THB SMALL CAP CORE STRATEGY QUARTERLY COMMENTARY

THB Asset Management®

As of September 30, 2024

Executive Summary

The THB Small Cap Core Strategy (the "Strategy") seeks long-term capital appreciation over full market cycles by using a disciplined, actively managed approach. The Strategy typically holds 60–80 securities from the approximately 2,000 stocks within the Russell 2000® Index and has a high active share. THB believes that the small-cap universe is inefficient and that a focused portfolio of high-quality securities in the space can offer strong risk-adjusted returns. THB Small Cap Core Strategy outperformed the benchmark by 1.85% in the third quarter and underperformed the benchmark by 1.52% for the trailing one-year period (net of fees).

Market Review

Equities delivered solid performance during the quarter as investors gained more confidence that the U.S. economy would experience a soft or no landing scenario. Moderating (but still strong) labor markets, cooling inflation, solid economic growth, and lower interest rates supported the notion that a hard economic landing was a low-probability event. The Russell 2000® and Russell Midcap® indices led the markets, delivering returns of 9.3% and 9.2%, respectively, while the S&P 500® Index posted a 5.9% gain. The shift to accommodative monetary policy began in September with the Federal Reserve cutting interest rates by 50 basis points. The federal funds rate had been held at the same level for over a year before this pivot began. This policy shift follows a period containing a series of eleven rate hikes aimed at combating the post-pandemic inflation surge.

July Surprise

A few months earlier than the proverbial "October Surprise," President Biden announced he was ending his presidential campaign. The announcement on July 21 ended weeks of speculation about his future plans.

Initially deemed misinformation, speculation regarding his health, mental acuity, and ability to finish the race and serve an additional four years in office appeared to have some elements of truth. Rumors and press leaks about this topic grew louder post his poor debate performance in June, and more leading Democratic figures directly or indirectly questioned the viability of President Biden's campaign. The pressure to exit the race intensified, and Vice President Harris is now the presidential nominee with Timothy Walz named as her vice-presidential running mate.

Post the surprise shift at the top of the ticket, Vice President Harris and former President Trump appear closely matched in both polls and betting odds. There are only slight variances between the two candidates. Vice President Harris experienced a typical bump in polling post her candidacy announcement but that has settled back down to the current virtual tie.

Neither candidate is likely to have their party control the Senate and House, implying that a significant portion of their policies (which need congressional approval) have little chance of being implemented. The equity markets' fairly muted response to the Biden-Harris shift illustrates this point. There is minimal chance the most radical agenda items from either candidate (Trump or Harris) could pass Congress.

Relief Rallies

Every U.S. presidential election cycle brings concerns about future policies, direction for the country, and other assorted issues. Beyond these concerns, the reality is that not much (on a day-to-day basis) changes for U.S. citizens. As pre-election angst gives way to reality, people tend to move on and so do the equity markets.

Over the past 50 years, presidential inauguration years have been incredibly positive for small-cap equities. Average annualized returns over this period have been +21.4%, with not one negative absolute return.

Inauguration Year	Small-Cap Return
12/30/1977	17.1%
12/31/1981	3.0%
12/31/1985	32.8%
12/29/1989	19.2%
12/31/1993	18.4%
12/31/1997	28.0%
12/31/2001	13.1%
12/30/2005	6.8%
12/31/2009	43.7%
12/31/2013	43.6%
12/29/2017	16.9%
12/31/2021	13.6%
Average	**21.4%**

Cuts Across the Globe

During the quarter, global central banks began a series of policy changes aimed at easing their previously restrictive stances.

These shifts are fostering positive sentiment as it appears the Federal Reserve, the European Central Bank, the PBOC (People's Bank of China), and others are aligning with a more accommodative policy approach to improve global growth prospects.

The Federal Open Market Committee (FOMC) started by lowering the federal funds rate by 50 basis points on September 18. The consensus leading up to the decision was split between a quarter-point and a half-point reduction, reflecting opinions that some level of reduction was needed.

The larger-than-anticipated rate cut highlighted the Fed's commitment to addressing fears of a hard landing and higher levels of unemployment. Fed Chair Jerome Powell stated, "You can take today's decision as a sign of our commitment not to get behind (the curve) … If the labor market were to weaken or inflation were to fall more quickly than expected, we are prepared to respond."

Simmering Inflation

The Fed's overall measures of inflation are trending down, but some drivers of inflation will continue and possibly be amplified by secular forces within the global economy. The green energy transition, geopolitical risks (wars, energy supply), accommodative central banks, and deglobalization will remain a backdrop for the foreseeable future. Any one (or more) of these elements could flare up, leading to more volatile inflation readings. The linear and stable inflation environment of the past decade will likely not repeat. More frequent monetary policy shifts driven by less stable inflation readings are likely to impact the economy and markets.

