Micro Cap market volatility had increased dramatically since our last mid-quarter report as the global economy rebounds from the pandemic and the US domestic economy struggles with the challenges of reopening. The preliminary estimated results for Uniplan Micro Cap Portfolio as of March 31, 2021 are as follows:

	QTD	YTD
Uniplan Micro Gross	19.32%	19.32%
Uniplan Micro Net	18.70%	18.70%
Russell Micro	23.89%	23.89%

The portfolio has lagged the broader micro cap universe benchmarks due to our underweight position in the strongly performing financial sector, which makes up about 18% of the micro cap universe. Our portfolios had a more modest 7% exposure, most of which was added early in the quarter via the addition of a group of special situation financial company opportunities, which had been researched in anticipation of a steepening yield curve and an acceleration of the US economy.

As of May 14, 2021, the broader micro cap benchmarks were down about 3% for the second quarter, while our portfolio had lost about 1% for the same period. Contrast that performance to the broader market, which was up about 5% for the quarter-to-date, and it is reasonable to conclude that the micro cap segment may have gotten too far ahead of its bigger capitalization brethren for the year-to-date. Although micro cap stocks are prone to move up and down in bigger increments than larger capitalization stocks, these types of moves are worthy of mindful examination and appropriate risk management in order to harvest returns and alpha that can easily appear and then disappear in a few ticks of the market. As such, we continue to trade a bit more actively than is typical given the unusual volatility we have seen recently in the markets.

Tax & SPACs

The recent volatility in micro cap stocks (and small caps too) may be attributable to a couple of prominent factors. Proposed changes in the taxation of businesses are certainly one which is garnering a lot of attention in the business and investment community.

The media has been running articles outlining where all the political interests stack up around the new tax law proposal. Net-net, it appears to be a huge gaggle of special interests jockeying for entitlements on Capitol Hill. President Biden has been meeting with both GOP and centrist Democrats this week to buy off any meaningful pushback aspects of the proposed changes to the tax code thus cementing greater government spending. The key issue from an investment standpoint is where and how this spending will be directed in the context of increasing taxes.

It is key to understand that Congressional aides unwaveringly point out that Democrats are unified in general on increasing taxes on both businesses and the wealthiest Americans. With broad populist support for increasing the top marginal tax rate on individuals and on corporations, it seems to be only a matter of what the new scheme will look like and who it will impact. Historically these types of tax hikes have fallen disproportionally on small business and small cap public companies, neither of which have the political clout or legal and technical resources to protect themselves from the legislation. There is also widespread support among Democrats for beefing up Internal Revenue Service enforcement and reversing other parts of the GOP 2017 tax law. It is fair to assume a more progressive set of tax laws will likely be established at the expense of small business, and this seems to have the micro cap market reassessing valuations and earnings in the context of higher taxes.

One area where there is less debate going on is the area of spending. The Biden administration and the Democrat-controlled Congress has proposed a $2.3 trillion jobs and infrastructure package that would be funded by tax hikes on corporations. It then released a $1.8 trillion American Families Plan funded by increasing enforcement at the Internal Revenue Service and higher taxes on high-income Americans and investors.

How this set of spending plans plays out in the next few months will determine the shape and scope of the pending tax structure. President Biden has said he would prefer new spending not to be added to the deficit. As such, coming up with roughly $4 trillion will be no easy task. But a White House official said in a statement that the president was not articulating a new negotiating position on spending and that the “only red line he continues to have is inaction,” suggesting that the administration would be open to a deal that adds to the national debt. Given the special interests in play, a continued rise in deficit spending is a likely outcome of the new policies and programs.

The road map currently looks to be one where Congress votes down narrowly divided party lines enacting partisan versions of the two spending plans sometime over the next couple of months and well before the August recess. Experts and pundits then suggest reconciliation that produces some form of final tax policies that will be enacted in the November-December time frame effective for 2022. Putting $4 trillion of spending into place forces the other hand to pay for it. And if not through deficit spending, then most certainly by way of an array of new taxes.

Another area where there seems to be little sympathy is the doubling of taxes on capital gains for wealthy households. As currently proposed, it affects only 0.3% of taxpayers but carries broad appeal among voters. In one way or another capital gains taxation is probably the bullseye for targeting a redistribution of wealth and a political mantra that coincided with the more progressive tax agenda. This alone could create a great deal of tax related flow across the financial markets as investors move to lock in gains and losses at prior rates.

