Small/Mid Cap Managed Account

Quarterly Review

- US equities delivered robust returns during the final two months of 2023, resulting in double digit-gains across most equity categories and styles for the fourth quarter and calendar year. The late-year rally reflected improving sentiment towards markets and the economy, boosted by a growing consensus that the Federal Reserve would not only stay on pause in regard to interest rate increases but may soon be cutting rates. Dovish commentary on the part of Federal Reserve Chair Jerome Powell after the December FOMC meeting seemed to confirm this predilection, and the rally gained steam in the final weeks of the year. For the calendar year, the strong quarter ensured broad based, double-digit equity returns with large cap stocks materially outperforming small- and mid-caps.
- During the quarter market leadership witnessed a strong reversal and absolute performance during the quarter reflected a pivot to a “risk-on” mindset by investors, after a more defensive posture and “risk-off” leadership over the prior several quarters. The leadership change was also reflected in sector performance within the index, with financials and health care outperforming, after materially underperforming for the first nine months of 2023. Similarly, energy moved to the bottom of sector performance rankings, after significantly outperforming for the prior nine months. Finally, many of the top performing smaller cap stocks during the quarter were some of the worst performers earlier in the year.
- The Small/Mid Cap Core portfolio underperformed its benchmark index during the fourth quarter of 2023 as both sector allocation and stock selection metrics lagged. Given the sharp reversals in market leadership, our high quality strategy underperformed in the fourth quarter after large outperformance for the year-to-date period through September and over the prior six consecutive quarters. Energy, which was previously a contributor to relative performance, detracted the most versus the index due to the strategy’s overweight to the sector. Positive stock selection across a few sectors (industrials and consumer discretionary) did not contribute enough to relative performance to offset the weakness across the portfolio and specifically in the health care and energy sectors.
- Strong stock selection metrics within the industrials and consumer discretionary sectors aided return as four of the top five contributors for the quarter were found in those two sectors. During the quarter positions in PulteGroup, Inc. and Kadant Inc. added the most to performance.
- **Pulte** is a top-five homebuilder with operations in most of the largest US new housing markets. The stock increased in the quarter due to continued strong single-family housing demand, which was helped by a decline in mortgage rates. Pulte has been a strong performer for our strategy since its purchase in January of 2021, and particularly so over the last twelve months. Over the past two years, the strong end market has allowed the company to attain historically high margins and returns on assets. Excess cash flow has been used to reduce debt and to aggressively repurchase stock. The stock’s valuation has moved higher, but remains attractive relative to the company’s fundamental prospects.
- **Kadant** is a well-managed industrial company with products primarily serving the wood and paper processing industries. The company is differentiated by high margins, strong returns on capital, and significant after-market exposure which lends stability to the business. During the fourth quarter, the company set new records for margins and continued its history of raising its earnings outlook which was rewarded with a 24% return during the quarter.

- Detracting from relative return was an overweight position in energy and financials, and lagging stock selection in the health care, energy communication services and information technology sectors. During the quarter positions in energy companies Expro Group Holdings and ChampionX Corporation detracted the most to performance.
- **Expro Group** is a provider of energy services offering well construction, well flow management and subsea well access to exploration & production companies in both offshore and onshore environments. Expro was a fairly recent addition to the portfolio, starting in November of 2022. However, a series of business execution challenges diminished our confidence in the company, culminating in a surprising earnings shortfall during the third quarter of 2023. Based on the disappointing news and with better energy stock alternatives, we elected to eliminate the position during the fourth quarter of 2023.
- **ChampionX** is an energy equipment and oil field service company. The stock underperformed in part reflected overall weakness in energy stocks during the quarter. Sector performance was driven by a sharp decline in oil and gas commodity prices off prior short-term peaks achieved near the end of the third quarter. The decline in ChampionX stock was further exacerbated by a modest revenue and earnings shortfall reported for the third quarter.

Outlook

- We remain committed to identify inefficiencies in the small/mid cap market resulting in stock prices and valuations not accurately reflecting our assessment of the underlying value of the corporate enterprise. This approach is applied consistently over time, regardless of the current market environment.
- While many forms of inefficiency may exist, we focus on companies that are misunderstood, underfollowed or in the midst of a "special situation" where we believe we can use our strengths in the form of our time horizon, resource deployment or a willingness to solve complex situations. We require fundamentally sound business models, capable management teams and financial stability. Fundamental to our process are unique, company specific catalysts on the horizon to sustain, enhance, or highlight the fundamental outlook.
- These principles are applied consistently over time, regardless of the current market environment. With a margin of safety and a proper time horizon, our goal is to achieve an attractive total return for our investors, while managing to an appropriate level of risk.

Important Disclosure

Key Risks: *Equity Risk, Market Risk, Non-US Securities Risk, Liquidity Risk. Investing involves risk including possible loss of principal.*

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Indices are unmanaged and do not incur fees. It is not possible to invest directly in an index.

Market conditions are extremely fluid and change frequently.

Commodity interest and derivative trading involves substantial risk of loss.

Top two and bottom two holdings may not be representative of current or future holdings and will evolve over time. The examples above do not represent all securities purchased, sold or recommended for client accounts. They should not be considered specific investment recommendations or representative of other investments made by Loomis Sayles. A list showing the contribution of each holding to the overall performance of the representative account during the measurement period is available upon request.

Holdings analysis is shown for a representative account as supplemental information. Due to systems limitations it is difficult to analyze sector distribution on a composite basis. This representative account was selected because it closely reflects the Loomis Sayles Small/Mid Cap investment strategy. Due to guideline restrictions and other factors, there is some dispersion between the returns of this account and other accounts managed in the Small/Mid Cap investment style.

Diversification does not ensure a profit or guarantee against a loss.

Any investment that has the possibility for profits also has the possibility of losses, including the loss of principal.

There is no guarantee that the investment objective will be realized or that the strategy will generate positive or excess return.

Past performance is no guarantee of future results.

MALR032483