Q3 2024 | ECONOMIC & PORTFOLIO COMMENTARY

EMERALD GROWTH OPPORTUNITIES

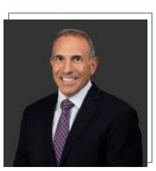
"Risk on, Risk off, a Tough Environment for Active Equities"

Q3 2024 WAS REALLY A TALE OF TWO HALVES - July started out ablaze with a strong risk on, small cap driven rally in anticipation of Fed easing. August and September – oftentimes among the worst investment months of the year – saw a more risk off environment with bond proxies and larger cap stocks taking over as performance leaders. The Emerald Growth Opportunities strategy – like most small/mid/large cap equity growth strategies - underperformed for the quarter as high stock correlations and underperformance from several of our larger cap Technology holdings detracted from performance, as did underweighting several Mega-cap names.

From a quarterly economic perspective, while the civilian unemployment rate ticked up, the economy overall continued to drift towards a soft landing with modestly strong real GDP growth, corporate profits, productivity, consumer confidence and ISM services data. Importantly, inflation measures like the Core PCE continued to moderate towards the Fed's 2.0% target giving investors' confidence that the Fed will pivot from worrying about inflation to focusing on the other side of its dual mandate of promoting maximum employment. While the economy seems headed for a soft landing, we continue to monitor areas of persistent weakness such as ISM Manufacturing data, Leading Economic

KEY POINTS:

- *The Emerald Growth Opportunities strategy – like most small/mid/large cap equity growth strategies - underperformed for the quarter as high stock correlations and underperformance from several of our larger cap Technology holdings detracted from performance, as did underweighting several Mega-cap names.*
- *Portfolios outperformed the benchmark in the financials, healthcare and utilities sectors, but underperformed in materials, consumer discretionary and staples, energy, industrials, real estate and technology.*
- *Beyond small and mid-caps, portfolios are overweight energy, healthcare, financials, consumer staples and utilities. Portfolios are underweight materials, consumer discretionary, industrials, real estate and information technology.*



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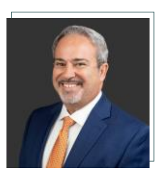

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Indicators and existing homes sales.

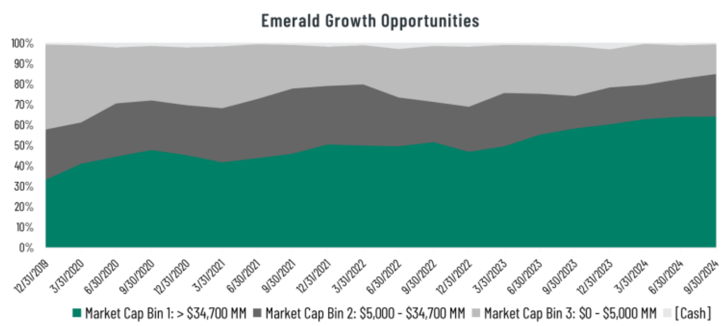
For the quarter as a whole, as noted above, small- and mid-cap equites outperformed large by virtue of their torrid July performance. Interest rate sensitive sectors like utilities, real estate and materials led, while communication services, healthcare, information technology and energy lagged. Beyond size, higher leveraged companies with more domestic sales, and higher yields, notably bond proxies - outperformed. Lower ROE companies and non-earners also performed significantly better in July, driving their quarterly outperformance. Interestingly, according to UBS, from a YTD perspective, price momentum played an important role in manager performance. Funds with the greatest weight in momentum stocks returned +23.0%, compared with +16.7% for lower momentum funds.

