



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.

## A Narrow Escape

**Smid Cap Equity Net Performance Statistics Since Inception  
(12/31/2012 – 3/31/2024)\***

	Annualized Alpha (%)	Upside Capture (%)	Downside Capture (%)	Sharpe Ratio	Information Ratio
1 Year	0.8	85.7	90.3	0.7	-0.3
5 Year	-0.1	86.5	92.5	0.3	-0.2
10 Year	0.0	91.4	94.6	0.4	-0.1
SI*	0.3	94.0	95.4	0.5	-0.1

*\*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 2500 index. The risk-free rate used to calculate the Sharpe ratio is the FTSE 3-month T-Bill.*

### Markets/Economy

The U.S. economy appears to have avoided the broad-based recession that has been forecasted for the past 18 months. As we have mentioned in past quarters, many industries have experienced individual recessions – yet in aggregate, the economy has had positive overall growth over the past two years. The ISM manufacturing PMI entered expansionary territory by exceeding 50 during the month of March, after having remained below this threshold for the past 17 months. The impact of this development seems likely to be overshadowed by fluctuations in inflation, interest rates, and consumer sentiment, which appear likely to drive corporate earnings and market sentiment going forward.

While much attention has been made of concentration in the large cap space, narrow leadership within small cap has been largely overlooked. The Russell 2000 Information Technology sector was up 12.8% in the first quarter of 2024, more than double the index's 5.2% return. This outperformance was driven by two heavily-weighted index constituents: Super Micro Computer (SMCI), which rose 255%, and MicroStrategy (MSTR), up 170%.

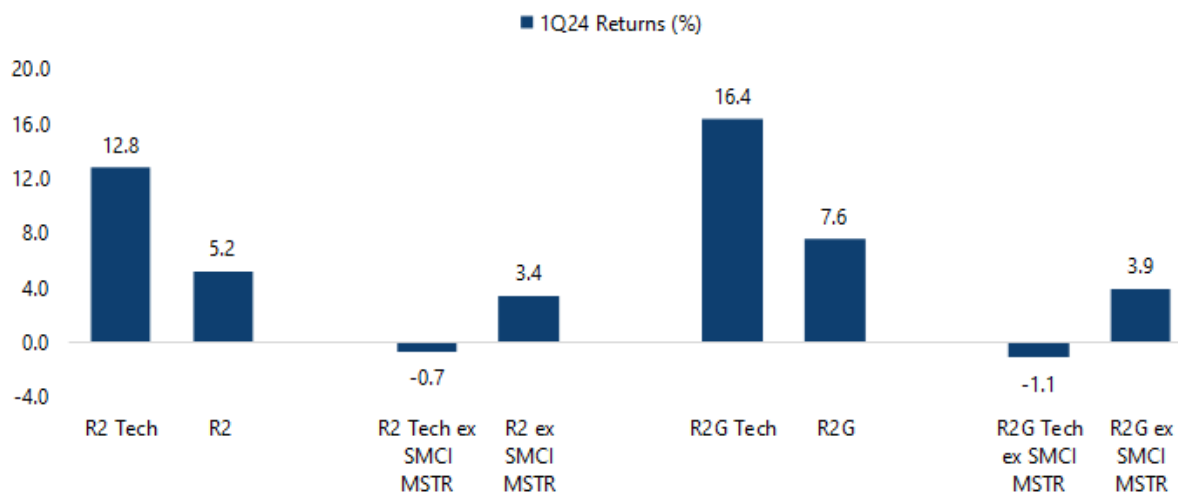
These two companies reflected two of the biggest themes in smid cap in the first quarter, artificial intelligence (AI) and cryptocurrency. To put their impact into perspective, the Russell 2000 Information Technology sector would have returned -0.7% without these two companies. As the following chart indicates, the influence of these two stocks on index performance has been extraordinary.



