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Q3 2023 | ECONOMIC & PORTFOLIO COMMENTARY

EMERALD GROWTH OPPORTUNITIES

"The Dreaded Summer Swoon"

EMERALD GROWTH OPPORTUNITIES multi-cap portfolios posted negative absolute returns in the 3rd quarter, giving back a bit of our material YTD relative outperformance versus our Russell 3000 Growth Index. After a strong start to the quarter, macro factors such as increasing interest rates, fears of a government shutdown, and a continued hawkish Fed, caused equity investors to take a risk off attitude, driving markets lower in August and September. Portfolios benefited from being overweight Energy, the best performing sector for the quarter, while our overweight to several small cap names detracted from performance, with small/mid-caps lagging large-caps for the 4th consecutive quarter.

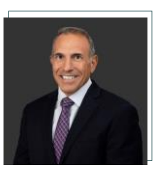
From an economic perspective, GDP forecasts for the 3rd quarter improved as the quarter progressed, with the Atlanta Fed GDPNow estimate ending the quarter at close to 5% growth. Rates, as mentioned above, surged, led by a 46-basis point jump in the 10-year yield. Inflation continued to moderate, with core PCE inflation decelerating to a 0.1% month over month rate in August. While retail sales, selected output and capacity measures and employment indicators stabilized, or improved as the quarter progressed, a few indicators, such as the

KEY POINTS:

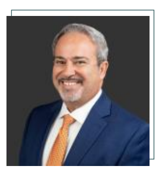
- ***Emerald Growth Opportunities multi-cap portfolios posted negative absolute returns in the 3rd quarter, giving back a bit of our material YTD relative outperformance versus our Russell 3000 Growth Index.***

- ***Portfolios benefited from our Energy overweight and strong stock selection in that sector. Portfolios underperformed in the Materials, Financials, Healthcare, Industrials and Technology sectors, while the contribution from Consumer Discretionary and Staples was largely breakeven.***

- ***Despite a challenging 3rd quarter, we believe the year -to-date returns of the Growth Opportunities strategy serve as validation of the value of our Dynamic Barbell portfolio construction methodology.***



DAVID A. VOLPE, CFA
PORTFOLIO MANAGER &
DEPUTY CIO

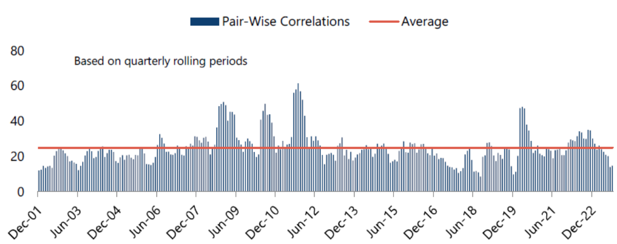


STEPHEN L. AMSTERDAM
PORTFOLIO MANAGER &
SENIOR RESEARCH ANALYST

Leading Economic Index and the ISM Manufacturing report continued to point towards a weakening economy.

During the quarter, large cap equities beat small and mid, with the Russell 1000 Growth benchmark outperforming the Russell Mid Cap and Small Cap Growth Indices by 200 and 400 basis points respectively. Beyond size, companies with lower leverage, foreign sales and P/Es outperformed, as did stocks with high Free Cash Flow/Enterprise Value ratios. Pair-wise stock correlations continued to moderate lower, which should have been a good set-up for active managers, and would have been in our case, but for the overweighting to small cap equities.

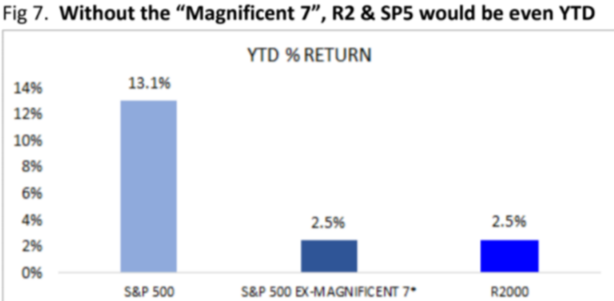
Chart 10 - Pair-wise correlations back to levels last seen in '20



Source: FactSet; Lipper Analytical Services; FTSE Russell; Jefferies

While large led for the 3rd quarter and the year-to-date, we find it very interesting that without the "Magnificent 7," S&P 500 returns would be even with the Russell 2000 year to date, vs. the +13.1% reported for the Index.

