IN FOCUS

FINDING OPPORTUNITIES AT THE INTERSECTION OF QUALITY & VALUE

A GUIDE TO ACTIVE INVESTING IN SMALL CAPS

WHY SMALL CAPS?

Investing in small cap stocks can offer several advantages over time. While small cap stocks are generally associated with higher risk due to their relatively smaller size and potential volatility, they can also provide unique opportunities for growth and long-term returns.

Here are some key reasons why active investing in small cap stocks can be important over time.

KEY BENEFITS OF SMALL CAPS

PERFORMANCE POTENTIAL

Small cap stocks usually represent young and growing companies with significant potential for expansion. By identifying promising small cap stocks early on, investors can potentially benefit from the growth trajectory of these companies as they mature and increase in value.

MARKET INEFFICIENCIES

Small cap stocks tend to receive less attention from analysts and institutional investors compared to large cap stocks. This relative lack of coverage can create market inefficiencies and undervalued opportunities.

DIVERSIFICATION

Including small cap stocks in a well-diversified portfolio can enhance overall diversification. Small cap stocks often exhibit low correlation to other asset classes, which can reduce portfolio volatility and potentially increase risk-adjusted returns.

FLEXIBILITY

Small cap companies are typically more agile and adaptable compared to larger corporations. They can respond more quickly to market changes, capitalize on emerging trends, and implement innovative strategies. This flexibility enables them to seize growth opportunities and navigate market conditions more effectively.

01

PERFORMANCE POTENTIAL

IMPACTS FROM A LOOMING RECESSION

Historically, small cap stocks have outperformed large cap stocks coming out of recessions. Small caps are typically more levered to oscillations in the economic cycle than large caps, presenting an attractive opportunity for capital allocation during recessionary periods.

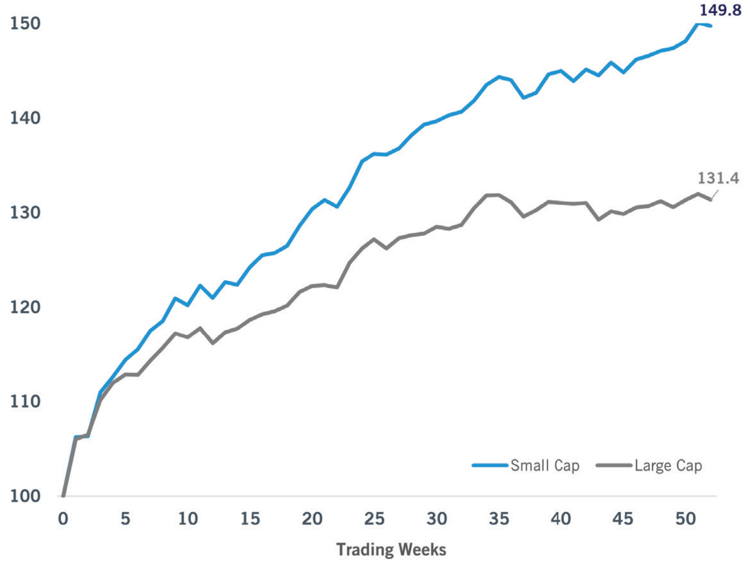
THE SMALLER CAP EFFECT

Over long arcs of time, small cap stocks have historically shown the potential to outperform large cap stocks.

One reason behind this outperformance is the higher growth potential of small cap stocks. Smaller companies often have more room to grow and expand compared to large, mature companies. This growth potential can lead to greater capital appreciation and potentially higher returns for investors in small cap stocks.

SMALL VS LARGE CAP RETURNS - 12 MONTHS POST-RECESSION

(LAST SIX RECESSIONS - REBASED TO 100)