#### Performance Summary (through 3/31/2024)\*

	1Q 2024	1 Year	3 Year (Annualized)	5 Year (Annualized)	10 Year (Annualized)	Since Inception† (Annualized)
	(%)	(%)	(%)	(%)	(%)	(%)
<b>Smid Cap Equity (Gross)</b>	12.1	20.6	-0.7	9.8	9.2	11.8
<b>Smid Cap Equity (Net)</b>	11.8	19.5	-1.6	8.8	8.2	10.8
<b>Russell 2500</b>	6.9	21.4	3.0	9.9	8.8	11.1
<b>Strategy Excess Return (Gross)</b>	5.2	-0.8	-3.7	-0.1	0.4	0.7
<b>Strategy Excess Return (Net)</b>	4.9	-1.9	-4.6	-1.1	-0.6	-0.3

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Source: FactSet; FTSE Russell; Jefferies

Much investor attention has been focused on mega-cap AI-related companies such as Nvidia, but we are finding ways to gain exposure in smid cap as well. We identified Super Micro Computer as a key supplier in the AI arms race, and while we trimmed the name nine times, our strategy was overweight for most of the quarter. The company offers many attributes of an Established Quality company – including double-digit revenue growth, return on equity, gross margin, and EBITDA margin – and it traded at a reasonable valuation when we initially bought it in May of 2023. We also maintain some semiconductor and hardware exposure associated with the AI theme, and also hold some engineering and construction companies that are involved in semiconductor fabrication plant and datacenter construction. It is early in the evolution of AI, and we continue to look for new opportunities that are associated with this secular theme.

We have never held MicroStrategy, as we are not comfortable with its business model. MicroStrategy’s shares have evolved into a proxy for Bitcoin, and we do not believe that anyone can accurately assess the real and appropriate values of cryptocurrencies at this time. We therefore remain on the sidelines, as we feel that the risk outweighs the reward. To benefit from the overall cryptocurrency trend, we are gaining peripheral exposure through key suppliers to hyperscale data centers and crypto miners.



#### First Quarter 2024 Results

During the first quarter of 2024, the Eastern Shore Smid Cap Equity Composite delivered a return of 12.07%/11.82% gross and net of fees, outperforming the Russell 2500's 6.92% return for the quarter.

Companies with the highest market caps within the Russell 2500 emerged as the clear leaders for the quarter. Higher-quality businesses within our universe generally tend to be larger, as is reflected in the meaningful outperformance of companies with higher returns on invested capital (ROIC) and returns on equity (ROE): the top quintile in the index by both metrics outperformed the lowest by over 13%. As we have mentioned in the past, conditions such as these are generally favorable for our approach. Our Established Quality holdings outperformed for the quarter by approximately 150 basis points.

Growth companies were in the lead in the first quarter, with the Russell 2500 Growth index outperforming the Russell 2500 Value by over 200 basis points. Smid cap companies with higher multiples generally outperformed those with lower ones, and higher beta companies outperformed as well. From a sector perspective, the Russell 2500 Growth benefited from being underweight Financials holdings and overweight Information Technology relative to the Russell 2500 Value.

The strongest sector contributors to the Smid Cap Equity strategy's relative performance during the first quarter were Information Technology and Financials. Outperformance in the Information Technology sector was driven by stock selection among technology hardware and equipment holdings. Relative performance in Financials was largely driven by stock selection among non-bank financial companies. Sector detractors for the quarter included Health Care and Utilities. The strategy lost relative performance within the Health Care sector due to outliers in pharmaceuticals and biotechnology. Similarly, the underperformance of a few electric utility holdings detracted from relative results within this sector.

At the individual company level, the two most significant contributors to the strategy's performance for the quarter were information technology solution provider Super Micro Computer (SMCI) and specialty insurance firm Kinsale Capital Group (KNSL). Investors view Super Micro Computer as a direct beneficiary of developments in artificial intelligence (AI), which fueled its over 255% gain during the quarter. Kinsale Capital Group rose over 50%, boosted by a strong earnings report featuring better-than-expected underwriting income and net investment income (NII). Additional significant contributors for the period included cloud-based business software firm AppFolio (APPF), footwear company Deckers Outdoor (DECK), and component manufacturer BWX Technologies (BWXT). AppFolio's share price surged upwards following a strong earnings report offering above-consensus guidance. Similarly, Deckers experienced a sharp share price increase following the release of its strong earnings and expectation driven primarily by its HOKA and UGG brands. BWX moved higher during the quarter as the firm reported earnings ahead of the consensus and gave 2024 guidance that was also above expectations. We see potential for additional upside across all five of these companies and continued to hold them as of quarter-end.