SPACs

The other important macro factor that will certainly have a profound impact on the micro cap space over the next few years will be Special Purpose Acquisition Companies (SPACs). SPACs also known as “blank check” companies, are public companies created through an initial public offering (IPO) for the purpose of acquiring an existing operating business which is usually operating as a private company. The history of SPACs goes back over 40 years, but until the second half of 2020, when they exploded into the mainstream, SPACs were largely relegated to a sleepy corner of the finance world which focused on bringing promising private businesses into the public market without the extensive and costly process of an underwritten IPO.

As of March 31, 2021, SPACs have raised about $900 billion of equity capital in 326 deals for the sole purpose of making acquisitions of private companies. The management of these SPACs normally have multiple financial incentives to do a transaction and bring a private company into the SPAC to create value for the shareholders of the SPAC. Given the financial incentives, it is likely that most of these SPACs will execute a transaction. And, with an average size of $317 million, many of these newly minted public companies will be new entrants into the micro cap space. Some will do well as public companies and others will stumble, but at the end of the day it provides Uniplan Micro Cap Portfolio investors with hundreds of new opportunities in which to invest in the micro cap universe.

Beyond the hundreds of new potential investments available for review, it is highly likely that SPACs, as they execute their business plans, will trigger a wave of merger and acquisition activity in the micro cap space. Newly public announced SPACs in many instances will be looking for opportunities to grow and create value. Acquiring or merging with other public companies in their industries will be a key avenue of growth for the SPACs. Overall, this should lead to what we believe will be a highly active wave of M&A activity within the micro and small cap market space over the next few years. Knowing and understanding the impact of SPACs in the micro cap space and in particular which industries and companies may benefit from this activity will be the focus of much of our ongoing research as we seek opportunities for our clients.

As we move forward into a post COVID world, we will be watching the implications of any new tax policies as they emerge from the body politic, and we will be following the evolution of the SPACs as they potentially reshape the investment set within the micro cap universe.

Portfolio Review

Given the continued strong and variable moves of many of our micro cap names, we were more active than normal across our portfolios. During the quarter for the purpose of risk management we trimmed numerous positions which had grown to outsized weightings within the portfolio. Among them were Arrowhead Pharmaceuticals (ARWR), Neogenomics (NEO), and Seelos Therapeutics (SEEL), all of which are in the strong preforming bio-pharma sector. We also trimmed Sunrun (RUN), Chromadex (CDXC), and trimmed and then ultimately sold OnTrak (OTRK). We added these proceeds to numerous existing positions including Caesarstone (CSTE), and Vishay Precision (VPG). We also initiated positions in several new names and a small basket of specialty financial companies (CTBI, ESQ, FFIC, NBN, and SFST), all of whom we believe will benefit from increasing business activity, improving portfolio credit, and the steepening yield curve.

Conclusion

During this current quarter, we've seen micro cap value names advance by about +6.6% while we observed micro cap growth names fall about -9.7%. For the past several years, growth has led value by a large margin. This recent sell-off in growth may have been too far too fast or, as we detailed in our prior Flash Report, it may be the beginning of a rotation toward value. The flow seemed to be prompting some market players to use the growth stock source of funds to reduce or manage risk. While it is possible that there may be a reversal over the next month or two, where growth again outperforms value, it seems likely, given the steepening yield curve, that we will get back to a longer-term rotation out of growth and into cyclicals and value. That is the upcoming rotational phase of this new investment cycle. Carefully making that transition from growth to value will be the key to keeping up with the surging market benchmarks. To that end, managing the market risk and volatility will be a key factor to maintaining good relative returns. We will be focused on Tax and SPACs in the near term as the market evolves into a post COVID new economy.

Rick Imperiale
Chief Investment Officer
May 2021

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.

represented within the composite for the full year. The standard deviation of the annual returns for the period August 1, 1999 to March 31, 2021 is 20.98% for the composite and 27.01% for the Wilshire Micro Cap Index. 9. 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. 10. There have been no changes in the personnel responsible for the management of this composite. 11. 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. 12. Uniplan Investment Counsel does not claim GIPS Compliance. The performance has been verified by an independent source as of 1/01/2006 – 12/31/2020. Individual account performance may vary from the results shown because of differences in inception date, restrictions and other factors. 13. 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. 14. 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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