"I was reading in the paper today that Congress wants to replace the dollar bill with a coin. They've already done it. It's called a nickel."
— **Jay Leno**

Summary for 2020 Q3 – The Fed Signals a Shift in Policy

After a strong rebound of over +26% during Q2, the Micro Cap portfolio continued its move during Q3 advancing +10.8% vs. +3.7% for the benchmark Russell Micro Cap Index. For the year-to-date period ended September 30, 2020, the ***preliminary estimated*** investment results for the Uniplan Micro Cap Portfolio are as follows:

	QTD	YTD
Uniplan Micro Gross	10.82%	-7.98%
Uniplan Micro Net	10.24%	-9.51%
Russell Micro	3.69%	-7.94%
Wilshire Micro	3.59%	-11.61%

The Fed and the Risk-On Value Trade

Since the late 1990's, the Federal Reserve has supported the idea that a long-term target of 2% inflation is the correct amount of inflation. This target is not just a one-year goal, but rather a permanent, long-term target. The Fed's favorite measure of inflation, the PCE deflator, has averaged 1.5% over the past decade. The Fed now says it could let inflation in the future run high so that the long-run average rises to 2%. This suggests that the Fed could be willing to have inflation run at 2.5% for the next ten or fifteen years so that the 20-year average trends upward to 2%. At least this is what they seemed to conclude at the annual Jackson Hole Symposium in August with the adoption of flexible average inflation targeting (AIT).

Going forward, we anticipate that the FOMC will target for inflation somewhat above 2 percent after any periods when inflation has run persistently below 2 percent so as to average 2 percent over that period. This rise in inflation expectations could lead to significant rotations in leadership across equity markets with a notable shift from growth to value companies over time and facilitate a broader appetite for smaller value companies as the market broadens.

