EMERALD DIVERSIFIED SMALL CAP GROWTH

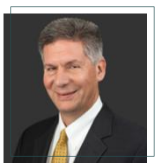
MEGA CAPS LED, GROWTH OUTPERFORMS VALUE

THE BULLS ARE CHARGING, and offense was the name of the game in the second quarter as the fears surrounding the banking crisis ebbed, corporate earnings were better than expected, the Federal Reserve paused, the soft-landing narrative once again gained momentum and fear of missing out on the artificial intelligence boom drove another leg higher within the technology sector. The Nasdaq Composite surged +12.81% during the second quarter and has gained +31.73% on a year-to-date basis. The return profile of the technology sector of the Russell 1000 Growth Index was more impressive gaining +19.3% and +49.1% for the respective second quarter and year-to-date periods, and at more than 47% of the Index, contributed 920 bps and 2095 bps respectively to the Russell 1000 Growth's second quarter and year-to-date returns of +12.8% and +29.0%, respectively, according to Factset.

While the market spoils on a year-to-date basis have been largely concentrated within the large capitalization stocks and the technology sector, market participation did broaden during the quarter, enabling the Russell 2000 to play catch-up, gaining +5.21%. Although the performance of the Russell 2000 continued to lag the Russell 1000 (+8.58%) and the S&P 500 (+8.74%), it is

KEY POINTS:

- ***While the market spoils on a year-to-date basis have been largely concentrated within the large capitalization stocks and the technology sector, market participation did broaden during the quarter, enabling the Russell 2000 to play catch-up, gaining +5.21%.***
- ***The Emerald Diversified Small Cap Growth portfolio outperformed the Russell 2000 Growth Index for the quarter, driven by stock selection and allocation effect, as headwinds to first quarter portfolio performance turned to tailwinds.***
- ***As we enter the third quarter of 2023, the portfolio currently holds the largest active exposures in the healthcare, consumer staples and financials sectors.***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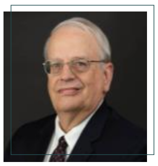
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noteworthy in our opinion that the Index outpaced the S&P 500 (equal-weighted) Index which gained a more modest +3.99%. As a matter of fact, after the strong second quarter performance, the Russell 2000 year-to-date return of +8.1% now stands ahead of the S&P 500 (equal-weighted) Index year-to-date total return of +7.03%.

From a style perspective, strength within the technology sector has continued to power growth stocks ahead, with the Russell Growth Indices outperforming their Value counterparts across the capitalization spectrum. Within the Russell 1000, the Russell 1000 Growth (+12.81%), significantly outpaced the Russell 1000 Value (+4.07%). Similarly, within the Russell 2000 Index, the Russell 2000 Growth (+7.05%) outpaced the Russell 2000 Value (+3.18%), although the gap of relative outperformance was substantially narrower at 387 bps for the same period. While the technology sector within the Russell 2000 Growth gained +7.90% and contributed 148 bps to the Index performance, the healthcare and industrial sectors also demonstrated relative strength gaining +12.81% and +9.11% respectively and contributing 289 basis points and 188 basis points to the Index's total return.

Also noteworthy from Emerald's perspective was the relative outperformance of the fastest growing companies as measured by sales growth within the Russell 2000 Growth benchmark. After underperforming the Index overall during the first quarter by 541 basis points, the top quintile or fastest growers outperformed the Index overall by 401 basis points according to a July 6, 2023, report from Steve DeSanctis of Jefferies. Similarly, whereas the non-revenue generating cohort underperformed the Russell 2000 Growth Index by 1659 basis points during the first quarter, that same cohort outperformed the Index by 1430 basis points in the second quarter.

PORTFOLIO REVIEW

Historically, the outperformance of the fastest growing companies as measured by sales growth as highlighted above has been a tailwind to Emerald's relative performance, and this proved to be true in the second quarter. After a challenging start to the year, the Emerald Diversified Small Cap Growth portfolio outperformed the Russell 2000 Growth Index for the quarter, driven by stock selection and allocation effect, as headwinds to first quarter portfolio performance turned to tailwinds. Specifically, the relative outperformance of the healthcare sector, which remains the portfolio's largest overweight, improved stock selection within the technology sector and the broader tailwind from the relative outperformance of the fastest growing companies as measured by sales growth drove positive contribution to return within the technology, healthcare, materials, and consumer staples sectors which more than offset the negative contribution to return from the industrials sector.

The technology sector was a top contributor to return driven by improved stock selection and a narrower underweight relative to the benchmark.

