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EMERALD DIVERSIFIED SMALL CAP GROWTH

STOCK SELECTION PREVAILS AGAINST MEGA CAP HEADWINDS

KEY POINTS:

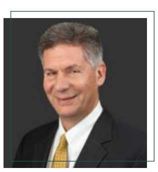
- ***The Emerald Small Cap Diversified Growth portfolio finished with a positive return and outperformed the Russell 2000 Growth Index for the second quarter driven by stock selection.***

- ***At the sector level, relative outperformance within the industrials, technology, basic materials, healthcare and financials sectors more than offset relative underperformance within the consumer discretionary and telecommunications sectors.***

- ***As we enter the second half of 2024 and adjusting for the Russell 2000 index rebalance that went into effect at the close of business on June 28, 2024, the portfolio currently holds the largest active exposures in the technology, financials and consumer staples sectors.***

THE SECOND QUARTER OF 2024 was, again, a story of large capitalization dominance. After some signs of broadening breadth in May, with the Russell 2000 (+5.02%) modestly outpacing the Russell 1000 (+4.71%), escalating concerns about the health of the U.S. consumer and broadly disappointing high frequency indicators of economic activity took the wind out of the sails of the cyclical sectors of the economy and pressured small capitalization returns. The Russell 2000 fell -0.94% in the month of June, finishing the second quarter with a total return of -3.28%, and a year-to-date return of +1.73%.

Although small capitalization stocks have languished, large capitalization stocks have pushed to new all-time highs on the back of the Magnificent 7 and secular strength from investment in artificial intelligence. The S&P 500 and Russell 1000 gained +4.28% and +3.57%, respectively, for the quarter, pushing year-to-date gains to +15.29% and +14.24% respectively. The Russell 2000's sizeable 685 bps second quarter underperformance to the Russell 1000 widened the Russell 1000's year-to-date lead to 1251 bps, unfortunately making the first six months of 2024, the 6th worst first half underperformance gap in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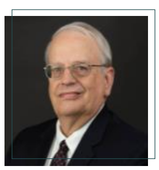
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the history of the Russell 2000, according to Steve DeSanctis of Jefferies.

Although little consolation, it is notable that second quarter equity returns outside of the Mega caps, looked more like the Russell 2000 than the S&P 500, with the S&P 500 Equal-Weight (-2.63%), and the Russell Midcap (-3.35%) both in negative territory. From a style perspective, growth stocks remain in the driver's seat, with growth as a style outperforming across the market capitalization spectrum. Returns were again concentrated up cap, with the Russell 1000 Growth (+8.33%) significantly outpacing the Russell 2000 Growth (-2.92%), and the Russell Midcap Growth (-3.21%), although all the growth cohorts outperformed their respective value counterparts.

Within the Russell 2000 Growth, only the consumer staples (+6.86%), utilities (+2.49%) and telecommunications (+1.07%) sectors posted gains for the quarter, whereas the real estate (-7.35%) and energy (-5.28%) sectors were the most meaningful laggards. Decomposing the Russell 2000 Growth index further, the highest return on equity quintile, the top two largest market capitalization quintiles, and the highest leveraged companies were sources of relative strength, outperforming by 320 bps, 33 bps, 140 bps, and 164 bps respectively according to the same report from Jefferies cited above. Also noteworthy from that report was the performance by sales growth. Although the fastest growers in the top quintile lagged by 309 bps, there appeared to be an underlying trend toward growth as both the second and third quintiles of companies as measured by sales growth, outperformed by 404 and 430 bps respectively.

PORTFOLIO REVIEW

Despite what was admittedly a choppier market backdrop, the Emerald Small Cap Diversified Growth portfolio finished with a positive return and outperformed the Russell 2000 Growth Index for the second quarter driven by stock selection. At the sector level, relative outperformance within the industrials, technology, basic materials, healthcare and financials sectors more than offset relative underperformance within the consumer discretionary and telecommunications sectors.

The industrials sector was the largest positive contributor to portfolio performance this quarter driven by stock selection within the commercial vehicle-equipment leasing, aerospace, defense, and electronic equipment industries.

Performance within the technology sector also contributed positively to performance, driven by stock selection within the software, semiconductor and production technology equipment industries. From a thematic perspective, the portfolio's exposure to those companies positioned to benefit from the acceleration in artificial intelligence related capital spending was a tailwind to performance.

The healthcare sector also contributed positively to performance for the second quarter. After a challenging first quarter, performance within the healthcare sector improved sequentially, driven by stock selection within the biotechnology and health care services industries.

The financial services sector also contributed positively to performance driven by both stock selection and interaction effect within the full line insurance and property casualty insurance industries.

Partially offsetting the sources of relative outperformance was challenging relative performance within the consumer discretionary sector. At the industry level, stock selection weighed on relative performance within the specialty retail and restaurant industries.

As we enter the second half of 2024 and adjusting for the Russell 2000 index rebalance that went into effect at the close of business on June 28, 2024, the portfolio currently holds the largest active exposures in the technology, financials and consumer staples sectors. Thoughts on those sectors are highlighted below.