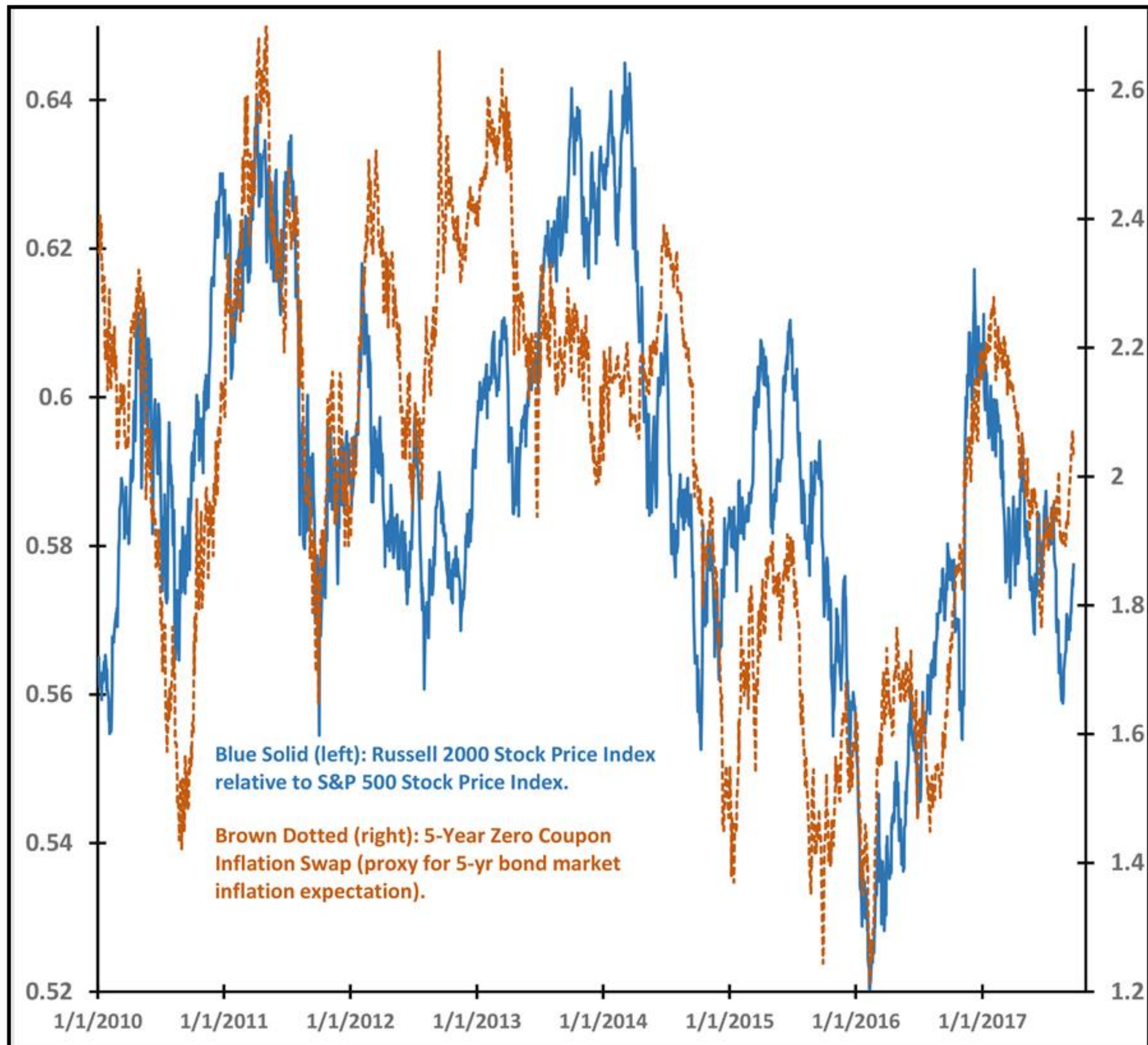
Equities versus bonds

In a world of deflation, equities generally suffer while government bonds, even at very low yields, tend to perform well. However, a very low bond yield can be good for equities as it tends to push the P/E higher for equities as the discount rate falls. The correlation between equities and inflation varies according to the level of inflation. In a low inflation period, like today, we generally see a positive relationship between changes in equities and inflation. This is most notable in the Materials, Energy and REIT sectors where increasing inflation from a low base is usually taken as a sign of improving growth prospects and a diminishing risk of deflation, both supportive of commodity valuations and equities in general.

Today, corporate debt levels and valuations have increased as a result of such low interest rates, so it takes a much smaller rise in bond yields in the current interest rate environment to propel equity valuations lower than would have been the case in periods when rates were higher. For example, when the financial crisis hit, 10-year Treasury yields were around 4%. At the time many argued that these were too low. It seems inconceivable now that we could see a rise in bond yields to those sorts of levels without inflicting significant damage on the economy and the stock markets along the way. A rise in inflation expectations would be a positive development, but policymakers may need to be careful because there is much narrower acceptable bandwidth in terms of higher inflation expectations. Run too high, which is arguably much lower than in the past, and we would likely see a reversion to concerns about secular stagnation.

In the current environment, rising bond yields from extremely low levels should be a positive for equities, as it would reflect a positive growth signal and would likely go along with a decline in the equity risk premium. Rising inflation expectations would also support owning inflation-protected assets such as small cap and higher yielding value equities.

Most do not think of small caps as an inflation play, but historically, they have done best relative to the market when inflation expectations are rising. The graph below depicts the relative price performance of small cap stocks versus a proxy for the bond market's inflation expectation (derived from the 5-year Zero coupon inflation swap). The closeness of this correlation illustrates that Small Stocks respond well in an environment of rising inflation expectations. The 5-year inflation expectation peaked at about 2.65%.in late 2014. If inflation expectations begin to rise again due to the Fed's new AIT policy, small company stocks should again outperform.



(Source: Barron's)

In a macro context, growth has outperformed value because the scarcity of growth has benefited a narrow range of stocks – The FAANGs as they are called. In recent years, these stocks have delivered more growth in margins and earnings than most other companies. Within the US it has strongly benefited large-cap technology stocks, at least partly explaining the increased narrowness of the market leadership. Growth, in general, has outperformed significantly ever since the global financial crisis.

Investors are now prepared to pay more for higher expected future growth than in the past, especially anything that is perceived to be safe top-line growth. The scarcity of growth means that investors are prepared to pay a big premium for stable secure growth in the few areas that offer it - but the lower levels of inflation mean both lower average levels of nominal growth in the economy and lower interest rates, which further boost the net present value of these long-duration growth companies.

The increased valuations for the highest growth areas, particularly in defensive growth such as staples and healthcare, also make sense because these stocks have the highest duration or sensitivity to bond yields. They tend to do best as bond yields fall (alongside inflation), while financials and cyclicals tend to do best when bond yields and inflation rise. This is very consistent in looking at estimates of the equity duration of various market sectors.

In the case of lower volatility stocks, we see another version of a similar relationship. Very low levels of bond yields and an uncertain future path for growth not only raise the value of longer-duration growth companies, but also increase the attraction of companies that have a record of achieving stable and low volatility returns. In effect, their risk premium falls relative to that applied to other more volatile and cyclical companies, thereby generating a widening valuation premium. Clearly, strong economic growth, higher bond yields and inflation expectations would tend to reverse this, at least in part.

