Global Small Cap Strategy

Representative Commentary — 3Q22

Performance				
			Annualized	
	3Q22	**1YR**	**3YR**	**Since Inception (1/1/2018)**
Global Small Cap Composite (Gross)	-5.41%	-31.49%	-2.20%	-0.29%
Global Small Cap Composite (Net)	-5.62%	-32.12%	-3.08%	-1.18%
MSCI World Small Cap (Net) Index	-5.28%	-25.01%	2.62%	1.44%

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—using the MSCI World Index as a proxy—began the third quarter in fine fashion (up 8% in July) but stumbled (down -4% in August) and then fell further (-9% in September). For the full quarter, the greatest discomfort was in emerging markets with a -12% return, followed by relative improvements in developed non-U.S. markets with its -9% showing, and -4% for the U.S. Measures of global economic activities fell to the demarcation line between expansion and contraction—with manufacturing showing greater weakness than services though both noting slower rates of new orders. That ebbing tide contributed to falling prices among commodities, especially oil and natural gas.

Central banks commanded investor focus during the quarter as they continued constricting their respective monetary supplies. Leading the charge, the U.S. Federal Reserve increased rates twice during the third quarter at 75 basis point intervals and to a new range of 3.00% to 3.25%. There also were a pair of hikes from the European Central Bank, which made its first increase since 2011 in July and followed that with another in September, swinging European interest rates from negative territory to the current 0.75%. Other money centers shadowed those moves including Switzerland, which lifted its interest rates above 0% for the first time since 2014. The one notable holdout remained Japan, which was steadfast with maintaining its negative interest rate policy, though the Bank of Japan bought yen for the first time in over 20 years to buoy its falling currency. Currency woes also knocked the U.K. late in the quarter—bringing its pound to all-time lows vs. the U.S. dollar—as new Prime Minister Truss unveiled an economic stimulus plan that included significant tax cuts (in response to the market reaction, that portion of the plan was withdrawn). Despite all those actions, global inflation rates remained at elevated levels.

Momentum performed well while Value moved lower in most regions. Meanwhile, Quality/Profitability diverged: U.S. markets rotated away from higher quality while the factor remained more resilient outside of the U.S. Within the global small cap universe, the Americas led the regional performance while Europe underperformed. Energy was the only positive sector, though Health Care, Financials, and Industrials held up relatively better than others.

Amid this environment, the portfolio performed in line with the MSCI World Small Cap Index for the quarter. Our holdings in the Americas, Middle East, and Asia/Pacific ex Japan contributed while other regions lagged.

Regional Performance: Americas

Positive stock selection more than offset the negative allocation effect from our underweight position in the Americas.

Our U.S. financials sector holdings offered mixed results. Reinsurance provider **RenaissanceRe Holdings** reported solid second quarter results driven by higher net premium growth and net investment income. However, its stock lost -9%, which is attributable to the uncertainty associated with the hurricane season. Rotating back to positive were the shares of **Silvergate Capital.** Providing financial infrastructure solutions and services for the digital currency industry, Silvergate reported improvements in net interest income from deposit growth and lower expenses, that combined to produce better-than-expected earnings. After a difficult spring, Silvergate bounced back by 40% this quarter and we trimmed our holdings.

Within the industrials sector, **Regal Rexnord** manufactures electric motors, electrical motion controls, power generation, and power transmission products. Management reaffirmed guidance and announced new three-year financial targets, which led its shares up 24%. Gaining 13% was **EMCOR,** which provides electrical and mechanical construction, and facilities services. As an industrial company well-positioned to pass along higher costs and maintaining its margins, EMCOR reported higher-than-anticipated revenues and earnings, increased guidance for the balance of the year, and authorized an additional $500 million share repurchase plan. There was a healthy backlog of orders for refinery services, building retrofits, construction, and advanced industrial areas.

There was a -15% decline from **Planet Fitness**, which franchises fitness centers across the U.S. Planet Fitness reported revenues and earnings that were less than anticipated. Activities at the centers were stable, though equipment sales declined—mostly from a lack of supply from Chinese manufacturers. In addition, some marketing expenses temporarily increased, which pinched margins. We believe that both of those influences should wane; meanwhile the company's core business was growing steadily.

We trimmed our position in **MACOM Technology** after its shares bounced back by 13%. This designer and manufacturer of semiconductors used in the telecommunications, industrials, defense, and datacenter markets reported solid quarterly results. Strength in their industrial & defense business offset weakness in data center and telecommunications. Supply chain constraints have started to abate, and management is now seeing improving lead times and availability.

Regional Performance: Europe

Geopolitical risk continued to dominate the headlines in Europe. While our European holdings outperformed the benchmark's regional performance, the overweight position as well as weaker currencies detracted from relative performance.

The culprit of the underperformance was leading forklift manufacturer in Germany, **KION Group**. Due to the long-term nature of some of its projects, the company has not been able to pass on higher material, labor, and logistics costs. As a result, the company issued a profit warning and shares tumbled -53%. We are reevaluating KION's position in the strategy. Experiencing a -24% decline was **Saab,** an aerospace and defense company. Military spending in the world has been in a long-term decline and given the current geopolitical situation, there will be structural increases in spending, leading to more organic sales growth for Saab. The market misunderstood and punished the stock when its CEO expressed frustration on slow sales of its Gripen fighter jets. Though its fighter jet business generates high revenues, the margins are low, therefore we do not expect its jet business to materially impact our investment thesis. United Kingdom-based food ingredients company **Tate & Lyle** finished the quarter with a -17% pullback. Their addressable market is focused on Soluble Fiber, Starches and Specialty Sweeteners where demand is stable. The market raised concerns on the company's relative exposure to Europe (around one third of food and beverage solutions sales) and rising corn and gas input prices. Given the necessity of Tate & Lyle's ingredients for food companies, we have confidence that the company will be able to raise prices and sustain profitability.

