

# Small Cap Core

## Portfolio Update: Second Quarter 2023

During the second quarter ending June 30, 2023, the RMB Small Cap Core Equity Composite (the "Strategy") returned +3.38%, gross of fees, (+3.16%, net of fees), compared to a +5.21% for the Russell 2000® Index.

	3 Months	YTD	1 Year	3 Years	5 Years	10 Years	Since Inception (Annualized)
Small Cap Core (Gross)	+3.38%	+10.25%	+10.67%	+12.02%	+7.14%	+9.59%	+10.77%
Small Cap Core (Net)	+3.16%	+9.78%	+9.73%	+11.07%	+6.15%	+8.56%	+9.69%
Russell 2000® Index	+5.21%	+8.09%	+12.31%	+10.82%	+4.21%	+8.26%	+7.71%

*Inception date: April 30, 1999. Please see important disclosures at the end of this document. Past performance is not indicative of future results, and there is a risk of loss of all or part of your investment. Data as of June 30, 2023. RMB Capital acquired the composite by combining with IronBridge Capital Management on June 24, 2017. Composite performance prior to that date was achieved by IronBridge Capital Management. Refer to important information regarding performance and fees at the end of the document.*

## The Economy through the Looking Glass

Stocks marched higher amid conflicting data around inflation, economic growth, and corporate profits:

- Inflation is falling but is expected to remain higher than the Fed's 2% target;
- Economic data such as Leading Economic Indicators, Purchasing Managers' Index (PMI), Durable goods, tightening lending standards, etc., are crashing, but jobs remain plentiful, and consumers continue to spend;
- The yield curve is deeply inverted which suggests a recession is eminent, but stock market strength indicates we have exited a bear market and recession risk is low.

Given such conflicting data, the Federal Reserve paused its interest rate hiking campaign and left interest rates unchanged at their last meeting. Then indicated they expect to raise rates two more times before the end of the year. Corporate profits fell 6% year over year, but generally continued to beat expectations. Believe it or not, this makes sense to us. Markets are responding rationally, but in a way that appears somewhat bizarre and reminiscent of Alice in Wonderland when she proclaimed "Nothing would be what it is because everything would be what it isn't."

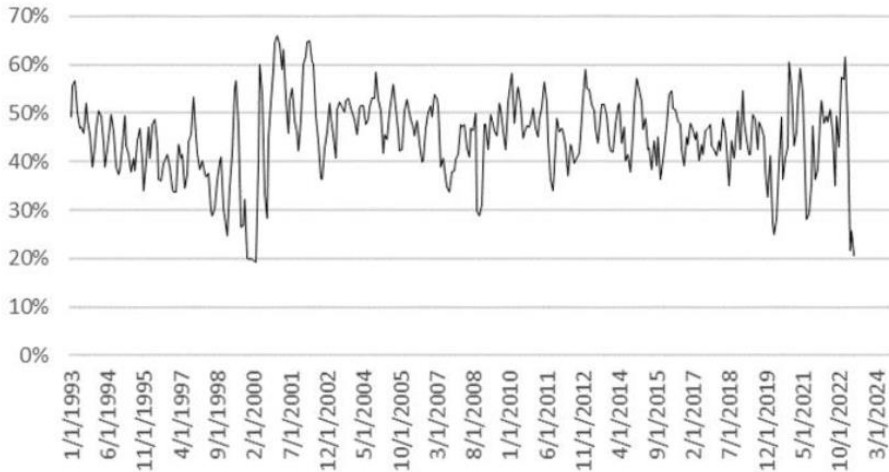
One example of unexpected outcomes is the year-to-date performance of homebuilders. Normally when mortgage rates shoot up over 400 basis points to a 6.75% (as they have since the COVID stimulus lows) "it is" a disaster for homebuilding stocks, *but "it isn't!"* Homebuilding stocks are hitting new highs. And it makes perfect sense, because when the Fed dropped interest rates to 0% during the COVID crisis, mortgage rates collapsed to 2-3%, driving people to re-finance at once-in-a-lifetime low rates. This distorted the housing market because now homeowners are trapped in ultra-low mortgage rates. Even though their home value is significantly higher, they can't afford to sell because if they buy a different home, their monthly payments may double for essentially the same home. Housing affordability is at an all-time low. Therefore, existing homeowners are much better off staying in their home vs. buying a different one. This is just one example of how markets have been distorted by monetary and fiscal policies meant to prop up consumers and businesses to help them survive the demand shock associated with COVID lockdowns.

