Global Small Cap Strategy

Representative Commentary — 3Q21

Performance

	3Q21	1YR	Annualized 3YR	Annualized Since Inception (1/1/2018)
Global Small Cap Composite (Gross)	1.38%	30.19%	11.17%	10.20%
Global Small Cap Composite (Net)	1.16%	29.05%	10.19%	9.22%
MSCI World Small Cap (Net) Index	-1.43%	40.24%	10.87%	9.95%

Please see the important performance and other related disclosures at the end of this Commentary, which are an integral part of this quarterly Commentary Newsletter.

Global markets struggled to find stable footing in the third quarter. While the worldwide interconnected supply chain rattled with continued difficulties, changes were afoot in many economic centers. After only one year in the role, Japan's Prime Minister Suga announced he would step down as his party's leader. While his successor appears to follow the existing political and economic policies, a broader election is planned for November. Germany had a much longer tenure with its leader—Chancellor Merkel was at the helm for 16 years—though she did not seek reelection. As of this writing, it was unclear which coalition of parties would form the new government after the late September election. In another shift, the U.S. Federal Reserve indicated that it might taper its $120 billion of monthly asset purchases as soon as its November meeting, potentially raising the federal funds rate in mid-2022. Elsewhere in the credit markets, with possible reverberations across other asset classes and geographies, one of China's largest real estate developers—and one of the largest companies globally—teetered on the edge of failing to meet its debt obligations. Meanwhile, global economic activities downshifted their growth pace from midyear, though continuing to expand at a faster rate than they had at the start of the year. Nearly universally, struggles with the supply chain—higher commodity prices, labor shortages, or shipment delays—blocked higher activities levels of manufacturing or services.

The collective effect left developed markets with flat returns (-0.1% for the U.S. and -0.5% for non-U.S.), while emerging markets faltered (-8.1%). Within developed markets, Japan was the top performer with hopes of further stimulus and economic reopening. Within emerging markets, Chinese equities struggled, which also dragged emerging markets equities down. From a sector standpoint, financials and energy outperformed, while all other sectors were hit with September's sell-off.

The Global Small Cap Portfolio outperformed the MSCI World Small Cap Index in the third quarter of 2021. Holdings in the Americas, Japan, and Asia/Pacific Ex Japan outperformed while Europe remained flat and relative weakness was seen in Emerging Markets.

Regional Performance: Europe

The portfolio's European holdings slightly underperformed benchmark regional performance. Relative weakness in Germany, Finland, and Spain was partially offset by strength in the United Kingdom and Sweden.

In the United Kingdom, **Spirent Communications** is a leading provider of automated testing and assurance solutions for networks, security, and positioning (GPS). The company delivered solid quarterly results driven by strong demand for lab and assurance solutions, as well as 5G test devices, and its shares ascended 11%. Rising 15% was **Future plc**, a specialty content publisher transitioning from print to a multichannel online platform. They own 220 brands/titles and create niche interest, high-quality, branded, and expert-led content. The company reported solid results driven by ecommerce and digital ads. They also announced the acquisition of Dennis, a consumer subscription business focused on wealth, knowledge, and B2B technology which provides Future with the opportunity to scale up within the wealth vertical.

Less positive was France-based **Rubis**, which provides bulk storage and distribution of petroleum and liquefied petroleum gas. Despite delivering robust profit, the continued business disruptions from COVID have yielded lower than expected visibility of its 2021 volume growth.

We exited the name on those mid-term headwinds and shares decreased -22% for the period it was held during the quarter.

Moving up north, leading the gains was Sweden-based **Nordic Entertainment (NENT)**, the region's leading entertainment provider. Shares climbed 23% as its Viaplay streaming business grew by 30% year-over-year. In July, NENT announced that they won the Premier League rights in the Netherlands, Poland, Estonia, Latvia, and Lithuania. As they have secured all the core sports rights for their markets until 2028, this meaningfully de-risks its operations and solidifies its outlook. Offsetting some of these gains was Finland-based **Valmet** and its -17% decline. They are a process technology provider supplying entire production lines to the pulp and paper industry. Valmet's portfolio of solutions includes renewable energy driven power plants to help customers reduce carbon emissions and energy/raw material consumption. Global supply chain and logistical challenges have caused some hiccups and cost inflation. Shares were also pressured by concerns that service demand would be held back by travel restrictions and postponed maintenance breaks. We believe the concerns are overdone and added to the name on weakness.

Regional Performance: The Americas

The portfolio's holdings in the Americas outperformed the benchmark and housed some of the portfolio's top contributors. Unfortunately, we had to exit some of these strong performers as their market capitalizations grew too large for a global small cap portfolio. Case in point is information technology research advisory firm **Gartner**. The company reported an earnings beat and announced shares buyback. With its market capitalization above $25 billion, we exited our position and booked a 24% gain for the time it was held in the portfolio. A contract research organization serving the biopharmaceutical industry, **Charles River Laboratories** printed another impressive quarter, benefiting from a strong business environment. With its stock up 12% for the quarter and 65% year-to-date, we trimmed our position into the price strength. **Rexnord** specializes in water management (WM) and process and motion control (PMC) products for end markets including industrial, energy, food and beverage, aerospace, and construction. Rexnord's revenues and earnings exceeded expectations. More importantly, the WM operations drove that strength while the PMC business was as expected. Earlier in the year, the company announced it would divest the PMC operations to Regal Beloit, and then narrow its focus on this higher growth WM segment. This led to a 29% gain for its shares. Shortly after quarter end the transaction occurred, and the WM business of Rexnord was renamed **Zurn Water Solutions** while the PMC business became the newly christened Regal Rexnord.

