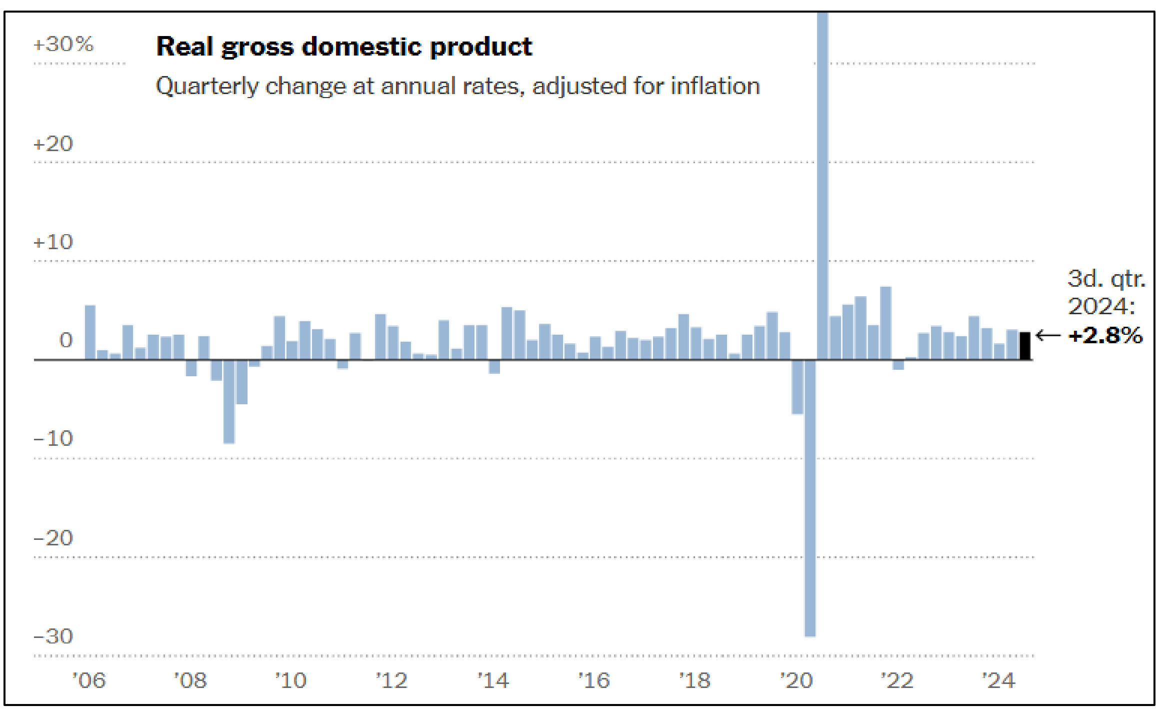
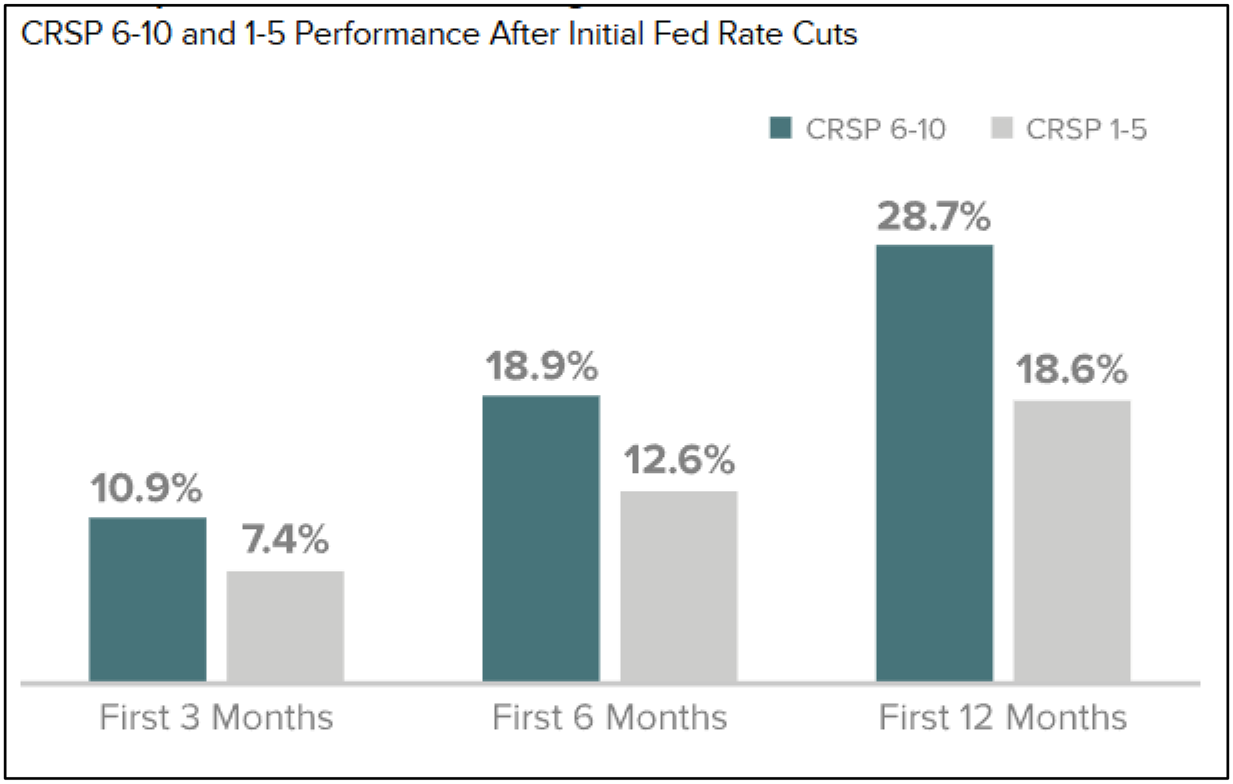
Uniplan Micro Cap Portfolio Flash Report Mid-Quarter 4, 2024
"It was the best of times, it was the worst of times."
-Charles Dickens' *"A Tale of Two Cities."*