The global economy is a complex dynamic system, not a light switch. As governments re-opened their economies, pent up demand exceeded supply. Producers and supply chains require time to reach productive efficiency. This timing mismatch contributed to the inflation the Federal Reserve is trying to tame. As markets respond to economic imbalances, it can appear as if some industries are broken and "what is" has become "what isn't." Eventually, we believe markets will adjust and "what would be" will be "what is" again. In the meantime, conflicting data appears to investors as rolling recessions, booms (Consumer Services/Housing/Infrastructure/Auto/Reshoring) and busts (Banking/Commodities/Life Sciences/Commercial Real Estate) making it difficult to see what is really going on underneath the surface. Underneath the surface, stocks are weaker than the headlines suggest.

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## The Majority of S&P 500 Companies are Underperforming Index

### % S&P 500 Stocks Beating the Index - Trailing 3 Months



Source: Piper Sandler

The narrowness of the market leadership suggests the Federal Reserve’s record pace of rate hikes is starting to have an effect on corporate profitability. Widening breadth and a steepening yield curve may provide greater confidence to investors that we have started a new secular bull market.

Given our portfolio construction discipline, the Strategy benefitted from the booms and was hurt by the busts. Our dual diversification portfolio risk controls generally helped us in the long term, but it was a headwind during the extreme narrowness in the market leadership this quarter.

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## Contributors and Detractors

Contributors benefited from strong business execution as well as tailwinds from the “booms” in housing, infrastructure, and artificial intelligence.

Eagle Materials Inc. (EXP) is a cement manufacturer benefiting from strong demand in housing and infrastructure. We purchased EXP in 2018 as a “Turnaround” that we anticipated would benefit from consolidation, reduced supply due to higher regulation, its Southern location as a beneficiary of demographic shifts and a management focused on allocating capital to higher return projects. So far, EXP is tracking our positive thesis as economic returns have improved from 0% to 15%. Our thesis has shifted toward believing it can sustain these higher returns and growth rates for longer than the market is currently pricing in. We expect EXP to “beat the fade” due to the secular need for more housing, barriers to entry for new supply, the federal infrastructure program, the demographic population shift to the South, and its savvy positioning as a regional monopoly.

Carpenter Technology Corp. (CRS) is another Turnaround, earlier in its transition to higher economic returns. New CEO Tony There has been working on the turnaround for several years as the management team allocated capital away from “commodity” steel toward producing specialty alloy and performance engineered steel used in Aerospace and medical technology. CRS delivered a very strong quarter and Tony sees “a path to significantly increase earnings for several years”.

Omnicell Inc. (OMCL) manufactures automated pharmaceutical dispensing machines reducing mis dosing and theft at hospitals. During Covid the company was hurt by plummeting hospital utilization rates as elected surgeries ground to a halt and staffing shortages that negatively impacted hospital capital expenditures. The OMCL systems were always superior and positioned to take share, but volumes declined. Now that utilization is increasing again and hospitals’ financial conditions have improved, OMCL is recovering to pre-covid levels of profitability and growth.

Portfolio detractors were concentrated in the Life Sciences and Regional Bank sectors. Catalent Inc. (CTLT), a contract manufacturer for pharmaceuticals and biologics declined 34% for the quarter on several negative headlines. First, CTLT announced that productivity issues and higher-than-expected costs experienced at three of its facilities, including two of its largest manufacturing facilities, would negatively impact financial results. Second, Bloomberg published an article indicating that Danaher has stopped its alleged takeover pursuit of Catalent. Finally, CTLT quantified the operational and productivity issues with the impact greater than expected and also subsequently delayed the earnings release and 10-Q filing. New CEO Allesandro Maselli is in the process of bringing in new management and addressing operational issues. While we have not had a chance to speak with Mr. Maselli directly yet, we are encouraged that they have filed their 10-Q with no issues and have articulated a path back to pre-covid profitability, no clients have cancelled orders (in fact they are continuing to win new business), and management is committed to lowering cap ex with a focus on debt reduction.

