

US small cap growth market summary

Small Cap Growth Performance

- Small cap growth stocks, measured by the Russell 2000 Growth Index, were up 9.1% in November.
- The index closed November down over 31% from the peak in November of 2021. Recall that the average decline during a bear market is around 30%.

Earnings outlook for small cap still subdued

- Earnings estimates for small cap stocks continue to be revised lower. *See Exhibit 1*
- The NTM EPS outlook for the S&P Small Cap 600 has not yet found a bottom. *See Exhibit 2*
- Historically, markets tend to bottom multiple months before earnings estimates bottom.

Small cap valuations attractive

- The Russell 2000 Index slightly underperformed the Russell 1000 Index in November and is trailing by over 1600bps YTD. *See Exhibit 3 for the Rolling 5-year Relative Performance of small vs large*
- The Russell 2000 Index now trades at a Forward P/E discount to the Russell 1000 Index compared to historically trading at a premium.
- Valuation of the small cap sector relative to large caps is in the 6th percentile historically (zero being the least expensive relatively and 100 being the most expensive). *See Exhibit 4*

Companies with the lowest ROE outperformed in November

- In the Russell 2000 Growth Index, the companies in the bottom quintile of ROE (return on equity) outperformed in November and were up 12.9%.
- Additionally, companies with no revenue outperformed and were up 9.4%.

Inflation high but declining has historically been good for small cap stocks

- Inflation was elevated during 2022 but started to ease in the last couple months of the year and this has continued throughout 2023 based on the CPI reports.
- When inflation is above 3% but declining, this tends to be a good backdrop for small cap stocks. *See Exhibit 5 for performance across varying CPI environments*

Historical performance around recessions

- Small cap stocks tend to underperform in the later stages of the economic cycle as interest rates become a headwind to growth and profitability.
- This underperformance accelerates as we get closer and into the start of the recession.
- Following this and very early on into the recession, small cap stocks tend to sharply outperform and continue to do so for the next 3-4 years.
- *See Exhibit 6 for the historical performance around recessions.*

Fed outlook top of mind for investors

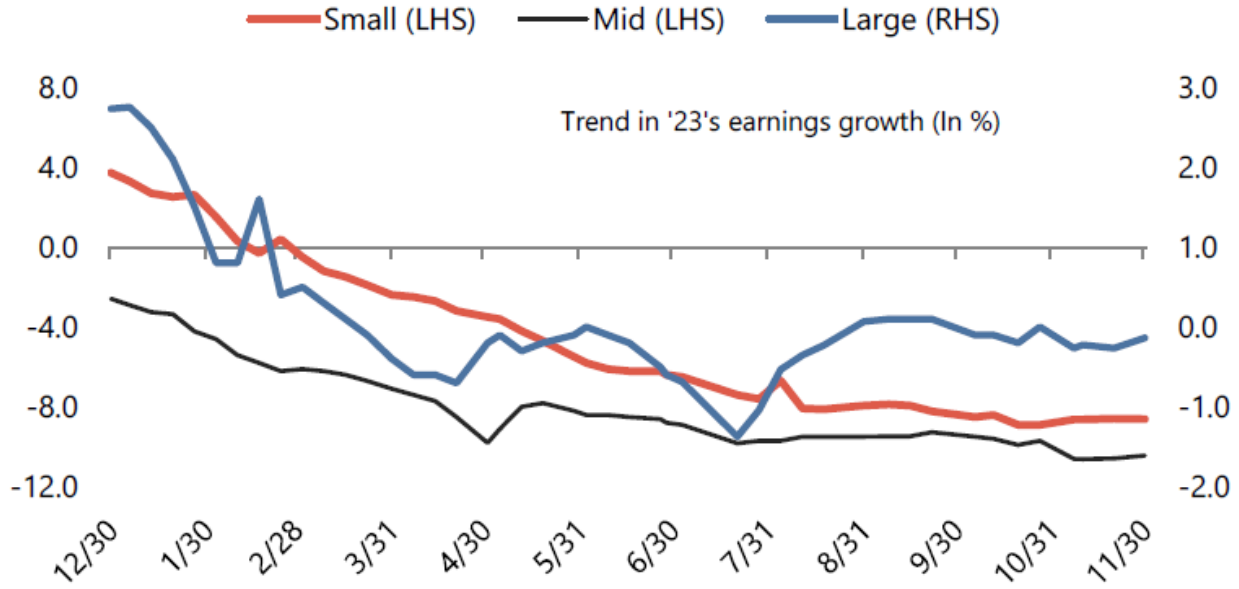
- The market is pricing in interest rate cuts from the Fed early in 2024.
- Small cap stocks have historically experienced strong performance after the first cut. *See Exhibit*

