Kennedy Capital Management LLC

Small Cap Select SRI Commentary
4th Quarter 2023

<u>The Market In General</u>:

US small-cap stocks surged in the fourth quarter of 2023 as Federal Reserve officials revised their 'higher-for-longer' interest rate expectations. Prompted by sustained economic growth and robust employment data, along with continued disinflation, the Fed signaled the conclusion of its rate-hiking cycle and projected multiple rate cuts in 2024. These shifts led to a significant decrease in treasury yields. Moreover, the market priced-in more rate cuts in 2024 than the Fed suggested, softening financial conditions, boosting equity markets, and potentially affecting future economic growth and inflation.

This quarter's volatility mirrored the broad trends observed throughout 2023. Small cap equities fluctuated wildly throughout the year as investors assigned continuously changing probabilities to inflation metrics, growth rates, employment statistics, interest rate levels, and Fed actions. We account for these evolving dynamics in our investment decisions; however, this does not alter our fundamental philosophy. We remain committed to investing in firms that we believe are capable of implementing their specific strategies for value creation.

<u>Performance</u>:

For the fourth quarter of 2023, the Select SRI Composite experienced a return of 12.69% (gross of fees) and 12.42% (net of fees) compared to the Russell 2000®, which returned 14.03%. Year-to-date, the Select SRI Composite experienced a return of 12.30% (gross of fees) and 11.21% (net of fees) compared to the Russell 2000®, which returned 16.93%. 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 information is included in the table below.

	1 Year	3 Years	5 Years	10 Years	Since Inception
Gross	12.30%	3.89%	11.14%	8.24%	10.91%
Net	11.21%	2.87%	10.03%	7.16%	9.81%
Index	16.93%	2.22%	9.97%	7.16%	8.94%

Data as of 12/31/2023

For 2023, despite achieving considerable returns, our performance did not meet our expectations. This was due to a period of adjustment in several of our investments following their exceptional performance during the peak of the pandemic. We also noticed certain stocks were affected due to their debt levels, even when maturities were years away and credit spreads were tightening. We are confident that as market conditions and interest rates stabilize, these investments will emerge as beneficiaries.

During the quarter, Industrials was our weakest sector with a provider of infrastructure construction, affecting returns. Their challenges stemmed from delays in renewable energy projects due to ambiguous federal tax incentives and customer financing challenges. The company also provided a weaker than anticipated outlook for 2024. We exited the position but may revisit if we can get comfort with financing and tax credit availability. An oil and gas production company, was our largest underperformer for the period. The stock performed well in the previous period, but struggled as the price of oil fell throughout the fourth quarter. We remain invested here as we believe in their strategy of geographic diversification, carbon neutrality, and focus on cash generation.

Consumer Staples was our best-performing sector this quarter helped by a specialty food distributor to restaurants. As we wrote about in our last letter, we believed that several of our investments with minor financial hiccups were overly punished during the third quarter. This company was one of those stocks and we took advantage of the share price dislocation to meaningfully increase our position. The company subsequently reported solid financial results and announced a plan to increase cash generation which sent the shares higher. We remain invested here. Our best individual name was a software company focused on data management. The company has been growing their cloud-based solution and is now expanding margins nicely. We expect the company to generate significant cash over the coming quarters and remain invested in the stock.

<u>Portfolio, New Investments, and Positions Exited</u>:

During the quarter, we increased our weighting to cyclical industries, but remain underweight as compared to the benchmark. As of December 31, 2023, we are overweight the Materials and Consumer Staples sectors and underweight the Consumer Discretionary and Energy sectors.

<u>The Future</u>:

Financial markets remain nuanced. Data is generally supportive of economic growth, strong employment, and continued disinflation. However, the market is also factoring in more interest rate cuts than the Fed has indicated. While the economic trends suggest a successful soft-landing scenario, we recognize the possibility of diverse outcomes. Accordingly, we are adopting a balanced stance in the portfolio, mindful of economic sensitivities. Our focus remains on identifying and investing in companies who 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. Please do not hesitate to reach out if you are interested in additional information or have questions about the positioning of the portfolio.

Sincerely,

Alex Mosman, CFA®
Portfolio Manager

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The Small Cap Select SRI 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 Index, while observing social restriction strategies. 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 composites 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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