catalysts for 2024; however, we continue to identify attractive investment ideas that are not predicated on a particular economic backdrop.

With the market focused on the potential for a “soft vs. hard landing” and interest rates, companies can generate shareholder value by improving their overall return structure through divestitures and turnarounds regardless of these macro events. This is one of the reasons we remain overweight Industrials, where we continue to see value creating opportunities on a company-specific basis.

Sector weights did not change materially since our update last quarter. We continue to look for good risk/reward opportunities within the biotechnology sector, an area we see ripe for M&A. We are pleased to highlight that in early January one holding was acquired for a >100% premium to the prior closing price. While our position was not overly material, we view this exposure as evidence that our approach can be effective in the biotech industry.

While we still have concerns around low-end consumer spending and retailer destocking, we believe the risk/reward within several consumer areas is beginning to look more attractive, especially in light of an economy that has remained relatively resilient.

Overall, we continue to believe that a bottom-up approach to portfolio construction and stock selection is most appropriate in the microcap domain, and we expect that if some of the macro factors begin to stabilize in 2024 the market will allow for even greater stock selection differentiation.

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
Portfolio Manager

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Although the statements of fact and data in this report have been obtained from, and are based upon, sources that the Firm believes to be reliable, we do not guarantee their accuracy, and any such information may be incomplete or condensed. All opinions included in this report constitute the Firm's judgment as of the date of this report and are subject to change without notice. This report is for informational purposes only and is not intended as an offer or solicitation with respect to the purchase or sale of any security.

A complete list of all securities recommended by KCM in the preceding year, a full compliant GIPS Composite Report, and the list of composite descriptions are available upon request from KCM at 10829 Olive Blvd., Suite 100. St. Louis, MO, 63141.

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.

The performance figures reported herein are unaudited, may be based upon information obtained via electronic data sources ("feeds") and may be subject to change. Data feeds from many of KCM clients' selected custodians are obtained through third party sources, and are used to compare custodial data to KCM's client account records as frequently as daily. Monthly, KCM reviews clients' account holdings along with cash and share quantities against the custodial statements. In some instances, variances may exist between final audited custodial information and the information KCM obtains via such data feeds. Generally, any such variances are researched and reconciled within thirty days of the period end.

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Sector Weightings are subject to change at any time. Sectors are based on the Global Industry Classification Standard ("GICS") classification scheme. Both are measured as a percentage of the total composite in terms of asset value as of the date indicated on page 1. Individual client portfolios may be different based on variations in security purchase price and date, and individual client restrictions.

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Allocations to various assets classes change over time and deviate from any stated or targeted percentages of a total portfolio as a result of market conditions and reallocation decisions. Therefore, nothing herein reflects a static portfolio allocation that will remain the same or match stated target allocations of asset classes.

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The Russell Microcap[®] Index measures the performance of the microcap segment of the U.S. equity universe. Microcap stocks make up less than 2% of the U.S. equity market (by market cap, as of the most recent reconstitution) and consist of the smallest 1,000 securities in the small-cap Russell 2000[®] Index, plus the next 1,000 smallest eligible securities by market cap. The Russell Microcap[®] Index is constructed to provide a comprehensive and unbiased barometer for the microcap segment trading on national exchanges, while excluding lesser-regulated OTC bulletin board securities and pink-sheet stocks due to their failure to meet national exchange listing requirements. The Index is completely reconstituted annually to ensure new and growing equities are reflected and companies continue to reflect appropriate capitalization and value characteristics.

The Russell Microcap[®] 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.

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