Small Cap Equity

2Q 2021 Commentary

Small caps post modest quarterly return amidst improving economic backdrop

Economic data continued to improve across developed markets as vaccination rollouts gained traction in the second quarter. Coinciding with the positive vaccination trends, general easing of local COVID-19 restrictions has led to an uptick in economic activity. While investors have weighed these positive developments against inflationary concerns, especially the question of whether or not inflation will be mostly transitory, the general trend for equity prices has been positive. Small cap equities generated a positive total return of 4.29% in the second quarter as measured by the Russell 2000 Index. Although this may seem modest compared to the last several quarters, it is more indicative of the asset class' historical output over the long term. Considering the significant rise in equity prices since the pandemic-induced bear market in March 2020, it is not surprising that the small cap rally would take a breather. Despite the Russell 2000 Index being down from its March 2021 highs, we believe the outlook for the market remains positive, not only for the asset class, but for active managers going forward.

Growth and Value continue to trade blows, meme stocks continue to make noise, and index concentration rises

Since the end of 2020, many have been calling for the value rally to finally take hold following the many years of significant outperformance by growth. While the Russell 2000 Value Index did outperform during the quarter (generating a total return of 4.56% versus the 3.92% return for the Russell 2000 Growth Index), this outperformance was not sustained throughout the period as the value index ended the second quarter in a relative downtrend. We continue to believe that more reasonably valued securities are due for a multi-year relative recovery versus their growth counterparts; however, as we've noted in the past, these recoveries are not always linear. For example, following the early 2000's dot-com bubble, the Russell 2000 Value Index also experienced short-term periods of underperformance versus the Russell 2000 Growth Index in the early stages of what would become a very strong multi-year period for the value style. While the past does not always repeat itself in investing, we would note that the valuations for both the Russell 2000 Index and Russell 2000 Value Index are historically attractive (on a forward P/E basis) relative to the Russell 2000 Growth Index. We believe investors with a focus on identifying attractively valued long-term investment opportunities can benefit going forward as the relative performance relationship between investment styles continues to normalize.

In our first quarter 2021 commentary, we highlighted the emergence of the January "meme stock" rally, where heavily shorted securities such as GameStop and AMC Entertainment rose exponentially on the strength of heightened retail trading activity. These meme stock gains significantly boosted benchmark returns in the first quarter and were a thorn in the side of many active managers that possess a quality discipline. Unfortunately for active managers, meme stocks experienced another strong run starting in May, which led to a pronounced low-quality rally in the second half of the second quarter. Similar to our previous comments on the value/growth dynamic, what we consider to be higher quality companies are historically attractive (on a forward P/E basis) relative to their lower quality counterparts. Following the unprecedented underperformance of quality factors in 2020 and the additional dislocation created by the two meme stock rallies in 2021, we believe higher quality companies will benefit on a relative basis going forward as earnings growth becomes a stronger driver of future returns and valuation multiples begin to contract following the significant gains in the market since March 2020.

Another interesting component of the market's returns can be seen in the index's concentration. Over the last several years, the Russell 2000 Index has become more concentrated by industry weighting as well as the combined weighting of the largest stocks in the benchmark. For example, the top three industries in the Russell 2000 Index represented roughly 32% of the overall benchmark at quarter-end, compared to a historical average of roughly 25%. The combined weighting for the top decile of stocks in the benchmark was also roughly 32% at the end of the period. This has implications for returns as well – historically, the top 10 stocks in the benchmark have accounted for roughly 11% of the overall benchmark's returns (in quarters where the Russell 2000 Index has returned more than 4%). In the second quarter, the top 10 stocks accounted for 31% of the benchmarks' return, nearly three times more than their historical contribution. By these measures, the Russell 2000 Index has not seen this level of concentration since the dot-com bubble. As active managers are more likely to outperform when market breadth is higher, normalization of these measures should benefit active managers going forward.

