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Q3 2024 | ECONOMIC & PORTFOLIO COMMENTARY

EMERALD MID CAP GROWTH

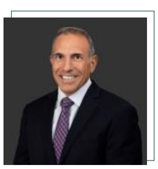
"Risk on, Risk off, a Tough Environment for Active Equities"

Q3 2024 WAS REALLY A TALE OF TWO HALVES - July started out ablaze with a strong risk on, smaller 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 Mid Cap Growth strategy – like most mid-cap growth strategies - underperformed our benchmark for the quarter as high stock correlations and underperformance from several of our technology and energy holdings failed to offset strength in health care.

From a quarterly economic perspective, while the civilian unemployment rate ticked up, the economy overall continued to drift towards a soft, or no-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:

- ***Emerald Mid Cap Growth portfolios moderately trailed the performance of our Russell Mid Cap Growth benchmark during the quarter.***
- ***Portfolios outperformed the benchmark in the health care sector, but underperformed in other Russell sectors as stock selection for the quarter was challenged by high correlations, as well as due to our not owning or underweighting some of the better performing larger benchmark holdings.***
- ***Portfolios are overweight energy, health care, industrials, and consumer staples. Portfolios are underweight materials, consumer discretionary and information technology.***



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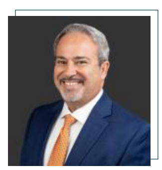

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Indicators and existing homes sales.

During the quarter, as noted above, small- and mid-cap equities outperformed large caps by virtue of their torrid July performance. Within the Russell Mid Cap Growth Index, interest rate sensitive sectors like utilities, real estate and industrials led, while communication services, health care, consumer staples information technology and energy lagged. Beyond size, companies with higher foreign sales, yields and beta outperformed as did companies with lower sales growth and P/Es - notably bond proxies. Interestingly, lower ROE companies and non-earners also performed significantly better in July, driving their quarterly outperformance. According to UBS, from a YTD perspective, price momentum has 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.

PORTFOLIO REVIEW

As noted, Emerald Mid Cap Growth portfolios moderately trailed the performance of our Russell Mid Cap Growth benchmark during the quarter. Portfolios outperformed the benchmark in the health care sector, but underperformed in other Russell sectors as stock selection for the quarter was challenged by the aforementioned high correlations, as well as due to our not owning or underweighting some of the better performing larger benchmark holdings. In particular, our overweight to energy hurt quarterly performance, while our overweight to health care contributed to returns.

Portfolios maintained their projected earnings growth and valuation advantage vs. the benchmark, as according to FactSet, the estimated weighted average 3-5-year earnings growth rate of Emerald's Mid Cap Growth holdings is 24.33% annually vs. 19.49% for the Russell Mid Cap Growth benchmark[1]. Beyond growth, according to FactSet, portfolio valuations are significantly below our benchmark on most major valuation characteristics including Price/Earnings, Price/Cashflow, and Price/Book. We echo our previous statements 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.

Portfolios are overweight energy, health care, industrials, and consumer staples. Portfolios are underweight materials, consumer discretionary and information technology. Our largest overweight sector is health care 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. We are also overweight both

[1] *FTSE Russell is the source and owner of the Russell Index data contained or reflected in this material and all trademarks and copyrights related thereto. This is a presentation of Emerald. The presentation may contain confidential information and unauthorized use, disclosure, copying, dissemination or redistribution is strictly prohibited. FTSE Russell is not responsible for the formatting or configuration of this material or for any inaccuracy in Emerald's presentation thereof.*

energy and aerospace and defense as beyond the strong earnings growth we project for our holdings, we like the tail risk protection we are afforded in these sectors and industries.

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 health care, 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 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 Emerald's Mid-cap Growth 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 Mid Cap Growth	Russell Mid Cap Growth*
Est. 3-5 Year EPS Growth Rate**	24.3%	19.5%
P/E Ratio (using FY1)***	23.7x	26.8x
R^2 vs. Russell Mid Cap Growth (1 Year)	0.94	1.00
Price/Book Value***	5.6x	9.3x
Median Market Cap (By No. of Stocks)	$17,392 mm	$12,623 mm
Weighted Average Market Cap	$27,066 mm	$29,877 mm
Turnover (Trailing 12 mos.)	60%	--

*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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