

## Small-Mid Cap Sustainable Growth Portfolio

Third Quarter 2022 | Managed Accounts

### Portfolio Review

This was a volatile quarter in the markets. Earlier in the quarter many investors felt the Federal Reserve may pivot in the summer which caused riskier and lower-quality assets to perform well. However, when investor expectations were not met as high inflation persisted, the risk of a recession seemed more likely and in September there was a material flight to quality. The decline in stock prices was more pronounced in large cap, with the S&P 500 Index declining 4.88% in the quarter while the Russell 2000 Index was down 2.19%. Given the U.S. dollar's unprecedented strengthening, this makes sense as larger companies tend to have more international exposure and currency translation risk. The Russell 2500 Index declined 2.82% in the quarter. We saw a reversal of style trends in the third quarter with growth outperforming value. The Russell 2500 Value Index declined 4.50% in the quarter while the Russell 2500 Growth Index only declined 0.12%. The Kayne Anderson Rudnick Small-Mid Cap Sustainable Growth portfolio underperformed the Russell 2500 Growth Index in the third quarter. Poor stock selection in health care and industrials detracted from performance. Strong stock selection in information technology and an underweight in real estate contributed positively to performance. In general, sector allocation helped performance overall while stock selection was a negative contributor.

The biggest contributors to performance during the quarter were Silk Road Medical and Clearwater Analytics. Silk Road Medical reported solid results this quarter and management raised guidance. The company also received FDA approval for use in standard risk patients, which expands its addressable market. In the latest quarter, Clearwater Analytics' management announced continued revenue growth and plans to move towards a more fixed pricing structure from the current assets under management-based fee. Market participants positively interpreted the results causing shares to outperform. Other top contributors included Avalara, Old Dominion Freight Line, and HEICO.

The biggest detractors to performance during the quarter were Azenta and West Pharmaceutical Services. Azenta's core business continues to be very healthy, however, it is currently facing some temporary headwinds. Firstly, the company's results had benefited from COVID, which have declined naturally as we pass through the pandemic. Results were also negatively impacted by COVID-closures in China reducing demand for its Life Sciences Services. We view both of these issues as transitory. West Pharmaceutical Services' COVID-related revenue declined more precipitously than expected and guidance called for a material decline in 2023. That said, ex-COVID growth is still tracking in the mid-teens, giving us confidence that the business is still strong. Other bottom contributors included TransUnion, Rightmove, and Teledyne Technologies.

### Purchases and Sales

During the quarter, there were no new purchases and we sold our positions in Avalara and Old Dominion Freight Line. We sold Avalara as the company announced on August 8, 2022 that it had agreed to be acquired. We sold our position in anticipation of the sale. We sold Old Dominion Freight Line as the market cap grew to a level that is outside the mandate of this portfolio.

### Outlook

We believe the plethora of bad news has led the stock market to a price level that already discounts a shallow-to-mild recession. However, simply put, equities will not bottom out until long-term bond yields (10 to 30 year) stop increasing. It was not a coincidence that stocks rallied from the middle of June until the middle of August when long-term yields were declining. We need a sustained decline in reported inflation statistics for this to happen. This seems likely at some point over the next six-to-twelve months. Monetary policy is working—raw material prices are falling (including oil); housing and autos are being hit hard (including used car prices and even new recently); semiconductors have turned from a shortage to a surplus in many areas; and many companies are starting to shed workers. Supply chain difficulties, which the Fed cannot directly control, are improving as well, but the Russian war and China's zero-COVID policy continue to create some supply difficulties. Given pessimistic investor sentiment, bearish positioning, and many attractively valued companies on a long-term basis, any better-than-feared news on the course of future interest rate increases could cause the markets to substantially improve from here. Historically, periods of stock market pessimism with zero speculation in them have been good long-term entry points for patient investors.

