Westwood®

Westwood **Quality SMidCap Fund (WHGMX)**

Commentary

3Q
2024

Performance Highlights

- Despite a few bumps in the road, the equity markets continued their upward march in the third quarter. In this environment, the Westwood Quality SMidCap Fund lagged the representative benchmark index slightly. The Fund returned 8.49% while the Russell 2500 Value Index returned 9.63%. The primary benchmark, Russell 3000 Index, returned 6.23% for the quarter.
- In the third quarter, the U.S. stock market maintained its upward trajectory, but the nature of the rally shifted as it broadened. Small-cap stocks led a brief surge in early July, with the Russell 2000 Index gaining more than 10% in a single week. However, the Bank of Japan's decision to raise interest rates, ending the Yen carry trade, triggered a temporary market decline, causing the S&P 500 to fall by 8.5% over three weeks. Stocks quickly rebounded, pushing domestic equity indices to new highs as the quarter closed. Small- and mid-cap stocks outperformed large-caps, while value stocks outshined growth, which lagged as the previously dominant "Magnificent 7" tech companies underperformed. On a sector level, Utilities and Real Estate surged due to their interest rate sensitivity, while Information Technology, Telecommunications and Energy struggled. Utilities edged ahead of tech stocks for the year-to-date, though Information Technology still led on a one- and two-year basis.
- The U.S. economy continued its growth trend, despite some mixed signals. Inflation, as measured by the Consumer Price Index (CPI), trended downward, with the August reading at 2.5%, a significant drop from 3.7% a year ago and the 9% high seen in mid-2022. However, the employment situation raised concerns, as unemployment edged up slightly and new jobless claims rose. Other economic indicators, like manufacturing health, new orders and personal bankruptcies, were also troubling. In response, the Federal Reserve cut its benchmark fed funds rate by 0.50%, a widely anticipated move. The Fed noted that while inflation was nearing its 2% target, job growth had slowed, making the rate cut necessary to balance economic risks.
- Stock selection in the quarter was a positive contributor to relative performance but was offset by the negative impact of asset allocation. Stock selection was beneficial in the Health Care, Real Estate and Financials sectors, while it was a detractor in the Information Technology and Materials sectors. The interaction effect — the combination of allocation and selection was a detractor. For example, we were overweight the Energy sector and our holdings underperformed an underperforming sector, resulting in a negative attribution from interaction.
- During the quarter, we reduced our exposure to the Consumer Discretionary sector and repositioned our holdings in the Industrials sector, reducing exposure to nonresidential construction and housing. The changes are due to our concern that the economy is in a precarious position, given interest rates and potential deterioration in the labor market. We have increased our weight in the Real Estate and Financials sectors, as we see falling interest rates providing an opportunity for selected companies in those sectors.

Performance Drivers

- In terms of absolute performance, we enjoyed double-digit gains from five sectors, while two sectors experienced double-digit declines. Leading the charge were Communication Services and Real Estate, while the lagging sectors were Energy and Information Technology.
- The top performer in the quarter was American Healthcare REIT, Inc. (AHR), which surged more than 70% in the quarter, helped in part by declining interest rates. The diversified REIT also posted strong earnings growth in the second quarter and guided future quarters higher. Mercury Systems Inc. (MRCY) leaped ahead on the strength of

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an earnings report that indicated higher revenue and much higher margins; management commentary gave some indication that margins would continue to expand.

- Investment bank Piper Sandler (PIPR) added just under 25% to close near an all-time high; lower interest rates helped as did an increase in advisory income. Another financial firm that did well was International General Insurance (IGIC), rising by more than 30% after reporting earnings well above estimates and managing reserves and losses well. Cooper Companies Inc. (COO) also jumped in the quarter as they reported higher operating income and greater profit margins, driven by greater demand in their fertility and women's health segments.
- Semiconductor maker Rambus Inc. (RMBS) led the detractors in the period, as the stock price fell almost 30%. The company reported revenue below expectations and provided guidance for slower growth ahead, causing some analysts to reduce their price targets. Chord Energy (CHRD) declined in the quarter despite reporting production that was at the high end of expectations, declaring a variable dividend and returning 75% of free cash flow to shareholders.
- Domino's Pizza (DPZ) struggled in the quarter, as the stock fell after releasing earnings in mid-July. While revenues were in line and earnings above expectations, same-store sales were lower and management reduced expectations for new stores, both weighing on the stock price. Ecovyst Inc. (ECVT) fell after a cut in guidance due to overcapacity in the renewable fuels market. And Atkore (ATKR) declined after management offered disappointing guidance for 2025 due to concerns as to whether they would be able to maintain their pricing advantage.

