Small/Mid Cap Managed Account

Quarterly Review

- The US equity market experienced a moderate recovery in the fourth quarter, a welcome respite to close an overall difficult year. Widespread strength in October and November reflected improving data points regarding inflation, and investor sentiment lifted on renewed expectation of an eventual pause in the Federal Reserve's efforts to slow economic demand through interest rate hikes. Lower inflation data points were in part due to evidence of slowing economic growth, raising the likelihood of a recession in 2023. As investors appeared to refocus on the upcoming year, markets once again turned lower during December and ended the year on a negative note reducing overall gains for the quarter. Every domestic equity size and style recovered some value, with valuation expansion as the primary driver behind higher stock prices. Forward earnings forecasts moved lower on prospects for a slower economy in 2023. Nevertheless, consensus earnings forecasts continue to project single-digit earnings growth in the coming year, despite tightening financial conditions and an inverted yield curve that would otherwise indicate tougher economic times are ahead.

- High quality remained in favor during the quarter, as global economic uncertainty appeared to encourage investors to favor business models with resilient cash flows, stronger balance sheets and more conservative valuations. Value stocks outperformed growth stocks across all market categories, a reversal from the third quarter where growth beat value and lower quality prevailed over higher quality.

- We believe our Small/Mid Cap strategy outperformance during the fourth quarter was in large part driven by the high quality nature of our portfolio. The defensiveness of our holdings as notable resilience in our portfolio during the final weeks of the quarter accounted for most of the relative return. Specifically, our portfolio return on equity was higher than the index average, and the portfolio valuation was lower. Both factors were helped by the lack of developmental stage and unprofitable companies in our portfolio, whereas close to 15% of the companies in the Russell 2500™ Index are currently unprofitable. Stock selection metrics were broadly positive reflecting our style difference versus the index, with information technology and health care leading, and only financials being a modest drag on relative performance during the quarter.

- Strong performance in stock selection across multiple sectors was responsible for the outperformance. ChampionX Corporation and AECOM were the two largest contributors to performance during the quarter.

- **ChampionX** provides a variety of products and solutions to help operators produce oil and gas. While energy stocks stood out in 2022 delivering strong gains in a weak overall equity market, ChampionX's stock price was largely flat through the first three quarters, before providing stronger returns in the final quarter of the year. Key factors behind the fourth quarter rally included strong earnings reported in late October, with each reporting segment demonstrating sequential and year-ever-year growth. Management commentary noted the company's ability to grow at or above overall industry production levels, and directly addressed concerns which had previously weighed upon the stock. Finally, strong free cash flow generation has resulted in reducing debt levels, allowing the company options to increase return of capital to shareholders through dividend payments or share repurchase.

- **AECOM** is a multinational infrastructure consulting firm, designing bridges, roads, and airports. AECOM has benefited from margin expansion, accelerating revenue growth, and disciplined capital allocation. The company has increased margins by divesting business units and exiting sub-scale geographies while its core US and European markets continue to benefit from increased infrastructure spending while management returns excess capital to shareholders in the form of dividends and buybacks.

- Detracting from relative return was lagging stock selection in the financials sector. Chart Industries, Inc. and Catalent Inc. were the two largest detractors to performance during the quarter.

- **Chart Industries** is a leading provider of cryogenic equipment with increasing demand from a number of fast growing end markets including liquefied natural gas and hydrogen liquefaction. With record orders and backlog, the company was poised for substantial growth over the next few years. In November, the company announced the purchase of privately held Howden, a manufacturer of compression equipment. The primarily debt funded acquisition would double Chart's revenue. While we understand the industrial logic of the acquisition, the size and the significant narrative change along with financing concerns noticeably hurt investor's sentiment on the shares. Following a capital raise, shares appear to have stabilized. We retained a position in the shares after trimming at higher levels, but will continue to review the position in light of the increased leverage and greater reliance on merger synergies versus organic growth.

- **Catalent** is a global outsource manufacturer of oral, injectable, and respiratory products and drug delivery technologies that serve the diverse biopharmaceutical industry. As expected, Catalent's COVID-19 related vaccine production declined during 2022, but the rate of decline may not have been accurately reflected in investor forecasts. More surprising, in our view, was a macro-related slowdown in certain consumer end-markets where inventories became elevated and production levels were adjusted lower. The net result was a notable decrease in earnings forecasts during the second half of the year and cash flow was under pressure as 2022 was a heavy investment year for the company. Looking forward, we expect earnings to remain well above pre-COVID-19 levels, and cash flow to rebound in 2023 as capital investment programs begin to wind down. With earnings expectations now reset and the share price now trading back at pre-COVID-19 levels, valuation of the stock has settled near multi-year lows. We are maintaining our reduced position in Catalent, and considering opportunities to add once visibility on favorable secular growth trends return.

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 distinct, 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 2 and bottom 2 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.