Electricity Costs

The price of electricity in the United States highlights how secular forces within the U.S. economy are driving up a central element of most consumers' budgets. What historically was a predictable cost for households has experienced sharp increases over the past few years.

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Electricity Cost per Kilowatt-Hour, U.S. City Average

Source: Federal Reserve Bank of St. Louis

Utility bills are rising for a variety of reasons, including higher input (fossil fuel) prices, green energy investments, increasing demand (EVs, data centers), and electric grid expansion/upgrades. The once-stable electric bill is now at the intersection of fossil fuel price volatility, population migration, green energy transition, and technological revolution (AI, data centers).

Green energy transition initiatives are taking place just as demand for electricity is increasing. Simultaneously navigating these two trends is putting pressure on rates and reliability.

Public commissions oversee regulated utilities. Regulators (usually political appointees) decide how much utilities are allowed to charge in an effort to allow the company to earn a fair return while also protecting consumers.

Recently, utilities have raised rates for a host of reasons, piling on increased costs to already stretched consumer budgets. Con Edison in New York hiked rates in January by 4% to implement grid upgrades for offshore wind and neighborhood electrification investments. In Texas, CenterPoint increased rates in September from 3.87 to 5.35 cents per kilowatt hour, increasing utility bills by $57.90 per month on average, to cover infrastructure investment costs. In Connecticut, Eversource increased electricity bills substantially in mid-2024 through state-mandated public benefits surcharges that now account for approximately 28% of the total bill on average. These charges are related to covering a $265 million shortfall due to non-paying accounts during the COVID-19 pandemic and paying back $605 million to Eversource for requiring it to purchase power from the Millstone nuclear power plant at elevated rates. The overpayment to Millstone was deemed necessary (by regulators) to reduce the state's usage of fossil fuel (natural gas).

In September 2024, Constellation Energy announced plans to restart the Three Mile Island nuclear power plant to sell the power to Microsoft (Microsoft needs the electricity for AI data centers). Three Mile Island is the site of the worst nuclear accident in U.S. history, which caused one of its reactors to be permanently closed after the 1979 incident. Microsoft (market capitalization of ~$3 trillion and ~$75 billion in cash on the balance sheet) is also having the plant owner, Constellation Energy, pursue a $1.6 billion federal, taxpayer-backed loan needed to fund the restart. If approved, much of the risk of reopening Three Mile Island would be shifted to taxpayers and not Microsoft and/or Constellation Energy. Debates have already begun regarding this situation and will surely intensify as various factions weigh the merits of reopening the plant and, more importantly, who should pay for this project.

Solutions to the challenges facing the electrical grid and power generation needs are being developed in real time, which provides investment opportunities within our small and mid-size investment universes.

BENCHMARK PERFORMANCE

The Russell 2000® Index (the "Index") returned 9.27% in 3Q 2024. Real Estate (+17.94%) was the best performing sector in 3Q, followed by Communication Services (+17.79%) and Financials (+15.22%). Energy (-8.36%) was the worst performing sector, followed by Information Technology (+4.30%) and Materials (+8.24%).

PORTFOLIO PERFORMANCE & POSITIONING

The THB Small Cap Core Strategy returned 11.12% in USD (net of fees) in 3Q, outperforming the Index by 185 bps.

The portfolio saw positive contribution from stock selection in Consumer Discretionary (+1.75%) and Industrials (+1.10%) as well as overallocation to Consumer Discretionary (+0.82%). Negative contribution came mainly from stock selection in Health Care (-0.62%) as well as underallocation to Real Estate (-0.53%) and Financials (-0.47%).

The portfolio's top five performing stocks (from a contribution standpoint) were Latham Group, Inc. (Consumer Discretionary, +2.13%); ePlus, Inc. (Information Technology, +0.78%); CorVel Corp. (Health Care, +0.69%); Atmus Filtration Technologies, Inc. (Industrials, +0.64%); and AAON, Inc. (Industrials, +0.53%).

The bottom five performing stocks (from a contribution standpoint) were Expro Group Holdings N.V. (Energy, -0.63%); STAAR Surgical Company (Health Care, -0.44%); FormFactor, Inc. (Information Technology, -0.30%); Alarm.com Holdings, Inc. (Information Technology, -0.23%); and Diodes, Inc. (Information Technology, -0.16%).

During the quarter, our portfolio companies announced 22 acquisitions and seven stock repurchase authorizations.

