# Kennedy Capital Management LLC

## Micro Cap Opportunities 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 Q423, 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 Micro Cap Opportunities returned 14.51% (gross of fees) and 14.34% (net of fees) in Q4, underperforming the Russell Microcap® Index by 155 basis points (gross) and 172 basis points (net). Stock selection was -131bps, with the sector detractors coming from Health Care and Information Technology. For 2023, the Micro Cap Opportunities strategy returned 11.97% (gross) and 11.17% (net) outperforming the Russell Microcap Index by 264bps (gross) and 184bps (net). Additional performance information is included in the table below.

| | 1 Year | 3 Years | 5 Years | 10 Years | Since Inception |
|---|---|---|---|---|---|
| **Gross** | 11.97% | 22.99% | - | - | 27.40% |
| **Net** | 11.17% | 21.95% | - | - | 26.30% |
| **Index** | 9.33% | 0.61% | - | - | 6.50% |

Data as of 12/31/2023

The best-performing relative sector in Q423 was Energy and Communication Services, each adding 33bps of outperformance. Information Technology was the largest detractor in the quarter, -81bps, due to being overexposed to communication equipment which I believe is being impacted by a short-term delay in customer upgrade cycle. Additionally, Health Care lagged as well, -80bps, due largely to owning an underweight position relative to the Russell Microcap® benchmark in a biotechnology company which was acquired for a significant premium.

The top contributing stock in the strategy was a leading digital advertising technology company focused on providing pharmaceutical and biotechnology companies solutions that directly market therapeutics to healthcare providers. The company is benefitting from adoption of their AI-driven software, solution to help identify specific patient populations.

The largest individual detractor from relative performance in Q423 was a branded pharmaceutical company focused on selling oncology and acute care treatments. I was expecting an increase in shareholder value from the potential to significantly improve corporate earnings from divesting the loss-producing acute care business. Unfortunately, during Q423, management announced several products would be impacted by negative market conditions, and I believe at a minimum any strategic divestitures will be delayed. In addition, following these announcements, the CEO announced he would be leaving the organization. Given a change in my thesis, I've begun selling the position and redeploying assets into ideas with improved risk/reward characteristics.

**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 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 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.*

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*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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