TriCo Bancshares (TCBK) is our largest bank holding and reported a disappointing quarter as investors overestimated TCBK’s ability to sustain an above average net interest margin in the face of rising short-term rates. TCBK modestly

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#### SECOND QUARTER 2023 CONTRIBUTION REPORT

Ranked by Basis Point Contribution

	Basis Point Contribution	Average Weight
<b>Top Contributors</b>		
Eagle Materials Inc.	+78	3.00%
Carpenter Technology Corp.	+61	2.55%
Omnicell Inc.	+50	2.04%
Trex Company Inc.	+45	1.46%
MKS Instruments Inc.	+43	1.96%
<b>Bottom Detractors</b>		
Catalent Inc.	-82	1.51%
TriCo Bancshares	-71	3.06%
Repligen Corp.	-50	2.99%
Fox Factory Holding Corp.	-41	2.66%
Valmont Industries Inc.	-32	2.98%

*Past performance is not indicative of future results, and there is a risk of loss of all or part of your investment. The above does not represent all holdings in the Strategy. Holdings listed might not have been held for the full period. To obtain a copy of RMB’s calculation methodology and a list of all holdings with contribution analysis, please contact your service team. The data provided is supplemental. Please see important disclosures at the end of this document.*

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underperformed the bank sector. The strategy remains underweight banks due to industry wide pressures on net interest margins and lower loan growth. The portfolio continues to own higher quality banks like TCBK because a lot negative information is in the price. What may not be reflected in broader bank share prices is increased credit risk, which has yet to appear. Recent bank stress tests confirm credit is not an issue for the sector at this point. However, if credit risk does appear, we are confident that TCBK's conservative credit culture will drive outperformance relative to the bank sector.

## Portfolio Activity

During the quarter the team made three sales and three purchases. We reduced the position size of semi-conductor capital equipment provider MKS Instruments Inc. (MKSI) as it approached our fair value on excitement around the Nvidia quarter and AI. We reduced Valmont Industries Inc. (VMI) as it approached our fair value and we noticed a deterioration in some of its end markets. We sold Synaptics Inc. (SYNA), a semi-conductor company, to zero as it became clear our positive thesis for long-term value creation was not playing out as expected and the negative thesis was becoming more probable.

We added to Applied Industrial Technologies Inc. (AIT), a value-added distributor. We continue to gain conviction in this name and results support our long-term value creation thesis that economic return and growth will improve as AIT continues to shift capital allocation toward higher return niche markets associated with IoT, and factory automation. We increased Neogen Corp. (NEOG), which has essentially become a monopoly in animal and food safety after its transformational acquisition of 3M's food safety business. After a rough start, and investor concerns that the company bit off more than it can chew, it appears to be turning the corner in terms of integration and new product adoption. We initiated a small position in PTC Therapeutics, Inc. (PTCT), a commercialized biotech, with many shots on goal targeting rare diseases.

## Outlook

The Alice in Wonderland analogy is a good one for thinking about our near-term outlook. The rabbit hole investors find themselves operating in is an environment where markets have been distorted by ten years quantitative easing (QE), which distorted the price of risk. We believe this led to:

- An overallocation of capital to unicorns (unprofitable businesses valued > \$1b),
- An unnaturally low number of bankruptcies,
- Generally higher asset prices across most asset classes,
- Risky capital structures for some businesses dependent on short term rather than longer term interest rates,
- Potential bubbles in parts of private equity and private credit where allocators actually believe they can get higher returns with lower volatility.

Add to that the adjustment process associated with a post-COVID world seeking to re-balance supply and demand, we suspect more of the same in the near term. Lots of conflicting data that, at first glance, may look like broken markets but are merely temporary distortions in the process of returning to a more normal economic reality.

The task of returning markets to economic reality is in the hands of Federal Reserve Chairman Jerome Powell. Exiting the era of free money is not easy or predictable. Things can break. For example, in 2022, the standard 60/40 balanced portfolio asset mix convention failed to protect investors when the model produced record declines. Diversification failed to work because "what is" - normally uncorrelated assets became correlated - became "what wasn't" because of a non-diversifiable systematic discount rate adjustment associated with unwinding QE and ZIRP (zero interest rate policy). UK pensions almost went bankrupt due to over reliance on short term 0% interest rates. This year, unicorns and over-levered businesses are starting to go bankrupt. AAA rated Regional Banks SIVB/FRC went bankrupt. Commercial Real Estate is showing signs of stress as well. These cracks in the system caused us to skew our outlook slightly more to the side of caution.