Offering a bright spot in France was **Nexans**, one of the largest players globally in the cable manufacturing industry. They reported solid organic growth and shares jumped 16%. The company aims to become a pure player in the electrification end-market by 2024.

Regional Performance: Japan

Japan was another area of weakness both due to our underweight position and stock selection. There were some idiosyncratic challenges this quarter. **Kadokawa Corporation** is a comprehensive entertainment publisher that monetizes its significant anime library across an increasing array of e-books, mobile games, and movie titles. The Chairman of Kadokawa was arrested on suspicion of possible bribery to a member of the Tokyo Organizing committee of the Olympic and Paralympic games. Although this event has limited direct impact on the company's earnings and its long-term growth trajectory, considering the uncertainty and the importance of company management to our evaluations, we exited the position. The stock lost -10% during the period it was held in the portfolio during the quarter.

New to the portfolio is **Internet Initiative Japan** (IIJ), one of Japan's oldest Internet Service Providers that has leveraged its early extensive Internet connectivity footprint across Japan's government and blue-chip enterprise customers. It upsells and cross-sells additional network connectivity solutions and has transformed itself into a dominant data infrastructure player, network services provider and system integrator. We expect that IIJ will continue to benefit from the digital transformation of Japanese companies. With its shares down -16% since we initiated a position, we used the price weakness to build up our position throughout the quarter. Offering a brighter spot was discount supermarket **Kobe Bussan**, which ended the quarter only down -1%, outperforming the benchmark's regional performance of -5%. The company continues to see steady sales growth and is well positioned as Japanese consumers trade down.

Regional Performance: Asia Pacific ex-Japan and Middle East

The portfolio's Asia Pacific Ex-Japan holdings delivered positive relative performance.

Leading insurance broker **Steadfast** raised guidance for 2023 to a level that was ahead of consensus. However, the market was not supportive when they raised capital to purchase Insurance Brands Australia (IBA) where its current multiple was above the upper end of its historical range; this dampened Steadfast's share price by -13%. IBA is one of the few remaining large acquisitions and serves well in Steadfast's strategy to consolidate the insurance broker industry. In discussing mergers, the long-awaited

Canadian acquisition by intellectual property services provider **IPH** finally arrived and at an attractive price. Canada's legal system is based on similar principles as Australia (legacy of the Commonwealth) and material operational synergies can be extracted. On top of this comes the cross-border opportunities in the rest of IPH's markets with notably growing presence in Singapore, Indonesia, and Malaysia. IPH has a strong track record in integrating acquisitions and extracting operational synergies. Investors were pleased with the acquisition and its shares were rewarded with an 11% share boost.

Bouncing back by 17% was **CyberArk Software**, a global leader in Privileged Access Management (PAM) based in Israel. PAM controls access to critical enterprise applications and data on internal networks. In a recession scenario, CyberArk's demand is more durable given the critical nature of identity security spending by its clients. The company delivered another strong quarter and raised guidance, highlighting its strength despite the difficult macro environment.

Regional Performance: Emerging Markets

Within the Emerging Markets, Latin America was an area of strength while China and Korea lagged. Our top detractor in the region was **Chinasoft International.** One of the largest information technology services providers in China, partnering with tech giant Huawei, **Chinasoft** is at the forefront of the creation of China's homegrown HarmonyOS. In August, Huawei warned its employees of tough conditions ahead and emphasized its main target is survival. While Chinasoft affirmed that they would not be impacted by Huawei's cost cutting measures, this news nonetheless drove its shares down -40%. South Korea's **K Car** is a platform service for used cars. A key part of the company's business operation is its K Car Data Driven Management System, which allows K Car management to make better purchasing, pricing, and market decisions. K Car's second quarter results showed improvements but impact of the tight used car supply lingered. In September, one of its facilities was flooded along with 200 vehicles due to a recent typhoon. Although the damage is expected to be recovered through insurance and K Car gained market share from smaller used car dealers during the recent floods, its share price retrenched -39%.

With the monetary tightening cycle coming to an end, our Brazilian holdings were some of the top performers of the portfolio. Delivering a 21% price appreciation was **TOTVS,** Brazil's largest software-as-a-service provider. They reported a solid quarter with revenues up 30% year-on-year. Strong momentum is likely to continue into the second half as demand remains healthy along with cross selling. Merger and acquisition opportunities reemerge with prices coming down and companies more open for conversations with TOTVS.

Conclusion

Surveying the remainder of 2022, there seem to be many uncertain balances ready to tip either way. With nearly all central banks well on the quantitative tightening path, there are concerns whether they might raise rates too high too fast, as well as worries that they may pivot and begin easing too soon. Many economies across the global teeter on the edge between expansion and contraction with the determining factor appearing to be new order demand, which has not yet fully recovered. Across our investment universe, companies are concerned about a future recession, and many have taken precautionary steps for a more challenging future business environment. Our bottom-up analyses and discussions with company management teams aim to find holdings that can be resilient whichever way the scales tilt. As always, we are available for any questions you might have as we endeavor to protect 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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Benchmark returns are not covered by the report of independent verifiers.

This composite generally invests in stocks with market capitalizations at time of purchase generally within the range of capitalizations of stocks in the MSCI World Small Cap Index. The process is fundamental research driven. The investment style is growth. Primary selection criteria include quality management, distinct competitive advantage, and strong, sustainable growth. Portfolios will hold approximately 110 stocks. Composite inclusion threshold $500,000. Fee basis is 90 basis points. The composite creation and inception date is January 1, 2018.