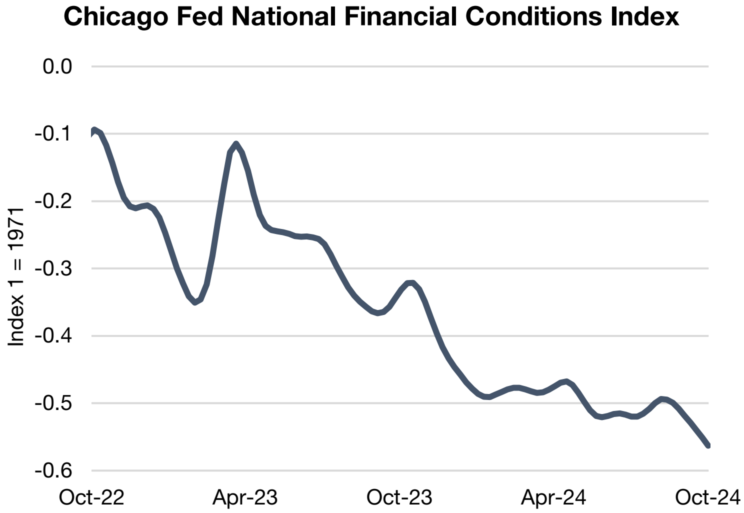
Hawkins, Inc.

Hawkins, Inc. is a recent addition to the strategy that highlights how the prudent use of acquisitions can enable companies to expand their addressable market and scale their operations. Hawkins is the 10th largest specialty chemical and ingredient company in North America and the 30th largest globally. Specializing in formulating, manufacturing, blending, and distributing products for Industrial, Water Treatment, and Health & Nutrition sectors, the company is expanding through acquisitions, particularly focusing on growing its higher-margin water treatment business, which has now become the largest reporting segment following 11 acquisitions since 2021. Hawkins differentiates itself through its value-added services, such as custom manufacturing and toll blending, supported by tailored and strong customer service through a robust network of 60 facilities in 27 states. By leveraging synergies between the industrial and water treatment segments, the company optimizes costs through bulk purchasing of raw materials and shared resources, thereby leveraging fixed costs effectively and creating a competitive cost advantage, positioning itself to generate robust cash flow for future growth and expansion opportunities.

Outlook

The equity markets have recently experienced significant shifts driven by expectations of a Fed policy pivot, easing inflationary pressures, and mixed economic data. With the unemployment rate moderating and other indicators suggesting some economic softness, there has been increased speculation about future potential rate cuts (both size and timing). In recent statements, Fed Chair Jerome Powell has telegraphed that they would move aggressively if any further weakening of the labor markets emerged.

Despite some uncertainty, we remain optimistic about future economic activity and the prospect of lower interest rates. One of our biggest concerns was the possibility of a policy mistake if overly restrictive rates were imposed by the Fed. As we now enter an easing cycle, we believe that threat has largely passed. Financial conditions (as measured by the Chicago Fed National Financial Conditions Index) have continued to trend more accommodative (lower number) throughout the year and now sit at the lowest level in two years. These levels indicate credit is readily available (albeit at a higher rate than five years ago) and there is no systemic stress in the banking system.

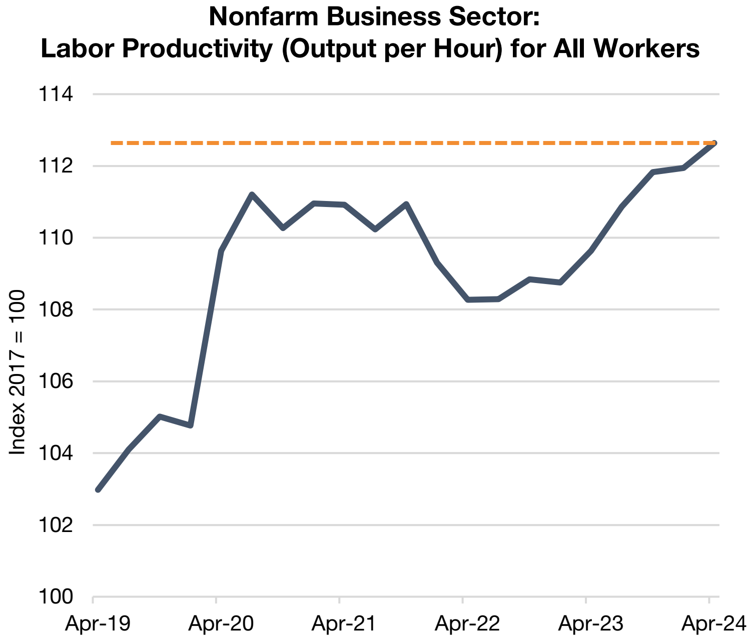


Source: Federal Reserve Bank of Chicago

The Bureau of Economic Analysis (BEA) released several sizable positive revisions to real Gross Domestic Product (GDP), real Gross Domestic Income (GDI), and personal income. These data releases have effectively negated the economic “hard landing” scenario and also highlight rising levels of economic productivity.

