EASTERN SHORE
CAPITAL MANAGEMENT
A Division of Moody Aldrich Partners

Small Cap Equity
Fourth 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.

Turning Tides

Small Cap Equity Net Performance Statistics Since Inception (3/1/2007 – 12/31/2024)*

	Annualized Alpha (%)	Upside Capture (%)	Downside Capture (%)	Sharpe Ratio	Information Ratio
1 Year	3.9	91.3	82.0	0.5	0.7
5 Year	-1.5	80.4	91.9	0.1	-0.2
10 Year	0.0	86.5	91.5	0.3	-0.2
SI*	2.1	91.3	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

Small cap investors have experienced a sharp reversal in market conditions during the two months since the election. Euphoria set in during November with the market pricing in deregulation, an extension of the Trump tax cuts from 2017, and an overall pro-growth agenda. The Russell 2000 gained 10.9% for the month as investors piled into procyclical areas such as Industrials and Information Technology.

In December, the market mood shifted as investors contemplated possible unintended consequences of the incoming administration's policies. Tax cuts are stimulative and could increase demand, which is inflationary. Tariffs are inflationary as well, given that they drive up costs and may cause supply chain disruptions. Stricter immigration policies could also increase inflation by driving up wages. In response to these potential inflationary forces, as well as concerns regarding larger budget deficits, bond yields rose sharply in December. Higher rates and inflation are typically not positive for equities. As a result, the Russell 2000 returned -8.3% for the month, largely erasing November's strong gain.

While it is too soon to forecast how the new administration's policy decisions will play out over the next few years, we do have a few early indications. First, M&A announcements have increased in size and frequency over the past few months, signaling confidence on the part of corporate management teams. Deals have been particularly plentiful among financial, healthcare, and industrial firms. This increase appears to reflect the expectation that the staunch anti-trust stance presented by the Biden team might reverse under the new administration. The second area that we are watching closely is the bond market. While high yield spreads remain tight, the long end of the bond curve has risen rapidly. The yield on 10-year bonds has climbed over 1% since mid-September to approximately 4.8% in mid-January. This presents a significant risk, as it could dampen growth prospects going forward.

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We anticipate volatility to both the upside and downside over the coming months as we transition to a new president and congress. We expect that the headline risk associated with the implementation of new policies will cause dramatic swings among small cap stocks and have positioned the strategy to withstand a period of market turbulence. Historically the strategy has generated its strongest relative returns during periods of elevated volatility, and we are cautiously optimistic that the strategy's outperformance in 2024 will continue into 2025.

Performance Summary *(through 12/31/2024)**

	4Q 2024	1 Year	3 Year (Annualized)	5 Year (Annualized)	10 Year (Annualized)	Since Inception 3/1/2007 (Annualized)
	(%)	(%)	(%)	(%)	(%)	(%)
Small Cap Equity (Gross)	0.9	16.0	-0.2	6.0	8.0	9.8
Small Cap Equity (Net)	0.7	14.9	-1.1	5.0	7.1	8.9
Russell 2000	0.3	11.5	1.2	7.4	7.8	7.4
Strategy Excess Return (Gross)	0.6	4.5	-1.4	-1.4	0.2	2.4
Strategy Excess Return (Net)	0.4	3.4	-2.3	-2.4	-0.7	1.5

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Fourth Quarter 2024 Results

During the fourth quarter of 2024, the Eastern Shore Small Cap Equity Composite delivered a return of 0.89%/0.66% gross and net of fees, outperforming the Russell 2000's 0.34% return for the quarter.

As noted earlier, the Russell 2000's flat return for the quarter masks a period of dramatic reversals: a modest decline in October, a post-election rally in November, and a steep decline in December. While disruptive, conditions such as these can create attractive opportunities for active investors. Active investors also typically fare better in periods of greater market breadth, which the market also experienced during the quarter: sector dispersion was relatively wide, with the highest performing sector (Information Technology) outperforming the weakest (Health Care) by approximately 17.6%.

From a style perspective, growth stocks were in the lead in the fourth quarter. The Russell 2000 Growth Index outperformed the Value Index by approximately 275 basis points, and companies with higher multiples generally outperformed less expensive peers. Higher quality companies – those with higher returns on equity (ROE) and returns on invested capital (ROIC) – generally lagged, as did higher market cap companies within the small cap universe. Higher beta companies outperformed significantly – a condition that is generally not favorable to our approach. Fortunately, having exposure to earlier-stage Improving Quality holdings – which outperformed in both October and November – allowed the strategy to outperform net of fees for a fourth consecutive quarter.

