EASTERN SHORE
CAPITAL MANAGEMENT
A Division of Moody Aldrich Partners

Small Cap Equity

Third Quarter 2024

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.

Cutting Rates, Raising Optimism

Small Cap Equity Net Performance Statistics Since Inception (3/1/2007 – 9/30/2024)*

	Annualized Alpha (%)	Upside Capture (%)	Downside Capture (%)	Sharpe Ratio	Information Ratio
1 Year	3.7	88.3	81.9	1.1	0.2
5 Year	-1.3	81.5	92.1	0.2	-0.4
10 Year	0.0	86.4	91.6	0.3	-0.2
SI*	2.1	91.4	89.4	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. Net of fee performance was calculated by retroactively applying the highest model fee for the composite (.90%). 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. Inception date is 03/01/07. 2007's return represents a partial year beginning at the inception of the fund on 3/01/2007 and is not annualized. Performance from March 1, 2007 through October 26, 2012 occurred while Robert Barringer was the strategy's sole Portfolio Manager at FBR Asset Management.*

Markets/Economy

The third quarter proved eventful in many dimensions. The equity market experienced sharp rallies followed by steep drawdowns, with fluctuations driven by rapidly shifting investor sentiment. Macroeconomic news and fundamental data contributed to short term market movements, as did headlines related to the U.S. election and geopolitical developments. The overall outlook for small cap stocks improved in mid-September when the Fed lowered interest rates by 0.50%. The Fed has signaled that more rate cuts will follow if data indicates that inflation continues to moderate. We view the Fed's shift in focus from controlling inflation to supporting employment as a potentially positive sign for the U.S. economy.

The Fed's decision to initiate rate cuts helped support rate sensitive areas of the market such as utilities, real estate, and regional banks. The strategy began the quarter with significant exposure to each of these areas, which contributed positively to relative performance. Despite the uncertainty related to the election and the wars in both Europe and the Middle East, investor sentiment has inflected positively on interest rate cuts, stronger employment numbers, and recent upward revisions to GDP. The market is about to enter the third quarter earnings season, a key catalyst for equities going into year end. Upcoming inflation data and the outcome of the upcoming U.S. elections are likely to increase market volatility in the weeks to come, conditions that often prove favorable to our quality-oriented approach.

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Performance Summary *(through 9/30/2024)**							
	3Q 2024	YTD	1 Year	3 Year (Annualized)	5 Year (Annualized)	10 Year (Annualized)	Since Inception 3/1/2007 (Annualized)
	(%)	(%)	(%)	(%)	(%)	(%)	(%)
Small Cap Equity (Gross)	10.0	15.0	29.0	1.8	7.9	8.8	9.9
Small Cap Equity (Net)	9.8	14.2	27.9	0.9	7.0	7.9	9.0
Russell 2000	9.3	11.2	26.8	1.8	9.4	8.8	7.5
Strategy Excess Return (Gross)	0.7	3.8	2.2	0.0	-1.5	0.0	2.4
Strategy Excess Return (Net)	0.5	3.0	1.1	-0.9	-2.4	-0.9	1.5

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Third Quarter 2024 Results

During the third quarter of 2024, the Eastern Shore Small Cap Equity Composite delivered a return of 10.01%/9.77% gross and net of fees, outperforming the Russell 2000's 9.28% return for the quarter.

Russell 2000 companies with the lowest returns on equity (ROE) and returns on invested capital (ROIC) modestly outperformed higher quality peers during the quarter, while higher beta stocks strongly outperformed. These conditions represented a reversal from those the market experienced in the second quarter and presented a slight headwind for our quality-oriented approach. Our Improving Quality holdings outperformed our Established Quality holdings for the quarter, and both components are outperforming the Russell 2000 year-to-date. The Russell 2000 Value index outperformed the Russell 2000 Growth by roughly 175 basis points for the quarter, though the Russell 2000 Growth remains approximately 4% ahead of the Russell 2000 Value year-to-date.

Stock selection rather than sector allocation was the strongest influence on the strategy's relative performance for the quarter, as is typically the case. The most significant positive sector contributors to the Small Cap Equity strategy's relative performance during the third quarter were Health Care and Industrials. Outperformance in the Health Care sector was driven by stock selection among pharmaceutical and biotechnology holdings, while aerospace/defense and construction-related holdings outperformed among Industrials. Sector detractors for the quarter included Information Technology and Consumer Staples. Within Information Technology, the strategy's semiconductor-related holdings and those in the technology hardware/equipment industries detracted from relative returns. The strategy lagged within the Consumer Staples sector largely because of the underperformance of its food and beverage holdings. The team maintained its level of exposure to these two sectors during the quarter and made only two meaningful changes to sector allocation in this timeframe – increasing exposure to the Financials sector by 4.20% and decreasing exposure to the Consumer Discretionary sector by 2.53%. No other sector adjustments exceeded 2% during the quarter.

At the individual company level, the two most significant contributors to the strategy's performance for the quarter were respiratory disease therapy developer Verona Pharma (VRNA) and aerospace and defense firm Loar Holdings (LOAR). Verona Pharma's stock price appreciated significantly throughout the quarter, driven by the success of its novel COPD therapy. The stock price of Loar Holdings rose sharply during August in response to the company's strong earnings report.

