

August 2024 small cap commentary

US small cap growth market summary

Small Cap Growth Performance

- Small cap growth stocks, measured by the Russell 2000 Growth Index, were down 1.1% in August.
- YTD through August, the Russell 2000 Growth Index is up 11.7%.

Earnings are now expected to decline y/y in 2024 for small caps

- Earnings expectations have been gradually declining for small cap stocks in 2024 and are now expected to be down y/y in 2024, but growth is expected to improve and turn positive as the year progresses. *See Exhibit 1 and Exhibit 2*
- For 2025, small cap earnings are currently expected to increase 17%. (*Source: Factset*)

Small cap takes a step back vs Large after strong July

- In August, the Russell 2000 Index was down 1.5% and underperformed the Russell 1000 Index, which was up 2.4%.
- The Russell 2000 Index ended August up 10.4% YTD compared to the Russell 1000 Index up 18.6%. *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 15th percentile historically (zero being the least expensive relatively and 100 being the most expensive). *See Exhibit 4*

Notable areas/factors of performance in August for the Russell 2000 Growth Index

- Stocks in the highest revenue growth quintile in the index outperformed and were up 0.1%.
- Stocks in the lowest valuation quintile in the index underperformed and were down 5.7%.
- The health care and financial sectors were the top performing sectors in the index, both up 1.0% in August.

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

- Inflation was elevated during 2022, eased throughout 2023, and this has generally continued into 2024, with signs of significant improvement from the latest CPI report that was released at the beginning of July.
- 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*

Fed outlook top of mind for investors

- The Fed is forecasting rate cuts to begin in 2024 and the market believes there is high probability the Fed will cut at their next meeting in September and then follow with additional rate cuts in 2024.
- Small cap stocks have historically experienced strong performance after the first cut. *See Exhibit 6*

Small Cap Performance (%) (ending August 30, 2024)

	MTD	QTD	YTD	1-year	3-year	5-year
Russell 2000	-1.5	8.5	10.4	18.5	0.6	9.7

Russell 2000 Growth	-1.1	7.0	11.7	17.7	-2.1	8.3
Russell 2000 Value	-1.9	10.1	9.2	19.3	3.1	10.4

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

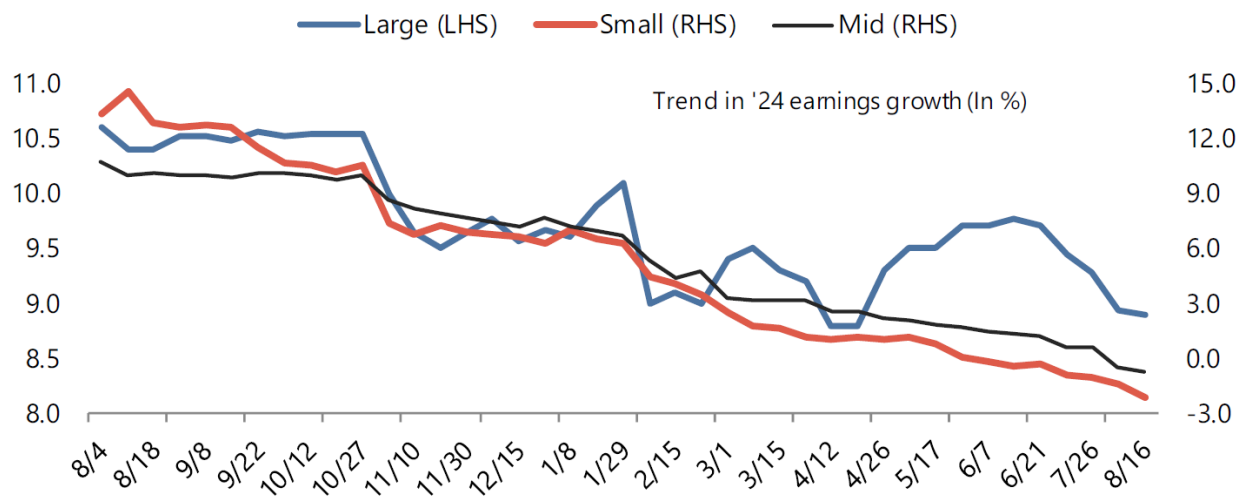
Exhibit 1. 2024 and 2025 Earnings Growth Estimates (as of 8/27/2024)

Quarter/Year	Earnings Growth (%)								
	Small	Mid	Large	Small Caps		Mid Caps		Large Caps	
				Growth	Value	Growth	Value	Growth	Value
1Q24A	-13.4	-0.9	6.9	-10.3	-15.2	5.4	-2.4	23.6	-3.1
2Q24P	-8.9	2.1	13.3	-3.7	-9.5	14.3	0.2	19.1	8.1
3Q24P	-7.3	1.0	4.8	-0.7	-10.7	9.6	-0.5	12.2	0.5
4Q24P	13.6	9.1	15.3	7.5	12.6	12.3	9.6	17.4	11.6
2024P	-1.6	-0.6	9.0	-0.5	-1.5	3.5	-1.8	16.1	3.4
2025P	16.7	15.1	14.2	17.8	15.4	19.7	14.1	16.5	11.9

