EASTERN SHORE
CAPITAL MANAGEMENT
A Division of Moody Aldrich Partners

Small Cap Equity

First Quarter 2023

COMMENTARY

Eastern Shore exploits a market phenomenon known as the **Quality Anomaly** which refers to the consistent mispricing of quality companies that leads to their outperformance over time. The strategy focuses on higher quality stocks which tend to have lower volatility and lower risk of capital loss. The strategy also invests in companies experiencing positive change in quality drivers and prefers those with long runways for future growth. Valuation discipline is used to enhance returns.

Threading a Needle

Small Cap Equity Net Performance Statistics Since Inception (3/1/2007 – 3/31/2023)*

	Annualized Alpha (%)	Upside Capture (%)	Downside Capture (%)	Sharpe Ratio	Information Ratio
1 Year	-4.5	87.8	101.6	-0.7	-0.8
5 Year	-1.6	83.0	94.0	0.1	-0.4
10 Year	0.1	90.1	94.0	0.4	-0.1
SI*	2.1	91.7	89.6	0.4	0.3

This information is presented as supplemental to the GIPS Report, which is available **here. Statistics are calculated using net of fee performance. Performance Statistics are calculated using the Russell 2000 index. The risk-free rate used to calculate the Sharpe ratio is the FTSE 3-month T-Bill. Contains performance from predecessor firm. See important notes at the end of this document*

Markets/Economy

The voting members of the Federal Reserve Open Market Committee (FOMC) currently face the unenviable task of bringing long-term inflation down to 2% while maintaining high employment: a combination that may prove impossible to achieve in the near term. Evidence of unintended consequences from the Fed's rapid rate hiking campaign has already emerged in the form of large duration mismatches on the balance sheets of regional banks. This issue caused material unrealized losses in banks' securities portfolios, which led to the runs on deposits at many banks – a development that ultimately caused the failure of Silicon Valley Bank and others.

The Fed's interest rate increases are also causing significant deposit outflows from banks as customers chase higher yields and structure their finances to avoid potential loss of deposits above the prescribed insured FDIC limits. Additional disruptions may unfold in the quarters to come, as the lagged effects of such aggressive rate hikes might not show up for several months. The Fed faces a series of extremely challenging monetary policy decisions that will likely determine the path of inflation and the economy in the coming months.

Performance Summary *(through 3/31/2023)**

	1Q 2023	1 Year	3 Year (Annualized)	5 Year (Annualized)	10 Year (Annualized)	Since Inception† (Annualized)
	(%)	(%)	(%)	(%)	(%)	(%)
Small Cap Equity (Gross)	3.3	-14.2	11.0	3.6	8.3	9.2
Small Cap Equity (Net)	3.1	-15.0	10.1	2.7	7.4	8.2
Russell 2000	2.7	-11.6	17.5	4.7	8.0	6.7
Strategy Excess Return (Gross)	0.6	-2.6	-6.5	-1.1	0.3	2.5
Strategy Excess Return (Net)	0.4	-3.4	-7.4	-2.0	-0.6	1.5

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First Quarter 2023 Results

During the first quarter of 2023, the Eastern Shore Small Cap Equity Composite delivered a return of 3.34%/3.12% gross/net of fees vs. the Russell 2000's 2.74% return.

The underlying drivers of performance shifted dramatically from month to month during the first quarter. The strategy struggled to keep up with the benchmark during January, when higher beta, lower market cap companies were strongly in favor. The strategy went on to outperform in February when conditions reversed and held its lead in the volatile month of March as Quality factors including higher ROEs and ROICs proved a tailwind for the strategy, as these outperformed strongly during the Russell 2000's decline during February and March.

The Established and Improving Quality segments of the portfolio performed roughly in line with each other, with both outperforming the Russell 2000 by roughly equal amounts. From a style perspective, the Russell 2000 Growth index outperformed the Russell 2000 Value by nearly 7% during the quarter. While some of this outperformance was due to the negative influence of regional banks on the Value index during the month of March, the outperformance of growth-oriented sectors such as Information Technology and Consumer Discretionary also played a significant role. The strategy is evenly balanced from a style perspective, so style did not exert a meaningful influence on its relative return.

