Kennedy Capital Management LLC

Small Cap Core Commentary
1st Quarter 2024

The Market

The US Federal Reserve steered market sentiment during the first quarter of 2024. Investor focus centered on the potential for a soft economic landing, the timing of interest rate adjustments, and the health of the labor market. These factors, all intertwined, significantly influenced US equity market performance.

Inflationary pressures remained a constant concern. Market rallies generally coincided with expectations of looser financial conditions, while pullbacks occurred whenever the "higher for longer" interest rate narrative gained traction.

Geopolitical tensions continued to present headwinds, but markets unfortunately appeared to be developing a degree of tolerance for such events, potentially reflecting an acceptance of such volatility as the "new normal."

We have seen an increasing correlation between the small-cap market and the "risk-on" trade, which itself is heavily influenced by long-term interest rate fluctuations. While this linkage is understandable, we believe it may be an exaggerated concern, potentially creating attractive investment opportunities in the small-cap space.

Performance Recap

For the first quarter of 2024, the KCM Small Cap Core Composite rose 3.56% (net of fees), compared to the Russell 2000® Index, which gained 5.18%. Additional performance information is included in the table below.

	1 Year	3 Years	5 Years	10 Years	Since Inception
Gross	11.02%	0.70%	8.05%	7.91%	12.42%
Net	10.02%	-0.20%	7.14%	7.00%	11.40%
Index	19.71%	-0.10%	8.10%	7.58%	9.05%

Data as of 3/31/2024

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

During the quarter, our strongest relative outperformance was achieved in Consumer Discretionary, Materials, and Health Care. On the negative side, Information Technology, Industrials, and Energy had an unfavorable impact on performance. Stock selection was a negative factor during the quarter, particularly within the Industrials and Information Technology sectors. Our continued underweight in Communication Services contributed positively to relative performance.

This was an unusual quarter, as the stocks that were the largest detractors from relative performance were two that we did not own: a manufacturer of high performance server and storage solutions and a provider of enterprise analytics software and services. Our position in a provider of worldwide technology-infused customer experience solutions also weighed on performance.

The manufacturer of server and storage solutions reached a market capitalization over $50 billion at the end of the first quarter. Remarkably, not owning that one stock resulted in 130 basis points of underperformance. The company's participation in the AI revolution was a boon to its growth prospects and its stock price. Although not to the same magnitude, not owning the provider of enterprise analytics software and services was a 48-basis point drag on performance. The company made the decision to purchase cryptocurrency with the company's excess cash, and this has paid off as the cryptocurrency has jumped in value. The provider of customer experience solutions has been on the other end of the AI revolution. The company is involved in global call centers, and investors believe its business model could face pressure as AI lessens the need for their services.

Our best-performing stocks during the quarter included a software company, a biopharmaceutical company, and a provider of vacation experiences.

Revenue growth of the software company that helps companies manage their data has accelerated each quarter during 2023, helping to drive the shares steadily higher throughout the year. Looking ahead, we believe the burgeoning adoption of generative AI and large language models will further propel the data management market. Consequently, this company remains a compelling investment opportunity in our view.

The clinical stage biopharmaceutical company focuses on commercializing treatments for rare muscle disorders. During December 2023, after our healthcare team conducted research on the space and realized the valuation potential, we initiated a position in the stock. It has been a strong performer in 2024 as other investors have come to realize its potential.

Finally, the vacation company rallied nicely during the first quarter after languishing for much of 2023. The company develops, markets, and sells vacation ownership interests to consumers, and they may help to finance these sales. Along with continued revenue growth throughout 2023, credit performance has been better than we expected. This has led to the solid share price performance.

Outlook

The global geopolitical landscape remains a source of concern, with ongoing conflicts impacting human lives and potentially prolonging economic uncertainty. However, we remain hopeful for peaceful resolutions.

Exiting the first quarter of 2024, inflationary pressures re-emerged as a key concern for the economy. Rising input costs pose potential challenges for future business endeavors. However, this inflationary environment could also be indicative of an expanding and vibrant economic landscape. The subsequent months may determine whether inflation is more of an offshoot of growth or a constraint on economic activity.

The volatile period from 2020-2023 undoubtedly challenged many companies. The pandemic, unprecedented liquidity injections, and supply chain disruptions forced strategic reassessments and operational refinements. However, this adversity has also fostered innovation and resilience within many businesses, positioning them for future success.

This underlying strength gives us confidence that our carefully curated portfolio is well-positioned to navigate the market landscape and deliver long-term value for our clients. Thank you for the continued opportunity to serve you and your clients.

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.*

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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. ***Investors cannot invest directly in an index.***

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