

# Kennedy Capital Management LLC

## Small Cap Select Commentary 1st Quarter 2024

### The Market:

Entering the year, financial markets anticipated more interest rate cuts in 2024 than what the US Federal Reserve projected during their December meeting. However, throughout the quarter, strong economic growth and employment metrics persisted, while inflation levels remained stubbornly high. The combination of robust employment data and stagnant disinflation led expectations for rate cuts to recede and longer-dated yields to steadily increase. Despite shifting rate expectations, markets rose during the first quarter, deviating from last year's trend where higher rates dampened market gains.

### Performance:

For the first quarter of 2024, the Select Composite experienced a return of 9.08% (gross of fees) and 8.85% (net of fees) as compared to the Russell 2000®, which returned 5.18%. Certain account performance may vary from this composite performance due to client-initiated account restrictions on certain types of holdings or due to client cash flows. Additional performance is included in the table below.

|              | 1 Year | 3 Years | 5 Years | 10 Years | Since Inception |
|--------------|--------|---------|---------|----------|-----------------|
| <b>Gross</b> | 19.13% | 3.03%   | 9.84%   | 8.78%    | 12.00%          |
| <b>Net</b>   | 18.14% | 2.15%   | 8.89%   | 7.82%    | 10.61%          |
| <b>Index</b> | 19.71% | -0.10%  | 8.10%   | 7.58%    | 8.13%           |

Data as of 3/31/2024

During the first quarter, the Industrials sector emerged as our top performer. We are overweight in this sector, and our investments yielded strong results. Notably, three of our top five performing stocks belong to this sector, covering essential industries like transportation, heavy equipment, and machinery. A stock we purchased during the first quarter, stood out as our best-performing name. The company designs and manufactures specialty vehicles such as fire trucks, ambulances, and RVs. The stock performed well as the company executed important strategic moves, including divesting less profitable product lines and issuing a special dividend. Looking ahead, we believe there will be robust margin expansion in their largest segment as they fulfill orders under a new pricing structure that more adequately accounts for cost inflation. Another top performer was a company known for its cosmetics and skincare products. The company continues to capture market share, expand product offerings, increase brand awareness, and improve operations. Over recent quarters, meaningful growth in product volumes, average selling prices, and margins have driven strong earnings. While we remain invested in this stock, we have scaled back our position size.

Information Technology emerged as our weakest-performing sector. This quarter presented an uncommon scenario where our largest negative contributor was a stock we did not hold. This company is an assembler of technology hardware, experienced significant revenue growth driven by strong demand for AI systems, which they put together. While acknowledging the impressive demand, we held concerns regarding potential market share loss and margin compression as competitors scaled their manufacturing capabilities. Given the current valuation, we believe much of the anticipated growth is priced in and doesn't accurately account for potential risks. A regional bank also hindered performance this quarter. We underestimated the challenging deposit environment in the Pacific Northwest. The additional costs incurred to secure deposits pressured profitability, a headwind we believe is persisting for the near future. Consequently, we opted to exit our position.

#### Portfolio Changes:

We were quite active during the quarter, initiating positions in many new investments while closing others. We continue to find very compelling opportunities throughout the small cap universe. Below, we highlight three of our largest newly initiated positions and discuss the sale of three significant holdings.

#### New Investments:

A manufacturer of aerospace-grade composite materials, making airplane structures stronger and lighter than metal alternatives. We believe there is significant potential for this stock, as aerospace customers increase commercial airplane volumes. This uptick in production, coupled with efficiency improvements, should drive earnings growth for years to come.

A dominant producer of hydraulic tools used in demanding environments such as manufacturing, aerospace, mining, and infrastructure projects. We believe the market underestimates the company's potential for earnings growth.

A company who offers manufacturing and packaging services to optical equipment customers in the communications sector. We believe the company's growth is likely to accelerate as the telecom industry rebounds from low spending levels and data center demand increases due to Artificial Intelligence applications.

#### Positions Sold:

A company who manufactures and sells an implantable medical device for treating overactive bladder. We sold our position following the announcement of its acquisition.

A company who specializes in contract drilling for oil and gas companies. We exited our position as our thesis on their ability to command higher prices for drilling rig usage had been realized.

A company who operates electric and natural gas utilities in the northern United States along with offering construction-related services. We sold the stock when the revenue growth rates in the construction services segment unexpectedly fell even as this sector of the US economy remains robust. We anticipate the company may need to adjust their return profile to sustain growth.

#### Portfolio Characteristics:

During the quarter, we increased our weighting to cyclical industries and are now slightly overweight the benchmark. As of March 31, 2024, we are overweight Industrials, Materials, and Consumer Staples. We are underweight Health Care, Consumer Discretionary, and Energy.

### The Future:

The macroeconomic landscape remains dynamic. The recent lack of progress in fighting inflation is directly influencing real-time expectations for interest rates. Notably, the elevated rates have not hindered economic growth or employment. Strong wage growth and a robust US dollar are likely buffering the impact of these higher rates. Amid these conditions, the duration needed for high rates to effectively dampen inflation remains uncertain, as does their potential to disrupt economic activity. Given these varying outcomes, we continue to hold a balanced approach with regard to the portfolio's economic sensitivity. Our focus remains on identifying and investing in companies who we believe can implement their unique strategies for value enhancement. This approach positions us to adapt and capitalize on changing market dynamics.

Thank you for your continued confidence in us. Should you have any questions or concerns, never hesitate to call.

Sincerely,

Alex Mosman, CFA®  
Portfolio Manager

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*The Small Cap Select Composite invests in small cap value and small cap growth companies that demonstrate valuation below, return on assets above and return on equity above those of the Russell 2000® Index, while observing tax sensitivity strategies. For*

comparison purposes the composite is measured against the Russell 2000<sup>®</sup> 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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