Performance Review

For the second quarter of 2021, the Aristotle Small Cap Equity Composite generated a total return of 3.89% gross of fees (3.76% net of fees) compared to the 4.29% total return of the Russell 2000 Index. Security selection contributed positively to performance, while sector allocation detracted. Security selection within the Health Care, Financials, Real Estate and Utilities sectors added the most value on a relative basis, while selection within Industrials, Information Technology, Communication Services and Materials detracted. From an allocation perspective, the portfolio benefited from an underweight in Health Care and an overweight in Information Technology; however, this was offset by an underweight in Communication Services and an overweight in Industrials.

The Small Cap Equity Composite's underperformance occurred in the second half of the quarter following the market's shift toward what we consider to be lower quality leadership and a resumption of growth's outperformance. While we are disappointed in this reversal, we believe the portfolio continues to be positioned well going forward and that our time-tested discipline of favoring what we believe to be higher quality business models at attractive valuations will be rewarded over the long term.

Relative Contributors	Relative Detractors
Charles River Laboratories	US Xpress Enterprises
CAI International	Dycom Industries
QTS Realty Trust	Haemonetics
Cross Country Healthcare	Bottomline Technologies
Customers Bancorp	Team

CONTRIBUTORS

Security selection added the most value within the Health Care, Financials, Real Estate and Utilities sectors. Additionally, an underweight in Health Care and overweight in Information Technology contributed positively to relative performance. At the company level, **Charles River Laboratories** and **CAI International** were two of the largest contributors during the quarter.

- **Charles River Laboratories (CRL)**, a contract research organization that provides outsourced clinical trial services to pharmaceutical and biotechnology companies, benefited from strong operating results and an announced acquisition to bolster its cell and gene therapy capabilities. We maintain a position, as we believe the company is well-positioned to benefit from the continued trend of large pharmaceutical companies outsourcing an increasing amount of their discovery, research and testing functions.

- **CAI International (CAI)**, a freight container leasing and management company, benefited from strong container demand and the announcement of the company's pending acquisition by Mitsubishi Capital. We maintain our investment, as we assess the risk-reward associated with the pending acquisition.

DETRACTORS

Security selection detracted within the Industrials, Information Technology, Communication Services and Materials sectors. Additionally, the portfolio's underweight in Communication Services and overweight in Industrials detracted from relative performance. At the company level, **US Xpress Enterprises** and **Dycom Industries** were two of the largest detractors during the quarter.

- **US Xpress Enterprises (USX)**, a leading asset-based truckload carrier in the U.S., was negatively impacted by lower-than-expected truckload utilization driven by weather-related headwinds. We maintain a position, as we believe the company is well-positioned to benefit from strong industry supply and demand dynamics, and that recent company-specific operational efficiency initiatives, such as fleet digitization, can create value for shareholders.

- **Dycom Industries (DY)**, a provider of engineering and construction services to the telecommunications and cable television industries, declined due to mixed spending trends associated with its customer base. We maintain a position, as we remain confident that demand for broadband should continue to expand and the upcoming spending cycle associated with 5G infrastructure will drive demand for the company's services.

Recent Portfolio Activity

Buys/Acquisitions	Sells/Liquidations
Huntington Bancshares	Gartner
KB Home	HMS Holdings
PetIQ	John Wiley & Sons
Viad	MTS Systems
	TCF Financial

BUYS/ACQUISITIONS

- **Huntington Bancshares (HBAN)**, a bank holding company based in Columbus, Ohio, was added to the portfolio by virtue of its merger with existing portfolio holding TCF Financial.

- **KB Home (KBH)**, one of the largest homebuilders in the U.S., was added to the portfolio. We believe the company's unique build-to-order model, which provides strong pricing power and margin potential, combined with the stock's attractive valuation offer a compelling risk-reward opportunity over the next several years.

- **PetIQ (PETQ)**, a holding company which engages in the manufacturing, procurement, packaging and distribution of pet health and wellness, was added to the portfolio. We believe the company is well-positioned to benefit from secular demand tailwinds for pet health products. Additionally, management's focus on increased penetration for its wellness clinics has the potential to drive further upside and create value for shareholders.

