

THE QUALITY ADVANTAGE IN SMALL CAP STOCKS

Hassan Chowdhry and James Mendelson | June 5, 2024

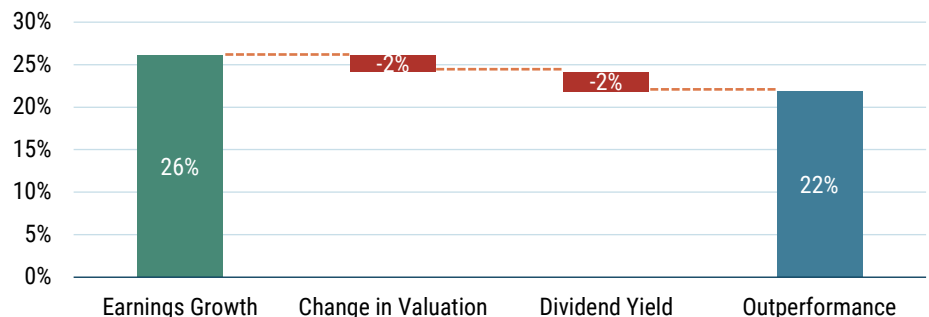
OVERVIEW

GMO's Small Cap Quality portfolio managers, Hassan Chowdhry and James Mendelson, discussed why small cap valuations are attractive today and why they believe using quality is a better way of investing in the asset class. A quality lens helps to identify the truly special companies with sustainable competitive advantages and, like large cap quality, has offered protection in down markets.

KEY POINTS

- GMO's Focused Equity team applies the same quantitative tools and fundamental analysis used in large cap quality to identify the highest quality companies in the small cap universe with the best forward-looking prospects trading at attractive valuations.
- High-quality small cap companies have outperformed both the small cap market in the U.S. and the broader all-cap U.S. market over time.
- Small cap underperformance over the last decade has been driven by valuation decline; fundamentals have been strong. Small cap companies have actually grown earnings faster than large cap companies over the period.
- Relative performance between large and small cap stocks has been cyclical throughout history. Small cap valuations are now much cheaper than large caps, after starting the decade much more expensive.
- Our portfolio has outperformed the S&P 600 Index by a cumulative 22% since inception powered by superior earnings growth, as shown in the chart below.
- Despite these strong returns, portfolio valuations remain attractive as there is ample opportunity to rebalance our concentrated portfolio of roughly 40 stocks.

SMALL CAP QUALITY RELATIVE TO S&P 600 RELATIVE RETURN DECOMPOSITION



Data from 9/21/2022 – 4/30/2024 | Source: Worldscope, S&P, GMO

The above information is based on a representative account in the strategy, selected because it has the fewest restrictions and best represents the implementation of the strategy.



Hassan Chowdhry

Mr. Chowdhry is engaged in portfolio management and research within GMO's Focused Equity team. Previously at GMO, he was a member of the Global

Equity team focusing on the Quality Strategy. Prior to joining GMO in 2007, he held analyst positions at Batterymarch Financial Management and Putnam Lovell NBF. Mr. Chowdhry earned his BS in Economics and BAS in Systems Engineering from the University of Pennsylvania, his MPA from Harvard University, and his MBA from the Massachusetts Institute of Technology.



James Mendelson

Mr. Mendelson is engaged in portfolio management and research within GMO's Focused Equity Team. Prior to rejoining GMO in 2019, he worked at D.E.

Shaw & Co. as an analyst. He previously worked on GMO's Global Equity team from 2013 to 2015. Mr. Mendelson earned his bachelor's degree in Applied Mathematics from Yale University.

Disclaimer

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AVERAGE ANNUAL TOTAL RETURN (NET) IN USD AS OF 3/31/2024

	<i>Inception</i>	<i>1-Year</i>	<i>3-Year</i>	<i>5-Year</i>	<i>10-Year</i>	<i>ITD</i>
Small Cap Quality Strategy	8/31/2022	25.90	N/A	N/A	N/A	27.34
S&P 600		15.93	N/A	N/A	N/A	10.44

Performance data quoted represents past performance and is not predictive of future performance.

Net returns are presented after the deduction of a model advisory fee and incentive fee if applicable. These returns include transaction costs, commissions and withholding taxes on foreign income and capital gains and include the reinvestment of dividends and other income, as applicable. Fees paid by accounts within the composite may be higher or lower than the model fees used. GMO LLC claims compliance with the Global Investment Performance Standards (GIPS®). A Global Investment Performance Standards (GIPS®) Composite Report is available on GMO.com by clicking the GIPS® Composite Report link in the documents section of the strategy page. GIPS® is a registered trademark owned by CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. Actual fees are disclosed in Part 2 of GMO's Form ADV and are also available in each strategy's Composite Report. The portfolio is not managed relative to a benchmark. References to an index are for informational purposes only.