The bottom line is that a change in future inflation expectations should be positive for small companies in general and the Financial, Industrial, Materials, Energy, Real Estate, and Consumer Discretionary sectors, which show the most relative value across the market.

As our thinking evolves, we are carefully examining our top investment themes that have traditionally been the framework within which we look for companies that present as a relative value while experiencing an internal or external catalyst for positive change. Secular themes like the digitization of retail or the growth of e-commerce remain intact and have accelerated into the current environment. Others, such as the rise in experiential travel and the growth in leisure mobility have been thoroughly destroyed – for the time being. As such we made tactical changes to the Micro Cap portfolio last quarter to reflect these changing themes and have continued to do so this quarter as the available real time data evolves.

Portfolio Notes

During Q3 we continued to make adjustments in positions and holdings at a much higher rate than in Q2 given the rebound in the market and the chance to reposition based on our evolving thinking.

We sold seven long term holdings from the portfolio. Three were energy related and were hurt by both lower energy prices and the collapse in global energy demand. Three others were sold on failure of management to execute the business plan as articulated and the seeming lack of willingness to adapt in a COVID environment. And one position in the hotel sector, which was the subject of a merger agreement, was sold due to the collapse of the deal and the thematic outlook for hotels going forward.

Three positions within the portfolio were trimmed for risk management purposes as the stocks had moved nicely higher. In one case, Sunrun (RUN-NYSE), the position

was trimmed twice during the quarter due to the strong price appreciation after running up +231% during the quarter and +458% for the year-to-date.

Source: StockCharts.com

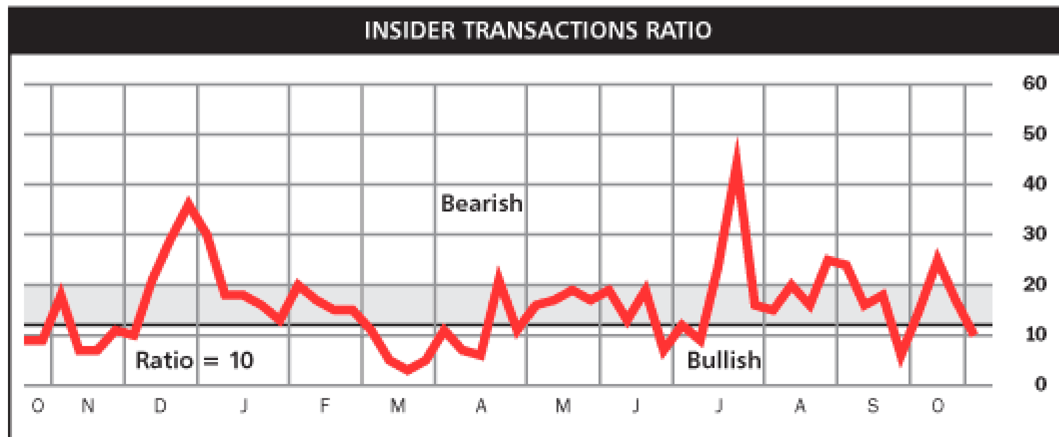
The proceeds from those trims were reinvested across twenty-one existing portfolio positions which had declined sharply earlier in the year and appeared to show exceptional value and solid long term outlooks even when reviewed in the light of the Covid pandemic.

Finally, we added eight new names to the portfolio in small increments with the intention of building out larger positions over time as the thesis for these names evolve and the opportunity unfolds.

In volatile environments like today, we maintain an even more active and engaged dialogue with our portfolio companies. We are always thinking about and looking for ways to help create value by encouraging our management teams to pursue intelligent, value accretive capital allocation moves or making changes to upgrade governance, oversight, and business performance. In these times, our quiet and trusted approach to engagement is more productive and appreciated, as we often act as a sounding board for our company management partners.

As our investors know, we also 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, signaling confidence in their companies and the future of the business and sending the Insider Transactions Ratio into positive territory. This is generally a positive signal for 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 390,190,436 and 41,056,176 respectively; Source: Thomson Reuters

Value vs. Growth

Another indicator of opportunity is the gap between Value and Growth. The gap exploded during Q1 and continued to widen during Q2 and again in Q3. During the quarter, the Russell Micro Cap Value benchmark underperformed the Growth benchmark by 410 basis points. That brings the total disparity to 2,799 bps for the year-to-date as of September 30. In fact, Value benchmarks were the worst performers across the US equity benchmark universe again this quarter as growth no matter what the valuation continues to be the preference of investors across all market segments. Historically, these large disparities in performance revert to the mean and the out of favor style rotates back by outperforming for some period. During 2018 and 2019 both Growth and Value benchmarks performed very closely with neither significantly besting the other. If history is any guide, value should close the performance gap over time.