- **Viad (VVI)**, a provider of high-quality, experience-based services for the hospitality and live events industries, was added to the portfolio. We believe the company's growing service offerings, expanded marketing platform, and cyclical recovery of its end markets provide ample opportunities for shareholder value creation over the next several years.

SELLS/LIQUIDATIONS

- **Gartner (IT)**, a leading provider of research and advisory services for the information technology industry, was sold from the portfolio due to market capitalization considerations.

- **HMS Holdings (HMSY)**, a healthcare technology company that provides cost-containment services to government and private healthcare payers and sponsors, was removed from the portfolio after being acquired by a private equity firm.

- **John Wiley & Sons (JW.A)**, a multinational publishing company focused on academic publishing and instructional materials, was removed from the portfolio as the company's valuation had approached a level where we felt the risk-reward opportunity no longer justified maintaining the position.

- **MTS Systems (MTSC)**, a global supplier of test systems and industrial position sensors, was removed from the portfolio after being acquired by Amphenol Corporation.

- **TCF Financial (TCF)**, a Michigan-based bank holding company, was removed from the portfolio after being acquired by Huntington Bancshares.

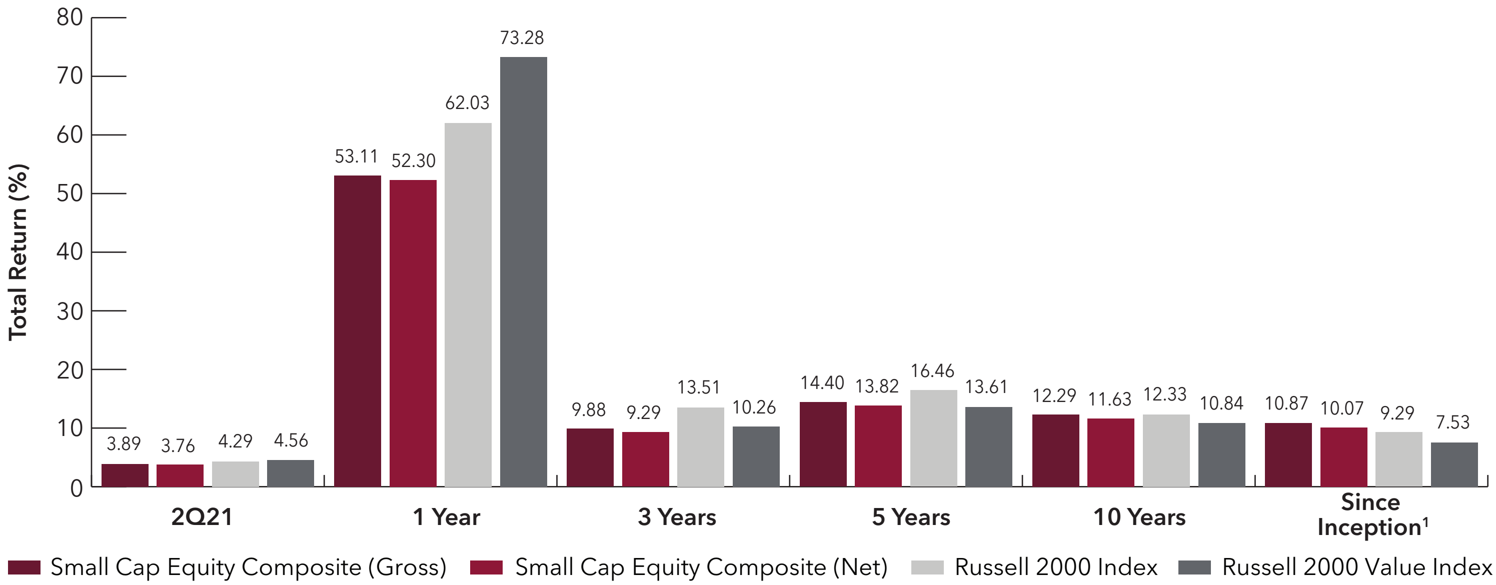
Outlook and Positioning

Our long-term outlook for the small cap equity market remains positive, and we believe the current environment should provide a favorable backdrop for companies with strong fundamentals and attractive valuations over the next multi-year period. The pandemic environment that drove the markets last year created a headwind for many cyclical areas of the market, leading to a favorable environment for longer-duration growth companies and significant outperformance of money-losing companies relative to profitable businesses. Thus far in 2021, we have seen short-term periods where more reasonably valued companies have recovered on a relative basis, but this has not been a linear shift in the market. Additionally, short-term dislocations driven by the meme stock rallies have allowed the low-quality rally to continue, but we believe higher quality businesses have the potential to recover meaningfully going forward. Overall, we believe our focus on businesses with strong fundamentals and attractive valuations will be rewarded as these relative performance relationships continue to return to more normalized levels. Additionally, earnings growth is expected to continue to improve from last year and outpace that of large cap, which we believe provides further upside for the asset class. We believe active managers with a focus on quality should benefit as earnings growth becomes a more dominant driver of equity returns going forward.