Outlook
In our Mid-Quarter 2 Note, we discussed the notion that the relative valuation disparity between small and large cap stocks had reached an extreme level while noting that these valuation disparities can signal upcoming periods of outperformance for small companies. During Q3 there was some reversal as small stocks outperformed large stocks with the S&P 500 gaining 5.9% while the Wilshire Micro Cap Index gained 9.5% and the market leading "Mag 7" returned 1.5% for the same period. The durability of this reversal remains to be seen. As of this writing, 10/25/24, the above referenced benchmarks all remain about even for the month. There was abundant news during the quarter, with the leading business story coming in mid-September when the Fed finally delivered a larger than expected 50 basis point interest rate cut, along with signals that a second reduction might be forthcoming later in the year. Inflation held steady while unemployment remained low due largely to government hiring, and Q2 GDP was revised upward to 3% with Q3 GDP coming in at a robust 2.8% providing the latest indication that the surprisingly resilient recovery from the pandemic recession remained on solid footing.



Source: Commerce Department Bureau of Economic Indicators

Portfolio managers will tell you there is nothing better than a rate cut to propel the markets higher and, in a rate cutting environment, small stocks tend to outperform large stocks. Given the Fed's recent rate reduction, it's worth looking at how small-caps have done following previous rate cuts. The Fed Funds rate data goes back to July 1954, with the first cut coming in 1957. Using data from the University of Chicago Center for Research in Security Prices CRSP, we took CRSP deciles 6-10 as a small company proxy and CRSP deciles 1-5 as a large stock proxy. The chart below shows that small-caps beat large-caps in the 3-, 6-, and 12-month periods following Fed rate reductions—and averaged double-digit returns in each period.

