EASTERN SHORE
CAPITAL MANAGEMENT
A Division of Moody Aldrich Partners

Smid Cap Equity

Fourth Quarter 2021

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.

Catch-22

Smid Cap Equity Performance Statistics Since Inception (12/31/2012 – 12/31/2021)*

Annualized Alpha (%)	Upside Capture (%)	Downside Capture (%)	Sharpe Ratio	Information Ratio
3.5	100.5	88.1	1.0	0.6

**This information is presented as supplemental to the GIPS Report, which is available upon request at information@eshorecap.com or by calling (781) 639-2750. Statistics are calculated using gross of fee performance. Performance Statistics are calculated using the Russell 2500 index. The risk free rate used to calculate the Sharpe ratio is the FTSE 3-month T-Bill.*

Markets/Economy

Joseph Heller's Catch-22 is among our favorite novels, and seems a fitting theme for this quarter's commentary as we head into a year that seems as rife with paradoxes as the previous two. Decisions that would have seemed absurd two years ago – such as whether or not to send children to school in person – now seem commonplace. The markets themselves have offered up a string of paradoxes in recent quarters, tempting investors to compromise their principles in pursuit of ephemeral short-term gains. We have resisted this temptation, and we recognize that irrational market behavior creates conditions that can be highly favorable for active managers. We see indications that fundamentals are starting to drive equity market performance once again, and are entering the year with renewed optimism in spite of the uncertainty of the environment.

2021 presented a stream of opportunities, risks, cross-currents, and uncertainties – with visibility at its conclusion no clearer than at its start. From an opportunity perspective, the resilience of the U.S. equity market has been extraordinary given the startling developments that unfolded during the year, beginning with the storming of the U.S. Capitol and concluding with the surging of the Omicron variant. Capital market flows underpinned this strength: the Financial Times recently reported that global capital markets raised a record $12T during the year, with $5T raised in the U.S. alone. For the first time in history, more money was raised through SPACs than through IPOs – though IPO activity reached record levels as well. As a result, the number of companies in our opportunity set increased by over 20% during the course of the year.

The U.S. economy also appears to be on relatively solid footing, in spite of the challenges presented by supply chain disruptions, labor shortages, and inflation. The strength of the housing market has been particularly notable, driven by the potent combination of favorable demographics, flexible working arrangements, and low interest rates. We see the automotive market as poised for further recovery following the chip shortages that diminished inventories throughout much of the year, and are encouraged by the development of new electric vehicle models and technologies which could prove instrumental in helping to preserve the environment. Regardless of the eventual outcome of the Build Back Better plan, we expect that many areas of the market will benefit from bipartisan support for increased infrastructure spending going forward. Our recent conversations with management teams across a wide range of industries also provide cause for optimism: while headwinds are real, much of their impact can be reduced through inventory management, innovation/automation, and pricing power.

Nonetheless, risks that cannot be so readily controlled abound in today's environment. We remain mindful of the geopolitical instability across many parts of the globe, and are carefully monitoring situations such as the ongoing tension between Russia and Ukraine and the precarious state of the real estate market in China. The interplay between inflation and interest rates also commands our attention: while Jerome Powell's nomination for a second term alleviates some uncertainty, Fed over- or under-reaction to changing dynamics could have dramatic and lasting consequences. The "Great Resignation" of 2021 has also left the U.S. labor force deeply depleted, while the latest wave of COVID-19 threatens further disruption across all areas of the economy.

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U.S. markets were also buffeted by significant cross-currents throughout the year, some of which are likely to have lingering impacts. 2021 was the year of the "meme stock," with companies such as AMC and GameStop experiencing wide swings in performance that reflected little in terms of their underlying business prospects. Rising awareness and acceptance of cryptocurrencies also fueled some seemingly irrational investor behavior, the consequences of which have yet to be fully understood. Factor investing dominated smid cap performance for much of the year, with investor preferences for passive value and growth instruments driving hugely disproportionate moves in individual stock prices.

These developments have created opportunities and value-traps across the smid cap landscape, providing an environment that is close to ideal for active managers like ourselves. As our fourth quarter results suggest, the market's preferences are swinging back towards strong fundamentals: quality characteristics such as high returns on equity are once again in favor, while lower quality indicators such as high beta have fallen out of vogue. We will continue to hold only attractively valued companies that offer the business model sustainability and management skill necessary to succeed and take share in their industries, and feel confident that our approach will continue to deliver competitive results across a range of potential market scenarios.

