

# QUARTERLY INVESTMENT REVIEW

## Small Cap Quality Strategy

### Performance returns (USD)

ANNUALIZED RETURNS (QUARTER-END)	Quarter-End	YTD	1-Year	3-Year	5-Year	10-Year	Since Inception
Small Cap Quality Strategy (net)	6.08	6.08	25.90	–	–	–	27.34
Small Cap Quality Strategy (gross)	6.28	6.28	26.85	–	–	–	28.28
S&P 600	2.46	2.46	15.93	–	–	–	10.44
Value Add	+3.62	+3.62	+9.97	–	–	–	+16.91

### Major Performance Drivers

This quarter marked a reversal of prior trends as fears of “higher for longer” interest rates disproportionately impacted the returns of more levered small caps, even as larger companies with healthier balance sheets benefited from the ongoing strength of the U.S. economy. The GMO Small Cap Quality portfolio delivered strong relative performance this quarter and outperformed the S&P 600.

A period of rising rate expectations would seem highly advantageous for high quality companies, given their strong balance sheets, but in fact our broader small cap quality universe merely kept pace with the S&P 600's anemic performance. Stock selection within that universe drove our returns. Our best performers this quarter were Medpace, Lancaster Colony Corp, and Bruker, which together can explain most of our relative gains. Our worst performers were Malibu Boats, New York Times, and Axcelis Technologies. Sector selection against the S&P 600 was modestly positive, as benefits from an overweight position in Industrials were largely offset by headwinds from an overweight in IT, a sector that was weak in small caps, in spite of large cap strength.

Medpace, a contract research organization focused on providing full-service solutions to smaller biotech companies, has benefited from strong results driven by superior execution, along with increasing optimism that a difficult funding environment for biotech start-ups is beginning to improve.

Lancaster Colony Corp, a Consumer Staples business focused on dressings, dips, and sauces, continues to benefit from ongoing strength in its brand licensing initiative, and has begun to see its inflation-pressured margins improve as commodity costs such as soybean oil began to fall.

Bruker, a life science tools company notable for its leading position in nuclear magnetic resonance spectroscopy, has seen strong trends across its differentiated portfolio, even as the broader life science tools market has struggled. The company announced in February that it was pulling already ambitious 2026 earnings targets into 2025.

Malibu Boats performed poorly as earnings results continued to disappoint. It is clear that the company misjudged run-rate demand for its boats in the context of high interest rates, and let too much inventory get into the channel. The company now faces a painful period of inventory adjustment before earnings can normalize. We believe on normalized earnings the company is significantly undervalued.

Composite Inception Date: 31-Aug-22

Performance for the year of inception is less than a full calendar year. Returns shown for periods less than one year are not annualized.

**Risks:** Risks associated with investing in the Strategy may include: Management and Operational Risk, Market Risk - Equities, Smaller Company Risk, Focused Investment Risk, and Illiquidity Risk. Returns shown for periods greater than one year are on an annualized basis. To obtain performance information to the most recent month-end, visit [www.gmo.com](http://www.gmo.com).

**Performance Returns:** 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](http://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. The local market in which some accounts in the composite are priced was closed for Good Friday on March 29, 2024. Therefore, the performance for the strategy and corresponding benchmark will utilize March 28 for purposes of the ending valuation for the March return and the starting valuation for the April return.

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## Major Performance Drivers Cont.

The New York Times Company saw solid-but-slower growth in its fourth quarter, as the ad market remained weak, and digital subscriber growth failed to live up to elevated investor expectations. We believe the company has numerous operational levers to maintain its solid digital subscriber growth, and the approach of the presidential election is also likely to be a tailwind to demand. More broadly, we see the New York Times as one of a small number of winners in a consolidating environment for news media; we believe there is high and growing demand for high quality news reporting, and the New York Times has built the brand, the scale, and the business model to benefit from broader industry turmoil.

Axcelis Technologies manufactures ion implantation devices used in the fabrication of semiconductor chips. Their products are especially optimized for the implant-intensive production of silicon carbide (SiC) chips, which are used in high-voltage applications, in particular battery electric vehicle (BEV); silicon carbide applications now represent roughly half of the company's revenue. The recent slowdown in BEV demand, which led several Axcelis customers to push out their orders, contributed to share price weakness this quarter. We believe as BEV technology and charging networks continue to improve and non-BEV SiC applications expand, demand for SiC will re-accelerate, and Axcelis will be a key beneficiary.

We are pleased with the strategy's performance this quarter, and with our portfolio positioning. We believe that focusing on high quality businesses is an effective and highly differentiated way to invest in small caps. Through careful risk control at the portfolio level, we limit our exposure to bets on Value or Growth or difficult-to-predict macroeconomic trends such as the trajectory of interest rates. Instead, we are able to focus on identifying companies benefiting from strong competitive advantages, healthy balance sheets, and good management teams that are available at attractive valuations. Over time, we expect the strong performance of these businesses will continue to drive healthy returns for our investors.

Portfolio weights, as a percent of equity, for the positions mentioned were: Medpace (1.4%), Lancaster Colony Corp (3.8%), Bruker (2.4%), Malibu Boats (2.1%), New York Times (3.1%), Axcelis Technologies (2.8%)

## PRODUCT OVERVIEW

The GMO Small Cap Quality Strategy seeks to generate total return by investing primarily in equities of U.S. small cap companies that the Focused Equity team believes to be of high quality.

The team believes that companies with established track records of historical profitability and strong fundamentals – high quality companies – are able to outgrow the average company over time and are therefore worth a premium price. The Strategy's disciplined approach uses both quantitative and fundamental techniques to assess the relative quality and valuation of U.S. small cap companies and aims to exploit a long-term investment horizon while withstanding short-term volatility.

## IMPORTANT INFORMATION

**Comparator Index(es):** The S&P SmallCap 600® seeks to measure the small-cap segment of the U.S. equity market. The index is designed to track companies that meet specific inclusion criteria to ensure that they are liquid and financially viable. S&P does not guarantee the accuracy, adequacy, completeness or availability of any data or information and is not responsible for any errors or omissions from the use of such data or information. Reproduction of the data or information in any form is prohibited except with the prior written permission of S&P or its third party licensors.

**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.**

## ABOUT GMO

Founded in 1977, GMO is a global asset manager committed to delivering superior performance and advice to our clients. We are privately owned, which allows us to singularly focus on our sole business – achieving outstanding long-term client investment outcomes. Offering multi-asset, equity, fixed income, and alternative strategies, we invest with a long-term, valuation-based philosophical approach.

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\*GMO's West Coast Hub is comprised of members of Investment, Global Client Relations, and other teams located in and around the Greater San Francisco area

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