Performance Update

As of September 30, 2024

Trailing Years Performance

	Inception Date	3Q24	YTD	1 Year	3 Year*	5 Year*	10 Year*	Since Inception*
WHGMX (Class I)	12/19/2005	8.49%	11.78%	25.43%	7.46%	10.19%	7.99%	9.22%
WWSMX (Class Ultra)	7/31/2020	8.70%	11.99%	25.88%	7.70%	--	--	15.03%
Russell 2500 Value Index	12/19/2005	9.63%	11.28%	26.59%	6.06%	9.99%	8.47%	7.98%
Russell 3000 Index	12/19/2005	6.23%	20.63%	35.19%	10.29%	15.26%	12.83%	10.38%

*Annualized

Total Annual Fund Operating Expenses by Share Class (gross/net): Class I 1.01% / 0.86%, Class Ultra 0.83% / 0.68%. The Advisor has contractually agreed to waive fees and reimburse expense until March 1, 2025. In the absence of current fee waivers total return and yield would be reduced.

Russell 3000 Index is a market capitalization-weighted equity index maintained by the Russell Investment Group that seeks to be a benchmark of the entire U.S. stock market. The index is composed of the 3,000 largest U.S. companies and represents approximately 98% of the investable U.S. equity market.

Calendar Year Returns

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
WHGMX	34.27%	26.38%	-2.29%	12.88%	33.80%	4.85%	-3.18%	12.04%	10.39%	-11.47%	29.40%	5.40%	21.31%	-10.36%	17.78%
Russell 2000 Value Index	27.68%	24.82%	-3.36%	19.21%	33.32%	7.11%	-5.49%	25.20%	10.36%	-12.36%	23.56%	4.88%	27.78%	-13.08%	15.98%
Russell 3000 Index	28.34%	16.93%	1.03%	16.42%	33.55%	12.56%	0.48%	12.74%	21.13%	-5.24%	31.02%	20.89%	25.66%	-19.21%	25.96%

Past performance is not indicative of future results. The investment return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost and current performance may be lower or higher than the performance quoted. For performance data current to the most recent month end, please call 877.FUND.WHG.

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Potential Risks

Mutual fund investing involves risk, including possible loss of principal. There can be no assurance that the Fund will achieve its stated objectives. There are specific risks inherent in small cap investing such as greater share price volatility as compared to other funds that invest in stocks of companies with larger and potentially more stable market capitalizations. REITs are subject to changes in economic conditions, credit risk and interest rates. International investing may involve risk of capital loss from unfavorable currency fluctuations, differences in generally accepted accounting principles or from social, economic or political instability in other nations.

Top 10 Holdings as of 9/30/2024

IDACORP Inc.	BWX Technologies Inc.
Piper Sandler Cos.	DigitalBridge Group Inc.
Integer Holdings Corp.	Cullen/Frost Bankers Inc.
Summit Materials Inc.	Glacier Bancorp Inc.
Kratos Defense & Security Solutions Inc.	Domino’s Pizza Inc.

Top 10 Holdings represents 21.11% of the total portfolio and represents the ten largest portfolio positions by market value in the Fund as of the period end date. Each quarter, the Westwood Funds use this same objective, non-performance based criteria to select the ten largest holdings. Holdings are subject to change. Current and future portfolio holdings are subject to risk.