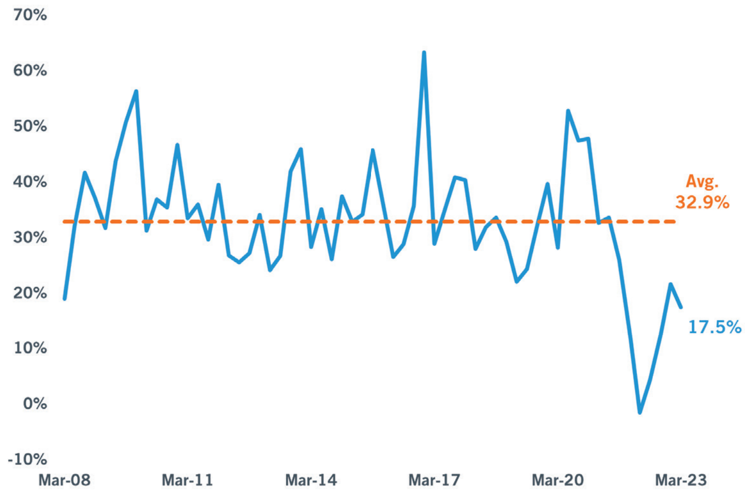


Small cap stocks have outperformed large caps in 6 of the last 6 recessions (back to 1980) by an average of over 1,800 bps in the 12-months following the recession trough date.

Source: Bloomberg/Cambiar
S&P 500 Index - Large Cap
Russell 2000 Index - Small Cap

ATTRACTIVE VALUATIONS

P/E PREMIUM/DISCOUNT
(RUSSELL 2000 VS. S&P 500)

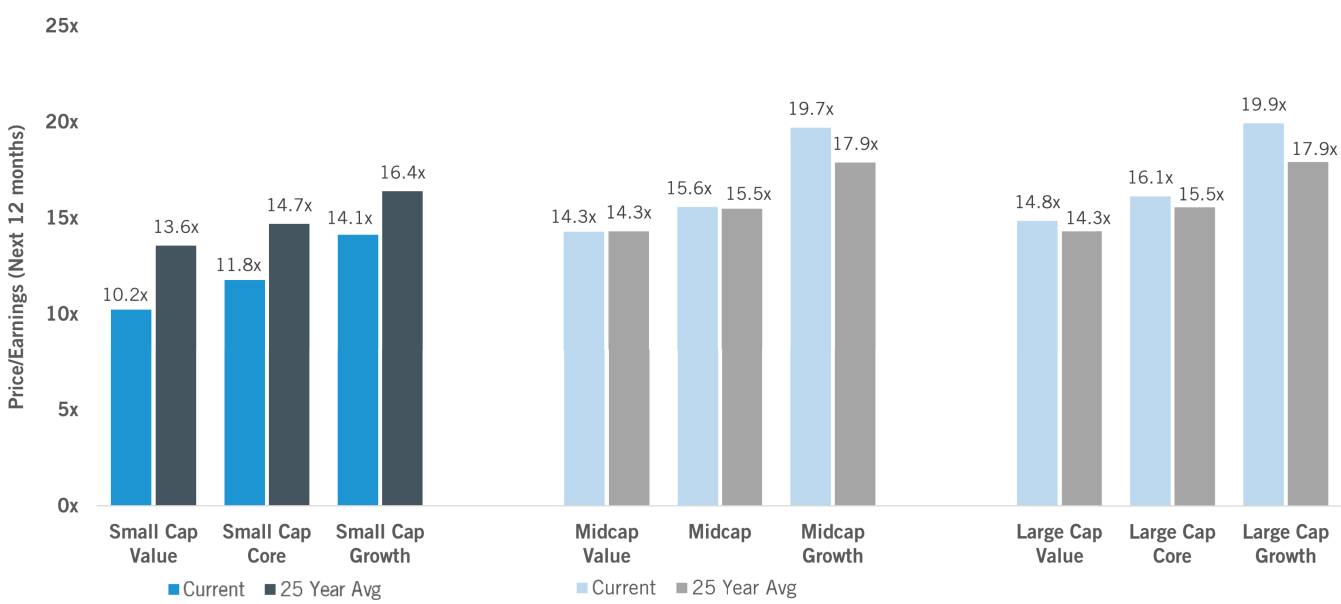


Source: Bloomberg/Russell/S&P

Currently in 2023, small caps are trading at compelling valuations relative to large caps and their historical averages.

We believe the fear-based selling of small caps is often overdone, which can present an attractive risk/reward opportunity for savvy investment professionals with the acumen to identify pricing/valuation anomalies.

