Kennedy Capital Management LLC

Small Cap Growth Commentary
4th Quarter 2023

Equity markets returns in 2023 were ultimately quite constructive, but the path was very volatile and dominated by expectations for interest rates. All year long, market participants were hyper-focused on every nuanced bit of news that might indicate the future path of the Fed Funds Rate, a key macro factor that will impact the depth and duration of this business cycle. While the Federal Reserve steadily increased the Fed Funds Rate during the year, from 4.5% at the start, to the current 5.25 - 5.50% level, it is the longer term 2 & 10-year Treasury yields that imbed the market's expectations of the *future* Fed Fund path (and thus the economy as well). Simply looking at the 10-year Treasury yield's small increase between the year's beginning & ending levels (3.5% and 3.9%, respectively), one might have thought that 2023 bore few surprises. However, the path of this yield was much more volatile, peaking at 5% in October and then dropping dramatically in the last two months of the year, largely explaining the hyper-volatile moves in the equity markets. Commentary from the Fed Chair indicating that we have seen the end of rate hikes this cycle was the catalyst for the most recent Q4 rally.

Negative earnings revisions were the other primary driver of both individual company and overall market returns in 2023, as the impacts of normalizing inventory levels, slowing inflation, and weaker pockets of demand became fully realized. These impacts were more acutely felt by smaller-capitalization companies which comparatively skew more cyclical and/or are impacted by physical supply chains.

Overall, despite the volatility, the macro-economic backdrop ending up being roughly as we originally expected (i.e., settling around 4%ish long-term rates & a "soft landing" for the economy) and a reasonable environment for investing for growth. And while the absolute performance for the strategy was good, the relative performance was slightly disappointing with the delta entirely self-inflicted due to several stock-specific missteps in the Health Care sector.

Performance:

The KCM Small Cap Growth (SCG) composite increased +15.74% (gross of fees) and +15.58% (net of fees) for the 4th quarter of 2023, outperforming the Russell 2000® Growth (R2G) Index, which increased +12.75%, by +299 bps (gross of fees) and +283 bps (net of fees). Year-to-date the KCM SCG composite increased +15.50% (gross of fees) and +14.76% (net of fees), underperforming the R2G Index, which increased +18.66%, by -316 bps (gross of fees) and -390 bps (net of fees). Additional performance information is included in the table below.

	1 Year	3 Years	5 Years	10 Years	Since Inception
Gross	15.50%	0.19%	13.23%	9.84%	14.06%
Net	14.76%	-0.52%	12.46%	9.09%	13.25%
Index	18.66%	-3.50%	9.22%	7.16%	10.47%

Data as of 12/31/2023

On a relative basis, Information Technology and Energy were the best-performing sectors versus the benchmark. The strength in Information Technology was led by a provider of endpoint security software. The company is gaining market share in a strongly growing end market and we were able to opportunistically purchase the stock this year due to general concerns over slowing IT budgets & any early-stage company that had not yet scaled to profitability. Our market checks indicated that the company has a very competitive solution – on par with their much larger competitor – and we believe they can scale to meaningful profitability over the next several years. The outperformance in Energy was simply due to our not owning any companies in the sector.

Our largest detractors to relative performance for the quarter were Industrials and Health Care. The Industrials underperformance was led by a manufacturer of ground mounting systems used in utility-grade solar projects. It's sales disappointed as they saw several large project timelines get pushed out vs. their key competitor has not seen a similar impact, leading to concerns of structural market share loss. We continue to hold the shares as we believe these revenue differences are temporary and the company has visibility into ramping project demand for 2024/2025. Within Health Care, the Biotechnology industry was the largest detractor, primarily due to one stock, who specializes in drug manufacturing for pharmaceutical and biotechnology companies. The company has just completed a major investment that significantly expanded their available capacity, and while the medium-term secular demand for this capacity remains strong, it is taking longer to fill than initially expected due to general end market weakness within the biotechnology sector.

For the calendar year 2023, the strongest areas of relative performance came from Consumer Staples and Energy. Health Care and Industrials were the largest detractors to performance. Our underperformance in Health Care was the reason that our overall performance lagged the benchmark and was primarily due to the Biotechnology industry. During the year, we held three biotechnology stocks that experienced significant declines, each due to individual company-specific reasons. As a result, we did not keep up with the strength in the biotechnology index – particularly in the fourth quarter when the sector saw a meaningful recovery.

Outlook:

Entering 2024 there is improved visibility on the key macro inputs, which should enable investors to return the focus to individual company earnings execution and longer-term growth opportunities. We believe the next meaningful leg of market performance will require improving corporate earnings, and this should also lead to a broadening out of the market, benefiting small-capitalization

stocks. While incremental macro-economic data continues to support the consensus view that "peak rates" are in, we do anticipate some continued volatility relating to the exact timing and realization of future rate reductions vs. expectations. This makes any short-term relative performance difficult to predict, but we believe that our strategy of investing in companies with higher CFROIs (cash flow return on investment) and higher asset growth (i.e., re-investment opportunities) will mean that they are better positioned to deliver on earnings growth expectations over the next couple of years. Assuming our companies can execute against these growth opportunities, we believe this should be a recipe for longer-term outperformance.

Thank you for your continued confidence in the Kennedy Capital team. Should you have any additional questions, please do not hesitate to contact us.

Sincerely,

Jean Barnard, CFA®
Portfolio Manager

Ryan Dunnegan, CPA
Assistant Portfolio Manager

Alex Mosman, CFA®
Assistant Portfolio Manager

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The Small Cap Growth Composite invests in growth securities of predominately small companies that generally have a market capitalization that is reflective of the Russell 2000® Growth Index. The Manager seeks companies with durable business models

able to deploy assets into growing sets of opportunities providing superior rates of return. For comparison purposes the composite is measured against the Russell 2000® Growth Index. The U.S. Dollar is the currency used to express performance.
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