As is often the case, stock selection rather than sector allocation was the strongest influence on the strategy's relative performance for the quarter. The most significant positive sector contributors to the Small Cap Equity strategy's relative performance during the fourth quarter were Financials and Health Care. Outperformance in the Financials sector was driven by stock selection among regional banks and capital markets-related holdings, while biopharmaceutical holdings outperformed within Health Care.

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Sector detractors for the quarter included Information Technology and Energy. Within Information Technology, the strategy's software holdings proved the largest detractors from relative returns. The strategy lagged within the Energy sector largely because of the underperformance of one energy services firm serving offshore drilling operations. 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 3.5% and decreasing exposure to the Health Care sector by 3.8%. No other sector adjustments exceeded 2% during the quarter. The decision to add exposure to Financials was prompted by our view that these companies might be positioned to outperform given the incoming administration's plans to cut back on regulations, while our reduction in exposure to Health Care was caused largely by our decision to lock in gains among outperforming holdings in this area.

At the individual company level, the two most significant contributors to the strategy's performance for the quarter were data infrastructure company Credo Technology Group Holding Ltd. (CRDO) and respiratory disease therapy developer Verona Pharma (VRNA). Credo's stock price increased sharply in early December in response to a strong earnings report. Verona Pharma's stock price continued its steady ascent through the quarter, driven by the success of its novel COPD therapy. Additional notable contributors during the quarter included engineered equipment manufacturer Chart Industries (GTLS), civil infrastructure company Construction Partners (ROAD), and Illinois-based regional bank Wintrust Financial (WTFC). We maintained exposure to all five of these holdings as of the end of the quarter, as we believe that their exposure to positive secular themes will continue to drive outperformance going forward.

The two most impactful detractors from the strategy's performance for the quarter were organ care technology firm TransMedics Group (TMDX) and vaccine company Vaxcyte (PCVX). TransMedics experienced a precipitous share price drop in late October following a disappointing earnings report, while Vaxcyte declined following Donald Trump's re-election given concerns that he might select anti-vaccine activist Robert F. Kennedy, Jr. to head up the Department of Health and Human Services. Other significant detractors included homebuilder Meritage Homes (MTH), construction products firm Installed Building Products (IBP), and aerospace/defense specialty materials firm ATI (ATI). We sold Transmedics during the quarter due to the diminished visibility brought about by some meaningful changes to their business but maintained exposure to the other four holdings at quarter end.

Q4 2024 Top 5 Contributors†

Security	Ticker	Avg. Weight (%)
Credo Technology Group Ltd.	CRDO	1.1
Verona Pharma	VRNA	1.2
Chart Industries, Inc.	GTLS	1.1
Construction Partners, Inc.	ROAD	1.4
Wintrust Financial Corp.	WTFC	2.6

Q4 2024 Top 5 Detractors†

Security	Ticker	Avg. Weight (%)
TransMedics Group, Inc.	TMDX	0.4
Vaxcyte, Inc.	PCVX	1.0
Meritage Homes Corp.	MTH	1.1
Installed Buildings Products, Inc.	IBP	0.8
ATI Inc.	ATI	1.2

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Full-year 2024 Results:

During 2024, the Eastern Shore Small Cap Equity Composite delivered a return of 15.98%/14.93% gross and net of fees, outperforming the Russell 2000's 11.54% return for the year.

Our decision to increase our exposure to earlier-stage Improving Quality holdings coming into 2024 served the strategy well throughout the year. While both components of the strategy outperformed the Russell 2000 in 2024, our Improving Quality holdings delivered additional excess return by outperforming the Established Quality segment by over 6%. We continue to avoid significant active industry exposures as well as large biases towards growth or value. This balanced approach has benefited the strategy for the past two years, particularly given the wide divergences in sector and style performance that the small cap market has experienced during this timeframe. The strategy has returned to its historical pattern of remaining roughly in line with the Russell 2000 during up markets while outperforming during down markets, allowing it to deliver positive relative returns net of fees in six out of the past eight quarters.

The strategy's overall quality orientation also proved beneficial during 2024, as stocks with higher ROEs and ROICs outperformed for the year. Higher market cap companies also outperformed, providing an additional tailwind for the strategy. The Russell 2000 Growth index outperformed the Russell 2000 Value by over 7% for the year, led by higher beta stocks in areas such as Information Technology and Industrials.

The most significant sector contributor to the Small Cap Equity strategy's relative performance during 2024 was the Industrials sector. Outperformance in this area was primarily driven by the strategy's aerospace and defense holdings, though holdings tied to infrastructure delivered positive relative performance as well. The Financials sector was another significant positive contributor to the strategy's relative return, as our regional bank and financial services holdings significantly exceeded investor expectations. The two largest sector detractors for the year were Information Technology and Consumer Staples. Much of the strategy's underperformance in the Information Technology sector came from the strategy's software holdings, several of which declined on concerns that their products could be replaced by AI-driven solutions. Within the Consumer Staples sector, underperformance among a few of our healthier food and beverage holdings weighed on relative returns.

