EASTERN SHORE
CAPITAL MANAGEMENT
A Division of Moody Aldrich Partners

Smid Cap Equity

Second Quarter 2025

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.

Crosswinds

Smid Cap Equity Net Performance Statistics Since Inception (12/31/2012 – 6/30/2025)*

	Annualized Alpha (%)	Upside Capture (%)	Downside Capture (%)	Sharpe Ratio	Information Ratio
1 Year	-2.5	91.8	102.6	0.1	-1.0
5 Year	-3.9	84.0	100.9	0.2	-0.9
10 Year	-0.1	90.4	94.2	0.3	-0.1
SI*	0.1	93.8	95.9	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

Equity markets experienced far more volatility during the first half of 2025 than the -1.8% year-to-date return of the Russell 2000 might suggest. Within the first six weeks of the year, the DeepSeek announcement caused investors to question the need for massive increases in capital expenditure for artificial intelligence (A.I.). The April second tariff announcements caused a substantial selloff in equity markets, causing the Russell 2500 to decline by over 15% within a week. Continued uncertainty regarding the massive tax and spending bill brought additional turbulence, as did the lack of visibility regarding inflation and the future path of interest rates.

The market shrugged off these concerns and staged a significant rally in May and June, which recovered nearly all of the Russell 2500's earlier losses. One of the key drivers of this rebound has been the Trump administration's reaction to the market downturn and to criticism about the negative effects that large tariffs would have on businesses and consumers. The president keeps moving the effective dates of the tariffs and continues to negotiate with countries who are bargaining in good faith. The market appears to be taking policy uncertainties in stride, and investors have been taking advantage of corrections to buy stocks that are trading at low valuations. Investors appear to maintain faith that the policies that are ultimately enacted will be manageable for companies and the U.S. economy. While visibility is improving on fiscal and tariff policies, potential risks including ongoing geopolitical conflicts continue to demand attention. Nonetheless, the market has been grinding upwards through volatility and negative headlines.

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The Conference Board's Expectations Index fell 9.6 points to 65.2, the lowest level in twelve years and well below the threshold of 80 – the level which usually precedes a recession. This soft data often precedes a deterioration in the hard economic data.

The increased volatility caused by these developments has created pockets of opportunity across our investment universe. While visibility is limited in the short term, we continue to seek out undervalued and mispriced stocks that can generate outsized long-term returns in this uncertain market.

Performance Summary *(through 06/30/2025)**

	2Q 2025	1 Year	3 Year (Annualized)	5 Year (Annualized)	10 Year (Annualized)	Since Inception† (Annualized)
	(%)	(%)	(%)	(%)	(%)	(%)
Smid Cap Equity (Gross)	10.0	7.9	7.9	7.5	8.7	10.9
Smid Cap Equity (Net)	9.7	7.0	7.0	6.5	7.7	9.9
Russell 2500	8.6	9.9	11.3	11.4	8.4	10.4
Strategy Excess Return (Gross)	1.4	-2.0	-3.4	-3.9	0.3	0.5
Strategy Excess Return (Net)	1.1	-2.9	-4.3	-4.9	-0.7	-0.5

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Second Quarter 2025 Results

During the second quarter of 2025, the Eastern Shore Smid Cap Equity Composite delivered a return of 9.95%/9.71% gross and net of fees, outperforming the Russell 2000's 8.59% return for the quarter. In a dramatic reversal from the first quarter, the Russell 2000 Growth index outperformed the Russell 2000 Value by approximately 4%. Higher beta stocks strongly outperformed as equity markets surged upwards from their early April lows.

Our Improving Quality holdings, which are earlier in their life cycles, significantly outperformed more mature Established Quality holdings during the second quarter, having lagged them in the first 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 second quarter were Information Technology and Financials. Semiconductor-related firms and software companies outperformed within Information Technology, while outperformance in the Financials sector was largely driven by banks and insurance companies.

Sector detractors for the quarter included Utilities and Consumer Discretionary. The strategy's underperformance in the Utilities sector was largely driven by the below-benchmark returns of three of its electric utilities and one natural gas utility. Within Consumer Discretionary, two of the strategy's retail and distribution holdings underperformed the Russell 2500 for the quarter. The team maintained its level of exposure to these two sectors during the quarter and made two meaningful changes to sector allocation in this timeframe: increasing exposure to the Industrials and Information Technology sectors by 3.24% and 2.76% respectively. No other sector adjustments equaled or exceeded 2% during the quarter.

At the individual company level, the two most significant contributors to the strategy's performance for the quarter were digital asset mining facility company Core Scientific (CORZ) and data infrastructure firm Credo Technology Group Holding (CRDO). Core Scientific rose in anticipation that its longtime partner CoreWeave (CRWV) might acquire it. On July 7th, CoreWeave announced plans to acquire Core Scientific in an all-stock deal, making Core Scientific the fifth holding in the strategy to announce that it was being acquired year-to-date.