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 this space. Do your homework, be mindful of valuation and actively manage risk; this is the road to adding alpha in a micro cap portfolio. This thesis, in part, is supported 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 investing public learns about these facts.

While some investors may try to gain exposure via the index or ETF trading 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 a post Covid-19 world, there will 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 low historic multiples of cash flow that will grow versus value trap stocks with poor underlying businesses.

Conclusion

We are more excited for the long-term prospects of our portfolio than we have been in a long time. As global markets continue to be rocked by extreme uncertainty and fear we have seen a rapid rise in stock price volatility and a steep decline in investor sentiment with high quality small companies offering compelling values. We have only seen this level of disruption a handful of times and they have always led to new opportunities for our investors.

For the patient long-term investor, micro cap stocks offer better return opportunities than any domestic equity class. In looking back at the history of micro cap securities they are often punctuated with periods of extreme volatility. It is easy to argue that we are in one of those periods of volatility. As such, we often look to those periods to reposition and evolve the portfolio while we continue to evolve our thinking to adjust for the new environment. For these reasons, we believe now more than ever micro-cap stocks have a meaningful place in the portfolios of individual investors.

While we have discussed here at length the investment opportunity that the market disruption has created, we are deeply saddened by the devastating loss of life and dangerous health impact the Covid-19 pandemic has had for so many globally. The health and safety of our employees, their families, our clients and the community around us remain our top priority.

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Richard Imperiale
Chief Investment Officer

October 2020

The Uniplan Micro Cap Portfolio is a low-turnover high-conviction micro cap strategy designed to offer investors a quality alternative to private equity having a similar unlevered return while providing daily liquidity. The core investment thesis is focused on companies trading at a low multiple of cash flow or EBITDA, with little or no balances sheet debt and having meaningful smart money activity in the form of insider buying, or 13G/13D activity along with identifiable macro or company level catalysts.

Important Information: 1. Uniplan Investment Counsel is a boutique investment firm, with roots dating back to 1984, that manages a variety of portfolios primarily for US clients. Uniplan maintains a complete list and description of composites that is available upon request. 2. The composite was created August 1, 1999. Performance is calculated in US dollars utilizing a time-weighted total rate of return. Total return for the composite is represented by the asset-weighted returns of the portfolios within the composite. Trade-date valuation is used. 3. Performance is net of all transaction costs and net performance is net of transaction costs and (maximum allowable total) investment management fee, but before any custodial fees (that may be incurred separately by the client). 4. The benchmark for the composite is the Wilshire US Micro-Cap Index that represents a float-adjusted, market capitalization-weighted portfolio of all stocks below the 2,500th rank by market capitalization in the Wilshire 5000 at March 31 and December 31 of each year. The index is used to measure small stocks and is adjusted to reflect the reinvestment of dividends, when applicable. 5. The Russell Micro Index may be used as an alternative benchmark. The Russell Microcap Index is an unmanaged total return index of the smallest 1,000 securities in the small cap Russell 2000 Index and the next smallest 1,000 companies based on a ranking of U.S. equities by market capitalization. 6. It is not possible to invest directly in an index. The index figures do not reflect any deduction for fees, expenses or taxes. 7. The dispersion of annual returns is measured by the standard deviation of asset-weighted portfolio returns represented within the composite for the full year. The standard deviation of the annual returns for the period August 1, 1999 to September 30, 2020 is 20.20% for the composite and 26.07% for the Wilshire Micro-Cap Index. 8. The composite does not have a minimum size criterion for composite membership. All fee-paying discretionary accounts with similar investment objectives are included. Leverage is not used in this composite as a means to generate higher returns. There may be non-fee-paying portfolios in the composite. Individual account holdings may vary depending on numerous factors including the size of an account, cash flows, and account restrictions. 9. There have been no changes in the personnel responsible for the management of this composite. 10. The composite contains both traditional and wrap fee portfolios. Uniplan has a flexible and negotiable fee schedule reflecting the differences in size, composition and servicing needs of clients' accounts. A complete description of investment advisory fees is contained in Uniplan's Form ADV and is available upon request. 11. Uniplan Investment Counsel does not claim GIPS Compliance. The performance has been verified by an independent source as of 1/01/2006 – 12/31/2019. Individual account performance may vary from the results shown because of differences in inception date, restrictions and other factors. 12. 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. 13. This information is not an offer to buy or sell a security nor does it constitute investment advice or an offer to provide investment advisory or other services. All information is subject to correction or change. **Past performance is no guarantee of future results. Investment involves a risk of loss.**

All investments carry a certain degree of risk, including possible loss of principal. 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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