The healthcare sector of the portfolio was also a positive contributor to return for the quarter. After lagging during the first quarter, the healthcare sector of the Russell 2000 Growth was the best performing sector within the index this quarter. At the industry level, the portfolio experienced noteworthy outperformance within the biotechnology, pharmaceutical, and medical equipment industries.

Stock selection within the consumer staples sector also contributed positively to performance driven by Emerald's holdings within the soft drink industry.

Holdings within the materials sector also contributed positively to performance.

Partially offsetting the highlighted areas of relative outperformance was underperformance within the industrials sector. Performance within the sector continued to be weighed down by a combination of stock selection and allocation effect resulting from the portfolio's sizeable underweight relative to the benchmark.

As we enter the third quarter of 2023, the portfolio currently holds the largest active exposures in the healthcare, consumer staples and financials sectors. Thoughts on those sectors and other notable areas of exposure are highlighted below.

- The healthcare sector represents the portfolio's largest nominal and active exposure. At the industry level, the portfolio currently holds the largest nominal and relative overweight positions within the medical equipment, biotechnology, pharmaceuticals, and medical services industries. We continue to be focused on medical device and diagnostic companies that are profitable and not trading on a revenue multiple. For therapeutics, we are focused on profitable companies and those with quality assets generating revenue with a view towards profitability. Approximately 70% of our therapeutics (biotech + pharma) exposure is in companies that have revenue.

- The portfolio also exited the second quarter with an overweight position within the consumer staples sector. Emerald remains positive on the fundamental outlook for growth-oriented consumer packaged goods companies. We see mounting evidence that the broad-based cost inflation and supply chain issues that plagued the industry throughout 2022 are abating, which should result in higher profit margins as the year progresses. We continue to focus on companies with disruptive brands, category leadership positions, strong secular growth opportunities, and improving profit margins that should enable them to navigate an often-turbulent business environment and post industry leading revenue and earnings growth.

- Emerald also held an overweight position within the financial sector. The portfolio also ended the quarter with an overweight position to the financial sector, comprised of holdings within the bank, full line insurance, investment services, and property and casualty insurance industries. The largest concentration of exposure is held within the full line and property casualty insurance industries where Emerald continues to focus on companies with strong balance sheets, and exposure to growing specialty end-markets with sustained pricing power.

MARKET OUTLOOK

The narrowness of the market's ascent thus far in 2023 has been historic in proportion. Large capitalization stocks have surged while small caps have languished, with the gap of underperformance approaching historical extremes. The outperformance of the mega-caps (Apple, Microsoft, Amazon, Nvidia, Alphabet, Telsa and Meta) has been so outsized that these seven stocks alone now account for just under 28% of the S&P 500 weight, with Apple on a standalone basis, now sporting a market capitalization that is greater than the entirety of the Russell 2000 Index according to a July 5, 2023 report from Furey Research Partners. The dominance of the mega-cap companies has been the driving force behind the sizeable outperformance of the Russell 1000 (+16.7%), which has outpaced the Russell 2000 (+8.1%) by 850 basis points year-to-date, marking the third worst first half performance since June of 2020, and prior to that June of 1998, according to a recent report from Steve DeSanctis of Jefferies.

WHILE DISPARITIES IN PERFORMANCE AND VALUATIONS CAN PERSIST IN THE SHORT-TERM AS EVIDENCED BY THE SMALL VERSUS LARGE VALUATION GAP OVER THE LAST SEVERAL YEARS, ULTIMATELY VALUATION MATTERS, AND EMERALD CONTINUES TO BELIEVE THAT THE BACKDROP IS RIPE FOR A CHANGE IN LEADERSHIP.

Given the sizeable year-to-date underperformance of the Russell 2000 Index, the rolling five-year trailing performance has now moved into the 6th percentile versus history, according to the same report. The relative valuation of the Russell 2000 to the Russell 1000 has also moved to extremes and now sits in the 7th percentile vs. history, a level last reached in February 2002. While disparities in performance and valuations can persist in the short-term as evidenced by the small versus large valuation gap over the last several years, ultimately valuation matters, and Emerald continues to believe that the backdrop is ripe for a change in leadership.

In the near term where the market goes from here remains a hotly debated topic. High frequency economic data continues to drive shifts in sentiment and rotations in equity market positioning. While recent data has continued to highlight the resiliency of the domestic economy, we believe a resumption in small capitalization stock leadership will be predicated on additional evidence of a soft landing including: a deceleration in the rate of inflation, a stabilization in employment gains, a durable Fed pause, and further confidence in a reacceleration in the corporate earnings growth in 2024.

Emerald, as always, remains vigilant and focused on utilizing our fundamental bottom-up research process to identify the most attractive growth opportunities within the small capitalization universe.

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