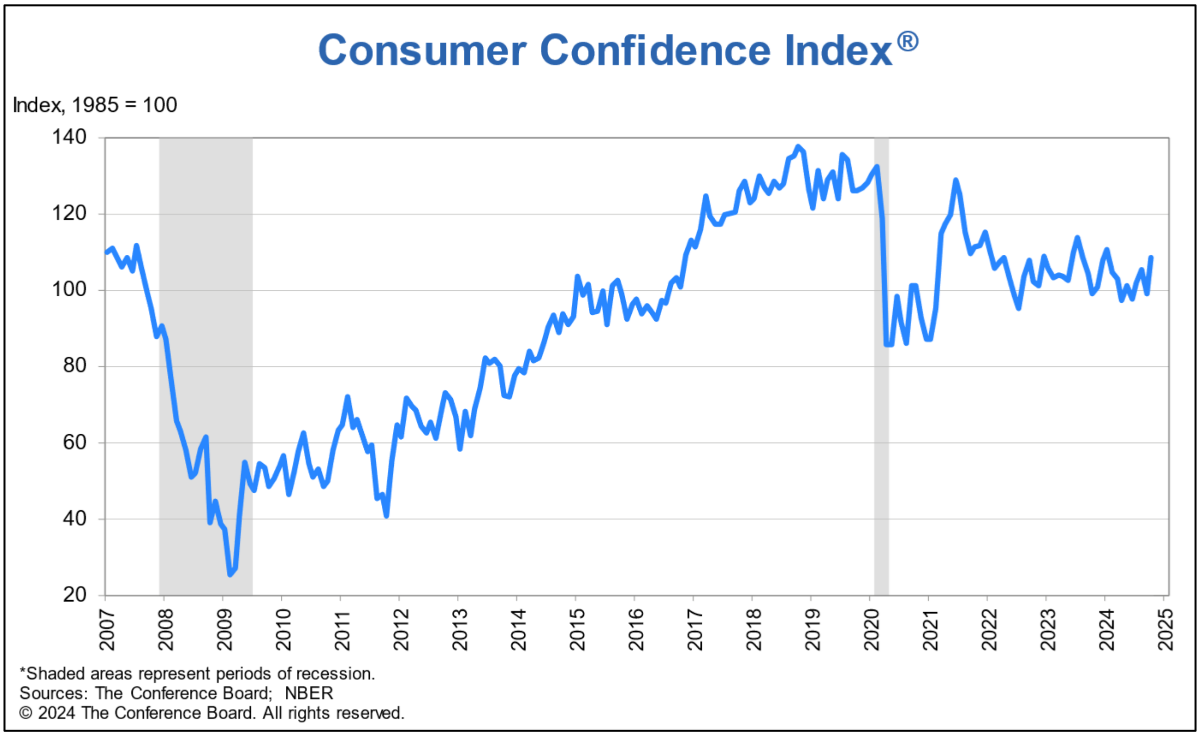


Source: University of Chicago Center for Research in Security Prices

The report was one of three important indicators on the economy scheduled for release this week, just days before the presidential election and more importantly ahead of the next policymaking meeting of the Federal Reserve.

The strength in the third quarter was again driven by healthy consumer spending, which grew at a 3.7% annual rate, adjusted for inflation. Rising wages and low unemployment helped consumers to earn more, while inflation continued to ease. Consumer prices rose at a 1.5% annual rate in the third quarter and were up 2.3% from a year earlier.

