UNIPLAN
A BETTER ALTERNATIVE

"Avoiding danger is no safer in the long run than outright exposure. The fearful are caught as often as the bold."
-- Helen Keller

Micro Cap market volatility moved higher since May, as the risk-on risk-off trade modulates across the small and micro cap space. Since our last mid-quarter report, the global economy has continued its rebound from the pandemic while the rise of the Delta variant has been a cause for growing concern and the US domestic economy has recently shown some signs of decelerating because of rising new infections.

The preliminary estimated results for Uniplan Micro Cap Portfolio as of August 31, 2021, are as follows:

	MTD	QTD	YTD
Uniplan Micro Gross	0.84%	-0.64%	17.43%
Uniplan Micro Net	0.66%	-1.01%	15.74%
Russell Micro	3.59%	-2.14%	26.26%

For the quarter-to-date, the Micro Cap portfolio has outperformed with positive contributions from the Communications and Industrial sectors of the portfolio. Financials and Energy were the lagging sectors for the quarter-to-date. The portfolio has trailed the broader micro cap universe benchmarks for the year-to-date due to our underweight position in pre-revenue biotech and biopharma companies which have performed very strongly in a post covid research environment and benefitted in numerous fund-raising rounds from aggressive liquidity in the equity capital markets.

Although micro cap stocks are prone to move up and down in bigger increments than larger capitalization stocks, the current spate of volatility is worthy of mindful examination and appropriate risk management to harvest returns and alpha that can easily appear and then disappear in a few ticks of the market while also adding incremental investment to current positions that have been curiously punished for no apparent reason. As such, we continue to trade a bit more actively than is typical given the unusual volatility we have seen recently in the markets.

Micro Caps Setting up for a Strong 2022

The case for micro cap exposure looks strong on a go-forward basis. The sizable pool of risk-on liquidity that has fueled Special Purpose Acquisition Companies (SPACs) and many new small and micro IPOs continues to roll through the market. This new liquidity is driven in part by SPACs, also known as “blank check” companies. These 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.

This SPAC phenomenon has triggered a wave of M&A activity in the US that has totaled a record $1.3 trillion during the first half of 2021 and continues strong according to REFINITIV Global. To date, this has been driven by private equity firms that have done over 6,000 deals in the past year and have accounted for nearly 20% of all M&A volume according to REFINITIV. This is likely to be the first wave in a long cycle of M&A driven by liquidity in private equity and the desire for stronger growth among both public and private companies. Among C-suite executives we speak with, balance sheets with ample cash coupled with easy access to reasonably priced debt have combined with increasing confidence in a durable post-COVID economic recovery to drive a broad-based interest in doing deals. Compelling relative valuations have made the small and micro cap space a primary target for attractive acquisitions.

Relative Valuations

It would be simple to cite a long list of small public companies that appear to be interesting businesses trading at compelling valuations. But it is more interesting to look at the aggregate value of small vs. large companies over time. Since the year 2000, the Russell 2000 P/E has traded at about a 6% premium to the larger cap Russell 1000, and the Russell Micro Cap Index has traded at about a 9% premium for the same period. As of August 31, the Russell 2000 and Russell Micro Cap are trading at a 27% and 30% P/E discount respectively to the Russell 1000. These deep discounts relative to their longer-term values suggest that small and micro cap companies offer an attractive relative value to their larger company counterparts while also providing an attractive universe of potential deal targets for M&A activity driven by both private equity players and larger growth-oriented public companies. This is further supported by an improving, albeit choppy economic outlook as the markets look forward into 2022.

Economic Backdrop

When looking at the economic outlook going forward it could be easy to focus on the negatives. Rising COVID cases, growing inflation concerns, and the prospect that pandemic era central bank stimulus may soon begin to wind down have all hung over the markets for the past few months. In addition, many economists lowered their 4Q GDP growth forecast and have suggested that the US economy will likely have seen its highest growth pace in the post-pandemic era during 2Q21.

August ended with news that Consumer Confidence has now dropped sharply as the Conference Board's latest survey index fell to 113.8 from a near-record 125.1 a month ago. Rising cases of the virus and ensuing measures to curb its spread appear to be driving the subdued consumer confidence and the slower growth expectations for the current quarter. But while the data (both hard and soft) are showing some erosion, markets appear to remain focused on the monetary and fiscal stimulus as an antidote for the economy's struggles. So, at least for now, both monetary and fiscal stimulus appears to be in place to offset the virus-driven slowdown, and investors continue to be focused on the here and now.

While the macroeconomic environment appears to have slowed somewhat, it still remains active at a relatively robust level. In looking at the 2Q earnings data, we saw no evidence of a corporate profit slowdown in the results. In fact, 2Q21 earnings results delivered the highest number of EPS and sales beats since at least 1998 according to S&P. As of August 31, 78% of the S&P 500 beat consensus earnings by more than a standard deviation of analyst estimates and 66% beat consensus sales compared with historical averages. This strength was also reflected in the results of small and micro cap companies. Putting the macro headwinds aside, management teams generally seem to be expecting corporate earnings to remain strong through the end of the year. This provides a solid ramp into the transition from 2021 earnings into the 2022 earnings outlook where supply chain disruptions are expected to subside, and materials shortages should begin to ease as global economic activity continues to move toward a more normalized environment. In the aggregate, this sets up a salubrious environment for continued strength in corporate earnings.

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 year we have trimmed numerous positions that had grown to outsized weightings within the portfolio. Among them were Arrowhead Pharmaceuticals (ARWR), NeoGenomics (NEO), and Seelos Therapeutics (SEEL), all of which in hindsight were good trades. We also trimmed positions in Sunrun (RUN), Chromadex (CDXC) and OnTrak (OTRK), before ultimately selling OTRK, all of which appear to have been timely in the capturing of alpha. We added the proceeds from those adjustments to existing positions including Caesarstone (CSTE) and Vishay Precision Group (VPG). We also initiated positions in several new names and a small basket of specialty financial companies (CTBI, FFIC, NBN, and SFST) all of which we believe will benefit from increasing business activity, improving portfolio credit, and the steepening yield curve.

Conclusion

As we move into 4Q and turn our attention to 2022, the environment seems to remain positive for small and micro cap stocks. We expect the robust M&A environment to continue strongly into the end of the year as record levels of deal activity continue to be driven by favorable liquidity (both equity and debt) and the desire to fuel strategic growth at the corporate level. The economic backdrop may be a bit more challenging as compared to the first half of 2021, but the overall level of activity remains solid, and the support of the central banks seems to be the palliative on which the market is focused. Add to these factors the compelling relative value of small and micro cap companies in the aggregate when compared to their larger-cap alternatives, and we believe the supporting trends remain strong for small and micro cap companies to do well as we roll into 2022.

Rick Imperiale
Chief Investment Officer
August 31, 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.

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.

Uniplan Investment Counsel is a registered investment advisor. The views expressed contain certain forward-looking statements which can be speculative in nature. Uniplan Investment Counsel believes these forward-looking statements to be reasonable, although they are forecasts and actual results may be meaningfully different. This material represents an assessment of the market at a particular time and is not a guarantee of future results. This information should not be relied upon by the reader as research or investment advice regarding any particular security and is subject to change without notice. Past performance does not guarantee future results. Prices, quotes, and other statistics have been obtained from sources we believe to be reliable, but Uniplan Investment Counsel cannot guarantee their accuracy or completeness. All expressions of opinion are subject to change without notice. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of this security. A list of securities purchased and sold in the portfolio during the past year, including the purchase or sale price and the current market price, is available upon request by calling 262-534-3000.