P/E RATIO - RUSSELL INDICES
(CURRENT & 25-YR AVG. MEDIAN P/E)

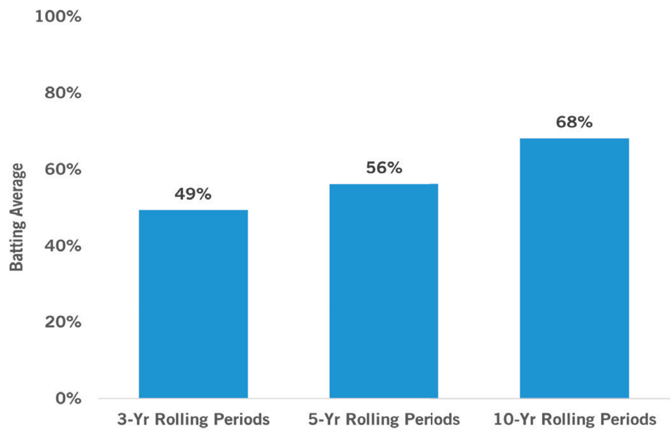


Despite the recovery in 2022, small cap stocks are still trading below their average P/E discount relative to large caps, suggesting a continued runway for renormalization of down-cap equities moving forward.

Charts Source: Bloomberg/Russell/S&P/Morningstar
Small Cap Value - Russell 2000 Value, Small Cap Core - Russell 2000, Small Cap Growth - Russell 2000 Growth
Midcap Value - Russell Midcap Value, MidCap - Russell Midcap, Midcap Growth - Russell Midcap Growth
Large Cap Value - Russell 1000 Value, Large Cap Core - Russell 1000, Large Cap Growth - Russell 1000 Growth

SMALL CAP RELATIVE TO THE BROADER MARKET

% OF TIME SMALL CAPS OUTPERFORMED LARGE CAP
(JAN '00 - DEC '22)



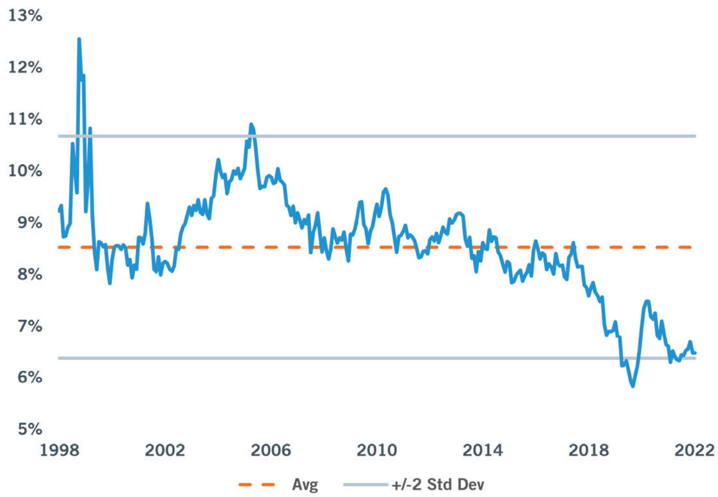
Source: Morningstar. Small Cap Stocks represented by the Morningstar US Small Cap Index. Large Cap stocks represented by the Morningstar US Large Cap Index.

Small cap stocks have historically demonstrated greater return potential relative to large cap stocks, with small caps outperforming large caps in 68% of 10-year rolling periods.

Recessionary fears have disproportionately impacted the valuations of small companies when compared to large caps.

Investors rationalize this behavior with the belief that small caps are more economically sensitive and less secure than large caps (large caps also exhibit higher perceived quality in revenues, operating risk, and supply chain power) – in turn, fleeing small caps in favor of the higher perceived quality in large caps.

MARKET CAP REPRESENTATION
(RUSSELL 2000 AS % OF RUSSELL 3000)



Source: FactSet/Russell

Small cap stocks are trading near their lowest aggregate market cap relative to large caps over the last 25 years, suggesting there is ample room for renormalization in favor of down-cap equities moving forward.

02

LARGER INVESTABLE UNIVERSE & GREATER INEFFICIENCIES

IMPROVED OPPORTUNITY SET

UNIVERSE OF STOCKS

LARGE CAP
1000+
Securities

SMALL CAP
1900+
Securities

Greater Growth Potential: Small cap stocks often have higher growth prospects compared to large cap stocks. These companies are typically in their early stages of expansion and have more room to grow their revenues, market share, and profitability. As a result, small cap stocks can offer investors the potential for significant capital appreciation over the long term.