Our current positioning is a function of our bottom-up security selection process and our ability to identify what we view as attractive investment candidates, regardless of economic sector definitions. Overweights in Industrials and Information Technology are broad-based with recent purchases across a variety of industries and end markets. Conversely, we continue to be underweight in Consumer Discretionary, as we have been unable to identify what we consider to be compelling opportunities that fit our discipline given the rising risk profiles as a result of structural headwinds for various brick and mortar businesses. We also continue to be underweight in Health Care due to our lack of exposure to early-stage biotechnology companies, which generally do not fit our discipline due to their elevated levels of binary risk. Given our focus on long-term business fundamentals, patient investment approach and low portfolio turnover, the strategy's sector positioning generally does not change significantly from quarter to quarter; however, we may take advantage of periods of volatility by adding selectively to certain companies when appropriate. As always, our focus remains on identifying what we view as attractive, long-term investment opportunities that can create value for shareholders over the next three to five years, which we believe gives us the best opportunity to generate alpha for our clients.

Aristotle Small Cap Equity Composite Performance

All Periods Ended June 30, 2021



Year	Small Cap Equity Composite (Gross, %)	Small Cap Equity Composite (Net, %)	Russell 2000 Index (%)	Russell 2000 Value Index (%)
2021 YTD	16.38	16.08	17.54	26.69
2020	10.08	9.47	19.96	4.63
2019	24.86	24.20	25.53	22.39
2018	-11.59	-12.03	-11.01	-12.86
2017	18.98	18.43	14.65	7.84
2016	19.53	18.92	21.31	31.74
2015	3.20	2.72	-4.41	-7.47
2014	3.32	2.45	4.89	4.22
2013	39.77	38.73	38.82	34.52
2012	17.39	16.58	16.35	18.05
2011	-0.85	-1.47	-4.17	-5.50
2010	24.92	24.03	26.85	24.50
2009	39.37	38.11	27.19	20.58
2008	-34.27	-35.01	-33.80	-28.92
2007	6.12	4.32	-1.55	-9.78
2006[2]	7.31	7.31	2.97	3.75

Sources: SS&C Advent, Russell Investments
Composite returns for periods ended June 30, 2021 are preliminary pending final account reconciliation.
[1]The Aristotle Small Cap Equity Composite has an inception date of November 1, 2006 at a predecessor firm. During this time, Jack McPherson and Dave Adams had primary responsibility for managing the strategy. Performance starting January 1, 2015 was achieved at Aristotle Boston.
[2]For the period November 2006 through December 2006.
Past performance is not indicative of future results. Performance results for periods greater than one year have been annualized.
Returns are presented gross and net of investment advisory fees and include the reinvestment of all income. Gross returns will be reduced by fees and other expenses that may be incurred in the management of the account. Please see important disclosures enclosed within this document.