Westwood®

Westwood **Quality SMidCap Fund (WHGMX)**

Commentary

1Q
2024

Performance Highlights

- While large-cap stocks posted a second consecutive quarter of double-digit returns, small- and mid-cap stocks posted more modest gains. In this environment, the Westwood Quality SMidCap Fund handily beat its benchmark Russell 2500 Value® Index. The strategy gained 7.99% in the first quarter, compared with 6.07% for the benchmark.
- Small- and mid-cap stocks continued to benefit from positive investor sentiment as the broad "risk-on" mentality held firm in the opening quarter of 2024. The path higher was a bit more volatile than many larger cap indices, but the small- and mid-cap markets climbed for most of the quarter on relatively healthy earnings growth and improving economic conditions. Large-cap stocks — especially those involved with artificial intelligence (AI) — led performance in the broad equity market. However, investors were still apt to reward smaller companies for better-than-expected earnings growth, despite what seems to be an increasingly challenged, yet resilient consumer. Growth outperformed value in the quarter as investor risk appetite remained strong.
- On a relative basis, our security selection had the largest positive impact while sector allocation added a modest boost. An overweight allocation and favorable stock selection drove outperformance in the **Industrials** sector, while an underweight allocation, along with superior stock selection, led the **Financials** sector to a positive contribution. The **Materials** sector was the third largest contributor to outperformance, primarily due to stock selection.
- The **Information Technology, Utilities** and **Health Care** sectors were the largest detractors to relative performance in the quarter, driven mainly in each case by security selection.

Performance Drivers

- On an absolute return basis, the best-performing sector was **Industrials**, followed by the **Materials** and **Consumer Discretionary** sectors. Industrials provided the greatest contribution, owing to a larger sector weight and strong absolute performance. The worst-performing sector was Communication Services, where we hold a single stock.
- Within the portfolio, the top-performing stock was **Masonite International Corp. (DOOR)**, which agreed to be purchased by Owens Corning for a significant premium over the existing stock price. We sold the position on news of the acquisition. **Vertiv Holdings Co. (VRT)** soared in the quarter as demand for the company's electrical products accelerated. Similarly, **Hubbell Inc. (HUBB)** continued its steady march upward; the company posted strong earnings amid demand for its electrical equipment and other positive signals for the business.
- Investment banker **Blue Owl Capital Inc. (OWL)** added nearly 30% as the asset manager and banker showed strong inflows and the ability to retain assets. Finally, **XPO Inc. (XPO)**, a less-than-truckload shipping specialist, added nearly 40% after a sizable beat on their earnings report, which was driven by price increases that improved revenue and yields.
- **Mercury Systems Inc. (MRCY)** declined after a messy quarter that fell short of revenue targets. Management lowered guidance but cleared up expectations on their development pipeline and showed some growth in future bookings. Other detractors included **QuidelOrtho Corporation (QDEL)**, which dropped following a disappointing earnings release and downbeat forward guidance. **J&J Snack Foods Corp. (JJSF)** was another leading detractor as investors became more cautious on consumer spending.

- Two industrial REITs were among the top detractors in the quarter. **Americold Realty Trust (COLD)** declined after a solid earnings report, while **Rexford Industrial Realty (REXR)** fell as investors became more cautious on REITs overall, amid tightening credit conditions and weaker rents.

Performance Update

As of March 31, 2024

Trailing Years Performance

	1Q24	YTD	1 Year	3 Year*	5 Year*	10 Year*	Since Inception*
Westwood Quality SMidCap Fund	7.99%	7.99%	23.02%	7.58%	10.69%	7.33%	9.28%
Russell 2500 Value Index	6.07%	6.07%	21.33%	5.36%	9.38%	7.68%	7.93%

*Annualized

Calendar Year Returns

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Westwood Quality SMidCap Fund	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 2500 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%

Inception date is 12/19/05. High short-term performance of the fund is unusual and investors should not expect such performance to be repeated. **The performance data quoted represents past performance. 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.** Expense ratio for the fund is 1.02% (gross) and 0.87% (net). The Advisor has contractually agreed to waive fees and reimburse expense until March 1, 2024. In the absence of current fee waivers total return and yield would be reduced.