Source: FactSet; Standard & Poor's; Jefferies

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

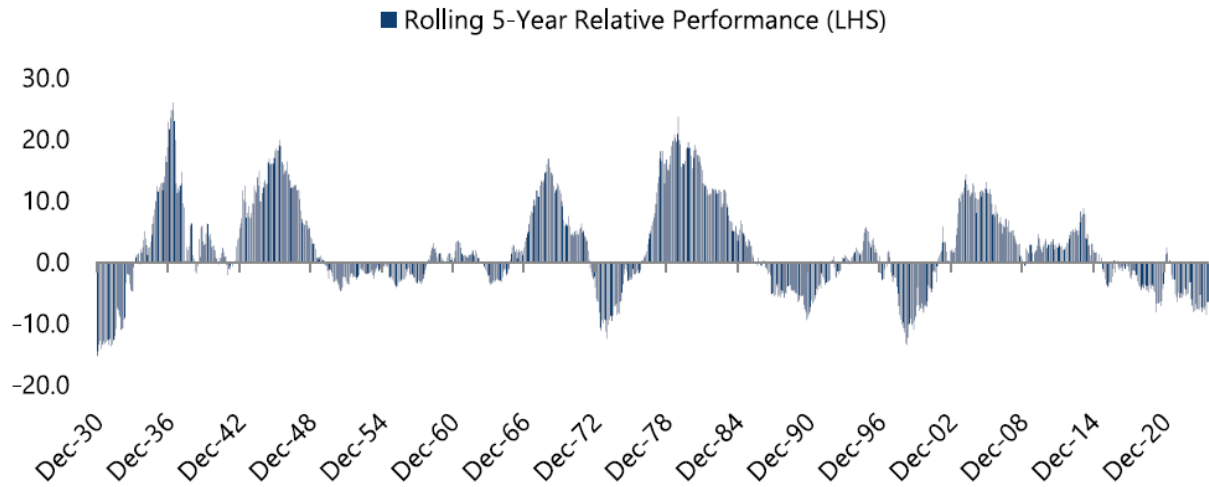
Exhibit 2. Trends in 2024 Earnings Growth Estimates



Source: Factset; Standard & Poor's; Jefferies

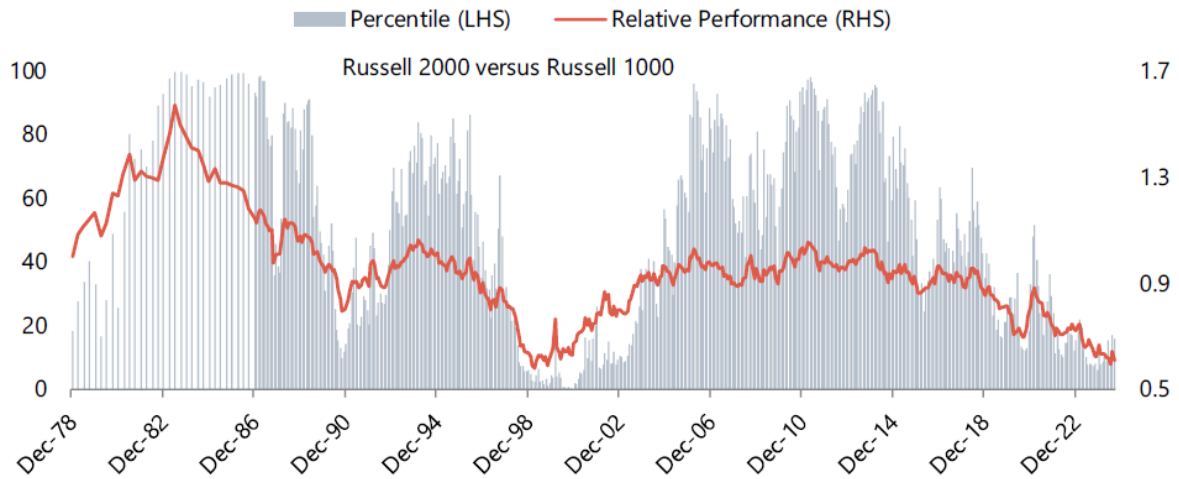
*Small represented by Russell 2000, Mid by Russell Midcap, Large by Russell 1000