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Additional notable contributors during the quarter included vaccine developer Vaxcyte (PCVX), Washington-based regional bank Columbia Banking System (COLB), and western apparel retailer Boot Barn (BOOT). We maintained exposure to all five of these holdings as of the end of the quarter, though we pared back exposure to Boot Barn to lock in gains in an uncertain consumer environment.

The two most impactful detractors from the strategy's performance for the quarter were offshore energy support firm Tidewater (TDW) and electrical infrastructure component manufacturer AtKore Inc. (ATKR). Tidewater's share price decline appears to have been driven primarily by the decline of oil prices throughout the quarter, while AtKore's dropped following its announcement that it was cutting guidance based on the challenging environment. Other significant detractors included semiconductor capital equipment manufacturer Axcelis Technologies (ACLS), engineered equipment producer Chart Industries (GTLS), and security product firm NAPCO Security Technologies (NSSC). We maintained exposure to all five of these holdings at quarter end, as we believe that each has the potential to stage a meaningful recovery in the months to come.

We are glad to see that our decision to increase our exposure to earlier-stage Improving Quality holdings coming into 2024 appears to have served the strategy well year-to-date, though we remain mindful of the many risks that this uncertain environment presents. We continue to avoid significant active industry exposures as well as large biases towards growth or value. This balanced approach has served us well for the past several quarters and we have been pleased to see the strategy return to its historical pattern of remaining roughly in line with the Russell 2000 during up markets while outperforming during down markets.

Q3 2024 Top 5 Contributors†

Security	Ticker	Avg. Weight (%)
Verona Pharma	VRNA	1.4
Loar Holdings, Inc.	LOAR	1.2
Vaxcyte, Inc.	PCVX	1.1
Columbia Banking System, Inc.	COLB	1.6
Boot Barn Holdings, Inc.	BOOT	1.4

Q3 2024 Top 5 Detractors†

Security	Ticker	Avg. Weight (%)
Tidewater, Inc.	TDW	1.2
Atkore, Inc.	ATKR	0.7
Axcelis Technologies, Inc.	ACLS	0.7
Chart Industries, Inc.	GTLS	1.0
NAPCO Security Technologies, Inc.	NSSC	0.8

*†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.*

Outlook

Despite the geopolitical and macroeconomic shifts that took place during the summer, our overall view on the economy remains largely unchanged. We expect GDP to grow in the 1.5-3.0% range in 2025, essentially achieving a soft landing with a decreased probability of a recession. Major global events such as a broadening conflict in the Middle East could certainly alter this view.

Several risks could potentially change our outlook. While the rate of inflation has declined over the past several months and is now closer to the Fed's desired 2% target, we see some potential inflation headwinds that have been more challenging recently.

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Crude oil prices are starting to climb again on Middle East tensions and the massive China stimulus package. Food inflation is picking up after several months of stability, and the September jobs report showed wage inflation above consensus estimates. We don't expect that inflation will re-accelerate to past highs, but it might affect the cadence of the Fed's rate cuts in the months to come.

While we are currently anticipating a soft economic landing, The U.S. manufacturing PMI remains in contractionary territory. The services PMI, which represents approximately 70% of the U.S. economy, is in solid expansion. Several industries continue to struggle, including autos, trucking, and most manufacturing. Infrastructure spending remains robust, but other areas of construction have been posting mixed results. Within this environment, we are finding promising opportunities across three key areas: housing, aerospace/defense, and health care.

The housing market presents promising dynamics due to the convergence of several influences. For over a decade, U.S. has built too few homes based on population and household formation, so pent-up demand is robust. Low affordability and historically low existing home inventories are making transactions more challenging and pressuring potential buyers. Higher rates have hindered new construction, yet new homes have been the only source of inventory for the past few years. We believe that activity in the U.S. housing market may increase significantly in the spring selling season if mortgage rates continue to trend lower.

We have maintained an aerospace and defense theme in the portfolio for several quarters and continue to find opportunities among these stocks. Within commercial aerospace, we believe that repair and maintenance visibility and new airframe backlogs bode well for the next few years. On the government side, we expect bipartisan support for defense spending to remain robust in this uncertain geopolitical environment.

Health care has been the most challenged sector in small cap in recent years. The strategy has remained overweight in pharma and biotech, positioning that served as a tailwind to relative performance during the past quarter. As Barron's September "Magical Moment" article on healthcare highlighted, both macro and company specific developments have aligned to create opportunities within these areas. Numerous approvals and successful trials have been announced recently, which have caused dramatic gaps between winning and losing stocks within the sector. In addition, given the winnowing of companies that has happened over the past few years, stable to lower rates should prove beneficial to the performance of surviving higher-quality small pharma and biotech stocks. We view the health care sector as the most inefficient in the market, and we believe that it offers a particularly attractive balance of risk and return in this environment.

We are cautiously optimistic as we embark on the final quarter of 2024. While we acknowledge the many potential challenges that the U.S. economy faces, we feel that the small cap equity market offer extraordinary opportunities at this specific point in time. We are excited by the acceleration in M&A and IPO activity, and we also recognize that long-duration assets should benefit disproportionately from declining interest rates. Additionally, small cap stocks look extremely cheap relative to their large cap counterparts – conditions that appear unlikely to persist much longer. As always, we will adhere to our process and will take advantage of the inefficiencies these unusual conditions present. We thank you for your interest in Eastern Shore, and we welcome your questions and comments.

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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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