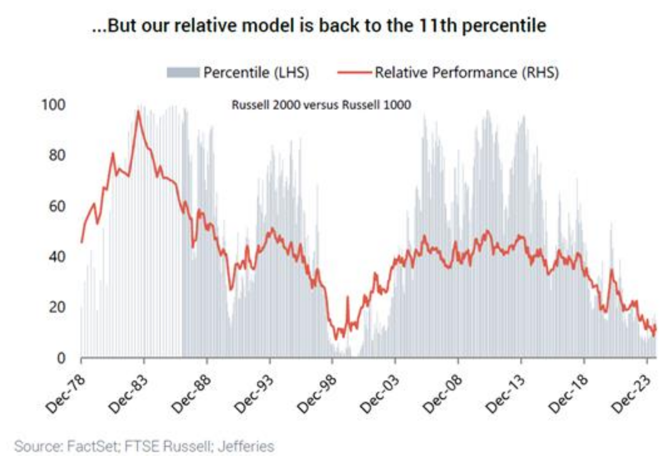
Market concentration continued to increase during the quarter, with our Russell 3000 Growth benchmark exhibiting its highest ever sector and holding concentration levels with technology growing to almost 60% of the index as a sector and the top 5 names approaching 45% of index weighting and the top 10 coming in at approximately 60%. Pairwise correlations – a driver of active equity outperformance – continued to trend up in both small and large caps hurting the performance of most active equity managers during the quarter.

PORTFOLIO REVIEW

As noted, Emerald Growth Opportunities portfolios moderately trailed the performance of our Russell 3000 Growth benchmark during the quarter. Portfolios outperformed the benchmark in the financials, healthcare and utilities sectors, but underperformed in materials, consumer discretionary and staples, energy, industrials, real estate and technology. In the technology sector, two names in particular detracted from performance (see below for explanation), while our underweighting the largest technology name in the benchmark also hurt relative performance. Interestingly, our overweight to small caps materially benefited quarterly relative and absolute performance. According to UBS, 71% of funds are below the benchmark based on size. This year, larger companies have outperformed their smaller peers by 7.7%, creating a headwind for active outperformance.

As we have noted in recent commentaries, portfolios have been overweight small- and mid-cap names given our thoughts on growth and valuation. (See the following market cap weighting chart over time for the Growth Opportunities portfolio, as well as a Jefferies chart showing small caps trading at an almost historic discount to large caps – a level not seen since the late 1990s).





Portfolios maintained their projected earnings growth and valuation advantage vs. the benchmark, as according to

FactSet, the estimated 3-5-year earnings growth rate of Growth Opportunities holdings is +21.93% annually vs. +18.48% for the Russell 3000 Growth benchmark[1]. Beyond growth, FactSet reports that portfolio valuations are significantly below our benchmark on every major valuation characteristic including Price/Earnings, Price/Cashflow, Price/Sales and Price/Book. We echo our previous statement that we like this set-up in the long term.

MARKET OUTLOOK

Not to sound like a broken record, but at Emerald our mantra is that over time, earnings growth drives stock prices. We state that our goal is to find stocks with strong, oftentimes mismodeled, earnings growth, great management teams, competitive advantages, and/or possessing other idiosyncratic growth drivers. We strive to construct portfolios that we believe will have earnings growth substantially above the projected level of the benchmark. We believe that is the case now and has been for quite some time. We construct our multi-cap portfolios using our Dynamic Barbell strategy which helps us to balance sector and individual name allocations considering many of the factors that drive market performance such as earnings growth, size, profitability, momentum, foreign sales, valuation, beta etc. We believe this portfolio construction methodology helps to create portfolios that stay true to our growth style mandate, and at the same time address the realities of our mega-cap-oriented benchmark and many of the factors driving the market's risks and rewards.

The Barbell currently has us positioned smaller than the benchmark with an allocation to small- and mid-cap companies 20 percentage points greater than the benchmark. We have held this small cap overweight for quite some time as we continue to believe that the valuation discount of small vs. large is just too great, upcoming rate cuts will favor small caps, and probably most importantly, small cap earnings growth is set to inflect higher in 2025 after two plus years of badly lagging large caps. Some interesting tidbits: The market cap of the largest name in the index is bigger than the entire Russell 2000 market cap; the recent period of small cap underperformance is the longest in history; and small at only 3.7% of the US equity market is close to previous lows from the 1930s. All these factors, which are multiple standard deviations below their historical norms, imply to us that we are close to a bottom in small caps and possibly the Q3 outperformance of small caps was the start of the performance reversal for small.

A look at '25 earnings growth sees small & mid jumping, more of the same for large

Note: Earnings as of September 27.