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However, financial stress can also create new opportunities, so we are keeping an open mind and looking for potential babies thrown out with the bathwater. Bank and REIT valuations have not been this attractive since the mid-1990s. Opportunities to add value through stock selection may be increasing as the end of free money should separate the good stewards of capital from the financial engineers. The economic system should grow stronger as capital exits those sectors overly reliant on the carry trade associated with 0% interest rates and flows toward true innovation like Artificial Intelligence, cleaner energy, more efficient manufacturing processes, infrastructure and innovative cash flowing new businesses. Exiting the world of free money will be a bumpy ride but good for the long-term health of the markets and the economy.

The near-term outlook is full of contradictions that we feel will likely be resolved over the coming quarters. The biggest contradiction to resolve is one between the bond and stock market. The bond market is signaling an imminent recession. The equity market is signaling no recession or at least a very soft landing. Which market is right? We honestly do not know, but we believe that our portfolio risk control discipline will keep factor risk manageable.

Our long-term outlook never wavers. By owning the best allocators of capital with skilled management teams that demonstrate knowledge building cultures, adaptability, and capital allocation consistent with long-term value creation, we believe we can own a portfolio of smaller companies that will grow to become larger companies thereby providing our investors attractive long-term risk adjusted returns.

Thank you for your commitment to the Strategy.

Sincerely,



Chris Faber  
Portfolio Manager

## TOP TEN HOLDINGS AS OF 6/30/23

Company	% of Assets
West Pharmaceutical Services Inc.	4.27%
Monolithic Power Systems Inc.	3.56%
PTC Inc.	3.50%
Eagle Materials Inc.	3.37%
EastGroup Properties Inc.	3.36%
Pool Corp.	3.33%
Curtiss-Wright Corp.	3.12%
ITT Inc.	3.07%
Kadant Inc.	3.01%
Carpenter Technology Corp.	2.81%

*Holdings are subject to change. Past performance is not indicative of future results, and there is risk of loss of all or part of your investment. The data provided is supplemental. Please see disclosures at the end of this document.*

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An investment cannot be made directly in an index. The index data assumes reinvestment of all income and does not bear fees, taxes, or transaction costs. The investment strategy and types of securities held by the comparison index may be substantially different from the investment strategy and types of securities held by the strategies. The benchmarks are shown for comparison purposes and are fully invested and include the reinvestment of income. The Russell 2000® is a subset of the Russell 3000® Index, representing about 8% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership. The Russell 2500® is a subset of the Russell 3000®, including approximately 2500 of the smallest securities based on their market cap and current index membership. The strategies include small- to mid-cap equity portfolios. The strategies may target investments in companies with relatively small market capitalizations (generally between \$500 million and \$10 billion at the time of initial purchase), that are undervalued as suggested by RMB Capital's proprietary economic return framework. The S&P 500 is widely regarded as the best single gauge of the United States equity market. It includes 500 leading companies in leading industries of the US economy. The S&P 500 focuses on the large cap segment of the market and covers approximately 75% of US equities. The Russell 2000® Value Index tracks the performance of companies with lower price-to-book ratios, which shows a company's market price relative to its balance sheet. The Russell 2000® Growth Index is a subset of companies with higher price-to-book ratios, or those expected to have higher growth values in the future.

**Basis Point (bps):** A unit that is equal to 1/100th of 1% and is used to denote the change in a financial instrument.

**The Purchasing Managers' Index™ (PMI™)** is based on monthly surveys of carefully selected companies representing major and developing economies worldwide.

## RMB Asset Management Small Cap Core Composite // GIPS Report

**Organization** | RMB Capital Management, LLC ("RMB Capital") is an independent investment advisor registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940 and established in 2005. The GIPS firm is defined as RMB Asset Management ("RMB AM"), a division of RMB Capital Management, LLC. Previously, the firm was defined as RMB Capital and was redefined on January 1, 2016 to only include the asset management business due to the difference in how its investment strategies and services are offered. RMB AM claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. RMB AM has been independently verified for the periods April 1, 2005 through December 31, 2020. The verification report(s) is/are available upon request. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report.