Performance Summary *(through 12/31/2021)**

	4Q 2021	1 Year	3 Year (Annualized)	5 Year (Annualized)	Since Inception† (Annualized)
	(%)	(%)	(%)	(%)	(%)
Smid Cap Equity (Gross)	5.1	18.7	29.1	18.7	16.6
Smid Cap Equity (Net)	4.9	18.1	28.2	17.8	15.7
Russell 2500	3.8	18.2	21.9	13.8	13.7
Strategy Excess Return (Gross)	1.3	0.5	7.1	4.9	2.8
Strategy Excess Return (Net)	1.1	-0.1	6.3	4.1	2.0

**Performance periods greater than one year are annualized.*

Fourth Quarter 2021 Results:

During the fourth quarter of 2021, the Eastern Shore Smid Cap Equity Composite delivered a return of 5.08%/4.94% gross/net of fees vs. the Russell 2500's 3.82% return.

Continuing the pattern set in the previous quarter, Established Quality strongly outperformed Improving Quality during the final three months of the year. The divergence in performance between the two categories can be partially explained by the pivot in investor preference towards businesses offering higher returns on equity and returns on invested capital during the second half of the year.

From a factor perspective, the outperformance of lower beta stocks during the quarter also provided a tailwind for the strategy. Interestingly, larger market cap stocks in the index – which often correlate with higher quality businesses – outperformed the smallest cap stocks by only a small amount for the quarter. Non-earning stocks lagged the rest of the smid cap market significantly in the final months of the year as investors shied away from longer duration growth stocks in anticipation of higher interest rates.

Style exerted some influence over smid cap stocks, but somewhat less so than in some recent quarters. The combination of the aforementioned interest rate concerns combined with high inflation expectations caused investors to once again favor value over growth: the difference between the Russell 2500 Value and Growth indices totaled 6.16% for the quarter. The spread between the two style indices has remained wide on a day-to-day basis, with leadership shifting back and forth as investors and algorithms reacted to the latest information available.

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The strongest sector contributors to the Smid Cap Equity strategy's relative performance during the fourth quarter were Information Technology and Financials. Stock selection among pharmaceutical and biotechnology holdings contributed positively to performance within the Health Care sector, as did being underweight in this deeply underperforming sector for the quarter. Outperformance in Financials was driven by stock selection among both bank and non-bank holdings. Sector detractors for the quarter included Real Estate and Industrials. Performance in the Real Estate sector was negatively impacted by the meaningful underperformance of one outlier. Stock selection among machinery holdings weighed on relative returns in the Industrials sector.

At the individual company level, the two most significant contributors to the strategy's performance for the quarter were and integrated circuit manufacturer Silicon Laboratories (SLAB) and pool supply distributor Pool Corporation (POOL). Silicon Laboratories announced strong results during the quarter, providing earnings and guidance that were well above analyst expectations and introducing an accelerated share repurchase (ASR) of $400M. Pool Corporation delivered a solid earnings beat during the quarter and raised guidance significantly given the strength of outdoor living trend. Additional notable contributors for the period included commercial real estate firm Walker & Dunlop (WD), decking manufacturer Trex (TREX), and technology infrastructure firm Switch (SWCH).

The two most impactful detractors from the strategy's performance for the quarter were online learning platform firm Chegg (CHGG) and engineered equipment producer Chart Industries (GTLS). Chegg reported an unexpected decline in college attendance in the fall, prompting a steep decline in the company's stock price. Chart Industries performed strongly earlier in the year, but gave back some of these gains during the fourth quarter due to investor concerns regarding the outlook for the overall economy. Other significant detractors for the quarter included power generation equipment firm Generac (GNRC), bioprocessing company Repligen (RGEN), and payment solutions provider Wex (WEX).

Q4 2021 Top 5 Contributors†

Security	Ticker	Avg. Weight (%)	Contribution (%)
Silicon Laboratories Inc.	SLAB	1.85	0.66
Pool Corporation	POOL	1.77	0.43
Walker & Dunlop, Inc.	WD	1.58	0.43
Trex Company, Inc.	TREX	1.48	0.36
Switch, Inc. Class A	SWCH	2.56	0.36

Q4 2021 Top 5 Detractors†

Security	Ticker	Avg. Weight (%)	Contribution (%)
Chegg, Inc.	CHGG	0.21	-0.28
Chart Industries, Inc.	GTLS	1.31	-0.25
Generac Holdings Inc.	GNRC	1.53	-0.19
Repligen Corporation	RGEN	1.85	-0.19
WEX Inc.	WEX	0.85	-0.17

†The information provided in this report should not be considered a recommendation to purchase or sell any particular security. Please see additional disclosures at the end of this letter.

Full Year 2021 Results:

For 2021, the Eastern Shore Smid Cap Equity Composite delivered a return of 18.68%/18.05% gross/net of fees vs. the Russell 2500's 18.18% return.