Source: FactSet; Standard & Poor's; Jefferies

Beyond small and mid-caps, portfolios are overweight energy, healthcare, financials, consumer staples and utilities. Portfolios are underweight materials, consumer discretionary, industrials, real estate and information technology. Our largest overweight sector is healthcare, as we think the sector is defensive having outperformed in the last four recessions, and particularly for Biotech – will be a beneficiary of interest rate reductions as a function of future years' cashflows being discounted back at lower rates, resulting in higher valuations. We also like the sector for its M&A potential and believe it is ideal for active management due to its high stock dispersion driven by the idiosyncratic nature of clinical data and capital market's driven stock movements. Geopolitical risks have become a near constant over the past several years and the market appears to have become somewhat desensitized to

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them and accepted these risks as a "new normal." Accordingly, we are overweight both energy and aerospace and defense as potentially direct beneficiaries of the heightened risk environment.

While we are a fundamental bottom-up active manager, we do pay close attention to macroeconomic factors. We believe the Fed is in the process of engineering the proverbial "Soft Landing" and is in the beginning stages of an appropriate recalibration of policy based on inflation moving closer to their stated 2% policy goal. We agree with the following Evercore ISI's Krishna Guha's comment:

> "Powell framed the 50 bps as jumpstarting the easing cycle, defined as a process by which the Fed will return rates to a more neutral setting at a pace determined by incoming information and the evolving balance of risks."

We think the Fed did the right thing in starting with the 50-bps cut and think that overall inflation is moving in the right direction with employment growth at least stable for now. We recognize the risks in the economy – particularly in the manufacturing sector - but note that the US economy benefits from its diversification, with healthcare, government and service sector employment still trending nicely upward. We think the Fed will likely still cut 25 bps in both November and December to get closer to the aforementioned neutral rate and in recognition of the real rate being too high considering the direction and level of the PCE inflation measure.

This rate-cutting cycle should benefit cyclical sectors of the market, long duration assets and small- and mid-cap stocks – areas portfolios are generally overweight. We think we will see a pickup in M&A and capital markets activity as we move past the election regardless of the winner, and think that as long as credit is generally available and high yield spreads stay towards the narrow-end of the spectrum, equities – particularly small- and mid-caps can and should outperform. Equities overall should benefit from the steepening of the yield curve and a weaker dollar, which should go hand in hand with the Fed's rate cutting cycle.

As always, we believe our flexible, research-based ability to adapt portfolios to changing market conditions will continue to be a hallmark of Growth Opportunities multi-cap portfolios. We continue to look for unidentified market inefficiencies and mismodeling to identify appropriate portfolio holdings and truly believe with the rise in passive allocations and liquidity driven strategies, markets inefficiencies will only grow to the benefit of active strategies.

Portfolio Characteristics Vs. Benchmark as of 09/30/2024

Characteristic	Emerald Growth Opportunities	Russell 3000 Growth*
Est. 3-5 Year EPS Growth Rate**	21.9%	18.5%
P/E Ratio (using FY1)***	27.2x	30.4x
Price/Book Value***	7.7x	11.9x
Median Market Cap (By No. of Stocks)	$14,781 mm	$2,066 mm
Weighted Average Market Cap	$1,319,669 mm	$1,504,501 mm
Price/Cash Flow***	21.0x	27.6x
Price/Sales***	4.7x	5.6x
Turnover (Trailing 12 mos.)	55%	--

*Source FTSE Russell – see full disclosure. **The estimated 3-5 year earnings growth rate is calculated utilizing a pre-calculated mean long-term EPS growth rate estimate for portfolio holdings, as available, provided by FactSet and sourced from brokerage estimate submissions to estimate services (FactSet, IBES, First Call, etc.). The estimated 3-5 year earnings growth rate for the portfolio is then calculated utilizing the weighted average of the individual portfolio holding estimated 3-5 year earnings growth rates, adjusted for outliers, which we have defined as greater than 100 and less than 0, or negative. The data reported is as of the report date. Estimated 3-5 year EPS growth rates may not correspond to future returns achieved by the portfolio or any particular security in it and are merely presented to show that the manager's bias is towards those positions that are projected to have a superior EPS growth rate to those of the index as a whole. ***In order to better reflect Emerald's characteristics relative to the Russell Indices, Emerald is now calculating its P/E and Price/Book ratios based on a weighted harmonic average in line with Russell's calculation methodology. Portfolio characteristics are subject to change periodically and may not be representative of current characteristics. Diversification does not assure a profit or protect against loss.

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