SMALL CAP CORE

INVESTMENT COMMENTARY & REVIEW

by Quinn Stills

Fourth Quarter 2023

There is no doubt that the overall economy is showing signs of slowing down. The cumulative effects of the previous Federal Reserve (FED) rate hikes are like a boa constrictor slowly choking off demand and constricting growth. The good news is that the FED has paused, so we could see some relief in the second half of 2024. More pertinent to our portfolio is the fact that our portfolio is heavily invested in companies with secular growth that we believe can carry on even as the economy slows. There are also value companies that have already discounted a recession and, therefore, appear attractive.

Our outlook is for continued moderate economic growth. As we move into 2024, we expect higher interest rates to slowly choke down broad economic growth. Specifically, we see a slowly growing collection of losses on securities and loans held in bank portfolios. In addition, we see some slowdown in consumer spending. In light of these developments, our portfolio has reduced its exposure to regional banks. Outside of the financials, our portfolio is invested in several companies that we believe are industry disruptors. These companies are growing sales because of their innovation. In addition, many of our portfolio companies have no net debt and are cash flow positive, which should enable them to weather any economic downturn. Importantly, we do not expect rates to stay elevated through all of 2024. Our portfolio has the potential to excel when rates plateau again similar to what we saw in the first half of 2023.

During the fourth quarter of 2023, the top contributing sectors included technology, industrials, and health care. The weakest contributing sectors included telecommunications, real estate, and basic materials. On the individual stock level of analysis, the top performing stocks included GigaCloud Technology, NAPCO Security, Ardelyx, and Transmedics. The weakest performing individual stocks for the quarter included Aehr Test Systems, Extreme Networks, Axcelis Technologies, and Sprinkler.

The PIA Small Cap Core Strategy is focused on companies with positive business momentum, positive and growing cash flows and low levels of debt. This bottom-up approach has led to a significant overweight in information technology, an overweight in industrials, and an overweight in select utilities. In contrast to these sectors, our focus on positive business momentum has also led to a significant underweight in the financials, consumer discretionary, and real estate, all of which have a plethora of negative revisions and negative business momentum. In particular, many regional banks are carrying growing portfolios of underwater loans, securities and real estate assets. We remain confident that our portfolio will prove resilient for 2024 and beyond.

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