Fund Positioning and Trade Rationale

Positions were initiated in the following companies:

- **Aktore Inc. (ATKR)** manufactures and supplies metal products such as pipes, electrical conduits, metal framing systems, armored wire and cable, and building components. The stock is a beneficiary of the electrification theme with an attractive valuation.
- **Permian Resources (PR):** A developer of unconventional oil and associated liquid-rich natural gas reserves in the Permian Basin, the company is a pure-play E&P. We believe the asset quality is underrated, and the company has a strong recently acquired technical team that can lead to more productive drilling.
- **American Healthcare REIT (AHR)** invests in healthcare real estate properties such as medical office buildings, senior housing communities and skilled nursing facilities. Demographic trends support near- and long-term demand for senior housing, where supply remains low, allowing for greater-than-expected NOI growth. Acquisitions of properties from sponsors facing refinancing challenges may also provide some upside.
- **Merchants Bancorp (MBIN)** focuses on financing multi-family and healthcare facilities, mortgage warehousing, and retail and residential mortgage banking. The innovative business model of originating to sell commercial real estate mortgages results in a high level of asset turnover and a return on equity twice the industry median. We believe there is a substantial growth opportunity to come from lower interest rates.
- **Allegro Microsystems (ALGM)** builds power and sensing solutions for motion control. The company should benefit from secular trends in the automotive industry, including market share gains from battery-electric vehicles (BEV), a shift from 400V to 800V powertrains and increasing safety features such as advanced driver assist systems (ADAS).
- **Pegasystems Inc. (PEGA)** develops customer relationship management software, automating customer interactions for enterprises in industries like banking, insurance and healthcare. After its successful transition to a subscription model led to improved cash flow conversion, and with a major legal judgment overturned, we see limited downside and potential for significant growth.

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- **Bio-Rad Laboratories, Inc. (BIO)** manufactures life science research products and clinical diagnostics that analyze and purify chemical and biological materials. We purchased the stock for its exposure to high-growth markets like diagnostics and life science tools, and we see significant potential in its Sartorius stake and margin expansion.
- **LPL Financial Holdings, Inc. (LPLA)** provides financial products and services through proprietary technology and clearing platforms, supporting financial advisors and brokerage services for retail investors. We purchased the stock due to its strong position in the wealth management industry, as its technology platform is becoming the leading solution for independent advisors, which is driving accelerated organic growth; its expansion into adjacent wealth management verticals further supports growth and advisor retention.
- **Weatherford International (WFRD)** provides drilling solutions and related services, including gas well unloading and restoration. International drilling growth outpacing U.S. activity could lead to higher revenue and margin expansion, along with strong free cash flow generation over the next cycle.
- **Federal Realty Investment Trust (FRT)** specializes in owning, managing, and redeveloping high-quality community and neighborhood shopping centers. The company has a strong retail portfolio with excellent demographics, a proven 56-year dividend increase track record, and the potential for further value creation through entitled land development, all while trading at an attractive valuation relative to peers.
- **Equity LifeStyle Properties, Inc. (ELS)** operates as a real estate investment trust (REIT) that owns and manages manufactured home resorts, retirement communities, rental homes and campgrounds. The company is a premier operator in manufactured housing, RV and marina properties, offering consistent cash flow growth and low correlation to GDP; moreover, the company can benefit from favorable supply trends and demographic shifts.
- **MarketAxess Holdings, Inc. (MKTX)** operates an electronic platform for trading U.S. and European corporate bonds and emerging markets debt. Its revamped strategy is expected to drive market share gains, benefiting from increasing volatility and turnover in bond markets, while declining interest rates will boost fee capture and trading volume, supporting long-term margin expansion.
- **Cameco Corporation (CCJ)** explores, develops and mines uranium, and also refines and converts it for use in nuclear power. Its position as the world's second-largest uranium producer, its ownership stake in Westinghouse, and the strong outlook for uranium demand driven by rising prices and increased global nuclear power needs position Cameco for significant volume and price growth.
- **H&E Equipment Services, Inc. (HEES)** is an integrated equipment services company that rents, sells and supports heavy construction and industrial equipment. The company is positioned to benefit from lower interest rates and an opportunity to expand its branch network by 10 to 15 locations annually.

