Mesirow

Equity Market Review
Small and SMID Cap Strategies

STRATEGY SUMMARY AS OF JUNE 30, 2023

Equity Management AUM	$1.0B
Portfolio managers	Kathy Vorisek Leo Harmon, CFA, CAIA Andrew Hadland, CFA
Investment philosophy	We believe that excess returns can be produced by investing in attractively valued stocks that are poised to appreciate due to catalyst driven earnings and cash flow growth
Vehicle offerings	• Separately Managed Account • Collective Investment Trust • Mutual Fund (Mesirow Small Company Fund)
Investment objectives	• Generate attractive risk-adjusted returns • Consistently outperform the benchmark over a market cycle • Participate in rising markets and protect capital in down markets

Market commentary

Equity market shows it has plenty of life left

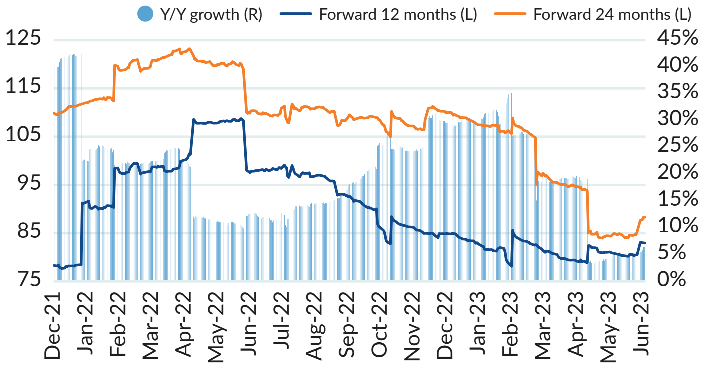
Equity markets embodied the spirit of the great Mark Twain as rumors of their impending demise have, apparently, been greatly exaggerated. Price levels continued to churn higher as the economy proved more resilient than initially feared and earnings results, though negative compared to last year, exceeded dire expectations. Fed policy – and investor interpretations of that policy – continue to play a role relative to the market outlook. But their impact has been lessened as we approach the end of the tightening cycle and we become more focused on the lagged impact these policies will have on future growth. However, levels of inflation remain persistently high and recessionary fears are still adding uncertainty to growth forecasts. As we progress through the next few months, we'll have a better opportunity to evaluate whether the maladies of slower growth and higher inflation will manifest into something more troublesome or if "Dr. Fed" has successfully transitioned our patient to a new level of health and prosperity.

A little change goes a long way

As the quarter commenced equity prices were under pressure due to slower overall economic activity, turmoil from bank failures and downward revisions in earning expectations. Prospects for a recession were pulled forward as economic activity continued to slow on the margin. However, company earnings reports were much better than expected; employment gains continued to show strength, and the most draconian scenarios related to the banking crisis did not materialize (Figure 1).

Earnings revisions moved higher but growth expectations slowed in 2Q

FIGURE 1: **RUSSELL 2000 EARNINGS EXPECTATIONS**



Data as of 6.30.2023. Source: MEM and Bloomberg. Past performance is not indicative of future results.

As a result, equity markets responded with a broad and sharp mid-quarter rally from mid-quarter lows to produce the following performance in our relevant indices:

Index	2Q2023	YTD 2023
Russell 2000 Value Index	3.2%	2.5%
Russell 2000 Index	5.2%	8.1%
Russell 2500 Value Index	4.4%	5.8%
Russell 2500 Index	5.2%	8.8%

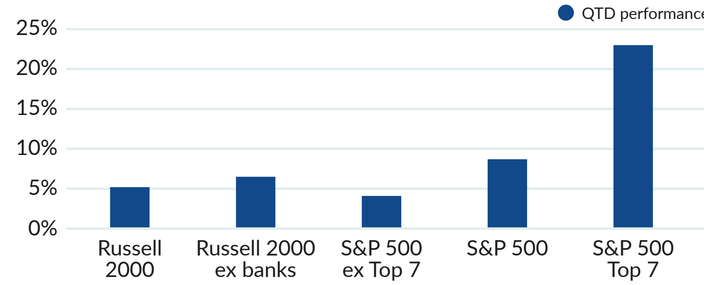
Data as of 6.30.2023. Source: MEM, Bloomberg and FTSE Russell.