### Portfolio Highlights

**Style:** Small-Mid Cap  
**Sub-Style:** Growth  
**Index:** Russell 2500™ Growth  
**Portfolio Inception:** 2018  
**Portfolio Assets:** \$418.6 M\*  
**Portfolio Turnover:** 25%–35%

### Investment Management Team

| Name  | Years of research experience |
|---|------------------------------|
| <b>Douglas S. Foreman, CFA</b><br>Chief Investment Officer              | 36                           |
| <b>Julie Biel, CFA</b><br>Portfolio Manager + Senior Research Analyst   | 14                           |
| <b>Chris Wright, CFA</b><br>Portfolio Manager + Senior Research Analyst | 10                           |
| <b>Todd Bailey, CFA</b><br>Senior Research Analyst                      | 23                           |
| <b>Jon Christensen, CFA</b><br>Senior Research Analyst                  | 27                           |
| <b>Julie Kutasov</b><br>Senior Research Analyst                         | 21                           |
| <b>Craig Stone</b><br>Senior Research Analyst                           | 33                           |
| <b>Sean Dixon</b><br>Research Analyst                                   | 14                           |
| <b>Arthur Su, CFA</b><br>Research Analyst                               | 7                            |
| <b>Adam Xiao, CFA</b><br>Research Analyst                               | 9                            |
| <b>Jordan Greenhouse</b><br>Senior Client Portfolio Manager             | 25†                          |
| <b>James B. May, CFA</b><br>Client Portfolio Manager                    | 34†                          |
| <b>Jason Pomatto</b><br>Client Portfolio Manager                        | 28†                          |

### Top Five Holdings

As of September 30, 2022

| Company                      | Percent of equity (%) |
|------------------------------|-----------------------|
| Ryan Specialty               | 7.2                   |
| Silk Road Medical            | 5.9                   |
| HEICO                        | 5.4                   |
| West Pharmaceutical Services | 5.1                   |
| Jack Henry & Associates      | 5.0                   |
| <b>Total</b>                 | <b>28.6</b>           |

\*Figures in USD.

†Represents years of industry experience.

This report is based on the assumptions and analysis made and believed to be reasonable by Advisor. However, no assurance can be given that Advisor's opinions or expectations will be correct. This report is intended for informational purposes only and should be not considered a recommendation or solicitation to purchase securities. Holdings are subject to change. Holdings and weightings are based on a representative portfolio. Individual Investors' holdings may differ slightly. Data is obtained by FactSet Research Systems and is assumed to be reliable. Numbers may not always add up due to rounding.

**Past performance is no guarantee of future results.**

## Investment Process: Discovering Quality

| <b>Development of KAR High-Quality Universe</b>   | <b>Proprietary Fundamental Research</b>   | <b>Portfolio Construction</b>  | <b>Sell Discipline</b>  |
|---|---|--|---|
| <b>Quantitative Screens</b> <ul style="list-style-type: none"> <li>High return on capital over a full economic cycle</li> <li>Long and resilient earnings history</li> <li>High return on net operating assets</li> <li>Minimal debt</li> </ul> <b>Other Resources</b> <ul style="list-style-type: none"> <li>Research on existing portfolio holdings</li> <li>Meetings with companies</li> <li>Industry reviews</li> <li>Investment conferences</li> <li>Third-party research</li> </ul> | <b>Qualitative Analysis</b> <ul style="list-style-type: none"> <li>Evaluate sustainability of business model and assess management's ability to direct capital where it can create further control of its market</li> </ul> <b>Financial Analysis</b> <ul style="list-style-type: none"> <li>Evaluate basis for profitability, long-term growth potential, and ability to allocate capital appropriately</li> </ul> <b>Valuation Analysis</b> <ul style="list-style-type: none"> <li>Determine the current and potential value of the business</li> </ul> | <b>Position Weights</b> <ul style="list-style-type: none"> <li>Maximum initial position size is 5% (at cost)</li> <li>Maximum position size is 10% (at market)</li> </ul> <b>Sector Tolerances</b> <ul style="list-style-type: none"> <li>Seek broad diversification, but no sector constraints</li> </ul> <b>Non-U.S. Holdings</b> <ul style="list-style-type: none"> <li>Up to 20%</li> </ul> <b>Holding Period</b> <ul style="list-style-type: none"> <li>Typically 3-to-5 years, but is often longer</li> <li>Portfolio turnover is typically 25% to 35%</li> </ul> <b>Cash Levels</b> <ul style="list-style-type: none"> <li>Typically will not exceed 10% once a portfolio is fully invested; review by CIO triggered if over 10%</li> </ul> | <b>Extended Valuation</b><br><br><b>Portfolio Upgrade</b><br><br><b>Acquisition Activity</b><br><br><b>Negative Company or Industry Changes</b> |