Niche Market Opportunities: Small cap stocks often operate in niche markets or specialized sectors that are underserved or less covered by large cap companies. This can create opportunities for small cap companies to establish dominance and capture market share in their specific industries. Investors who can identify promising small cap companies in niche markets may benefit from their potential for above-average growth and profitability.

ANALYST COVERAGE

Due to the lack of analyst coverage, small stocks may not receive the same level of attention and scrutiny as larger companies, creating greater dispersion between stock prices and fair value. While this may create challenges for average investors, these become potential benefits for seasoned investment professionals.

17%

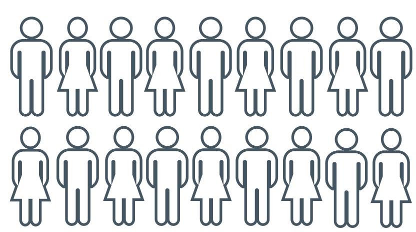
Small cap securities covered by fewer than three analysts

OPPORTUNITIES WITHIN THE OVERLOOKED

Arbitrage Possibilities: Because small stocks are often overlooked by analysts, 'hidden gems' may possess pricing inefficiencies and mispricings that can be exploited by investors who have done their own research and analysis.

This can lead to outperformance compared to the broader market or to peers who are only investing in larger, more heavily covered stocks.

AVERAGE ANALYST COVERAGE
(SMALL CAP)



AVERAGE ANALYST COVERAGE
(LARGE CAP)

Source: Factset. As of 3.31.2023.

03

WHY QUALITY MATTERS

BENEFITS OF SEEKING QUALITY COMPANIES

What is quality? Cambiar defines quality businesses as those with company-specific attributes such as high relative profitability, durable free cash flow generation, a defensible margin/return profile, and low leverage. These are viewed as critical inputs to delivering excess return over a full market cycle.

Historically, small caps have exhibited more volatility than large caps during periods of slowing economic growth and tighter financial conditions. While we believe that certain companies — mainly those with unprofitable business models, high debt levels, and low returns on invested capital — could be susceptible to headwinds during tough times, we also believe high-quality small caps can survive and grow in the face of adversity.

Additionally, we believe that high-quality companies with durable economic moats have more financial flexibility and pricing power, which helps dampen the impact of external forces like a rising cost of capital.

STABILITY

Quality stocks tend to exhibit more stable price movements and lower volatility compared to lower-quality or speculative stocks. These companies often have established business models, solid financials, and a track record of generating consistent earnings and cash flows.

CAPITAL PRESERVATION

Quality stocks have the potential to preserve capital even during market downturns. While no investment is completely immune to market fluctuations, high-quality companies with strong fundamentals tend to be more resilient during economic downturns.