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



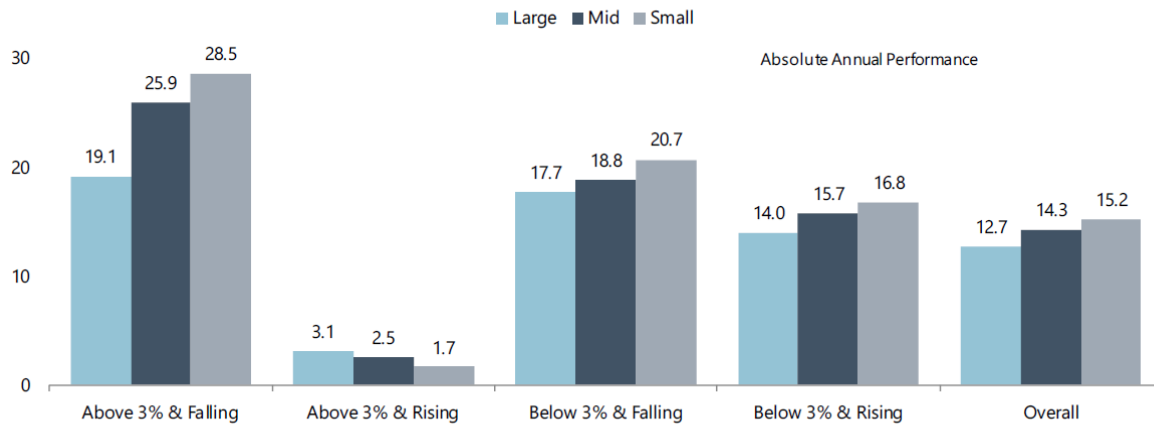
Source: Center for Research in Security Prices (CRSP®), The University of Chicago Booth School of Business; Jefferies

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



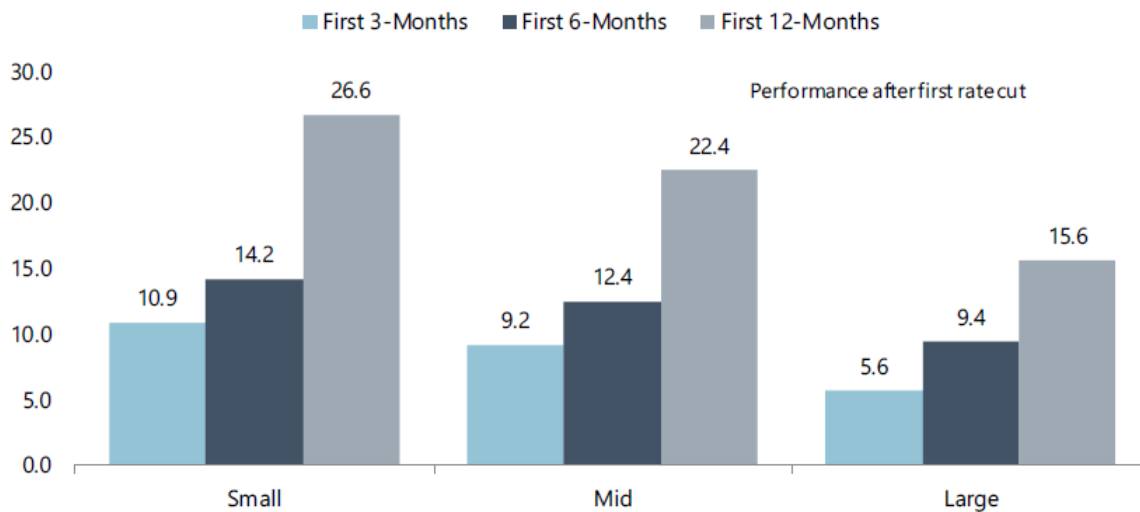
Source: FactSet; FTSE Russell; Jefferies

Exhibit 5. Performance across CPI environments



Source: 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. 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

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

^Past performance is not an indicator of future performance, and the value of your account may increase or decrease over time.

Next Century Growth small cap summary

NCG Small Cap Performance update

- The NCG US Small Cap Growth Fund was up 2.7% in August (gross of fees) and YTD is up 11.0% (gross of fees).
- Over the past 5 years, the NCG Small Cap Growth composite is up 17.5% compound annual returns (gross of fees).

Portfolio positioning

- We are overweight the technology sector due to our belief of attractive secular growth in the sector combined with our ability to find companies with strong growth prospects trading at attractive valuations.
- 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 companies selling into the aerospace and general industrial industries.
- The portfolio is underweight the health care sector. We are relying on our direct research to invest in companies with strong growth prospects trading at attractive valuations.
- The portfolio is underweight the financial sector and owns one holding in the insurance industry.
- We are also underweight consumer due to a lack of sustainable high growth franchises.

Rebound in relative performance in August

- After a challenging July, our relative performance rebounded due to solid quarterly earnings' reports from our portfolio companies as well as some pullback in the areas of the index that outperformed in July.
- With the Fed expected to start cutting rates in September, we believe we could be at an inflection point where small caps could start to improve on an absolute basis and outperform large caps on a relative basis. This should be good for NCG's core philosophy and process. We do not believe in trying to time this dynamic and are positioning for this time now.
- We continue to stay focused on investing in high-quality companies with strong business fundamentals and long-term growth opportunities, which we believe will lead to outperformance over the long-run.

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.