

Executive Summary

The Russell 2000 Index, a proxy for small cap equities, gained 2.14% in 4Q21 (“4Q”). After reaching new highs in early November, small cap stocks sold off on the initial spread of the Omicron variant but rebounded to finish stronger as Omicron proved highly contagious, but symptoms proved less severe than other variants. Despite fears that global supply chain challenges would spark empty shelves and lost sales, enthusiastic US consumers still accounted for a high single digit percentage increase in holiday sales. Consumption was fueled by continued strong demand for goods, an early start to the shopping season, reduced discounting and inflation driven price increases.

Overview

The 10-year US Treasury yield finished the year flat at 1.52% when compared to the end of 3Q21 (“3Q”). Within small cap equities, the Utilities, Real Estate and Consumer Staples sectors outperformed while Healthcare, Communication Services and Energy lagged. Small cap value stocks outperformed small cap growth stocks by 435 bps in 4Q as growth stocks continued to be impacted by weakness in the Healthcare sector, specifically Biotechnology. The spread-to-worst on the JP Morgan US High Yield Index drifted lower during 4Q, finishing at 375 bps, down from 385 bps at the end of 3Q. High yield market conditions remain highly favorable. Throughout 2021, issuers have been able to successfully refinance debt at low rates, thereby reducing interest expense, boosting free cash flow, extending maturities and de-risking their balance sheets.

Micro Cap Equity

Our Micro Cap Equity strategy outperformed its benchmark, the Bloomberg Micro Cap Index, during 4Q as the Delta variant peaked while the Omicron variant emerged. After living with Covid for nearly two years, the US has since developed many remedies to prevent and combat the virus. Although hospitalizations and quarantining have slowed certain segments of the economy, ultimately, we believe the world is on a path towards full recovery as the Covid virus becomes an endemic.

During 4Q, US Treasury rates first dipped then recovered to end the year as Omicron infections proved much less deadly relative to the previous Delta variant. The Federal Reserve (“Fed”) indicated a major shift during the quarter as they acknowledged that inflation had persisted much longer as was no longer transitory, thus becoming more hawkish as they look to normalize interest rate policy and raise rates in 2022. The Fed’s hawkish shift benefitted value stocks versus growth stocks as the year ended.

Top contributors of outperformance included the Healthcare, Materials and Industrials sectors. Our sizable underweight to the Healthcare sector was significant as it was the worst performing sector of the market by a wide margin. In the Materials sector, two of our holdings were acquired by large competitors in their respective space at significant premiums. In the Industrials sector, increased spend in both aerospace and farm equipment lead to strong performance in companies exposed to those areas. The strategy experienced underperformance within the Financials, Consumer Discretionary and Information Technology (“IT”) sectors during the quarter. In Financials, the strategy’s underweight position was a detractor as the sector featured strong performance. In Consumer Discretionary, a nursing university was negatively impacted as student enrollment suffered as nurses worked extra hours in light of Covid-related cases instead of progressing their careers with nursing degrees. In IT, a payment processing company experienced declines as valuations in the sector were impacted by Covid fears further disrupting payments into year end.

We expect a normalization of the US economy to a pre-Covid world in 2022. The key issue is how the market reacts to a Fed normalization of interest rate policy after such a stimulative backdrop during the past two years. The last few months of the quarter, where value stocks outperformed growth stocks, is likely a harbinger for what we could expect during the first half of 2022. We’re also watching how China’s restructuring of its real estate market impacts their global growth outlook.

Small to Micro Cap Equity

The Small to Micro Cap Equity strategy outperformed its benchmark, a mix of the Bloomberg 2000 and Bloomberg Micro Cap Indices, during 4Q. Top contributors in the quarter included the Healthcare, Energy and IT sectors.

Small to Micro Cap Equity (cont.)

Within Healthcare, a provider of contract research and development services for the pharmaceutical, chemical and medical device industries experienced valuation multiple expansion amid industry consolidation. In the Energy sector, a provider of oilfield services and equipment delivered significant margin upside in 3Q driven by cost savings actions and completed a highly accretive debt refinancing. In the IT sector, a semiconductor company delivered strong 3Q results and increased guidance due to customer share gains in mobile, new design wins and continued foundry capacity tightness. The company also announced a meaningful new accelerated share repurchase plan.