The top two largest contributors to the strategy's 2024 performance were information technology solution provider Super Micro Computer (SMCI) and data infrastructure company Credo Technology Group Holding Ltd. (CRDO). Both holdings benefitted from the buildout of data infrastructure needed to support generative artificial intelligence (AI) development going forward. Additional notable contributors during the year included respiratory disease therapy developer Verona Pharma (VRNA), aerospace products and leasing company FTAI Aviation (FTAI), and civil infrastructure company Construction Partners (ROAD). We sold Super Micro Computer during the second quarter ahead of its rebalancing out of the Russell 2000, but we maintain exposure to the other four holdings because we believe that their exposure to significant secular themes provides them with additional upside potential.

The two most impactful detractors from the strategy's performance for the quarter were biopharmaceutical firm Cytokinetics (CYTK) and offshore marine support and transportation service company Tidewater (TDW). Cytokinetics experienced share price deterioration that was driven in part by changes in the competitive landscape for therapies for treating hypertrophic cardiomyopathy (HCM Disease), while Tidewater's underperformance was largely driven by energy price volatility and uncertainty. Other significant detractors for the year included electrical product and infrastructure company Atkore (ATKR), biopharmaceutical firm BridgeBio Pharma (BBIO), and cloud security and compliance solution provider Qualys (QLYS). We sold four of these holdings due to a lack of visibility and the relative attractiveness of other opportunities, but we maintained exposure to BridgeBio Pharma given our optimism regarding future catalysts.

Overall, market conditions in 2024 aligned well with the expectations we held a year ago. Investor behavior proved more rational than it had in the previous three years, and as a result fundamentals exerted a stronger influence over individual stock performance. Higher quality stocks outperformed the broader market, much as they have done in the second leg of past recoveries. We are still awaiting a meaningful improvement in small cap performance relative to large cap, but we believe that the drivers for such a reversal in leadership are now stronger than ever: small cap stocks are cheaply valued relative to large, the probability of increased M&A activity has risen, and earnings growth expectations for 2025 are significantly higher for small cap stocks. While we are mindful of the many risks this environment presents, we are optimistic that the flexibility of our approach will allow us to continue to outperform in the quarters to come.

2024 Top 5 Contributors†

Security	Ticker	Avg. Weight (%)
Super Micro Computer, Inc.	SMCI	0.4
Credo Technology Group Holding	CRDO	1.1
Verona Pharma	VRNA	1.2
FTAI Aviation Ltd.	FTAI	0.9
Construction Partners, Inc.	ROAD	1.3

2024 Top 5 Detractors†

Security	Ticker	Avg. Weight (%)
Cytokinetics, Inc.	CYTK	0.7
Tidewater, Inc.	TDW	0.67
Atkore, Inc.	ATKR	0.78
BridgeBio Pharma, Inc.	BBIO	0.7
Qualys, Inc.	QLYS	0.6

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Outlook

The US economy is heading into 2025 in relatively good shape. The job market remains robust, as evidenced by the strong December jobs report released on January 10th. Recent data points indicate that a recession is unlikely in the near term. We anticipate that the economy will grow at a modest rate of 2-3% this year. Multiple expansion drove much of the gains in the equity market in 2024, a trend that we do not expect to persist into 2025. Instead, we believe that sales and earnings growth will drive stock market returns going forward.

The path of interest rates, inflation, and business and consumer confidence will determine what multiple the market places on the equity market going forward. Equity multiples declined sharply in 2022 when the Fed raised rates aggressively and could do so again if the outlook for inflation and interest rates deteriorates. We view interest rate-driven multiple contraction as a key risk, which we have offset by favoring companies with stable to accelerating earnings growth that are trading at attractive valuations. We have constructed our portfolio with a mix of high-quality stable growers and improving quality companies with meaningful catalysts. We believe that this positioning will also provide insulation against the other risks that we are focusing on, which include geo-political unrest and policy risks from the incoming administration.

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We are generally optimistic about the outlook for small cap stocks from both a relative and an absolute return perspective. Consensus 2025 estimates for both small cap sales and earnings growth are above those of large cap for the first time since 2021. Small cap stocks are trading at a significant discount to large cap, making them even more attractive from a relative perspective. An increase in M&A sparked by deregulation could provide an additional driver of small cap outperformance.

We appreciate your interest in Eastern Shore, and we wish you a healthy and prosperous 2025. As always, we welcome your questions and feedback.

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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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