The following positions were sold from the portfolio:

- **Vertiv Holdings (VRT)** was sold after significant multiple expansion, a decline in the reward-to-risk ratio and surpassing the high end of our market cap ceiling ($31 billion).
- **Boot Barn (BOOT)** stock increased by more than 60% since our purchase in December 2023. We sold the stock based on valuation concerns and a more cautious stance on consumer spending.
- **Middleby Corp. (MIDD)** was sold due to concern about rising prices and cost pressures in the restaurant business, and the potential for disappointment in residential sales due to weak home sales and remodeling spending.
- **Ecovyst Inc. (ECVT)** was sold as overcapacity in the renewable fuels market caused a reduction in forward guidance, which we viewed as a broken investment thesis.
- **Atkore, Inc, (ATKR)** was sold after the company reduced guidance for 2025 based on concerns about costs and pricing, a violation of our investment thesis.
- **Seacoast Bank (SBCF)** was sold as the valuation reached the high end of its historical range, resulting in a less favorable reward-to-risk ratio.
- **Blue Owl Capital (OWL)** was sold as the stock reached the high end of our market cap ceiling ($25 billion) and was no longer suitable for the portfolio.

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- **Urban Edge Properties (UE)** was sold as we repositioned our real estate positions, in favor of another real estate investment trust with a more attractive reward-to-risk ratio.
- **Mercury Systems (MRCY)** was sold based on an increased valuation and a lack of conviction in the investment thesis.
- **Century Communities (CCS)** was sold based on concerns over margins among homebuilders, particularly with increased building in Texas and Florida resulting in higher inventory.

Market Review

After a brief mid-quarter shock, the U.S. stock market continued its steady upward trend in the third quarter. But while the trend remained the same, the character of the rally changed. The market broadened significantly as more stocks participated in the rally, spurring domestic equity indices to new all-time highs.

Small-cap stocks rallied to begin the quarter, pushing the Russell 2000 Index ahead by more than 10% in about a week in early July. But equity investors were agitated in early August after the Bank of Japan announced they would raise interest rates, effectively ending the Yen carry trade — investors would borrow in Yen (at near-zero rates) and invest in dollars, or more likely in large growth stocks. Equity markets around the world crumbled and the S&P 500 gave up nearly 8.5% in about three weeks. However, investors quickly shrugged off the decline and stocks rebounded just as quickly to end September at a new high.

For the quarter, small- and mid-cap stocks outperformed large-caps. Value stocks outperformed growth, as represented by the "Magnificent 7," which formerly led the markets higher, and as a group, underperformed the broad market. The rally in equities has been historic and driven primarily by large-cap growth stocks. Over the past two years, the Russell 1000 Growth Index has gained 34.8% annualized, more than double the 16.5% return of the Russell 2000 Value Index.

At the sector level, within the S&P 500, the formerly market-leading Information Technology, Telecommunication Services and Energy sectors all struggled in the third quarter. The Utilities and Real Estate sectors, both sensitive to changes in interest rates, leaped ahead and rewarded investors for their patience. Year to date, Utilities have eased ahead of Information Technology, though technology still leads for the trailing one-year and two-year periods.

Meanwhile, the U.S. economy remained in growth mode, despite some concerning data points. Two key measures to watch are inflation, measured by the Consumer Price Index (CPI), and the employment situation, viewed as a combination of the unemployment rate and initial jobless claims primarily. Inflation continued to trend down; the August reading came in at 2.5%, well below the 3.7% report of 12 months ago and the high of 9% in mid-2022. The employment situation was a bit more concerning, as the unemployment rate ticked up during the quarter, and new jobless claims rose. Other measures such as manufacturing health, new orders and personal bankruptcies were not trending positively, creating further concern among economists.

The Federal Reserve had been expected to make a move, and finally reduced its benchmark fed funds rate in September, cutting rates by 0.50%. The Fed noted that while inflation was making progress toward its 2% goal, job gains have slowed, so the balance of risks between growth and recession moved them to make the rate cut.

