

Kennedy Capital Management LLC

Micro Cap Opportunities Commentary 1st Quarter 2024

Market Review

The Russell Microcap® Index increased 4.68% in the first quarter of 2024, as stable economic conditions in the U.S. and a shift in sentiment toward Health Care companies drove the index higher. After a challenging 2023, the Health Care sector led the way in the Russell Microcap® index during the quarter, returning 14.56%. Within Health Care, Pharmaceuticals increased nearly 26% and Biotechnology was up 18%. These two industries combined currently represent over 20% of the index overall. With strong employment levels sustaining, the market absorbed the scenario that any interest rate cuts – if they occur at all in 2024 – will most likely take place during the second half of the year. Thus, interest rate sensitive sectors – Financials (down 5.2%), Utilities (down 14.1%), and Real Estate (down 8.8%) – all struggled during Q1.

Performance Recap

The KCM Microcap Opportunities Composite increased 8.21% (gross of fees) and 8.06% (net of fees) in Q4, outperforming the Russell Microcap® Index by 353 basis points (gross) and 338 basis points (net). Both stock selection (+314bps) and sector allocation (+22bps) contributed to relative outperformance. Communication Services was the best relative performer, adding 204 bps to performance. Health Care was our largest laggard (-138bps deduction). The bulk of the underperformance in Health Care was tied to our underweight in biotechnology relative to the benchmark. Additional performance information is included in the table below.

	1 Year	3 Years	5 Years	10 Years	Since Inception
Gross	19.46%	14.71%			27.96%
Net	18.71%	13.78%			26.88%
Index	17.78%	-4.89%			6.16%

Data as of 03/31/2024

The largest individual detractor from portfolio performance in the quarter was a provider of systems and services for space, terrestrial, and wireless communications. The stock underperformed in the quarter after reporting results that fell short of investor expectations and announcing a change in the CEO role. The company is in the midst of a debt refinancing, and the CEO change has likely delayed this process, adding to investor concerns. We believe the company is likely to complete this debt refinance in the coming months, and we continue to hold a small position in the stock. The stock detracted 60 basis points from relative performance in the quarter.

The best-performing stock in the quarter was a provider of advertising technologies that are used by marketers to locate consumers more effectively. We believed the market was over-reacting to a short-term impact on advertising spend, which turned out to be true as Q423 results exceeded

street expectations. So far in 2024, the share price has increased by >100% from recent Q423 lows. Additionally, on April 1st, the Company announced a strategic acquirer has proposed to acquire the entire Company. At this point, we are holding onto a majority of our position given the potential for a higher offer.

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 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 didn’t 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.

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 considering 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,

Sean McMahon
Portfolio Manager

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The Micro Cap Opportunities Composite contains fully discretionary micro cap accounts that are invested primarily in micro cap companies (market cap generally in line with Russell Microcap® index) that have opportunities to grow within their respective markets. 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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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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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. **Investors cannot invest directly in an index.**

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