The strongest sector contributors to the Small Cap Equity strategy's relative performance during the first quarter were Consumer Staples and Financials. Outperformance in Consumer Staples was primarily driven by stock selection among food and beverage companies, while strength in Financials was largely due to the strategy's underweight positioning in regional banks. Sector detractors for the quarter included Information Technology and Energy. Being underweight the outperforming Information Technology weighed on relative performance, as did the underperformance of a few outliers in the sector. The strategy lost relative performance within the Energy sector due to the underperformance of two heavily weighted energy service names, which traded down as investors feared that their customers would pull back from spending due to weak crude oil and natural gas prices.

At the individual company level, the two most significant contributors to the strategy's performance for the quarter were wealth manager Focus Financial Partners (FOCS) and nutritional shake company BellRing Brands (BRBR). In late February, Focus Financial announced that it was being acquired by Clayton, Dubilier & Rice at a price significantly above the level the stock traded at when the year began. BellRing Brands benefitted from the easing of capacity constraints, as well as from the removal of overhang associated with Post Holdings selling its remaining stake in the company. Additional notable contributors for the period included timeshare operator Hilton Grand Vacations (HGV), mechanical and electrical contracting service firm Comfort Systems USA (FIX), and biotechnology company Revance Therapeutics (RVNC).

Four of the five most impactful detractors from the strategy's performance for the quarter were regional banks: Columbia Banking System (COLB), Independent Bank (INDB), Wintrust Financial (WTFC), and Brookline Bancorp (BRKL). These banks appear well-positioned from a deposit and balance sheet perspective but declined along with peers when Silicon Valley Bank and Signature Bank collapsed in March. One other significant detractors for the quarter was oil and gas drilling company Helmerich & Payne (HP).

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Q1 2023 Top 5 Contributors†

Security	Ticker	Avg. Weight (%)
Focus Financial Partners, Inc.	FOCS	1.2
BellRing Brands, Inc.	BRBR	1.5
Hilton Grand Vacations, Inc.	HGV	2.0
Comfort Systems USA, Inc.	FIX	1.5
Revance Therapeutics, Inc.	RVNC	0.1

Q1 2023 Top 5 Detractors†

Security	Ticker	Avg. Weight (%)
Columbia Banking System, Inc.	COLB	1.9
Independent Bank Corp.	INDB	1.7
Helmerich & Payne, Inc.	HP	1.2
Wintrust Financial Corporation	WTFC	1.7
Brookline Bancorp, Inc.	BRKL	1.0

*†The information provided above should not be considered a recommendation to purchase or sell any particular security. There is no assurance that any securities discussed herein will remain in an account's portfolio at the time you receive this presentation or that securities sold have not been repurchased. The securities discussed do not represent an account's entire portfolio and, in the aggregate, may represent only a small percentage of an account's portfolio holdings. It should not be assumed that any of the securities transactions or holdings discussed were or will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein. A complete list of all securities recommended during the preceding year is available upon request. Past performance is not indicative of future results. The information is presented as supplemental to the GIPS Report available **here**. Top Contributors and Detractors are considered Extracted. Attribution total return for portfolio differs from composite results due to attribution methodology not taking intraday trading into account. Return data presented gross of fees. Past performance is not indicative of future returns.*

Positioning & Outlook

Recent developments have caused us to adopt a more cautious outlook on the economy. Most of the economic data released in the first quarter proved marginally worse, and it now appears likely that financial conditions will tighten further due to the challenges facing banks. Lending standards had begun to tighten before the bank failure news broke, and they appear likely to get more stringent given liquidity constraints and reduced capital availability. This will effectively tighten financial conditions further, making it more difficult for the economy to grow. This increases the probability that the US economy will experience a downturn in the coming quarters. If it does, we believe that the recession is likely to be uneven, with some industries faring far better than others.