- The portfolio entered the third quarter with an overweight position in the technology sector. Exposure is broad based with holdings within the semiconductor, software, production technology, electronic components, computer services and consumer digital services industries. Of these, the semiconductor and software industries represent the largest absolute weights. On a relative basis, the portfolio holds the largest overweight positions in the semiconductors and semiconductor capital equipment/production technology equipment industries as these companies possess many of the strongest secular growth themes in the broader market such as AI infrastructure, and the relative maturity of the semiconductor industry leads to strong earnings and cash flow generation. We are also becoming increasingly constructive on the opportunity within the software industry where we continue to emphasize owning security-oriented software companies. Security spending remains a high priority in the corporate suite and continues to garner an ever-increasing portion of overall enterprise IT spending budget.

- The portfolio also held an overweight position within the consumer staples sector. We remain positive on the fundamental outlook for growth-oriented consumer packaged goods companies. We see mounting evidence that the broad-based cost inflation and supply chain issues that plagued the industry in recent years are abating, which should continue to drive higher levels of profitability. We continue to focus on companies generating industry leading revenue and earnings growth rates driven by disruptive brands, category leadership positions, strong secular growth opportunities, and improving profit margins.

- Emerald also held an overweight position within the financial sector driven by holdings within the bank, full line insurance, investment services, and property and casualty insurance industries. The hard market in property coverage did not abate in the first quarter of this year, while casualty lines pricing continued to move higher due to the resurgence of social inflation risk impacting claims from 2016-2019. We expect insurance premiums to move higher in 2024 despite customers' fatigue after several years of increases. We also have a very favorable opinion on Excess & Surplus (E&S) insurance carriers as submission flows are strong in early 2024 with more business being dropped from the admitted markets. Insurance brokers should continue to enjoy elevated organic growth though at a moderating pace and achieve additional EBITDA margin expansion due to rising premiums. We are optimistic about insurers and brokers in 2024 and their ability to generate strong earnings and margin growth even if the market experiences an economic slowdown.

MARKET OUTLOOK

The Domestic high frequency indicators of economic activity have been increasingly mixed over the course of the second quarter and into the early days of July, pushing the Citigroup Economic Surprise index well into negative territory. With economic softness now appearing more pervasive, unemployment rising and inflation resuming its deflationary trend, speculation has been rising that the Federal Reserve "put" is back in play. Weaker economic data has become positive for the market with large capitalization equities continuing to push higher into July, reflecting optimism that the Federal Reserve will move to cut rates. Market odds for a September rate cut have been rising and currently stand at 75%, according to a recent report from JP Morgan.

Although the large capitalization stocks have taken the weaker economic data in stride and continued to push higher, market participants are less sanguine about the implications to small capitalization stocks, which have continued to lag through the early part of July. Notably, although softening in domestic economic data is casting doubt on the trajectory of forward earnings growth for the Russell 2000, small capitalization stocks have historically demonstrated both strong absolute and relative performance in the first three, six, nine and twelve months post the first rate cut. In this regard, in the history of the index, the Russell 2000 index has posted an average return of 26.6% in the 12-months post the first rate cut as compared to the 15.6% average return for large capitalization stocks, according to the same research report from Jefferies cited above. That being said, we aren't convinced that small caps will get credit for this historical pattern in the near-term and acknowledge that economic uncertainty is likely to keep the long-awaited small capitalization catch-up trade simmering on the back burner for a bit longer.

While the small capitalization reversion trade is taking longer to materialize than we had anticipated, Emerald continues to believe it remains a matter of when not if the reversion occurs. Given the historically weak start to calendar 2024, the Russell 2000 has now endured the longest relative losing streak, underperforming the Russell 1000 for 7.5 years and by 580 bps annualized according to July 3, 2024 report by Steven DeSanctis, Equity Strategist at Jefferies. The extended period of relative underperformance has pushed the Russell 2000 to a historically low 5.1% of the Russell 3000, while at the same time the Russell 1000 has become the most concentrated it has ever been, according to the same report. This sizeable gap of underperformance has pushed the relative valuation of the Russell 2000 to the Russell 1000 to the 10th percentile, with the index continuing trading at a double-digit discount relative to the long-term average based on trailing P/E, forward P/E, price to book, price to sales, and P/E to growth according to the June 2, 2024 report from Steve DeSanctis of Jefferies. Earnings remain the last piece to the puzzle, and we continue to be optimistic that earnings growth for the Russell 2000 will regain its relative momentum. Risks to this outlook however remain ever present. The U.S. Presidential Election is coming into view, post the first televised presidential debate, and carries with it its own unique set of risks and opportunities. Geopolitical risks remain elevated, with tensions still high in the Middle East and no end to the war between Russia and Ukraine. Surging fiscal deficits and U.S. Treasury funding, also add an element of risk to the outlook as the Government must continue to fund the burgeoning national debt.

Emerald, as always, remains vigilant and focused on utilizing our fundamental bottom-up research process to identify the most attractive growth opportunities within the small capitalization universe.

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