An increase in productivity can provide a powerful tailwind to an already strong U.S. economy. It serves to increase overall economic output, dampen rising labor costs, and foster durable economic growth.

Automation, AI, and the trickle-down (to small businesses) effect of existing technologies are driving U.S. output per worker to record high levels. The recent pickup in productivity is a welcome change versus the stagnation experienced during the last ten years.



Source: U.S. Bureau of Labor Statistics

The last time the U.S. experienced solid increases in productivity was the 1990s. During that time, computers hit an inflection point (in both price and power) enabling sizable productivity gains across most industries in the U.S. economy. Secular economic improvements such as productivity can serve as powerful catalysts for both earnings and multiples of small and mid-size stocks.

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Top 10 Holdings (%)
as of September 30, 2024

Holding	Rep. Account
Latham Group Inc	3.34
BrightSphere Investment Group, Inc.	2.83
CorVel Corporation	2.82
ePlus inc.	2.77
Halozyme Therapeutics, Inc.	2.57
AAON, Inc.	2.50
UFP Technologies, Inc.	2.48
Atmus Filtration Technologies, Inc.	2.43
Badger Meter, Inc.	2.22
Insight Enterprises, Inc.	2.16

Sector Diversification (%)
as of September 30, 2024

Sector	Rep. Account
Communication Services	0.00
Consumer Discretionary	16.21
Consumer Staples	0.75
Energy	6.06
Financials	12.57
Health Care	17.46
Industrials	25.87
Information Technology	14.54
Materials	6.06
Real Estate	0.00
Utilities	0.00
Cash	0.47

Performance
Average Annual Returns (%) as of September 30, 2024

THB Small Cap Core Composite	QTD	YTD	1-YR	3-YR	5-YR	10-YR	Since Inception (January 1992)
Gross of Fees	11.37	13.51	26.37	6.09	14.44	11.38	11.27
Net of Fees	11.12	12.75	25.24	5.11	13.37	10.32	10.19
Russell 2000® Index	9.27	11.17	26.76	1.84	9.39	8.78	9.30

Past performance cannot guarantee future results. Returns for periods greater than one year are annualized. Returns are expressed in U.S. dollars and reflect the reinvestment of dividends and other earnings. Composite and benchmark returns are presented net of non-reclaimable withholding taxes, if any. Gross-of-fees returns are presented before management and custodial fees but after all trading expenses. Net-of-fees returns reflect gross performance less investment management fees. Net-of-fees returns are calculated by deducting 1/12 of the highest tier of the standard fee schedule in effect for the period noted (the model fee). The composite model fee for each period is either the highest tier of the current fee schedule or a higher value, whichever is required to ensure the model composite net-of-fee return is lower than or equal to the composite net-of-fee return calculated using actual fees. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size. The firm's fees are available on request and may be found on Part 2A of its Form ADV.

All investments carry a certain degree of risk including the possible loss of principal, and an investment should be made with an understanding of the risks involved with owning a particular security or asset class.

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Information relating to portfolio holdings is based on the representative account in the composite and may vary for other accounts in the strategy due to asset size, client guidelines and other factors. The representative account is believed to most closely reflect the current portfolio management style.

The THB Small Cap Core Composite contains fully discretionary small-cap equity accounts and for comparison purposes is measured against the Russell 2000® Index. Beginning June 1, 2016, there is no minimum account size for the composite. From January 1, 1996, to June 30, 2016, the minimum account size for this composite was $20 million. Prior to January 1, 1996, the minimum account size was $10 million. Due to an error in calculation, the composite dispersion value was revised for 2001 and 2008. The objective of the THB Small Cap Core Strategy is to capture multi-investment themes across five broad sectors in a risk-averse portfolio. The Strategy implements a disciplined long-term approach, with an average portfolio turnover of 50%–60%. The focus of the strategy is on smaller companies in the US market that are under-researched and overlooked.

The Russell 2000® Index is a market-capitalization-weighted index that measures the performance of the 2,000 smallest U.S. stocks by market capitalization in the Russell 3000® Index.

Index returns are provided to represent the investment environment during the periods shown. Index performance does not reflect management fees, transaction costs or expenses that would be incurred with an investment. One cannot invest directly in an index. **Past performance does not guarantee future results.**

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