LONG-TERM PERFORMANCE

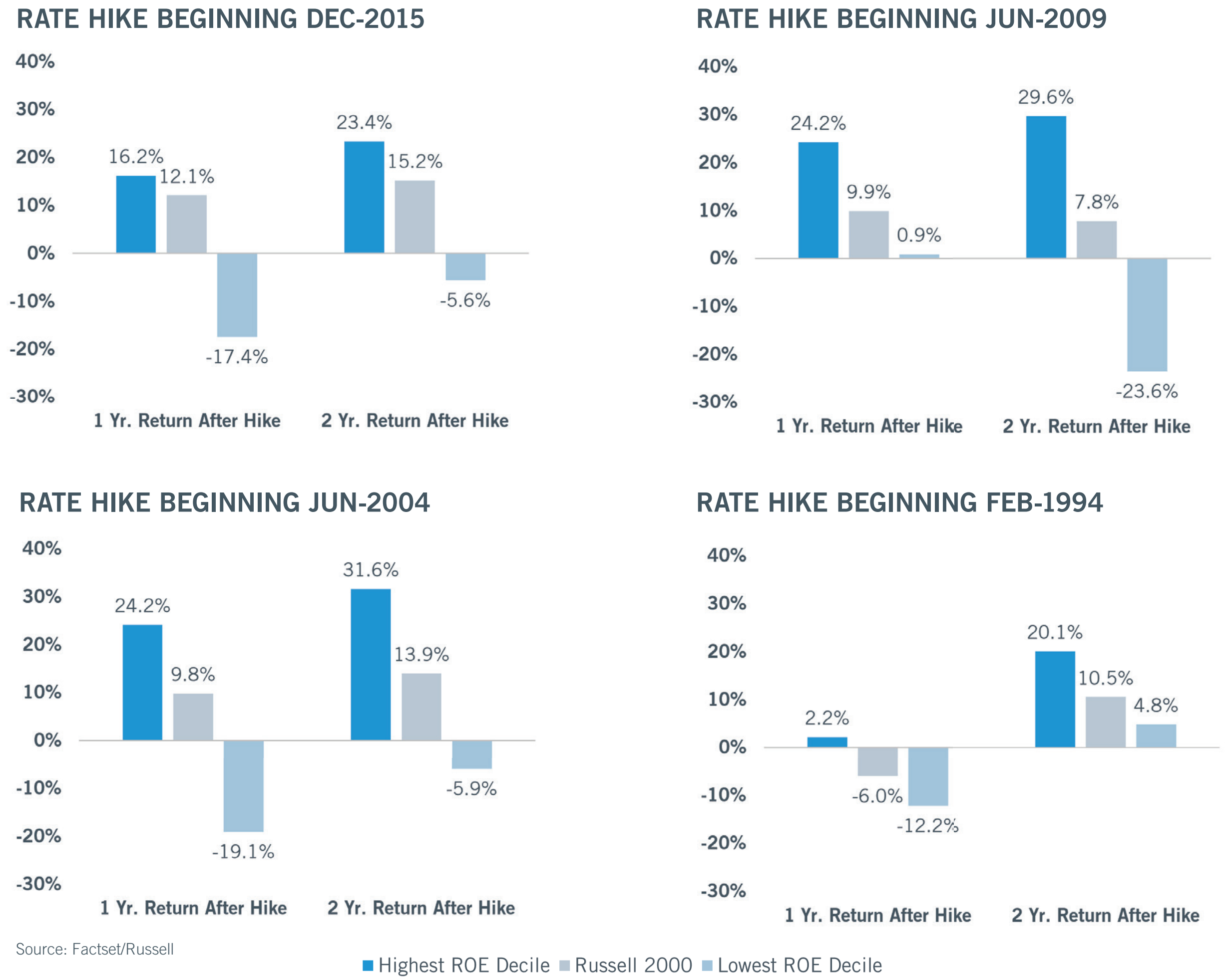
Quality companies with sustainable competitive advantages often outperform their peers over the long term. These companies have durable business models, strong brand recognition, and the ability to weather economic downturns.

REDUCE RISK

Investing in quality stocks can help reduce the overall risk in a portfolio, particularly during periods of market turbulence. Quality companies typically have solid balance sheets, manageable debt levels, and strong credit ratings. They are less likely to face liquidity problems or encounter difficulties in servicing their debt obligations. This reduces the risk of permanent capital loss for investors.

QUALITY FOLLOWING RATE HIKES

SMALL CAP PERFORMANCE FOLLOWING FED FUNDS RATE INCREASES
(LAST 30 YEARS)



Source: Factset/Russell

THE VALUE OF QUALITY

It is important to note that quality stocks may not always be available at bargain prices, as their quality and stability are often reflected in their valuation.

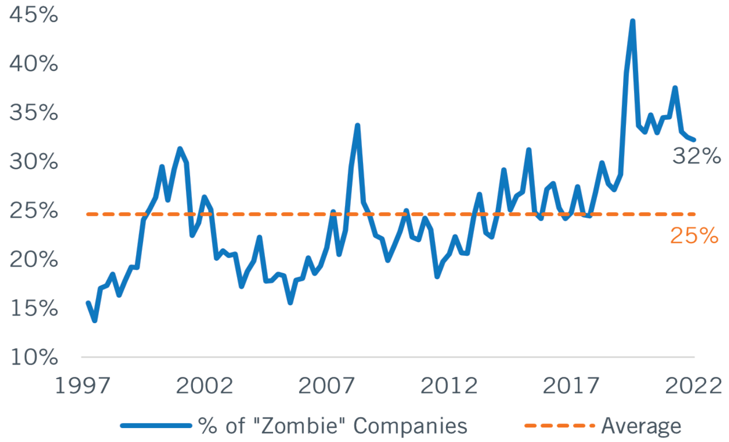
Therefore, it is important to consider active management and utilize seasoned investment professionals to help evaluate factors such as valuation, growth prospects, and investment objectives when investing in small caps.

