



Sapphire Star Capital Small Cap Strategy Q4 2023

Commentary

In Q4 2023, the Russell 2000 Index rebounded strongly, rising by 14.03% during this period. This performance reflects the recovery of the small-cap sector in Q4 2023, supported by easing financial conditions and expectations of the end of aggressive rate hikes. Despite this rally, it's important to remember that market performances can fluctuate, and should be viewed in the context of long-term investment strategies.

The recovery of Small Cap Stocks can be attributed to several factors including lower interest rate conditions. Small cap companies can benefit from a lower rate environment and the Russell 2000 has a higher sector weight in financials, making it more responsive to interest rate changes. Secondly, lending difficulties eased for small-cap companies compared to larger cap companies as the Fed held its policy rate and inflation continued to decline. Thirdly, the economic changes that small cap stocks endured relative to large cap stocks improved as the US economy showed resilience and growth prospects. Lastly, the Fed's actions signaled a more accommodative stance toward the economy, providing a market backstop and reducing the risk of a natural pullback. Therefore, the environment in Q4 2023 promoted a small cap comeback that outpaced large cap stocks.

Portfolio Review

The Fourth quarter of 2023 was marked by a strong recovery of the small cap market segment, as measured by the Russell 2000 Growth and the Russell 2000, which rose by 14.03% and 12.75% respectively. The Sapphire Star Small Cap Strategy also performed well, gaining 7.98% net, but lagged behind the benchmarks due to its lower exposure to the cyclical sectors that benefited from the easing of financial conditions and the end of aggressive rate hikes. The three sectors that aided relative portfolio performance the most during the quarter included producer manufacturing, non-energy minerals, and process industries. Technology services, energy minerals, and health technology were the three sectors which hindered relative performance the most during the quarter. Stock selection contributed to positive relative performance but unfortunately was overshadowed by sector allocation which hindered relative performance for the quarter as many beaten down sectors with negative earnings growth rallied off the lows. From a holdings perspective Rambus Inc. 22.33%, Mueller Industries 25.92%, and Arcos Dorados Holdings Inc., 34.57% were the three stocks that helped absolute performance the most while Target Hospitality (43.07%), Lattice Semiconductor Corp (19.71%) and Sanmina Corp (19.71%) detracted the most during the quarter. Very little runover was experienced during the quarter with electronic technology, finance and energy minerals continuing to be in the top three largest weighted sectors, while utilities, process industries and distribution services were the least weighted sectors represented in the portfolio.

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Looking Forward

Small cap stocks had a strong comeback in the fourth quarter of 2023, outperforming large cap stocks in both the U.S. and Europe. Despite the volatility and uncertainty caused by the COVID-19 pandemic, small cap stocks showed resilience and growth potential, benefiting from the easing of monetary policy and the recovery of consumer demand. Investors who are looking for long-term growth opportunities and are willing to accept slightly more risk in exchange for higher potential gains will still find value in including small cap stocks in their portfolios. Investing in small cap companies, those with a market capitalization between \$20 million and \$13.5 billion, as measured by the current market capitalization range of the Russell 2000 Index, can offer significant benefits. Here are some key advantages:

1. **Growth Potential:** Small cap stocks often have higher growth potential compared to larger companies. Many successful large-cap companies, such as Microsoft, Amazon, or Netflix, started as small caps. Investing in these companies at an early stage could lead to substantial returns. In the fourth quarter of 2023, the Russell 2000, an index tracking U.S. small-cap stocks gained 14%, while the S&P 500 increased by 12%.
2. **Undervalued Opportunities:** The share price of small-cap stocks is often lower, making the initial investment easier. Moreover, many institutional investors and mutual funds have rules restricting them from buying small-cap stocks, which can lead to these stocks being undervalued. According to RBC Capital Markets, small-cap stocks in the U.S. are putting up “a fight,” showing “better trends” while lagging the S&P 500 and Nasdaq Composite this year. The rate of upward earnings per share (EPS) has moved up to 50% for the Russell 2000, more than half the sectors in the index “now in positive revisions territory for both EPS and revenues.”

Although 2023 has proven difficult for small cap investors, as of the end of Q3 2023, the Sapphire Star Capital Small Cap Strategy has returned +7.29% net for our investors versus +5.27% for the Russell 2000 Growth Index and +2.54% for the Russell 2000 Index.

As always, we welcome any questions or concerns and thank you for your continued confidence in the Sapphire Star Small Cap Strategy.

Regards,

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