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 3/31/2024

Chord Energy Corp.	Summit Materials Inc.
Hubbell Inc.	Ecovyst Inc.
Northern Oil and Gas Inc.	Domino’s Pizza Inc.
Littelfuse Inc.	Timken Co.
Rambus Inc.	Constellium SE

Top 10 Holdings represents 22.91% 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:

- **Century Communities (CCS):** This homebuilder is well positioned to capitalize on the supply shortage in a housing market as well as strong demand.
- **SM Energy (SM):** The company is an E&P operator in the Middle Basin and South Texas, and we believe their valuation does not reflect the quality of those assets.
- **Kratos Defense (KTOS):** A defense contractor with a focus on drones, software, electronic warfare and propulsion, the company can benefit from the Defense Department's plans for future investment and spending.
- **Louisiana Pacific Corp (LPX):** This manufacturer of wood siding and other wood products sells into new home, repair and remodeling segments of the market. The company is shifting to the more valuable wood siding business, which should earn a higher multiple over time as sales and margin strength are reflected in future earnings.
- **Constellium SE (CSTM):** This downstream aluminum producer was added based on favorable demand trends of sustainability and reducing weight in larger machines. Additionally, a rising contribution to revenue and earnings from the aerospace division should also benefit the company, a factor we believe is underappreciated by analysts.
- **Verra Mobility (VRRM):** The software company designs and develops solutions for toll management, safety and traffic enforcement. There are opportunities for growth as highly populated states such as California, Florida and Pennsylvania have passed legislation creating opportunities for growth in their Government Solutions business, while there are additional opportunities in tolling with the shift to cashless toll roads.
- **Middleby (MIDD):** The company manufactures foodservice equipment for restaurants, retailers, hotels and homes. The stock has struggled as residential kitchen remodeling has slowed due to higher interest rates. The long-term fundamentals of the business remain extremely attractive, as we believe accelerating growth in restaurant openings and renovations will be a benefit to future sales.
- **Crown Holdings (CCK):** The company is a leading supplier of aluminum beverage cans, glass bottles, non-beverage cans, and aerosol cans, used in the food and beverage, personal care, and household products industries. The stock sold off last year due to weak fourth quarter earnings; we believe it was oversold as investors focused on non-core business. Long-term fundamentals are attractive as well as an 8% free cash flow yield.
- **Blue Bird Corp. (BLBD):** The school bus manufacturer was added to the portfolio based on an elevated backlog, providing a clear line of sight to future revenue streams. The company also manufactures EV buses, with support of a $5 billion EPA program, another potential growth driver.

The following positions were sold from the portfolio:

- **Diamondback Energy (FANG):** This best-in-class oil and natural gas producer has been a strong performer for the strategy. The market cap exceeds our limitations, so we reallocated the proceeds to other energy stocks.
- **Masonite International (DOOR):** Following the announcement that the company was to be acquired by Owens Corning for a 46% premium, we exited the position.
- **QuidelOrth Corp (QDEL):** We sold this medical diagnostics company after it reported poor fourth quarter earnings and that the CEO was departing.
- **CACI International (CACI):** We sold our position in this defense contractor to realign our exposure in the defense industry to companies with better reward-to-risk profiles.
- **Westrock Co. (WRK):** We eliminated the position as the company is in the process of a merger with Smurfit Kappa, and we believe the stock became fully valued.

- **Decker Outdoor Corp. (DECK):** After many quarters of solid revenue growth, and a strong run in the stock price over the past year, we believe the reward-to-risk ratio is no longer as favorable, so we exited the position.
- **Northwestern Energy Group (NWE):** We sold this Montana and South Dakota-based utility to reduce our exposure in the sector in favor of better opportunities.

Market Review

Equity markets experienced overall growth in the first quarter of 2024, with both the Dow Jones Industrial Average and the S&P 500 setting record highs in the quarter. The closely watched S&P 500 returned 10.6%, marking the second quarter in a row of double-digit gains and reaching a new high of 5,245 in March. Broad-based market optimism, confidence in corporate earnings and any “landing” still to come in the economy fueled those markets. Large-cap stocks continued to outpace small-cap issues, though small- and mid-cap stocks enjoyed a strong March. From a style perspective, growth outperformed value over the entire market cap spectrum.

Bond markets trended sideways to lower as resilient economic data and sticky inflation prompted a revival in the “higher for longer” interest rate case that was confirmed by the Federal Reserve in their March meeting. Despite the shift in the Fed’s sentiment, investors continued to believe in a benign risk environment.

Technology stocks performed well, driven by increased demand for digital services and the positive outlook on innovation, technology adoption and AI. Energy was the second-best-performing equity sector in the quarter, as concerns over the Middle East conflict kept oil and natural gas prices high. The Financials and Industrials sectors also saw significant gains, buoyed by the broader economic recovery and increased infrastructure spending.