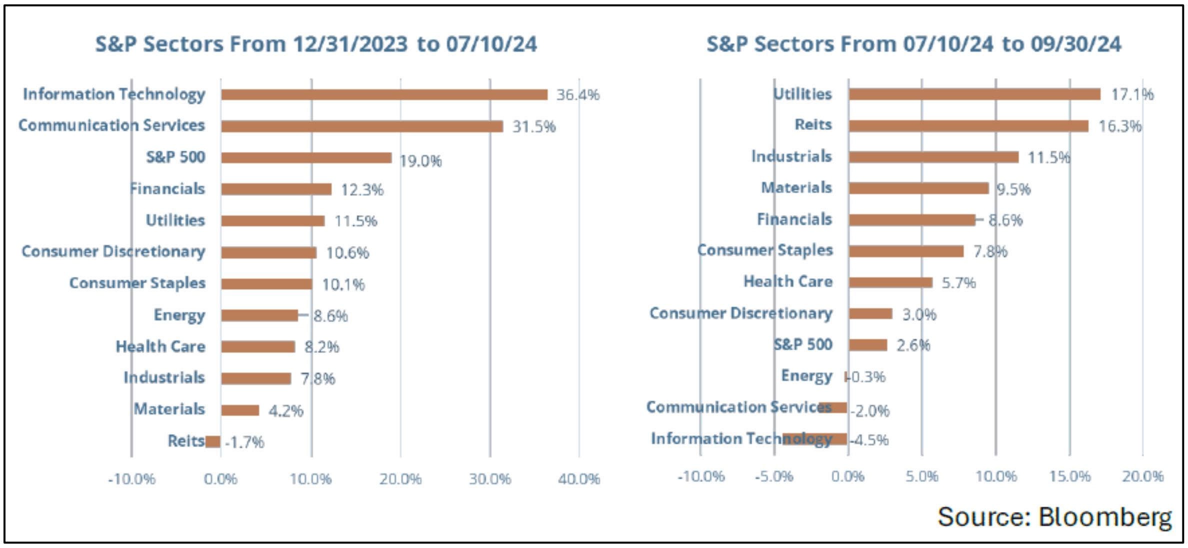
As recently as a few weeks ago, many economists were concerned that spending was going to slow as the job market weakened and household savings dwindled. But revised data released in September indicated that incomes and savings were stronger than initially reported, and recent job market data has remained strong. This supports the notion that spending could continue to grow. Also, data released by the Conference Board this week showed that consumers were beginning to feel more confident in the economy.



Despite the bounce in consumer confidence, other parts of the economy were more mixed. Businesses stepped up their investments in both equipment and intellectual property, which some economists said could reflect demand for chips and software associated with artificial intelligence. Government spending was also strong, with spending on defense contributing more than half a percentage point to overall G.D.P. growth during the quarter.

On the real estate side, businesses pulled back spending on new buildings, and the housing market contracted for the second straight quarter. To some extent this is the indication that that higher interest rates continue to take a toll on real estate capital spending. It's likely that the weakness in housing could continue as mortgage rates, which fell steadily over the summer, have been rising again in recent weeks.
Given the shift in Fed policy and a reemergent consumer, it's no surprise that there was a meaningful reshuffling of leadership across market sectors. Technology stocks underperformed after an extended period of dominance while more defensive and interest rate-sensitive sectors such as REITs and Utilities, which were largely underweight in active manager portfolios, gained favor. This rebalancing has led to a more equitable distribution of market performance and earnings growth across

various industries, potentially supporting a broader and more diverse market environment.



This has led to a positive trailing one-year performance across all market sectors which is increasingly unusual in this environment of winners and losers.


Sectors & Industries

1 Day | 5 Day | 30 Day | **1 Year**

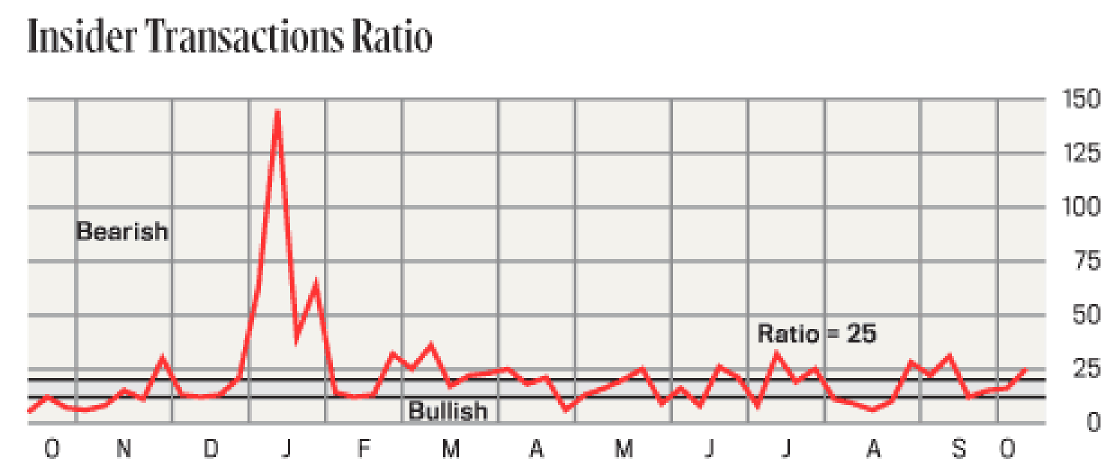
Information Technology	+50.98%
Communication Services	+47.34%
Financials	+45.42%
Industrials	+36.97%
Utilities	+35.17%
Real Estate	+33.18%
Consumer Discretionary	+31.85%
Materials	+23.01%
Consumer Staples	+20.56%
Health Care	+18.68%
Energy	+4.72%