We reduced our position in the game developer for mobile devices, **Zynga**. Although the company's fiscal quarterly results were as expected, there were unexpected levels of turnover among customers in recent months, in part because business reopenings siphoned time from users for mobile games. That and the challenges posed by Apple's new privacy framework led management to lower its guidance on bookings for the balance of the year, which in turn led Zynga's shares down by -29%. Manufacturing wood-alternative decking, railing, trim, and molding, **AZEK** produced higher-than-anticipated fiscal quarterly revenues and earnings, and its stock climbed initially. However, rising raw materials and logistic costs added to margin pressure and eventually led the stock down -14% for the quarter.

Regional Performance: Japan

Japan was another area of strength. During the quarter we participated in the IPO of **Simplex**, a leading systems developer and business consultant which re-listed after an eight-year hiatus. Emerging originally from the trading systems development team of Salomon Brothers in the late 1990s, Simplex since developed a broad client base of leading financial services wherein retains ownership of the core intellectual property (IP) developed during the project. As corporate Japan plays catchup in digitization, Simplex is monetizing healthy financial sector demand for solutions. It's proprietary IP library shortens development time and supports high incremental return on invested capital. Shares of Simplex rose 37% since they were added to the portfolio.

Climbing by 37%, **Kadokawa** is a comprehensive entertainment publisher with content creation at its heart. Profit growth is driven by Kadokawa's ability to monetize its significant *anime* library across an increasing array of e-books, mobile games, and movie titles. With a treasure trove on content rights, Kadokawa is garnering market attention as Japanese anime finds a growing audience in larger overseas market.

With inbound travel remaining in limbo, we exited our position in discount retail store operator **Pan Pacific International Holdings** and reallocated the capital to other opportunities. The company has slowly increased capital expenditure due to store growth, refurbishments of existing stores, and IT investments to improve customer data analysis, which will likely create margin pressure. Its shares traded down -11% while they were held in the portfolio during the quarter.

Regional Performance: Developed Asia Pacific Ex Japan

The portfolio's Asia Pacific Ex-Japan holdings also delivered positive relative performance. **IPH** is Australia's largest intellectual property management services provider. The company's outlook continued to improve with stabilization of revenues in New Zealand, a return to growth in Asia, and strong cost management which resulted in margin expansion. Management remained confident about a return to organic revenue growth and shares rose 16% as a result.

Regional Performance: Emerging Markets

Global emerging markets declined in the quarter and underperformed their developed peers.

The portfolio's holdings in Emerging Markets had mixed results, with holdings in China bearing the brunt of the impact. An independent payment platform and merchant acquirer, **Yeahka** reported solid first half results with inline revenue and an earnings beat. The company remains a beneficiary of the government's oversight and taxation initiatives on small businesses. Despite strong transaction volume growth and new technology services growth, its shares traded down -49%. Considering the increased uncertainties surrounding the Chinese real estate sector, we exited our position in property management company **A-Living Smart City Services**, which declined -21% while it was held in the portfolio. Leading e-commerce marketplace in Turkey, **D-Market Elektronik Hizmetler ve Ticaret** reported lower-than-expected revenue growth, as compared to the prior year's high base, as well as elevated expenses incurred from investments to address increased competition. Its stock tumbled -49%. On the positive side and delivering another good quarter was Taiwan's leading e-commerce player **momo.com** with its 12% gain. As online shopping increases in Taiwan, the company continues to gain market share thanks to its effective merchandise management, highly efficient warehousing management, and undisrupted logistics services.

Conclusion

Turning toward the end of the year, despite this quarter's setback, global equities in most areas have posted meaningful gains thus far in 2021. Yet all the usual suspects lie in wait: new COVID variants, higher-than-typical inflation, tighter monetary policies, and a slowly recovering global supply chain. Countering that is a high degree of stifled producer and consumer demands, along with improving consumer outlooks. Each effect can create or amplify both risks and opportunities for companies, which we continue to review and assess for your investments. As always, we are available for any questions you might have as we endeavor to enhance the assets you have entrusted with us.

General Disclosure:

The holdings discussed represent a particular point in time. It should not be assumed that the securities continue to be held, and/or continue to be held in the same percentage, and/or were held continuously throughout the period. In addition, the holdings of a particular client account may differ from the information provided. Securities discussed do not represent the entire portfolio and, in aggregate, may represent only a small percentage of a portfolio's holdings. Information is subject to change without notice. It should not be assumed that any of the securities discussed were or will prove to be profitable. Past performance does not guarantee future results.

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Performance is measured against the MSCI World Small Cap (Net) Index. MSCI World Small Cap (Net) Index is a trade or service mark of MSCI Inc. The MSCI World Small Cap (Net) Index is an unmanaged, market-weighted index of small companies in developed markets,. Its returns include net reinvested dividends but, unlike the Composite returns shown, do not reflect the payment of sales commissions or other expenses incurred in the purchase or sale of the securities included in the Index. All indexes, including the MSCI World Small Cap (Net) Index, are based on gross-of-fee returns, including net reinvested dividends.

Benchmark returns are not covered by the report of independent verifiers.

This composite generally invests in MSCI World stocks with market capitalizations below $7.5 billion at time of purchase. Portfolios will hold approximately 110 securities. The process is fundamental research driven. Composite inclusion threshold $500,000. Fee basis is 90 points. The composite creation date is January 1, 2018.