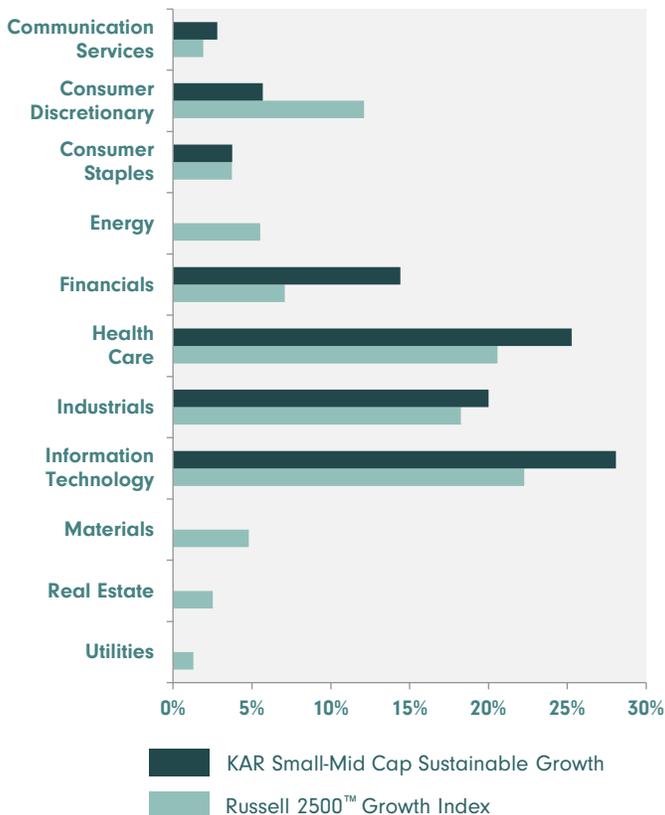
Higher Quality

Stronger, More Consistent Growth

Better Value

## Sector Diversification

As of September 30, 2022



Holdings are subject to change. Holdings and weightings are based on a representative portfolio. Individual investors' holdings may differ slightly. The sector information represented above is based on GICS sector classifications. Data is obtained by FactSet Research Systems and is assumed to be reliable.

## Portfolio Characteristics

As of September 30, 2022

|   | KAR Small-Mid Cap Sustainable Growth | Russell 2500™ Growth Index |
|---|--------------------------------------|----------------------------|
| <b>Quality</b>                          |                                      |                            |
| Return on Equity—Past 5 Years           | 22.8%                                | 15.1%                      |
| Total Debt/EBITDA                       | 3.3 x                                | 5.5 x                      |
| Earnings Variability—Past 10 Years      | 44.5%                                | 69.8%                      |
| <b>Growth</b>                           |                                      |                            |
| Earnings Per Share Growth—Past 10 Years | 13.5%                                | 13.7%                      |
| Capital Generation—{ROE x (1-Payout)}   | 19.6%                                | 13.0%                      |
| <b>Value</b>                            |                                      |                            |
| P/E Ratio—Trailing 12 Months            | 65.2 x                               | 45.7 x                     |
| Free Cash Flow Yield†                   | 1.5%                                 | 1.4%                       |
| <b>Market Characteristics</b>           |                                      |                            |
| \$ Weighted Average Market Cap.         | \$10.8 B                             | \$5.5 B                    |
| Largest Market Cap                      | \$26.9 B                             | \$18.3 B                   |

†Free cash flow data is as of June 30, 2022. Prices are as of September 30, 2022. Excludes financials.

Data is obtained from FactSet Research Systems and BNY Mellon and is assumed to be reliable. Other principal consultant firms may use different algorithms to calculate selected statistics. Estimates are based on certain assumptions and historical information. **Past performance is no guarantee of future results.**

**IMPORTANT RISK CONSIDERATIONS: Equity Securities:** The market price of equity securities may be adversely affected by financial market, industry, or issuer-specific events. Focus on a particular style or on small or medium-sized companies may enhance that risk. **Limited Number of Investments:** Because the portfolio has a limited number of securities, it may be more susceptible to factors adversely affecting its securities than a portfolio with a greater number of securities. **Market Volatility:** Local, regional, or global events such as war, acts of terrorism, the speed of infectious illness or other public health issues, recessions, or other events could have a significant impact on the portfolio and its investments, including hampering the ability of the portfolio manager(s) to invest the portfolio's assets as intended.