Established Quality's over 30% return for the year was more than double the Russell 2500's annual return, and strongly outperformed Improving Quality as well. This was driven in part by the outperformance of higher quality businesses: within the Russell 2500, the highest quintile in terms of both return on equity and return on invested capital beat the lowest quintile by over 35% for the year. Larger cap stocks within the smid cap universe underperformed, while beta appears to have exerted little influence on smid cap performance for the year.

From a style perspective, value emerged as the clear winner for the year in the smid cap universe. The Russell 2500 Value index generated a return of nearly 28% in 2021, dwarfing the Russell 2500 Growth's return of 5%. Energy and Real Estate emerged as the strongest performing sectors in the Russell 2500 for the year, while Health Care and Communication Services were the most significant laggards. Sector dispersion was very wide for the year, with the highest returning sector in the Russell 2500 (Energy, up 80%%) outperforming the lowest (Health Care, down 6%) by nearly 80%.

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The strongest sector contributors to the Smid Cap Equity strategy's relative performance during 2021 were Financials and Health Care. Stock selection was the strongest driver of outperformance in the Financials sector, though being overweight this outperforming sector proved beneficial as well. Stock selection among pharmaceutical and biotechnology holdings contributed significantly to the strategy's outperformance in Health Care. Sector detractors included Consumer Discretionary and Energy. Much of the strategy's underperformance in the Consumer Discretionary sector came from consumer services and durables, while lack of exposure to lower quality Energy companies hurt relative returns in this sector.

The top two largest contributors to the strategy's 2021 performance were Silicon Valley bank SVB Financial Group (SIVB) and Arizona-based regional bank Western Alliance Bancorp (WAL). Both of these banks delivered strong results throughout the year, benefitting from the recovery of the economy and the anticipation of higher interest rates. Additional notable contributors during the year included real estate and investment management firm Jones Lang LaSalle (JLL), water management device company Zurn Water Solutions (ZWS), and biotechnology reagent and instrument producer Bio-Techne (TECH).

The two most impactful detractors from the strategy's performance for the year were business spend management firm Coupa Software (COUP) and solar ground-mounting system producer Array Technologies (ARRY). Coupa had performed very strongly during 2020 as businesses looked to automate systems and migrate them to the cloud, but gave back most of these gains in 2021 when investor sentiment turned against companies that had fared well during the earlier stages of the pandemic. Array's stock price dropped significantly in May when it suspended guidance due to rising costs; we chose to sell this holding soon after given the lack of near-term visibility for this Improving Quality holding. Other significant detractors for the year included online real estate firm Zillow (Z), communications technology firm Bandwidth (BAND), and bioplastics company Danimer Scientific (DNMR).

While we have been encouraged to see higher quality businesses performing more strongly recently, we recognize that the current environment has created meaningful valuation disconnects across our investable universe. Specifically, many well-run, profitable companies with leadership positions in sectors such as Information Technology, Communication Services, and Health Care have sold off for reasons completely out of alignment with their prospects going forward. We also have been finding compelling valuations across several more cyclical areas, and are carefully evaluating the risk and return trade-offs implicit that each prospective holding presents. We are excited about the richness of this opportunity set, and feel that our approach is ideally suited to add value as investors continue to shift their focus from factors back to fundamentals.

2021 Top 5 Contributors†

Security	Ticker	Avg. Weight (%)	Contribution (%)
Repligen Corporation	RGEN	1.81	0.64
Jones Lang LaSalle, Inc.	JLL	2.01	0.46
Rexnord Corporation	RXN	1.87	0.45
Chart Industries, Inc.	GTLS	1.63	0.42
SVB Financial Group	SIVB	2.36	0.34

2021 Top 5 Detractors†

Security	Ticker	Avg. Weight (%)	Contribution (%)
Bandwidth Inc. Class A	BAND	1.16	-0.46
PubMatic, Inc. Class A	PUBM	1.01	-0.42
Zillow Group, Inc. Class C	Z	0.84	-0.27
Amedisys, Inc.	AMED	0.59	-0.26
Altra Industrial Motion Corp.	AIMC	1.37	-0.22

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Outlook:

Based on recent data and trends, we are anticipating decent but decelerating economic growth in 2022. Our conversations with dozens of companies in many sectors during recent months suggest that business is good and the outlook generally looks positive for the rest of 2022 as well. Economic data has improved since the third quarter of 2021, a timeframe dominated by escalating Delta variant COVID cases. Businesses across most industries hold historically low inventories, which combined with the robust demand they are experiencing should translate into decent GDP growth for at least the next four to six quarters.