Small Cap Performance (%) (ending November 30, 2023)

	MTD	QTD	YTD	1-year	3-year	5-year
Russell 2000	9.1	1.6	4.2	-2.6	1.1	4.8
Russell 2000 Growth	9.1	0.7	6.0	-0.8	-4.3	4.2
Russell 2000 Value	9.0	2.5	2.0	-4.7	6.5	4.7

Source: Factset; 1, 3, 5-year performance annualized

Exhibit 1. Earnings Growth Estimates Since the Start of 2023



Source: FactSet; Standard & Poor's; Jefferies

*Small represented by Russell 2000, Mid by Russell Midcap, Large by Russell 1000

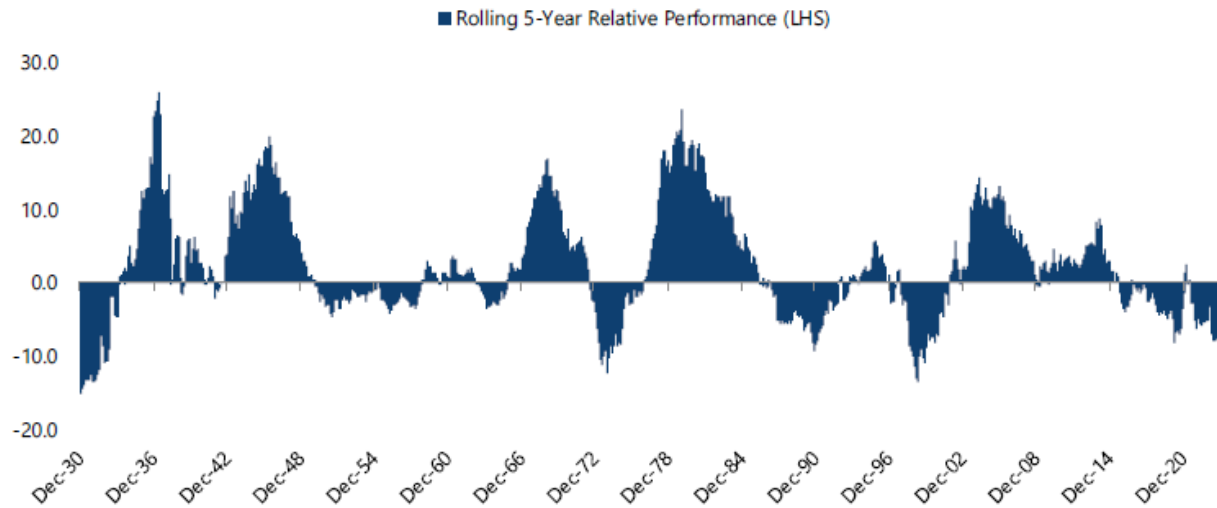
Exhibit 2. S&P Small Cap 600 NTM Consensus EPS Trend