-51% 0% 51%

Sectors are represented by CME Cash Indices

Source: Charles Schwab

Smart Money Activity
As our clients know, we closely monitor insider and smart money activity across our portfolio and the micro-cap universe. Insiders at many of our portfolio companies have continued to personally buy shares in the open market this quarter, while the broader insider buying ratio moved from positive territory last week back into a slightly negative zone. This happened after spending most of the first quarter in the negative range and the second quarter in the positive zone. Buying indicates executives signaling confidence in their companies and the future of the business. This is generally a positive signal about current valuations and future earnings outlook.



Ratio of Insiders Sales to Buys. Readings under 12:1 are Bullish. Those over 20:1 are Bearish. The total top 20 sales and buys are 443,752,592 and 18,049,900 respectively; Source: LSEG Data and Analytics

Source: LSEG Data and Analytics

It's worth noting that insider and smart money buying among small and micro cap companies have continued to be incrementally positive during Q3 and consistent with long term averages. The bearish reading recently was driven by extremely high levels of insider selling among large cap tech companies where executives sold large dollar amounts of stock at much higher rates than average which might suggest that some large company executives feel their stock might reflect fulsome valuations relative to long term averages or that earnings may not meet expectations in the near term.

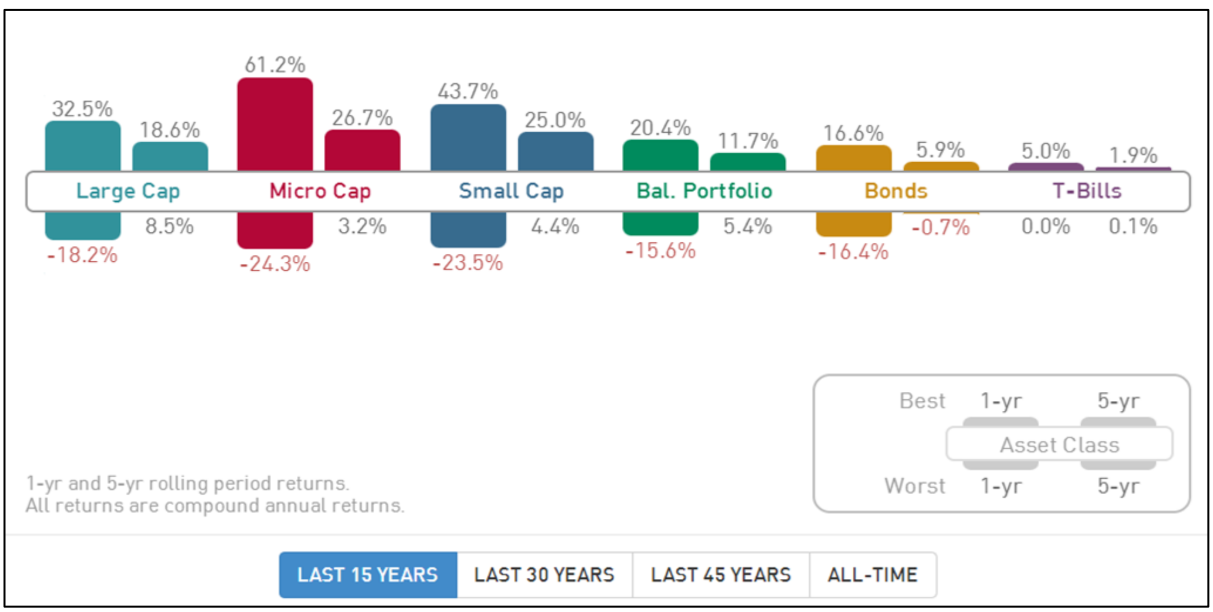
Portfolio Notes
During Q3 we leaned into market volatility and adjusted our positions at a slightly higher than average turnover rate, taking advantage of market strength to scale back seven of our larger holdings and rotate the proceeds into several new opportunities while adding to other fourteen smaller positions in high conviction ideas. As the market continues to grapple with election uncertainty, and global conflicts, we continue to adjust the strategy with an emphasis on cash flow & strong balance