Seventh heaven

Large cap companies continued their dominance over small cap companies, though most of the large cap outperformance was concentrated in several large names. In fact, without the seven largest contributors, small cap equities would have outperformed during the quarter (Figure 2) and even more so excluding the volatility within the banking industry. With stronger economic activity, equity returns began to broaden in the latter part of the quarter which should help small caps further close the gap.

Small cap underperformance attributed to seven large companies

FIGURE 2: **PERFORMANCE FOR SELECTED INDICES**



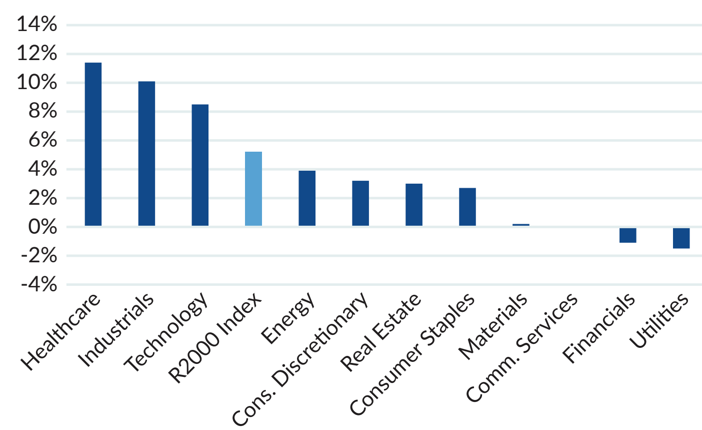
Data as of 6.30.23. Source: MEM and Furey Research Partners. Top seven = Apple, Microsoft, Amazon, Nvidia, Alphabet, Tesla and Meta.

You might have to turn sideways to get through

For the quarter, the market was driven higher by performance from traditional growth and cyclical sectors: Technology, Healthcare, and Industrials were the best performers. Traditionally defensive sectors (Utilities and Consumer Staples) along with Financials lagged the overall market. Sector performance was very narrow as only 3 of 11 sectors outperformed the overall index (Figure 3). Growth indices continued to outperform value, propelled by the outsized performance in Technology and Healthcare.

Narrow market leadership in 2Q

FIGURE 3: **PERFORMANCE BY SECTOR**



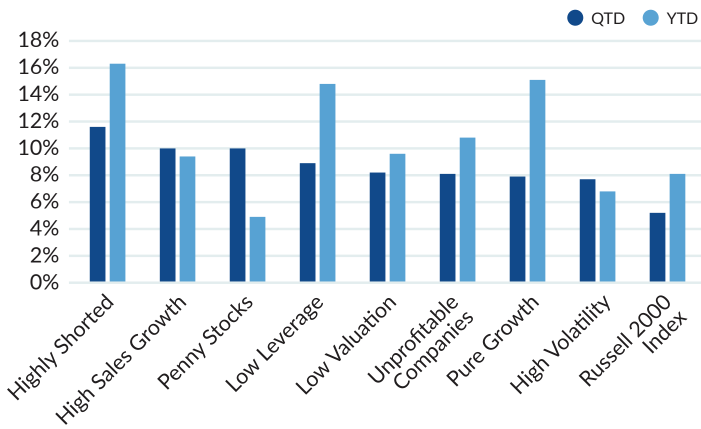
Data as of 6.30.2023. Source: MEM and Furey Research Partners.

Where am I going to put all of this junk?

The downside of the initial rebound in small cap performance is that leadership tends to be driven more by characteristics than fundamentals, which typically creates a headwind for active managers. This quarter was no exception. Mass market returns were influenced by lower-quality factors where unprofitable and higher beta companies outperformed their respective counterparts as small companies gained more traction (Figure 4).

Low quality factors led in 2Q

FIGURE 4: **PERFORMANCE BY FACTORS**



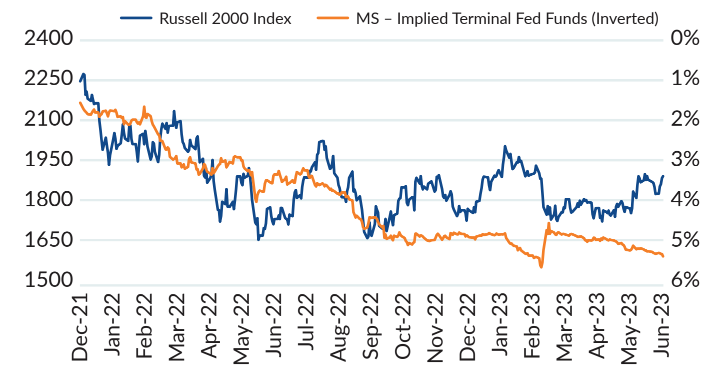
Data as of 6.30.2023. Source: MEM and Furey Research Partners.