The Magnificent 7 led the way for all stocks as AI remained a tremendous catalyst for earnings growth across a myriad of stocks and sectors. The Magnificent 7 were responsible for 40% of the S&P 500’s year-to-date gain, compared to more than 60% last year.

The bond market was not as bullish as we saw late last year, but showed signs of stabilization, with yields on government bonds remaining relatively steady. The 10-year Treasury yield, a key indicator for borrowing costs, closed the quarter at 4.20%, up from its final read in 2023 of 3.88%. The decline in the Treasury bond market reflects the Federal Reserve’s cautious approach to interest rate cuts, now expected to total just three for the rest of the year, less than half of what was expected in early January. Corporate bond yields, on the other hand, experienced a slight increase, reflecting the improved credit outlook for many companies and the overall optimism in the market.

In the U.S. economy, the first quarter saw a significant uptick in job creation, as over 1.5 million jobs were added across various sectors, most notably in technology, health care and manufacturing. This level of job creation points to a resilient and adaptable economy. On the other hand, there were an increasing number of layoffs and cost-cutting actions by companies large and small. Nearly 40% of business leaders surveyed by ResumeBuilder believe layoffs are likely at their companies this year, and about half say their companies will implement a hiring freeze.

Consumer spending remained strong in January and February, indicating relative confidence among the American public, with a notable increase in spending on durable goods. The housing market experienced a slowdown in price appreciation, suggesting a shift toward a more balanced market, though demand for housing remained healthy. Low-rate mortgage owners are staying put, restricting supply for now.

Global economic recovery efforts, particularly in major trading partners like the EU and China, have positively influenced American exports, contributing to the growth in manufacturing jobs and sectors reliant on international trade, but the relative economic health of many of our trading partners remains delicate. Recessions are occurring in the U.K., Finland and Ireland, and negative GDP rates for Q4 2023 were also reported in Germany and Canada.

International stocks are positive on the year, but are also showing divergence across regions and countries. The MSCI ACWI ex-U.S. Index was up 4.3% in the quarter, while the MSCI Emerging Markets Index gained 2.2%. Within developed international markets, Japan was certainly a standout, despite economic fragility and rising interest rates. Japan's Nikkei 225 recaptured a high last made 35 years ago as the Bank of Japan increased its short-term borrowing rate for the first time in 17 years. Japanese companies continue to benefit from corporate reforms and a very weak yen, weighed by years of easing monetary policy.

Outlook

We continue to maintain a cautiously optimistic outlook for both stocks and bonds for the coming year. While not as dovish as many might have hoped, the Fed should begin lowering rates at a slow pace around mid- to late-year as long as inflationary pressures remain in check. The jury is still out on two or three cuts this year; we are leaning more toward the former.

Headline consumer data still suggests optimism, but we remain concerned about housing costs, depleted savings and record high-rate credit card debt. And while easing inflation is good for consumers, it reduces pricing power and margin growth for companies. Earnings growth should continue to accelerate into 2024, assuming lower rates into the back half of the year.

With equity valuations elevated, multiple expansion from here forward is not likely and should limit the appeal of pure "beta" exposure. Earnings growth is likely to be the main driver of stock returns as we look ahead. Specifically, we seek to identify businesses with underappreciated earnings potential, as we believe those companies will be rewarded as their stock is trading cheaper than printed estimates imply.

We believe the U.S. economy will likely continue to slow due to the lagged impact of tighter financial conditions. Tighter lending standards accompanied by higher interest rates would lead to lower capital spend, higher risk of defaults and reduced spend. Small- and mid-cap stocks are more exposed to these risks given the inherent volatility in their revenue and cash flows relative to larger cap companies. In this environment, our focus on higher quality companies that generate strong free cash flows and have clean balance sheets should show relatively better stock performance.

About Westwood

Westwood Holdings Group, Inc. is a focused investment management boutique and wealth management firm.

Westwood offers high-conviction equity and outcome-oriented solutions to institutional investors, private wealth clients and financial intermediaries. The firm specializes in two distinct investment capabilities: U.S. Value Equity and Multi-Asset, available through separate accounts, the Westwood Funds® family of mutual funds and other pooled vehicles. Westwood benefits from significant, broad-based employee ownership and trades on the New York Stock Exchange under the symbol "WHG." Based in Dallas, Westwood also maintains an office in Houston. For more information, please visit westwoodgroup.com.

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 Westwood Quality SMidcap Fund was formerly known as the Westwood SMidCap Fund.

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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