**Description** | The Small Cap Core Strategy product reflects the performance of fully discretionary equity accounts, which have an investment objective of long-term growth using a portfolio of primarily small-cap stocks and for comparison purposes is measured against the Russell 2000® index. The inception date of the Small Cap Composite is April 30, 1999 and the Composite was created on March 31, 2002. The composite includes small cap equity portfolios invested in undervalued companies as suggested by RMB Capital's proprietary economic return framework, with relatively small market capitalizations (generally under \$2.5 billion at the time of initial purchase) and with both growth and value attributes. Valuations and returns are computed and stated in U.S. Dollars. Effective November 2021, Jeff Madden is no longer a portfolio manager for the strategy. There is no change to the strategy's investment process.

## ANNUAL PERFORMANCE RELATIVE TO STATED BENCHMARK

Year End	Composite Assets			Annual Performance Results					
	Total Firm Assets* as of 12/31 (\$M)	USD (\$M)	# of Accounts Managed	Composite Gross-of-Fees (%)	Composite Net-of-Fees (%)	Russell 2000® (%)	Composite 3-YR ST DEV (%)	Russell 2000® 3-YR ST DEV (%)	Composite Dispersion (%)
2022	5,228.66	89.70	<5	-23.96	-24.60	-20.44	24.04	26.02	0.00
2021	6,277.61	141.63	<5	25.60	24.55	14.82	20.18	23.35	0.00
2020	5,240.59	116.94	<5	19.38	18.28	19.96	22.02	25.27	0.00
2019	4,947.90	118.03	<5	28.91	27.57	25.52	13.97	15.71	0.34
2018	4,196.90	117.54	<5	-4.54	-5.40	-11.01	13.52	15.79	0.29

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2017	3,610.61	453.90	6	11.70	10.59	14.65	11.58	13.91	0.30
2016	NA	723.21	7	15.06	13.93	21.31	13.20	15.76	0.16
2015	NA	684.92	10	-0.98	-1.97	-4.41	12.61	13.96	0.17
2014	NA	714.83	5	7.46	6.39	4.89	12.01	16.59	0.25
2013	NA	868.35	8	34.58	33.27	38.82	15.56	16.45	0.22

\*RMB Capital acquired the composite by combining with IronBridge Capital Management on June 24, 2017. Firm assets prior to 2017 are not presented as the composite was not part of the firm. RMB Capital acquired the composite by combining with IronBridge Capital Management on June 24, 2017. Composite performance prior to that date was achieved by IronBridge Capital Management.

**Fees** | The standard management fee is 1% of assets annually, which is also our highest applicable fee. Actual investment advisory fees incurred by clients may vary. Composite performance is presented on a gross-of-fees and net-of-fees basis and includes the reinvestment of all income. For periods prior to 2018, net returns are computed by subtracting the highest applicable fee (1% on an annual basis, or 0.083% monthly) on a monthly basis from the gross composite monthly return, and the resulting monthly net figures are compounded to calculate the annual net return. Beginning in 2018, net returns are reduced by actual management fees and transactions costs incurred. The annual composite dispersion is an asset-weighted standard deviation calculated for the accounts in the Composite the entire year. Prior to 2018, internal dispersion was calculated using the equal weighted standard deviation for the accounts in the Composite the entire year. Risk measures presented are calculated using gross-of-fees performance. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request.

**Minimum Value Threshold** | The account minimum in the Small Cap Core product is currently \$2 million. Prior to January 1, 2015, the composite excluded portfolios under \$5 million.

**Comparison with Market Indices** | RMB compares its Composite returns to a variety of market indices. These indices represent unmanaged portfolios whose characteristics differ from the Composite portfolios; however, they tend to represent the investment environment existing during the time period shown. The returns of the indices do not include any transaction costs, management fees, or other costs. Benchmark returns presented are not covered by the report of independent verifiers. The benchmark for the Small Cap Core composite is the Russell 2000® Index, which for comparison purposes is fully invested and includes the reinvestment of income. The Russell 2000® is a subset of the Russell 3000® Index, representing about 8% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership. The Russell 2000® index is an unmanaged index that is designed to measure the small cap segment of the U.S. equity universe. The index does not reflect investment management fees, brokerage commissions, or other expenses associated with investing in equity securities. You cannot invest directly in an index.

**Other** | Past performance is no guarantee of future performance. Historical rates of return may not be indicative of future rates of return. Individual client performance returns may be different than the composite returns listed. GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. A list of Composite Descriptions and a list of Broad Distribution Pooled Funds are available upon request.