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Credo's share price had fallen after the DeepSeek announcement in February cast doubts on the need for data centers to support AI expansion in the United States but recovered during the second quarter as investors recognized the firm's advantageous positioning as a growing player in the data center interconnect market. Additional notable contributors during the quarter included financial services platform company Robinhood Markets (HOOD), specialty metals firm Carpenter Technology (CRS), and nuclear component producer BWX Technologies (BWXT). We maintained exposure to all five of these holdings at quarter end as we felt that they offered additional upside.

The two most impactful detractors from the strategy's performance for the quarter were biopharmaceutical holdings Edgewise Therapeutics (EWTX) and Crinetics Pharmaceuticals (CRNX). Edgewise Therapeutics experienced a sharp share price drop following its press release of topline data from it phase II trial of its cardiac therapy for Hypertrophic Cardiomyopathy (HCM), which disappointed investors and was followed by a $200M equity offering. Similarly, Crinetics Pharmaceuticals' stock slid after the Phase II trial for its treatment of endocrine disorders fell short of expectations. Other significant detractors included web-based investment portfolio platform provider Clearwater Analytics Holdings (CWAN), air conditioning and heating company AAON (AAON), and construction materials firm Knife River (KNF). We maintained exposure to all five of these holdings at quarter-end given their promising fundamentals and potential for share price recovery.

From a positioning standpoint, we have shifted the balance of the portfolio slightly towards Improving Quality. Our style positioning remains relatively neutral, and we continue to avoid large active industry exposures. This more balanced positioning has helped the strategy to outperform the Russell 2000 for the past six quarters, and we believe that it will continue to serve our clients well as we continue into the second half of this year.

Q2 2025 Top 5 Contributors†

Security	Ticker	Avg. Weight (%)
Core Scientific Inc	CORZ	1.0
Credo Technology Group Holding Ltd.	CRDO	0.7
Robinhood Markets, Inc. Class A	HOOD	0.7
Carpenter Technology Corporation	CRS	1.2
BWX Technologies, Inc.	BWXT	1.2

Q2 2025 Top 5 Detractors†

Security	Ticker	Avg. Weight (%)
Edgewise Therapeutics, Inc.	EWTX	0.3
Axsome Therapeutics, Inc.	AXSM	1.4
Clearwater Analytics Holdings, Inc. Class A	CWAN	0.7
AAON, Inc.	AAON	0.6
Knife River Corporation	KNF	1.7

*†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.*

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Outlook:

The market does not like uncertainty, and we had plenty of it in the first half of 2025. We are becoming more optimistic that this is abating now and will continue to improve going forward. The recently signed tax bill improves visibility across several key areas, and its stimulus elements should support growth. The tariffs most likely to be enacted won't be nearly as high as investors feared a couple of months ago. The tariffs will most likely prove manageable for higher quality small cap companies, and we believe that most of their impact has already been priced into markets. Another positive is that recent economic data has been stable, and the most recent jobs report beat expectations. On a final upbeat note, several Fed Governors indicated in recent speeches that they might be open to cutting rates sooner rather than later.

These developments have helped to alleviate uncertainty for markets, and as a result daily volatility as measured by the VIX has dropped significantly. While we have seen longer dated bond yields continue to fluctuate, overall bond volatility is lower as well. We view geo-political risk in Ukraine and the Middle East as potential drivers of volatility in the months to come.

Both the S&P 500 and NASDAQ reached all-time highs in early July, but the small cap Russell 2000 remains roughly 10% below the closing high reached in November of 2024. We are encouraged that expectations are set quite low as the second quarter earnings season begins. Analysts aggressively lowered earnings estimates earlier in the year when tariff uncertainty was at its peak. Individual companies have been issuing guidance that we consider conservative, and many have suspended guidance altogether. Because of this, we anticipate positive earnings surprises across many areas of the market. We don't expect much multiple expansion and believe that earnings will serve as the key driver of near-term positive returns.

We believe small caps could outperform in the second half for a couple of reasons. First, we saw small cap earnings cut more severely than large, meaning that they are more likely to exceed expectations. Small cap stocks are also trading at significantly more attractive valuations relative to their large cap counterparts.

There are certainly many risks that could cause us to revise this base case. As tariffs work their way through supply chains, we could see inflation start to re-accelerate. If inflation expectations increase and the deficit expands further, long-term interest rates may rise. Higher rates and inflation would likely compress equity valuations. We could also see companies unable to pass on increased inflationary and tariff costs, resulting in reductions in their margins and earnings. Another risk is that the decrease in immigration could lead to a shortage of workers in certain industries, driving up wage inflation.

We continue to focus on established quality companies that offer visible sales and earnings growth and are less economically sensitive, as well as improving quality companies that have visible catalysts and operating leverage in an expanding economy. This balance of quality and opportunity has served the strategy well during the past six quarters. Please do not hesitate to contact us for more detail – we wish you a wonderful summer and we thank you for your interest in Eastern Shore.

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