One eye in the rearview mirror

Equity markets have made considerable progress despite many indicators (money supply, industrial production, LEI, regional surveys, and the yield curve) that are signaling either a continued slowdown in economic activity or a recession of some uncertain magnitude. Strong employment formation, elevated consumer spending, and favorable corporate earnings remain supportive elements of the market. Though the lagged effects of tighter monetary policy are likely to have some marginal negative impact on growth, they have not yet weighed down economic activity. Equity markets are now less correlated with actual Fed policy as they become more dependent on the impact on economic growth (Figure 5). We are mindful that historically, every Fed tightening cycle has led to some negative economic consequences. But the Fed's policy actions in this cycle have produced relatively benign results and maybe the odds of the Fed engineering a "soft landing" are better than we anticipated. Nevertheless, we would not expect equity markets to take a more definitive path forward until the timing, magnitude, and duration of a potential recession has become more certain.

Equity markets disengage from rate expectations

FIGURE 5: **RUSSELL 2000 VS EXPECTED FED FUND RATES (INVERTED)**



Data as of 6.30.2023. Source: MEM and Bloomberg.

And one for the road

In the meantime, we continue to monitor several factors with respect to tactical portfolio positioning:

- An extension of the Fed tightening cycle if inflation remains persistent
- Timing and duration of a potential recession
- Risk factors related to liquidity and credit that could signal more material downside for equities
- Pricing power and margin stability
- Pace of employment formation
- Earnings revisions and changes in the growth cadence for 2023 and 2024

We believe equity prices will remain in a trading range – though the range will continue to move higher if the prospects for a recession are pushed out further or become more diminished. We continue to expect that inflation trends will decline as we move through 2023. That said, higher baseline inflation and employment growth will likely cause the Fed to leave rates higher for longer than many investors anticipate. We recognize that slight changes in expectations can lead to more meaningful changes in equity prices. In response, we have positioned the portfolio to be more tactically responsive to shifting backdrops as we evaluate both opportunities and challenges within this environment.

Benchmark definitions:

The Russell 2000 Index offers investors access to the small-cap segment of the U.S. equity universe. The Russell 2000 is constructed to provide a comprehensive and unbiased small-cap barometer and is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true small-cap opportunity set. The Russell 2000 includes the smallest 2000 securities in the Russell 3000.

The Russell 2000 Value Index offers investors access to the small-cap value segment of the U.S. equity universe. The Russell 2000 Value is constructed to provide a comprehensive and unbiased barometer of the small-cap value market. Based on ongoing empirical research of investment manager behavior, the methodology used to determine value probability approximates the aggregate small-cap value manager's opportunity set.

The Russell 2500 Index measures the performance of the small to mid-cap segment of the U.S. equity universe, commonly referred to as "smid" cap. The Russell 2500 Index is a subset of the Russell 3000® Index. It includes approximately 2500 of the smallest securities based on a combination of their market cap and current index membership.

The Russell 2500 Value Index measures the performance of the small to mid-cap value segment of the U.S. equity universe. It includes those Russell 2500 companies with lower price-to-book ratios and lower forecasted growth values. The Russell 2500 Index is constructed to provide a comprehensive and unbiased barometer for the small to mid-cap segment. Both indices are completely reconstituted annually to ensure large stocks do not distort the performance and characteristics of the true small to mid-cap opportunity set and that the represented companies continue to reflect value characteristics. (Source: Russell).

The S&P 500 is widely regarded as the best single gauge of large-cap U.S. equities. There is over USD 9.9 trillion indexed or benchmarked to the index, with indexed assets comprising approximately USD 3.4 trillion of this total. The index includes 500 leading companies and covers approximately 80% of available market capitalization. Please see the following GIPS disclosure for additional benchmark definitions.

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