



SMALL CAP CORE INVESTMENT COMMENTARY & REVIEW

by Quinn Stills

Third Quarter 2022

Our outlook for 2022 is for the equity markets to stage a significant rally before the close of this year. Our outlook is perhaps a contrarian view, given the steep decline the markets have experienced, especially in August and September, as the third quarter of 2022 came to a close. The catalyst for the rally will be inflation fears peaking and then receding, as we close out the year. As we wrote previously, the Federal Reserve is in the process of resetting interest rates to higher levels as a means to curb the rampant inflation that has gripped the economy.

Why are we still so optimistic? Because some signs of inflation are coming down. For example, according to the Bureau of Labor Statistics, the Consumer Price Index fell from 1.3% in June, to 0.0% in July, to 0.1% in August, and to 0.4% in September. Clearly, inflation is in decline, although the rate of decline moderated in September. If we just annualized the 0.4% rate of September, inflation would be under 5% on an annual basis. Further, if we annualized the CPI for the 3rd quarter of 2022, then the run rate for the CPI would be 2.00% on an annual basis.

The third quarter witnessed a firmer, hawkish tone from the Federal Reserve and a continuation of high inflation data in the mainstream economic statistics for the United States. As a result, the sharp market rally we experienced in July reversed sharply in August and, in particular, in September. For the third quarter of 2022, the top performing sectors in the portfolio included consumer discretion, financials, and health care.

Also, for the quarter, the weakest performing sectors included communications, real estate, and information technology.

The Small Cap Core Strategy is set up to thrive when interest rate changes begin to stabilize. The portfolio is, in some respects, like a crouching tiger or hidden dragon. PIA has an overweight in information technology, financials and industrials. Virtually none of the portfolio's technology companies have any net debt. The balance sheets of the portfolio's technology companies are fortresses, and we believe can easily withstand a recession. In addition, several of the portfolio's recent additions are down 30-80% off of their recent highs, despite rapidly growing sales and impressive end-market demand and expansion. Of note within technology, the portfolio recently initiated a significant investment in the electronic vehicle marketplace. The portfolio is invested in semiconductor stocks that are suppliers into the market for self-driving electric vehicles and advanced-driver-assisted vehicles and components including LiDAR. For perspective, we believe that the information technology sector is inexpensive and that current market conditions are providing the opportunity to buy these companies at an historic discount.

Quinn Stills
Small Cap Portfolio Manager

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