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Due to the surge in the Omicron variant, we expect that first quarter growth in the U.S. will be weaker than it was in the fourth quarter of 2021. Assuming no other variants take hold, we anticipate that economic performance will improve in the second and third quarters, with a gradual normalization to a 2-3% rate by the year's end. For 2022 overall, we would estimate a 3-5% GDP growth rate. If the Omicron variant surge continues well into the second quarter, U.S. GDP will likely end up on the lower side of that range. Earnings estimates indicate that smaller cap companies will grow earnings in the mid to high teens in 2022. With the Fed forecasted to initiate two to four short term rate increases as well as shrink its balance sheet we would not be surprised to see some multiple compression. The combination of decent earnings growth with some compression in valuations make a mid to high single digit return for smid caps appear reasonable. We view earnings growth as the key fundamental driver of smid cap performance in 2022.

As we monitor the evolving landscape, we remain aware of the risks that could cause us to change our outlook and positioning. Previously the risk we were most focused on was a Fed miscommunication or policy error. We believe that the probability of such an event has dropped with the re-nomination of Chairman Jerome Powell, but continue to track Fed communications carefully.

Inflation stands out to us as the key risk facing U.S. markets as we enter 2022. COVID has caused significant global supply chain disruptions, prompting significant delays and shortages of goods. At the same time, the U.S. is experiencing increased demand for goods due to work from home and extreme monetary and fiscal stimulus. This perfect storm has created a massive supply demand imbalance.

Labor force participation has declined by several million, causing worker shortages and accelerating wage inflation. The path to resolution of inflationary pressures remains uncertain.

We see some indications that inflation has already peaked, and while it is likely to remain above trend for the next year, it should moderate towards 2-3% annualized inflation in 2023. The recent outbreak of the Omicron COVID variant will most likely delay this moderation, but overall, we believe that inflation will track lower over time. Our rationale for this is based on both policy and supply chain reasons. First, we have clearly seen peak monetary and fiscal stimulus. The Fed has begun tapering bond purchases and the outlook is for three to four rate hikes in 2022. The recently released Fed minutes from the December meeting hinted that the Fed might begin to shrink its balance sheet shortly after the first rate hike, reflecting a more hawkish stance than earlier commentary had suggested.

On the fiscal stimulus front, we expect that money flowing from the recently passed infrastructure bill will be parceled out over many years. Extended unemployment benefits have come to an end, and the Biden administration's massive Build Back Better bill has a very difficult path to pass in Congress. It seems more likely that the smaller, more popular items in that bill will get passed separately.

Global supply chains will most likely remain a problem through the first half of 2022. The Omicron COVID variant will extend these issues, but we are encouraged to have heard from some companies that delays and disruptions are starting to ease. As supply chains head slowly towards normalization, we expect to see inventories rise and both input costs and finished good prices moderate.

We are also carefully monitoring labor inflation. The U.S. has experienced widespread labor shortages in many industries, and companies continue to raise wages to attract and retain employees. Wage gains have been most pronounced in lower income brackets, which is typically good for the economy as these workers tend to spend a higher percentage of their income. Wage inflation is generally sticky, so this component of overall inflation is usually not transient. Labor force participation remains well below pre-pandemic levels, but has increased slightly in recent weeks. This uptick seems likely to stall due to the COVID resurgence. We expect that labor participation will start to rise again as stimulus wanes and higher wages attract more workers to return to the workforce.

Above-trend inflation in 2022 is likely to have significant implications for U.S. bond yields. We anticipate that the rate on 10 year Treasuries will continue to rise for a couple of quarters before stabilizing and declining as GDP growth and inflation decelerate. From a style perspective, we expect value stocks to broadly outperform during the first half of 2022, with growth's relative performance improving as inflation and growth normalize later in the year.

Given the uncertainties this environment presents, we have positioned the strategy to outperform across a range of potential scenarios. We own a mix of high quality companies that will flourish even when growth eventually slows, combined with well-run businesses that present some cyclicality. Valuation is more important under these circumstances, especially given the Fed's intentions for the coming year. We are also focusing on companies that demonstrate strong pricing power, as these are best positioned to thrive in the current inflationary environment. Overall, we

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Smid Cap Equity

Third Quarter 2021

COMMENTARY

We have reinvested in our business as it continues to grow and are pleased to share that we have hired a new Director of Business Operations, Julie Donovan, and Chief Compliance Officer, Joe Stowell. Previously these roles were handled by Amanda Velluto.

We wish you a healthy and prosperous New Year and we encourage you to reach out with any questions.
equipped to take on the challenges and opportunities that 2022 presents.

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The Eastern Shore Capital Management Smid Cap Equity Composite contains all fully discretionary equity accounts managed in the Smid Cap Equity style which seeks capital appreciation through stock selection by investing in 60-100 stocks with market capitalizations approximating those of the Russell 2500 index at purchase. For comparison purposes, the Eastern Shore Capital Management Smid Cap Equity composite performance is measured against Russell 2500 index. There is no minimum account size for this composite. The strategy is managed by Eastern Shore Capital Management, a division of Moody Aldrich Partners, LLC.

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