Top detractors for the quarter included the Consumer Discretionary, Industrials and Real Estate sectors. Within Consumer Discretionary, a value-focused online retailer of home furnishings was pressured due to concerns about its ability to successfully lap tough revenue comparisons as consumer mobility increases and spending shifts away from goods and towards services. In the Industrials sector, a provider of online recruitment services exceeded expectations in 3Q but underperformed due to concerns about decelerating growth against tough comparisons and near-term margin pressure due to increased investments in brand marketing. Within Real Estate, underperformance stemmed primarily from allocation effect as the strategy was underweight the sector.

Small Cap Equity

The Small Cap Equity strategy underperformed its benchmark, the Bloomberg 2000 Index during 4Q. Top detractors included the Industrials, Communication Services and Real Estate sectors. Within Industrials, a provider of on-line recruitment services beat 3Q Street expectations but underperformed due to concerns regarding decelerating growth against tough comparisons and near-term margin pressure due to increased investments in brand marketing. In the Communications Services sector, an online travel research company sold off amid broader concerns that the rapid spread of the Omicron variant would negatively impact travel demand. Within Real Estate, underperformance stemmed primarily from an allocation effect as the strategy was underweight the sector but did outperform the benchmark.

Top contributors in the quarter were the Healthcare, IT and Energy sectors. Within Healthcare, a biopharmaceutical company experienced valuation multiple expansion following financial press reports of a potential merger with a competitor as well as consolidation in the contract research organization space. In the IT sector, a semiconductor company delivered strong 3Q results and increased guidance due to customer share gains in mobile, new design wins and continued foundry capacity tightness. The company also announced a meaningful new accelerated share repurchase plan. In Energy, a provider of oilfield services and equipment delivered significant margin upside in 3Q driven by cost savings actions and completing a highly accretive debt refinancing.

Small Cap Value Equity

During 4Q, our Small Cap Value Equity strategy underperformed its benchmark, the Bloomberg 2000 Value Index, as the Delta variant peaked while the Omicron variant emerged. After living with Covid for nearly two years, the US has since developed many remedies to prevent and combat the virus. Although hospitalizations and quarantining have slowed certain segments of the economy, ultimately, we believe the world is on a path towards full recovery as the Covid virus becomes an endemic. During 4Q, US Treasury rates first dipped then recovered to end the year as Omicron infections proved much less deadly relative to the previous Delta variant. The Fed indicated a major shift during the quarter as they acknowledged that inflation had persisted much longer as was no longer transitory, thus becoming more hawkish as they look to normalize interest rate policy and raise rates in 2022. The Fed's hawkish shift benefitted value stocks versus growth stocks as the year ended.

Top areas of outperformance in the strategy included weightings in the Materials, Energy and Healthcare sectors. In the Materials sector, a holding was acquired by a large multi-national company looking to expand in the area of cement additives. In the Industrials sector, increased spend outlooks in aerospace equipment led to strong performance in companies exposed to those areas. In Energy, a holding benefitted from increased payments for carbon credits related to carbon capture initiatives.

Small Cap Value Equity (cont.)

The strategy experienced underperformance within the IT, Industrials and Communication Services sectors in 4Q. In IT, a company that enables transactions in the airline and hotel industry was negatively impacted as a rival lured away one of its customers with aggressive pricing. In Industrials, airline companies were impacted by flight cancellations as the Delta and Omicron variants caused more caution on air travel. In Communication Services, an online travel advisory company was impacted by slowing booking trends in the European market.

We expect a normalization of the US economy to a pre-Covid world in 2022. The key issue is how the market reacts to a Fed normalization of interest rate policy after such a stimulative backdrop during the past two years. The last few months of the quarter, where value stocks outperformed growth stocks, is likely a harbinger for what we could expect for at least the first half of 2022. We're also watching how China's restructuring of its real estate market impacts their global growth outlook.

Small to Mid Cap Equity

The Delta variant extended the pandemic further into 2022 than previously expected. We believe the global economic recovery will follow the US providing opportunity for globally exposed companies in the Materials, Energy and Industrial sectors. Unprecedented government stimulus efforts supported companies through the pandemic as aggressive fiscal policy raised nominal growth. We believe the Fed will not tighten monetary conditions to the point of risking a US recovery over the coming months.

Our Small to Mid Cap Equity strategy outperformed its benchmark, the Bloomberg 2500 Index, during 4Q led by the Healthcare and IT sectors. Within Healthcare, a medical equipment company experienced strong adoption of two surgical procedure products. In IT, semiconductor companies expect to see supply chain issues resolve in 2022, further benefitting the sector.