04

IMPORTANCE OF ACTIVE MANAGEMENT

IMPROVE RETURN POTENTIAL

% OF ZOMBIE COMPANIES IN THE RUSSELL 2000 INDEX
(COMPANIES WITH INTEREST COVERAGE RATIO < 0)



Persistently low interest rates have translated into a low cost of capital, which has been a critical lifeline for many marginal companies.

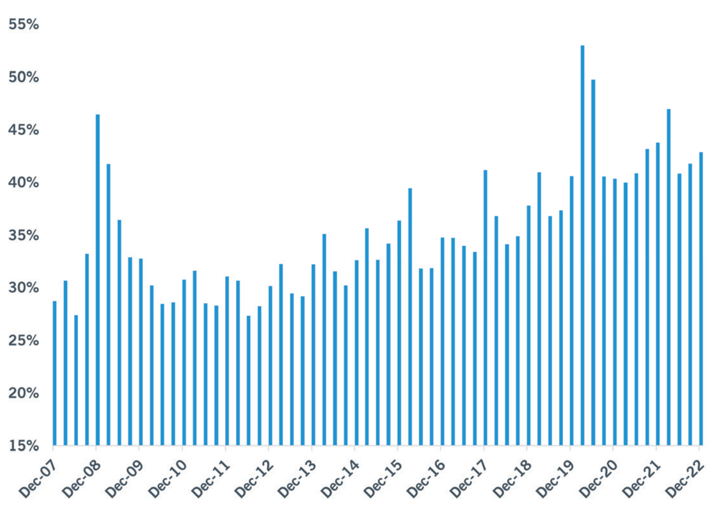
Many of these companies may not have been able to survive had they not been supported by unprecedented efforts from the Fed to bolster liquidity, allowing them to raise cash via cheap debt financing.

WHY ACTIVE?

A passive allocation to small caps in an asset allocation model is not nearly enough. Cambiar Investors believes that taking an active approach to this area of the investment universe is paramount.

The vast opportunity set and information inefficiencies within the asset class can enable seasoned, active managers like Cambiar to pinpoint investable opportunities, avoid pitfalls, and generate greater returns versus a passive index.

NON-EARNERS WITHIN RUSSELL 2000 INDEX
(% OF CONSTITUENTS WITH NEGATIVE DILUTED EPS)



Source: Factset. As of 3.31.2023.

When analyzing the makeup of the Russell 2000 Index, a popular proxy for the small cap asset class, the percentage of companies that have no earnings has remained above 40%.

>40%

OF THE RUSSELL 2000 INDEX IS UNPROFITABLE

With borrowing costs now significantly higher and inflation likely limiting the Fed's ability for additional support, profitless companies with elevated debt levels may be particularly challenged.

Taking a passive approach to the asset class means consistent, elevated exposure to these lower-quality businesses.

THE ACTIVE ADVANTAGE

Active management in small cap investing can provide several advantages compared to passive strategies. Here are some reasons why active management can be beneficial in the small cap space:

01

INFORMATION ADVANTAGE

Small cap stocks have less analyst coverage and receive less attention from institutional investors compared to larger companies. This information asymmetry can create opportunities for active managers to uncover undervalued small cap stocks through their in-depth research and due diligence.

02

FLEXIBILITY & ADAPTABILITY

Small cap companies tend to be nimbler and can adapt quickly to changing market conditions. Active managers have the advantage of making timely investment decisions based on new information, industry trends, and company-specific developments. They can take advantage of opportunities arising from events such as mergers and acquisitions, product launches, or regulatory changes.