The two most impactful detractors from the strategy's performance for the quarter were regional bank Independent Bank Corp. (INDB) and biotechnology firm BridgeBio Pharma (BBIO). Independent Bank had performed strongly during the previous quarter when rates appeared poised for a first-half rate reduction but gave back these gains in early 2024, as these prospects diminished. BridgeBio's share price drifted lower during the quarter, seemingly due to a perceived lack of near-term catalysts. Other significant detractors during the quarter included biotechnology firms Cytokinetics, Inc (CYTK) and Verona Pharma (VRNA) as well as supply chain solution provider GXO Logistics (GXO). Cytokinetics had an upcoming trial readout and timing can be difficult when it comes to binary outcomes in biotechnology. We were able to buy the stock after its announcement, but the short-term momentum remained negative. Verona declined gradually throughout the quarter given uncertainty around the launch of its newest therapy. GXO Logistics lagged during the quarter due to unexpectedly low volumes. We continued to hold all five of these stocks as of quarter end, as we feel they have strong potential for recovery in the months ahead.



Our decision to adopt a more balanced approach going into 2023 helped the strategy during the atypical market environment that we experienced last year. We chose to increase our exposure to earlier-stage Improving Quality holdings coming into 2024 and have been rewarded with outperformance as conditions have become more normal. We believe that the strategy is well-positioned for a range of potential market scenarios, and we remain vigilant regarding timing and position-sizing given ongoing macroeconomic and geopolitical uncertainty.

Q1 2024 Top 5 Contributors <sup>†</sup>		
Security	Ticker	Avg. Weight (%)
Super Micro Computer, Inc.	SMCI	0.8
Kinsale Capital Group, Inc.	KNSL	2.4
AppFolio, Inc.	APPF	1.8
Deckers Outdoor Corp,	DECK	1.8
BWX Technologies, Inc.	BWXT	2.1

Q1 2024 Top 5 Detractors <sup>†</sup>		
Security	Ticker	Avg. Weight (%)
Independent Bank Corp.	INDB	1.6
BridgeBio Pharma, Inc.	BBIO	0.9
Cytokinetics, Inc.	CYTK	0.6
Verona Pharma	VRNA	0.8
GXO Logistics, Inc.	GXO	1.1

<sup>†</sup>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

Inflation data has remained above consensus forecasts for the past few months, causing significant volatility in the market despite positive employment and economic data points. The current debate in the market appears to center on whether robust economic growth is possible with 3% core inflation. We believe that the answer is yes. During the 1990s, the US experienced strong economic growth and a positive stock market during a period characterized by elevated inflation and higher rates – a situation very much like the one we have experienced during the past several months.

Recent comments from several Fed Governors have sounded cautious regarding rate cuts, but at the same time express little appetite for additional rate hikes. We believe that the directionality of rate moves has more impact on the markets than the timing of the eventual cuts. The market appears to believe that policy is restrictive enough to keep potential hikes out of the equation.

Our base case for 2024 is for inflation to moderate and reach a range of 2-3% by year end. The Fed would most likely be comfortable with these levels and would be slow to reduce rates significantly. The economy can grow 2-3% under these conditions, and the outlook for corporate earnings remains relatively solid. The market can perform well in this scenario if corporate earnings meet expectations.

Regarding potential risks, a broader escalation of the conflict in the Middle East remains most prominent. The recent hostilities between Iran and Israel could escalate, driving oil prices higher. This could cause inflation to spike, potentially triggering a global recession. Further negative developments involving Russia and/or China pose risks as well.



**EASTERN SHORE**  
CAPITAL MANAGEMENT  
A Division of Moody Aldrich Partners

# Smid Cap Equity

First Quarter 2024

COMMENTARY

Another risk for markets is the possibility that corporate earnings do not live up to expectations. Much of the rally since last October has been driven by multiple expansion. A disappointing earnings season could sour investor sentiment, potentially causing a correction in the market.

We have not made any drastic changes to our positioning in recent months. We are emphasizing exposure to high quality companies with ample visibility and long runways for future growth. We have shifted the balance of Established and Improving Quality companies slightly towards the Improving Quality side, as we have been favoring stocks that should do well in a range of scenarios. We appreciate your interest in Eastern Shore, and we welcome your questions and comments.



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