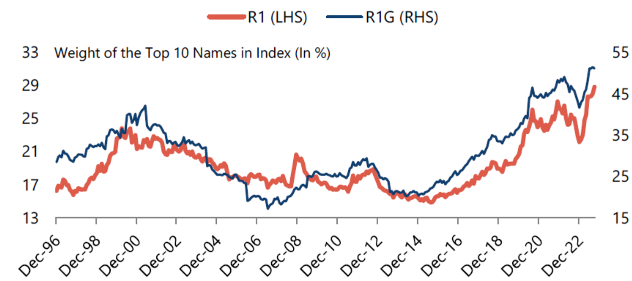
Fig 7. **Without the "Magnificent 7", R2 & SP5 would be even YTD**



*Source: Furey Research Partners and FactSet. *Magnificent 7 are Apple, Microsoft, Amazon, Nvidia, Alphabet, Tesla and Meta. Data as of 9/30/23.*

As we have noted in prior commentaries, Growth Indices have become increasingly concentrated, with the Top 10 names in the Russell 1000 Growth Index accounting for over 50% of that Index' weight. Using our Dynamic Barbell strategy, we have been able to maintain a sizable mega-cap weight, but also maintain more diversification than the Russell 3000 Growth Index, which has a Technology weighting of close to 50%. Technology has been our largest underweight vs. the Index, with Energy being the largest overweight.

Chart 7 - Large and Large Growth indexes are extremely concentrated based on Top 10 names



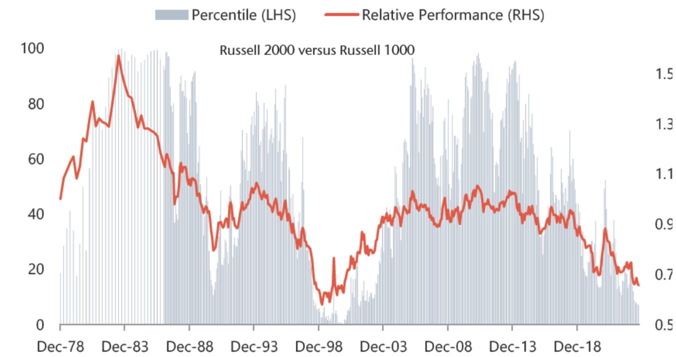
Source: FactSet; FTSE Russell; Jefferies

PORTFOLIO REVIEW

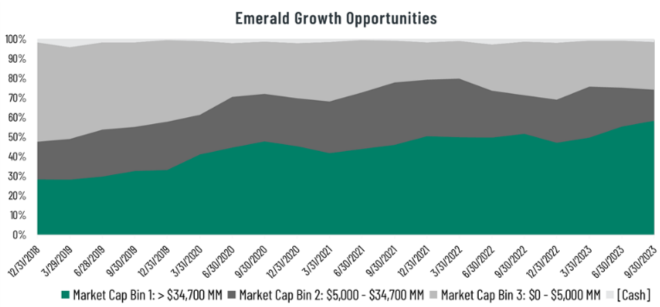
As noted, Emerald Growth Opportunities portfolios experienced negative absolute quarterly returns and modestly trailed our benchmark. Portfolios benefited from our Energy overweight and strong stock selection in that sector. Portfolios underperformed in the Materials, Financials, Healthcare, Industrials and Technology sectors, while the contribution from Consumer Discretionary and Staples was largely breakeven.

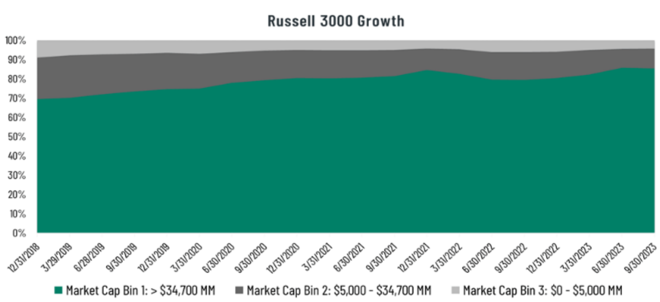
We continue to rely on our barbell portfolio construction framework of dynamically repositioning holdings by market cap, growth, economic sensitivity, geographic exposure, yield, momentum, and many other factors. This Dynamic Barbell approach allowed us to maintain exposure to selected large and mega-caps regardless of valuation, while at the same time allowing positioning in selected smaller cyclical-oriented names and equities with company-specific growth drivers. As has been the case for many quarters, Growth Opportunities portfolios remain overweight small- and mid-cap stocks vs. the benchmark given our thoughts on relative valuation and growth, with small caps relative valuations vs. large trading in the 7th percentile – a level not seen since 2002.

Chart 6 - ...While the relative model stayed in the 7th percentile



Source: FactSet; FTSE Russell; Jefferies





Portfolios widened their growth advantage vs. the benchmark with estimated weighted average 3-5-year EPS growth of +21.72% % vs. +16.97% for the Russell 3000 Growth Index. While portfolios have materially higher expected EPS growth, valuations are still discounted vs. the benchmark on most major characteristics such as Price/Earnings, Price/Cash flow, and Price/Book. This valuation/growth disparity in our portfolios has been in existence for several years – a setup we have tended to exploit successfully since before the onset of the pandemic.