Source: FactSet, Raymond James research

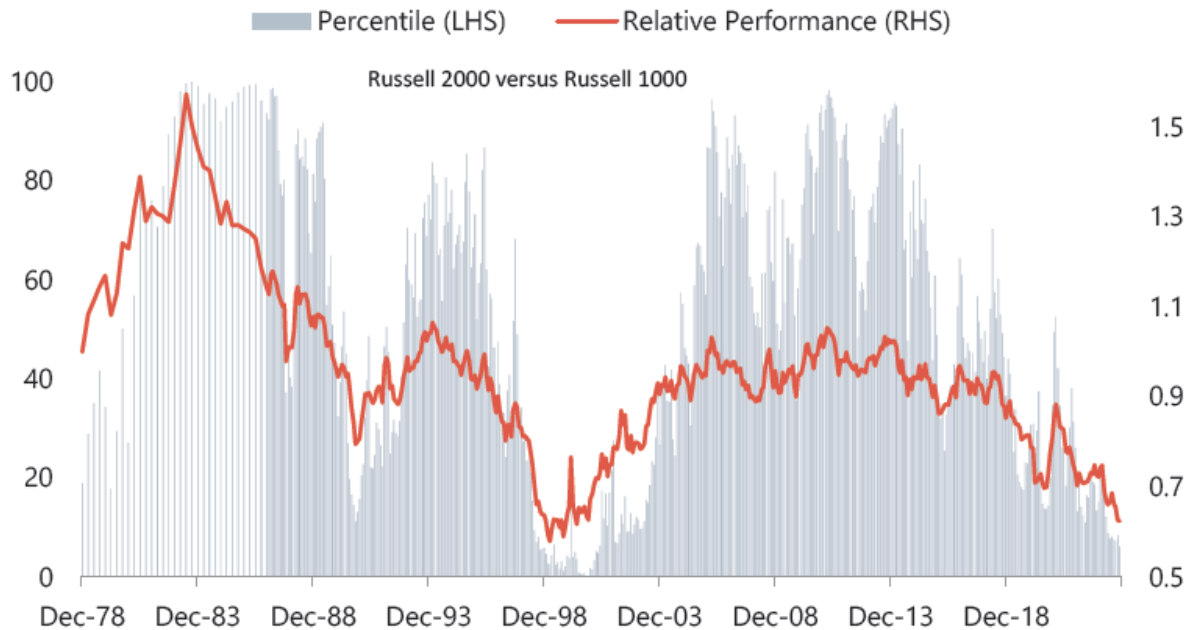
*Small Cap represented by S&P 600

Exhibit 3. Rolling 5-year Relative Performance of Russell 2000 vs Russell 1000



Source: Center for Research in Security Prices (CRSP®), The University of Chicago Booth School of Business; Jefferies

Exhibit 4. Relative Valuation and Relative Performance of Russell 2000 vs Russell 1000



Source: FactSet; FTSE Russell; Jefferies

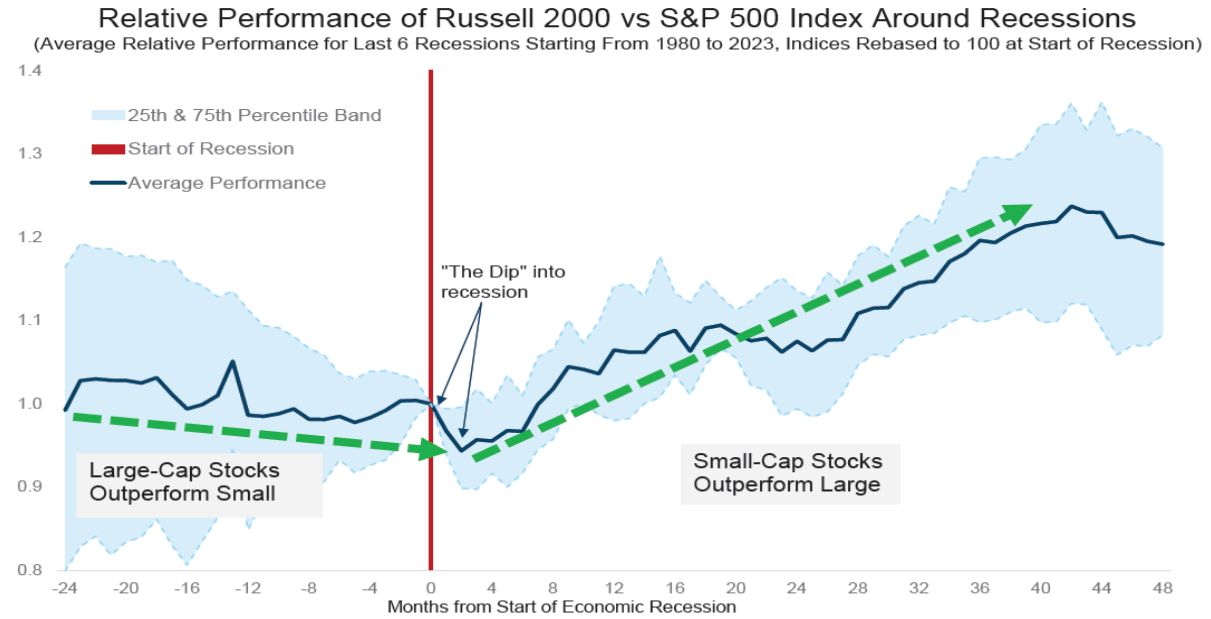
Exhibit 5. Performance across CPI environments

	Annual Return			3Y Returns Annualized			5Y Returns Annualized		
	Large	Mid	Small	Large	Mid	Small	Large	Mid	Small
CPI >3	8.5	10.2	10.4	9.0	11.4	11.6	10.3	12.7	13.0
CPI <3	16.1	17.5	19.0	13.7	14.2	14.9	12.0	12.6	13.1
CPI >3, Rising This Year	3.1	2.5	1.7	8.9	11.1	10.9	8.7	11.0	11.1
CPI >3, Declining This Year	19.1	25.9	28.5	8.5	11.3	12.5	12.4	15.3	16.3
CPI <3, Rising This Year	14.0	15.7	16.8	12.5	13.5	14.9	11.4	12.4	13.5
CPI <3, Declining This Year	17.7	18.8	20.7	14.6	14.7	14.8	12.5	12.7	12.7
Overall	12.7	14.3	15.2	11.6	12.9	13.4	11.2	12.6	13.0

Source: FactSet; FTSE Russell; Center for Research in Security Prices (CRSP®), The University of Chicago Booth School of Business; Jefferies

