Kennedy Capital Management LLC

Small Cap Core Commentary
1st Quarter 2023

The Market

While the markets were focused on how the Federal Reserve might modulate economic growth in 2023, an attack came from the blindside. An abrupt bank crisis developed, helping the Fed cool the economy without slamming on its own brakes. As we and others have described and discussed this crisis in various forums already, we'll constrain this discussion to the market reaction. Small cap stocks, as measured by the Russell 2000® Index, tumbled in March after a fairly strong start, but still ended the quarter up 2.74%. Value stocks were under pressure, falling 7.17% in March, to end the quarter in the red – down 0.66%. Larger cap stocks fared better in the quarter, with the S&P 500 rising 7.46%. Financials comprised more than 17% of the Russell 2000® Index, which was a meaningful negative driver for small caps during the quarter.

Performance Recap

For the first quarter of 2023, the KCM Small Cap Core Composite returned -1.49% (gross of fees) and -1.71% (net of fees), compared to the Russell 2000® Index, which rose 2.74%. This was a disappointing quarter, although we continue to outperform our benchmark over 1, 3, and 5 years as shown below. Additional performance information is included in the table below.

	1 Year	3 Years	5 Years	10 Years	Since Inception
Gross	-9.85%	20.72%	6.00%	8.47%	12.47%
Net	-10.66%	19.66%	5.14%	7.55%	11.45%
Index	-11.61%	17.51%	4.71%	8.04%	8.69%

Data as of 3/31/2023

Within the Small Cap Core Composite, sectors that we most heavily overweighted versus the benchmark were Consumer Staples, Industrials, and Real Estate. Sectors that were significantly underweighted included Communication Services, Information Technology, and Materials.

During the first quarter, our strongest relative outperformance was achieved in Consumer Discretionary, Real Estate, and Utilities. On the negative side, Health Care, Information Technology, and Industrials had an unfavorable impact on performance. Stock selection was a negative factor during the quarter as we had a challenging quarter in Health Care and Industrials.

The three stocks that were the most significant detriments to performance in the quarter were a distributor of natural and organic foods, a contract drilling firm, and a biopharmaceutical company. The distributor of natural and organic foods encountered profitability challenges early in 2023 after several years of encouraging growth. We believe the business is well positioned for long-term growth and expect that they will be able to work through some of the supply chain challenges that much of the distribution industry is facing. The contract drilling firm in the energy industry has rapidly emerged from the doldrums of the oil and gas industry over the past few years. After losing money in FY20 and FY21, they have moved solidly into profitability. However, being subject to commodity prices to some extent, investors are expecting a bit of a moderation in demand in 2023, leading to a pullback in the stock. Finally, the biopharmaceutical company, with an auto-injection technology that improves convenience and tolerability for some patients, did not perform well during the quarter. The company was buffeted by royalty revenue timing issues and an adverse decision by regulators. Their drug-delivery technology appears as if it may no longer qualify for specialized patent treatment, which could lead to lessening of demand from drug makers. We continue to believe in the patient benefits and expect profits to grow nicely but also concede that the valuation should now take into account some previously unforeseen headwinds.

The three best performing stocks in the portfolio were a producer of manufactured housing, a manufacturer of specialized electronics systems, and a manufacturer of cosmetic and skin care products. We believe that the producer of manufactured housing, including mobile homes, has seen a resurgence in its shares in 2023. During 2022, profits had grown sharply, but we believe the shares were pressured due to supply-chain issues and mortgage cost fears. After reporting extremely strong profit growth for several quarters in a row, the stock has moved higher, and it remains one of our top 20 positions. The second referenced company, which manufactures specialized electronic systems for security, health care, and optoelectronic applications, was awarded a major contract in March which we expect will lead to outsized growth. We believe their technology will enable continued opportunity for contract wins. Finally, the manufacturer of cosmetic and skin care products has produced a significant jump in profitability. This trend began shortly after the onset of COVID and has continued to grow. FY23 earnings expectations are now double those of FY21. We have sold the stock recently, as we believe the valuation is becoming stretched.

Outlook

Recessionary fears have ranged from the near background to the prominent foreground in recent months. This tends to shape investors' proclivity to add new money to the market or even keep funds invested. Of course, this layers into my repeated mantra that the price of a stock is simply where supply and demand for that security meet. Otherwise stated, recessionary fears inevitably dampen demand for stocks. To long-term investors like us, this engenders enthusiasm. While it is certainly possible that our economy is in for a long-lasting malaise, we see this as unlikely. Advancements in technology have created challenges in our economy (e.g., enabling rapid flight of deposits from Silicon Valley Bank), but we see technology enabling *solutions* surfacing more often than setbacks. This should enable profitability increases and wider-ranging improvements across the globe as we look forward. Piecing this all together, the challenging times in which we find ourselves spell opportunity for those prospecting for stocks (e.g., our investment team). We look forward to participating in the inevitable resurgence of the economy and the markets, and we thank you for allowing us to continue managing your assets.

Sincerely,

Donald M. Cobin, CFA®
Portfolio Manager

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The Small Cap Core Composite invests in a mix of small cap value and small cap growth companies, which KCM believes to have strong intrinsic value and growth rates above the Russell 2000® Index. For comparison purposes the composite is measured against the Russell 2000® 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 and are measured as a percentage of the total composite in terms of asset value as of the date indicated above. 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 2000® Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000® Index is a subset of the Russell 3000® Index representing approximately 7% of the total market capitalization of that index, as of the most recent reconstitution. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership. The Russell 2000® is constructed to provide a comprehensive and unbiased small-cap barometer and is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true small-cap opportunity set.

The Russell 2000® Index 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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