MARKET OUTLOOK

Last quarter and in several preceding quarters, we questioned the sustainability of the Mega-Cap-driven rally, which accounts for a huge percentage of major growth equity Index YTD returns. Well, although our Dynamic Barbell strategy has allowed us to outperform the Index year-to-date, we have thus far been wrong. The performance disparity between small and large has persisted and **grown,** despite an increasing valuation disparity and unprecedented Index concentration. But we stick by our Dynamic Barbell, which has us overweighting selected small and mid-caps and have courage in our conviction that market breadth will improve, and small caps can and will make up some of their longer-term underperformance.

Beyond valuations, which are as cheap as they have been relative to large caps since 2002, small caps in many ways have already factored in at least a mild recession and should start to outperform, in keeping with past cycles, as we get closer to the Fed's first rate cut. From a reversion to the mean standpoint, small caps now constitute less than 4% of the total market capitalization - a level last seen in March 2020 and before that in the 1930s. We think back to 2020 when Energy stocks reached generational lows as a percentage of market Indices and then very quickly almost doubled their weighting in the ensuing three years. See the above Emerald Growth Opportunities 5-year Portfolio Weight by Market Cap showing our recent additions to small caps.

As we wrote in last quarter's commentary, we do believe a recession is coming. We look at the Leading Economic Indicators which have registered negative readings for the last 18 consecutive months - a timeframe that has always predicted a recession. In addition, according to Tony Dwyer from Canaccord, it has been 15 months since the yield curve inverted, a timeframe which is in line with the median lead time to recession. Money supply, which normally correlates in some way to GDP, has been in negative territory for several months – the first time in history. Bank lending standards have tightened, signaling recessionary conditions, while at the same time loan demand has deteriorated. The ISM Manufacturing survey also remains in contraction although at levels just above those signaling recession.

AS A FUNDAMENTAL, GROWTH-ORIENTED, ACTIVE EQUITY MANAGER, WE BELIEVE TO OUR CORE THAT EPS GROWTH DRIVES STOCK PRICES.

While we talk about macro forces, small caps and recessions, the fact is we are fundamental, bottom-up driven managers focusing on finding companies with superior earnings and revenue growth and exemplary management teams. We can't remember a time when our portfolio's forecast 3-5-year EPS growth rate vs. our benchmark was as large as the almost 500 basis point advantage our portfolios currently possess vs. our Russell 3000 Benchmark. As a fundamental, growth-oriented, active equity manager, we believe to our core that EPS growth drives stock prices. It is our belief that over time portfolios will be "Paid" for this greater growth, assuming it materializes in the form of better performance. We also like the fact that our portfolios trade more inexpensively than the benchmark on most valuation metrics, a phenomenon that should cushion any impact from growth rates not materializing as projected.

As it relates to rates and inflation, we are confident the Fed is done raising rates. Geopolitical strife, a potential domestic government shutdown, union strikes, and student loan repayment issues should keep the Fed on hold. Also, when factoring QT and bank lending, the San Fransico Fed estimates the effective Federal Funds rate at over 7% - certainly sufficiently restrictive to satisfy the Fed inflation hawks. We think inflation will continue to surprise to the downside driven by owners' equivalent rents, auto prices and a myriad of other inputs.

From a portfolio positioning viewpoint, we continue to meaningfully overweight the Energy sector, particularly offshore/international oilfield services as we believe we are in the early innings of a multi-year capex cycle for international and offshore energy production. We have also significantly added to our Utility/Alternative Energy allocation, given the large pullback in share prices in the industry and our belief that rates are peaking and should be less of a headwind for that industry. We continue to underweight Technology mainly through our underweight of several slower growing Mega-cap Technology holdings and our ability to find greater growth in other sectors. We added to our Consumer Staples exposure last quarter given our recession concerns and maintain a strong position in Healthcare for the same reason.

Despite a challenging 3rd quarter, we believe the year -to-date returns of the Growth Opportunities strategy serve as validation of the value of our Dynamic Barbell portfolio construction methodology. Emerald has outperformed despite and because of the massive outperformance of Mega-caps by biasing our portfolio into names with specific idiosyncratic growth drivers and taking advantage of the inevitable broadening of equity markets. We believe our research-based flexibility will continue to benefit portfolios regardless of market factors. Our team's ability to generate alpha through stock selection has been a hallmark of Emerald throughout our 30-year history and we believe the ability to identify secular themes and company-specific idiosyncratic growth opportunities, coupled with the ability to bias portfolios across the market capitalization spectrum without losing sight of the broader benchmark will provide enduring opportunities to outperform.

CONTACT US

Emerald Advisers, LLC

Phone: 1-800-722-4123
info@teamemerald.com

3175 Oregon Pike | Leola, PA 17540
King of Prussia, PA

TO LEARN MORE ABOUT EMERALD OR TO SCHEDULE A CALL WITH OUR TEAM, VISIT:

WWW.TEAMEMERALD.COM