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THIRD QUARTER 2022

Small Cap Value Commentary

Market Summary

The Russell 2000® Value Index (the "Benchmark" or the "Index") lost 4.6% in the third quarter. Inflation is at lofty levels and the Federal Reserve continues to hike the Fed Funds rate. Fearing recession, investors pushed markets lower again this quarter. Debt and interest rate business sensitivity were major factors for individual stock performance – less was clearly better.

The worst performing sector this quarter within the Index was Communication Services/Media & Entertainment, down 15%, due to its exposure to advertising, a discretionary expense for many companies which often weakens quickly in slowing economies. Real Estate fell 11%, and Utilities fell 9% as companies in those groups typically have more debt than those in other sectors and their dividends must compete with higher bond yields. Materials finished the quarter lower by 9%, and Industrials fell by 7% as investors feared slowing or declining sales for these more cyclical sectors. More positively, Energy rose 8% on big gains in storage and transportation, refining and marketing, and coal. Healthcare gained 4% largely from biotechnology which is considered somewhat immune from economic volatility. Financials fell just 2% as positive performance from banks offset weakness at insurance and diversified financials. Consumer Discretionary and Technology each finished 5% lower as sales are slowing for many of the companies in these sectors.

Performance Summary - Quarter

For the quarter, our small cap value strategy (the "Strategy" or "Portfolio") underperformed the Benchmark.

Healthcare was the largest laggard for the Portfolio. Half the weakness was due to the underweight in the well-performing biotechnology group while the other half derived from weak performance from Owens & Minor, Integer Holdings, and Multiplan. All three are steady cash flow companies, but they also have a little more debt than the average healthcare company in the Index, thus pressuring returns.

Energy underperformed the Benchmark this quarter due to our outsized exposure to the lagging exploration and production group. The price of oil fell 25% in the quarter which drove energy investors towards refining and marketing, storage and transportation, and coal groups.

Real Estate lagged due to our ownership in office and retail owner Armada Hoffler and medical office building owner, Global Medical REIT. Armada has some office exposure, an unloved space today, while Global Medical REIT's strong dividend faces competition from higher bond yields.

Positively, our outperformance from the Communication Services sector benefited from continued strong results at our biggest position, TV station owner Nexstar Media Group, while avoiding another quarterly decline in the entertainment and interactive media sub-sectors. Industrials saw strong performance from vertically integrated window maker PGT Innovations which gives it better cost control and faster production and shipping time than its peers. Industrial supplies company WESCO International outperformed due to its ability to raise prices ahead of costs and by taking market share from its peers. It continues to raise earnings guidance.

Performance Summary – Year to Date

Year to date, the Strategy slightly underperformed the Benchmark. Communication Services outperformed thanks to Nexstar and their strong local broadcasting business, as well as our lack of exposure to many poorly performing stocks across this sector.

Real Estate has been impacted by weak performance from medical office building owner Global Medical and office owner Hudson Pacific.

Despite strong performance from the exploration and production group to which we are overweight, the Energy sector has underperformed due to our underweight in the high-flying refining & marketing and storage & transportation groups.

Healthcare was pressured by weaker performance from Owens & Minor and Multiplan which have slightly higher debt loads than those in the Healthcare sector. Coherus Biosciences was a poor performer as issues with their clinical trials for their drug for lung cancer caused delays for possible FDA approval. Biotechnology has been a poorly performing group for the Index and has not been a factor in our performance thus far in 2022. Our underweight has been positive, but our biotechnology stocks have performed slightly worse than those in the Benchmark. The better performing biotechnology stocks in the Benchmark are those without earnings promise for at least three years in the future, a group in which we rarely invest.

Financials were weaker than expected due to underperformance by Customers Bancorp, Triumph Bank, and Pathward Financial. These banks have more exposure to nontraditional banking activities which, while quite profitable and faster growing, are less in vogue in uncertain economic times.

Other Contributors for the Quarter

Bancorp offers non-traditional lending including margin loans for custodians' customers, vehicle leases, and SBA loans. It's also a leading white label debit card provider. This quarter they surprised investors with 30% annualized loan growth, higher net interest margins, healthy debit card use from its customers, and predictions of strong growth in 2023.

Materion provides high performing advanced materials used in smart devices, space, high speed connectivity, clean energy, autonomous driving, and many other faster growing applications. Growth continues to impress investors who moved the stock higher this quarter.

Other Detractors for the Quarter

Spectrum Brands provides products for the home including faucets, small appliances, pet supplies, and insect repellent. They hope to complete the sale of the door hardware and locks business but it's currently being blocked by the Department of Justice. The stock fell as a result.

Primoris engages in the provision of construction and infrastructure service to utilities, power, civil and pipeline customers. The stock fell this quarter due to higher labor and fuel costs they couldn't pass through in their fixed bid contracts. They believe this situation will alleviate itself in the second half of 2022.

Quarterly Purchase and Sales Summary

Biotechnology became a large weight in the Index after its reconstitution this quarter, and we increased our exposure in this group. We added PTC Therapeutics (muscular dystrophy and rare seizure related diseases), Ironwood Pharmaceuticals (stomach pain and constipation), Travere Therapeutics (kidney and liver disease), and Harmony Biosciences (sleep disorders). Partially funding these purchases were sales of Coherus Biosciences (trial related trouble for their cancer drug) and healthcare consultant company, Multiplan, as they forecast no growth in 2023.

In Industrials we added Alight, a provider of human resources services and technology for companies' employees, allowing them to view and make changes to all their benefits in one consolidated place via an app or online. We sold checks and small business services provider Deluxe as investors fixate on the slow decline in checks and discount the company's growth in its other services. We also sold JetBlue. The airline has several headwinds including higher jet fuel costs, pilot shortages, a battle with the Department of Justice for its deal to acquire Spirit, and another battle with the DOJ over its partnership with American Airlines.

In Technology we sold semiconductor capital equipment maker Onto Innovation as chipmakers scale back their capital expenditures for 2023. We used the proceeds to buy hardware and data analytics provider Teradata. The company helps customers store their data in the cloud and better understand business trends by querying that data. We expect margin growth and strong free cash flow over the next few years.

In Consumer Discretionary we sold apparel retailer American Eagle as they, along with many, struggle with excess inventory. We used the proceeds to fund western apparel retailer Boot Barn, which should fare much better than peers as their merchandise is less subject to fads and trends, reducing their need to liquidate inventory. In addition, the trend toward country/western music and lifestyle continues to grow.

We took some profits from each of our stocks in the Energy sector and purchased Antero Midstream, owner of 500 miles of gas and water pipelines in Pennsylvania and Ohio. Capital expenditures are declining, and strong free cash flow and dividends are ahead.

In Financials we added Southern California bank, Pacific Premier, due to its strong profitability and its conservative credit lending. We increased our weight in another Southern California bank, First Foundation, which is expanding into Florida and Texas. They also are experiencing some of the strongest growth in the banking industry and that's expected to continue through 2023.

Portfolio Positioning

Higher interest rates have caused a slowdown in the economy, and many now fear a recession. While making macroeconomic forecasts can be tempting, we understand that even the best economists can't consistently make the right calls. Instead, we focus on fundamental analysis and investing in attractive companies that trade at discounts to their business group peers. This value strategy has tended to create outperformance over the years, and we believe it will continue to do so because the price one pays for an asset is a critical component of the eventual return on that investment.

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Our current disclosure statement is set forth in our Form ADV Part 2 and CRS and is available for your review upon request.