The bond market had been in the process of pricing in the Fed rate cut since May, when market yields hit their highs. Treasury yields continued their decline in the third quarter, as the 10-year yield fell from 4.48% to 3.81%, a drop of 67 bps, and the two-year Treasury fell from 4.77% to 3.66%, or 111 bps. After being inverted for two years, the Treasury yield curve returned to its typical shape.

Looking closer at the bond market, investment-grade corporate credit outperformed high yield, while government bonds and municipal issues trailed. Longer-dated Treasury bonds outperformed the short end of the yield curve, as one would expect in a falling rate environment.

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Outlook

The Federal Reserve has dominated talk about the stock market for two and a half years, ever since the Fed began their campaign to cripple inflation. The rate hikes were unprecedented in the amount of the increase, the speed of the hiking campaign and the duration at the peak. Interest rates increased 525 basis points in just 17 months, and they stayed at their peak level for 14 months, one of the longest periods between the final increase and the first rate cut.

The market quickly moved from “When will the Fed cut?” to “Why did the Fed cut?” — a very different question. Economic news was mixed in the quarter, and there are plenty of reasons to argue for either continued expansion or a potential recession. From the growth perspective, economists point to lower inflation and the potential salutary effects of lower interest rates. Those bearish economists would point to the rising unemployment rate triggering the Sahm rule, or weakness in manufacturing reports.

Elsewhere, political uncertainty at home and conflicts abroad will no doubt lead to volatility through the fourth quarter and into the coming year. After President Joe Biden dramatically withdrew from the presidential election, the Democratic Party announced Vice President Kamala Harris as the new candidate. On the other side of the aisle, former President Trump was targeted twice for assassination. Polls are tight in many key states, and we may not see a declared victor until well after Election Day on November 5. Both candidates offer differing economic proposals that will impact the U.S. economy and the investment landscape.

Looking forward, we expect to see continued uncertainty driven by the political situation both at home and abroad. The economy is in a precarious position, as there are concerning signs in the labor market and the resilient consumer may in fact be weakening. The market is pricing in as many as seven rate cuts through the end of 2025, and while the accommodative stance should benefit the economy and small- and mid-cap stocks in general, monetary policy changes tend to have a long and variable impact. We expect to see volatility continue to increase as it did in the second quarter.

In uncertain environments, quality factors mean even more. Our focus remains on businesses that show strong free cash flow, that have high return on invested capital, and that are able to deliver strong returns to shareholders through dividends or share repurchases. Moreover, we seek to identify companies that show value characteristics as well — unappreciated businesses, misunderstood product lines or companies trading at a discount to their peers.

Important Information

To determine if this Fund is an appropriate investment for you, carefully consider the Fund’s investment objectives, risk factors, charges and expenses before investing. This and other information can be found in the Fund’s summary and full prospectuses, which may be obtained by calling 877.FUND.WHG, or by visiting our website at westwoodfunds.com. Read the prospectus carefully before investing or sending money.

The **Russell 3000 Index** is a market capitalization-weighted equity index maintained by the Russell Investment Group that seeks to be a benchmark of the entire U.S. stock market. The index is composed of the 3,000 largest U.S. companies and represents approximately 98% of the investable U.S. equity market. The **Russell 2500® Value Index** measures the performance of those Russell 2500® Index companies with lower price-to-book ratios and lower forecasted growth values. The Benchmark Index returns are for illustrative purposes only and do not represent actual fund performance. Index performance does not reflect any management fees, transaction costs or expenses. The Benchmark Index is unmanaged and investors cannot invest directly into an index. **Growth** is a term used to refer to a share in a company that is anticipated to grow at a rate significantly above the average for the market. Value is a term used to refer to a company that tends to trade at a lower price relative to its fundamentals, such as dividends, earnings and sales, making them appealing to value investors. **SMid cap** is a term used to refer to a company with a market capitalization value ranging between $50 million to $14.6 billion. A company's market capitalization is calculated by multiplying the number of a company's shares outstanding by its stock price per share.

This material represents the manager's assessment of the market environment and should not be relied upon by the reader as research or investment advice regarding any security, nor is it intended to be a forecast of future events or a guarantee of future results.

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