Kennedy Capital Management LLC

Small Cap Core Commentary
4th Quarter 2022

The Market

The theme has once again been the direction and tenor of inflation. The Federal Reserve is in the powerful yet tenuous position of modulating inflation while retaining some modicum of economic vitality. Management teams and their operating groups are beginning to conquer the disarray of the supply chain that reigned over 2022. Then we have the consumer, who is benefiting from strength in the job market, but also feeling the pain of rising interest rates. All of this has – perhaps predictably – led to gyrations in equity markets. Small cap stocks, as measured by the Russell 2000® Index, clawed back some returns in the fourth quarter, jumping over 6%; however, this meant that they only lost a bit more than 20% of their value in 2022. Overall, 2022 was not a rewarding year for investors.

Performance Recap

For the fourth quarter of 2022, the KCM Small Cap Core Composite returned 9.67% (gross of fees) and 9.43% (net of fees), compared to the Russell 2000® Index, which rose 6.23%. On a year-to-date basis, the respective gross, net, and benchmark numbers are -15.24%, -16.00%, and -20.44%. While we are pleased to have earned returns for our clients that compare favorably to our benchmark on a year-to-date basis, we are disappointed that our clients have not fared better this year. The following discussion will provide some context around the weightings and individual stock performance that drove performance during the fourth quarter. Additional performance information is included in the table below.

	1 Year	3 Years	5 Years	10 Years	Since Inception
Gross	-15.24%	6.60%	6.11%	9.91%	12.65%
Net	-16.00%	5.67%	5.25%	8.99%	11.63%
Index	-20.44%	3.10%	4.13%	9.01%	8.66%

Data as of 12/31/2022

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, Materials, and Financials.

During the fourth quarter, our strongest relative outperformance was achieved in Consumer Staples, Industrials, and Information Technology. On the negative side, Consumer Discretionary, Materials, and Energy had an unfavorable impact on performance. Stock selection was a positive factor during the quarter and on a year-to-date basis. It remained the primary factor driving relative outperformance this year.

The three stocks that were the most significant detriments to performance in the quarter were a provider of medication management systems, a fabric and craft retailer, and a provider of engineered equipment for industrial gas, energy, and biomedical industries. The provider of medication management systems has been a long-term holding for us. We think highly of their products, competitive positioning, and the management team. However, hospital spending appears to have slowed somewhat materially, leaving the company with a workforce that is outsized for the current opportunity. They have implemented a cost-cutting plan, but we expect margins to be under pressure in the near term. We believe this is a temporary challenge and still hold the business in high regard. The fabric and craft retailer has been pressured by a consumer pullback combined with a leveraged balance sheet. Given that we are now concerned that the debt load may become difficult to manage, we have exited the position. Finally, the provider of engineered equipment for the industrial gas, energy, and biomedical industries announced a large acquisition during the quarter. This announcement seemed to drive a sharp refocusing of the markets – from the fundamentals of their business operations to the newly acquired leverage on their balance sheet and increasing European focus. While we do not think it was an ideal time to take on such an acquisition, we do understand and appreciate the strategic merits of the transaction. We believe that the company will eventually benefit from the underlying fundamental strength of their businesses; hence, we see the stock as undervalued and continue to own it.

The three best performing stocks in the portfolio were a distributor of food products, an oil and gas drilling company, and a manufacturer of metal products. We believe that the distributor of food products has demonstrated remarkable resilience through varying economic periods. Earnings grew more than 90% in Fiscal 2022 and growth even accelerated in the most recent quarter. We believe the company has made sensible acquisitions and managed both the existing and the acquired businesses well. We still see the company as well positioned, and it remains a significant holding for us. The second referenced company, which engages in the contract drilling of oil and gas wells, has been well positioned to benefit from the increased pace of activity in the energy markets. We believe E&P companies are more disciplined than they had been in previous cycles, and we expect this bodes well for the stability of those who supply to them. The third referenced company, which was also a top performer during the third quarter, manufactures engineered fabricated metal products, including irrigation systems for farming and utility poles. We believe the company has managed its costs and supply chain well but has also benefited from global demand strength across many products. We have been pleased to see rising earnings over the past year and expect this trend to continue.

Outlook

Our view on the outlook for the market is shaped by both a micro and a macro perspective. Our conversations with management teams and our analysis of the earnings they produce forms the bedrock of our outlook. Additionally, we try to be well-attuned to the larger forces shaping our economy while avoiding too much "top down" thinking. We then take these inputs and analyses to direct our view of a company's future direction. We translate this view into a depiction of returns on capital and asset growth, key factors in value creation. If our view differs in a materially positive way from the crowd, we have found a candidate to include in the portfolio we manage for you. Once it passes other tests, such as market capitalization, corporate governance, and liquidity, we can invest. I present this pretext to give readers a basic perspective on how we have been populating portfolios based on our outlook. While the factors vary over time, this approach does not. It has served our investors well in difficult economic and market environments as well as bright, optimistic ones. We thank you for allowing us to continue to manage your assets and look forward to the future – whatever the economy will bring.

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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