The top laggards in the quarter were the Real Estate and Communication Services sectors. The Real Estate sector outperformed in 4Q while the strategy was underweighted due to rising rate concerns. Travel exposed companies struggled during the quarter as the

emergence of the Omicron variant raised concerns that government restrictions would be raised as a response.

The Omicron variant appears to be highly contagious and less virulent than previous Covid strains which could provide widespread resistance allowing for a further reopening of the economy over the coming months. The US has steadily added vaccine mandates, booster shots and therapies that will address the virus as it becomes an endemic. The US reopening phase will differentiate between service companies that will experience a return in demand and businesses that will miss the recovery due to enduring changes in consumer buying trends.

Inflation trends have endured beyond the "transitory" phase with supply chain disruptions and costs rising in many industries. We believe companies need to demonstrate their ability to manage their supply chains and raise prices to maintain profit margins. So far, companies that have pushed through price increases with little impact on demand will need to monitor if this effect will be altered. Companies with ready access to capital and credit spreads have confirmed that corporate balance sheets can weather the current challenges.

The strategy is invested in companies that we believe will benefit from a 2022 economic recovery. While looking for opportunity, strong balance sheets and improving cash flow generation are key indicators for inclusion. We continue to utilize credit spreads to guide our overall portfolio positioning, sector exposures and security inclusion through a volatile market environment. This is a critical indicator that differentiates between stock market sell offs and an adverse turn in the business cycle.

Mid Cap Equity

Our Mid Cap Equity strategy outperformed its benchmark, the Bloomberg Midcap Index, during 4Q. Top contributors to performance were the IT, Materials and Industrials sectors. In IT, semiconductor companies provided guidance that supply chain issues will resolve in 2022. In Materials, an aggregates company experienced strong demand from the non-residential construction and infrastructure markets. A barge operator benefitted from improving trends in 2022 by transporting commodities within the US.

Mid Cap Equity (cont.)

Top detractors to performance in 4Q were the Consumer Discretionary, Energy and Communication Services sectors. A cruise line company sold off as the Omicron variant weighed on the prospects of a 2022 recovery. In Energy, a refining company announced a large acquisition that weighed on performance in an improving oil market. The strategy's overweight position in the struggling Communication Services sector was also a cause of underperformance.

Outlook

Our outlook for small cap equities is constructive as we remain overweight cyclical equities that we believe will benefit from a strong economy and emergence from the pandemic. While consumer spending will face headwinds in 2022 due to the lapping of government stimulus, the underlying trend is fundamentally healthy. Consumers are benefitting from low unemployment, rising wages, elevated savings and positive wealth affects from home/stock price appreciation. Thematically, we expect a more bifurcated landscape, as lower-end consumers were greater beneficiaries of government stimulus efforts last year, are typically less likely to own a home or a stock portfolio and will witness more of their purchasing power sapped by inflation relative to higher income earners.

Additionally, we expect to see continued wallet share shift back in favor of services versus goods as the pandemic dissipates and we resume more pre-Covid patterns of living and working. While we expect the job market to remain tight and forecast continued upward pressure on wage rates, labor participation should improve as we lap extraordinary stimulus,

unemployment benefits and consumer spend through excess savings as the pandemic runs its course. For employers, this should ultimately mean fewer worker shortages, reduced inefficiency, less overtime and fewer special bonus payments. With the 2021 holiday rush in the past, we believe global supply chains will gradually normalize throughout 2022 as companies may start to experience slight improvements in freight costs, lead times, raw material availability and port congestion. Many key commodity costs have already begun to decline sequentially and are potentially on track for year-over-year deflation as we lap elevated levels in the Spring and Fall of 2022.

The hawkish pivot by the Fed and the risk of a policy mistake cannot be ignored, however, we believe moderation in consumer spending and some easing of inflation/supply chain headwinds provide the Fed more ability to move gradually. After four rate hikes this year, the Fed funds rate is likely to remain negative (accommodative). Rising interest rates coupled with a healthy economy is an attractive backdrop for small cap value stocks relative to longer duration growth stocks.

We expect strong earnings growth for small caps in 2022 and believe the sustainability of recent margin improvements and potential accretion from improved balance sheets (ex. buybacks, dividends, M&A) is underappreciated by the market. Corporate credit fundamentals remain robust, the refinancing boom has extended the maturity wall, and the percentage of the market that remains distressed is at historic lows, which augurs well for very low default rates in the intermediate term. Finally, the relative valuation of small caps versus large caps is compelling, particularly after large caps outperformed in 2021.

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