As we evaluate our positioning and consider new ideas, we aim to determine where each company or industry is within its own unique economic cycle. Given the uncertain economic environment, we believe that it is prudent to incorporate elements of both offense and defense into the portfolio.

The strategy's balance of holdings within the Industrials sector provides a good example of this positioning. As of quarter end, the strategy was approximately 5.3% overweight in this sector with a total weight of 22.3%. About 40% of this allocation is invested in Established Quality service companies that serve mainly government customers. These businesses operate in areas with high barriers to entry and long-term contracts and should therefore hold up well in a weaker economic environment. The other 60% of our Industrial holdings are exposed to themes that offer visible growth and catalysts tied to their specific end markets. These more cyclical holdings offer greater volatility but could also potentially capture more upside.

The housing industry has been in a recession for a year now, and we are finally seeing some tangible signs of a bottom. We added some exposure to residential construction companies due to their attractive valuations and the potential for earnings improvement. Nonresidential construction and infrastructure spending remain strong due to the stimulus and tax incentive programs initiated by the government. We continue to have exposure to this theme as it offers decent visibility across a range of potential economic scenarios.

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We are currently overweight Utilities, as we view these companies as direct beneficiaries of both infrastructure spending and clean energy initiatives at the federal and state levels. Regardless of the economic or political backdrop, our holdings in this area are targeting solid mid-to-high single digit earnings growth over the next several years. We have also become more optimistic about Health Care and have increased the strategy's weight in this sector. Investor sentiment has improved given recent transactions and breakthroughs in biotechnology and pharmaceuticals, and many of our holdings are well-positioned to benefit from the idiosyncratic risk associated with acquisitions and drug approvals. We therefore believe that our Health Care holdings have the potential to strongly outperform regardless of market conditions.

We are underweight Financials as we expect that the interest rate structure will continue to represent a headwind for the group. Regional banks appear particularly vulnerable given their exposure to commercial real estate: the loans on their balance sheets will need to be refinanced at much higher rates, causing considerable stress across the industry.

While the path of the economy remains uncertain and market volatility persists, we continue to find opportunities among both Established and Improving Quality companies. We are encouraged by recent market performance drivers, as fundamentals have been exerting much more influence on stocks than they did during the past two years. We believe this environment will continue to prove beneficial for active, quality-oriented managers. Thank you for your interest and support of Eastern Shore – please reach out to us with any questions.

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Past performance is not necessarily indicative of future results. This document includes returns for the Russell 2000 index. The Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 is a subset of the Russell 3000® Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership. This index is not intended to be a direct benchmark for a particular strategy, nor is intended to be indicative of the type of assets in which a particular strategy may invest. The assets invested in on behalf of a client will likely be materially different from the assets underlying this index and will likely have a significantly different risk profile. Performance statistics, portfolio characteristics, portfolio holdings and other information included in this presentation are targets only and may change without notice to the client. The value of investments can go down as well as up. A client may not get back the amount invested.

Strategy Performance, Strategy Characteristics, Strategy Sector Weights, and Top Holdings, Strategy Statistics are reflecting the aggregate composite for the strategy. As such, individual accounts performance, weights, statistics, and characteristics may vary. †Inception date is 03/01/07. For the period of March 1, 2007 through October 26, 2012, the performance presented occurred while the Portfolio Manager was at a prior firm. Performance for this period has been calculated using custodial transactions for the fund while it was managed as a mutual fund (FBRYX) at FBR Asset Management. Eastern Shore Capital Management has met the requirements for claiming performance record portability and keeps the appropriate books and records as well as a portability memo on file. The Eastern Shore Capital Management Small Cap Equity Composite has undergone a portability examination for the period of March 1, 2007 through October 26, 2012. A client's return will be reduced by the advisory fees as described in Form ADV Part 2A and other expenses incurred by the account. For example, an annual advisory fee of .90% compounded quarterly over 3 years will reduce a gross 28.92% annual return to a net 28.1% annual return. Actual returns may vary from the performance information presented.

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