sheets. We sold five underperforming positions from the portfolio for failure to reach desired threshold events or a change in earnings outlook which led to material selling pressure on the stocks.

We note the market's increasingly harsh treatment of companies that fail to execute their business plans, which produces stocks that appear attractive on a valuation basis but often fail to reverse the negative trend in stock performance. More now than we can ever recall, it seems that exiting holdings early that are struggling to execute is the best course of action as stocks that go down, tend to keep going down as market participants are unwilling to extend much patience to underperforming companies in the current market environment. Please contact us directly to schedule a call if you would like a more detailed analysis of portfolio trading activity during the quarter.

Summary & Conclusion

Over the years, we have argued that investing in micro-cap stocks can offer excess returns because of the inefficient information flow regarding the thousands of small companies which populate the space. Do your homework, be mindful of valuation and actively manage risk; we feel that is the path to adding alpha in a micro-cap portfolio. This thesis is supported in part by the fact that very few micro-cap companies have any formal sell side research analyst coverage. As a result, doing primary source research can often lead to gaining insights and finding opportunities long before the broader investing public discovers these facts. This information arbitrage is reflected in the performance of micro cap stocks. Looking at the best and worst five year and one year rolling returns across equities and bonds, micro caps remain far and away the best performing capitalization segment of the equity market as can be seen in the table below.



Source: Wilshire Associates

Historically micro caps have provided private equity level returns with the liquidity and transparency of public company opportunities.

While some investors may try to gain micro cap exposure via the index or ETF in an effort to time and capture market beta, we would argue that this is a less effective way to play small and micro-cap opportunities. In the current market environment, there seem to be bigger differences between winners and losers on an individual security basis. In a market segment where careful fundamental research can still result in an information advantage, our rigorously screened bottom-up work on business, management, and valuation along with our thematic macro framework helps us distinguish real businesses trading at attractive relative valuations.

Given the extreme current valuation disparities between small and large companies, we are excited for the long-term prospects of our portfolio and continue to find interesting opportunities with high quality small companies offering compelling values. As outlined in our last Micro Cap Note, https://uniplanic.com/alternative-thinking/doc/micro-cap-flash-q2-2024 valuations in the small and micro cap space look more attractive than they have in a decade. We believe that for the patient long-term investor, micro-cap stocks offer better return opportunities than any domestic equity class. For these reasons we believe now more than ever, micro-cap stocks have a meaningful place in the multi-asset portfolio of investors.

November 2024
Richard Imperiale
Chief Investment Officer

Mitchell Beine
Senior Investment Analyst

The views in this letter were as of October 2024 and may not necessarily reflect the same views on the date this letter is first published or any time thereafter. These views are intended to help viewers to understand the strategy's methodology and do not constitute investment advice or recommendations.

Investors should understand that micro cap stocks are subject to a higher degree of risk than other equity investments due to the small size of the companies and the limited trading volume inherent in micro cap stocks.

All investments carry a certain degree of risk, including possible loss of principal. Past performance does not guarantee future results. REITs are subject to illiquidity, credit and interest rate risks, as well as risks associated with small and mid-cap investments. It is important to review your investment objectives, risk tolerance and liquidity needs before choosing an investment style. Value style investing presents the risk that the holdings or securities may never reach their full market value because the market fails to recognize what the portfolio management team considers the true business value or because the portfolio management team has misjudged those values. In addition, value style investing may fall out of favor and underperform growth or other style investing during given periods.

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