03

PERFORMANCE ARBITRAGE

Active management in small cap stocks can aim to generate alpha, which is the excess return above the benchmark. The less efficient nature of the small cap market compared to larger cap stocks can provide opportunities for skilled active managers to identify mispriced securities and generate superior returns. Through careful stock selection, active managers can potentially outperform the market and deliver higher returns to investors.

04

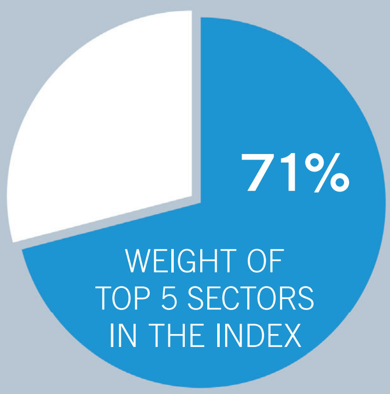
RISK MANAGEMENT & DUE DILIGENCE

Small cap stocks often carry higher risk due to their size, liquidity constraints, and greater sensitivity to market conditions. Active managers can employ rigorous risk management strategies and conduct thorough due diligence to mitigate these risks. They can actively monitor portfolio holdings, assess corporate governance practices, analyze financial statements, and evaluate management teams to make informed investment decisions.

DOWNSIDE OF PASSIVE IN SMALL CAP

Investing in a small cap index can be a suitable investment strategy for certain investors, but there are potential drawbacks and considerations to keep in mind. Here are some reasons why investing solely in a small cap index may not always be the best option:

PROTECTION THROUGH SELECTIVE AVOIDANCE



Sector concentration within the Russell 2000 Index is important to consider. **The top five sectors make up over 71% of overall index composition.**

Heavy concentration combined with unprecedented flows into passive instruments can lead to crowding in securities with already elevated prices.

An imbalanced exposure to these segments of the market without a rational understanding and reasoning of the underlying stocks is not a prudent approach.

Lack of Selectivity: By taking a passive approach and investing in the entire index, investors are exposed to the performance of all the constituent stocks, including those that may have weaker fundamentals, financial stability, or growth prospects. This lack of selectivity can dilute potential returns and expose investors to underperforming or riskier stocks within the index.

Concentration & Sector Bias: Small cap indexes are typically market-capitalization-weighted, meaning larger companies within the small cap segment have a higher weighting in the index. This can lead to concentration in a few select stocks or sectors, potentially reducing diversification benefits. Sector biases can also arise, with certain sectors having a larger representation in the index, exposing investors to sector-specific risks.

Source: Factset.

WHY CAMBIAR

INDEPENDENT

Mutually aligned interests

Entrepreneurial culture drives our commitment to continuously improve

Exceptional client-first focus in every facet of our business

UNWAVERING ACTIVE MANAGEMENT

Consistent implementation of our Quality, Price, Discipline (QPD) approach

High Active Share – willfully benchmark agnostic in pursuit of alpha

INTELLECTUALLY CURIOUS

Deep fundamental research insight

Collaborative team structure that emphasizes idea meritocracy

CAMBIAR SMALL CAP VALUE

The Cambiar Small Cap Value portfolio is a diversified strategy that invests primarily in small cap companies domiciled in the U.S.

	CAMBIAR SMALL CAP VALUE
AVAILABLE VEHICLES	CIT | Mutual Fund | Separate Account
HOLDINGS RANGE	45-55 stocks
MARKET CAPITALIZATION	Primarily $500M-$5B
MUTUAL FUND TICKER(S)	CAMSX (Investor Share Class) CAMZX (Institutional Share Class)
INCEPTION DATE(S)	Separate Account - 11/30/2004 CAMSX - 8/31/2004 CAMZX - 10/31/2008

QUALITY, PRICE, DISCIPLINE (QPD)

Be price sensitive buyers of high-quality assets.

QUALITY

Company-specific attributes such as high relative profitability, durable free cash flow generation, a defensible margin/return profile, and low leverage are viewed as critical inputs to delivering excess return over a full market cycle.

PRICE

Price sensitivity at attachment is the most critical determinant of both forward return potential and downside risk.

DISCIPLINE

Strict adherence to a well-defined stock underwriting process and a robust portfolio construction framework.

INVESTING WITH THE COURAGE OF OUR CONVICTION®

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