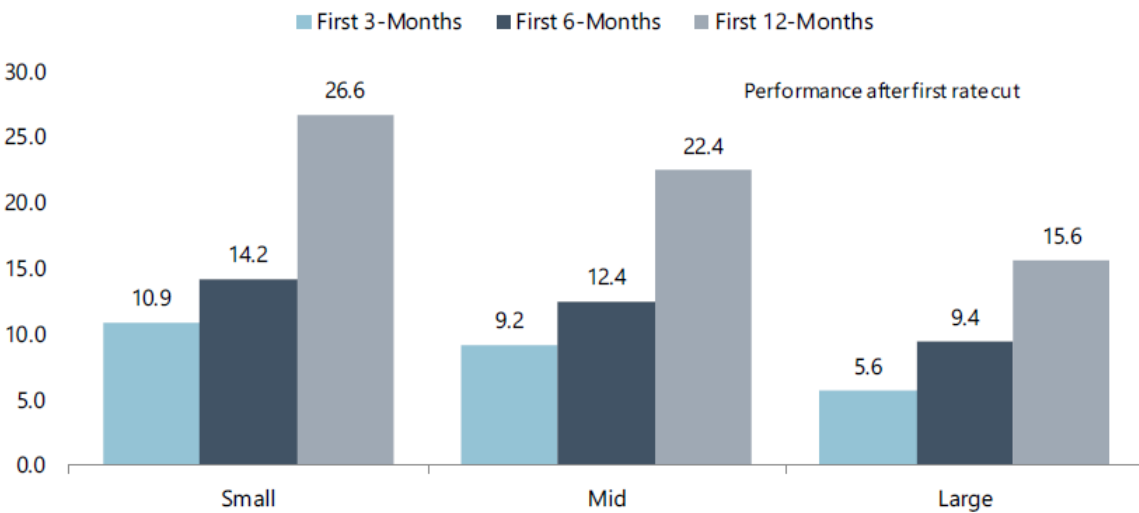
*Small represented by Russell 2000, Mid by Russell Midcap, Large by Russell 1000

Exhibit 6. Small Cap Performance Around Recessions



*Small represented by Russell 2000, Large by S&P 500; Past Performance is not an indicator of future performance

Exhibit 7. Performance after first Fed interest rate cut



Note: Used Fed Funds from 1954 until 1963, then used the Discount rate from 1963 until 1994 and Fed Funds rate after that.
 Source: Federal Reserve Board; Haver Analytics; Center for Research in Security Prices (CRSP®), The University of Chicago Booth School of Business; Jefferies

Next Century Growth small cap summary

NCG Small Cap Performance update

- The NCG US Small Cap Growth Fund was up 10.5% in November (gross of fees) compared to the Russell 2000 Growth Index up 9.1%.
- For the 12-month period ending November, the NCG US Small Cap Growth Fund was up 0.8% (gross of fees) compared to the Russell 2000 Growth Index down 0.8%.
- Over the past 5 years, the NCG Small Cap Growth composite is up 16.6% compound annual returns (gross of fees) compared to 4.2% for the Russell 2000 Growth Index.

Portfolio positioning

- We are overweight in the technology sector as we believe there is now a more favorable risk/return profile due to the attractive secular growth in the sector combined with expectations and valuations being reset over the past year.
- The portfolio is overweight the industrial sector as we seek to benefit from the unique individual growth drivers of our portfolio companies.
- We are slightly overweight basic materials with our holdings consisting of two companies selling into the aerospace industry.
- We are slightly overweight the financial sector with our holdings consisting of two companies in the insurance industry.
- The portfolio is slightly underweight the health care sector. Many healthcare stocks have been negatively impacted by investor sentiment related to the threat of the GLP-1 drug class. The long-term impact on business fundamentals for individual companies is somewhat unclear. We will rely on our direct research to inform our investment decisions in this space, as we do for all our investments.
- Consumer is one of the portfolio's largest underweights due to a lack of sustainable high growth franchises.

Volatile couple months for small cap stocks

- Small cap stock performance has been very sensitive to whether investors believe we are heading for a recession or a soft landing, causing significant swings in daily performance.
- While it may be tempting to try to chase stocks for short-term performance, we stay focused on investing in high-quality companies with strong long-term growth opportunities, which we believe will lead to outperformance over the long-run.
- After years of large cap outperformance, we believe we are nearing a time when small cap stocks enter a sustained period of strong absolute and relative performance. We do not believe in trying to time this dynamic and are positioning for this time now.

Investment Philosophy

- As a reminder, we seek to invest in the fastest growing and highest quality companies in America.
- We believe a portfolio consisting of high-quality growth companies, combined with a strong sell discipline, will lead to both compounding of portfolio value and better performance over the unmanaged index over the long-run.