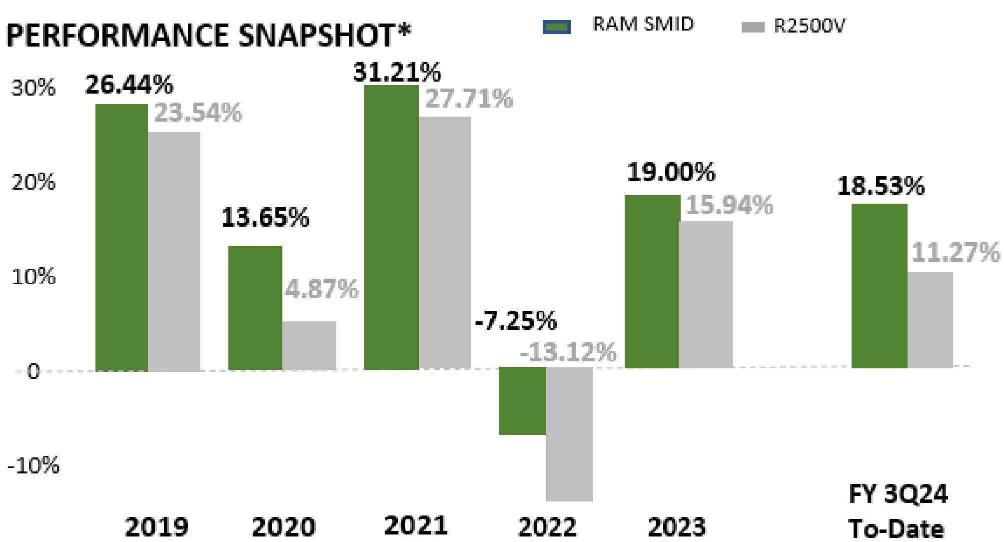
October 2024

Our RAM Smid Composite's 9.83% rise in 3Q24 and 18.53% year-to-date, outperformed our benchmark, the Russell 2500 Value index, which gained 9.63% in 3Q24 and up 11.27% YTD.

One of our learnings from our almost 34 years' experience is that "it matters when it matters," and having an allocation to small and smid value rewarded investors in 3Q24. As we wrote in our 2Q24 letter, we believed the strong signal by the Fed that it would move to cut rates could have a positive impact on small and smid-cap value returns. This view played out in 3Q24, as the Russell 2500 Value Index outperformed the S&P 500 which returned 5.89%.

The Russell 2500 Value Index surged 7.67% from June 30 to July 16, before moderating to a 2.49% gain through September 30. While the first two weeks represented a strong move for the small and mid-cap value sectors, we see this as a beginning and not a one-off. We believe a mix of undervaluation, neglect, Fed rate cuts, and a soft economic landing should drive solid returns in small and smid cap value through 4Q24 and into 2025.

We are continuing to find exciting individual investment opportunities and believe the general investor rush towards indexing is creating more individual security neglect and valuation opportunities.[1,2]



Source: Rewey Asset Management, Index returns sourced from Bloomberg 09/30/2024.

**Note that there are material limitations inherent in any comparison between RAM Smid strategy and the R2500 Value Index. The R2500 Value Index is unmanaged, and you cannot invest directly in an index. The RAM portfolio is actively managed and holds concentrated investments in the equity securities of small-mid capitalized companies. Please see important disclosures at the end of this letter.*

S&P 500 Returns Broaden Beyond the Mag 7: A New Trend?

This quarter, the most notable market shift saw the equal-weighted S&P 500 (SPW) outperform the S&P 500, with returns of 9.59% vs. 5.89%. We anticipated this in our 2Q24 letter:[3]

> *"if the Fed does end up cutting rates, as expectations suggest, we think it would represent a nice tailwind for small caps and would likely hasten a rotation away from the high concentrated position levels at the top of the major indexes."*

The heavy concentration of large-cap tech in the S&P 500 (the Magnificent 7) has skewed the index, with these top names appearing to hold very high-expectations. This quarter, the Mag 7 posted a modest 1.68% gain (NVDA, GOOG, AMZN, and MSFT all reported negative returns), while the remaining 493 stocks delivered a strong 7.85%.[4]

The Fed Brought the Thunder with a 50 bp Rate Cut: The Recalibration of Rates Begins

Not only did Fed Chairman Powell bring the thunder with a 50-bps rate cut on Sept 18th, but also the Fed's dot plot (the median forecasts of the voting members) is for rates to fall to 4.4% by year end and to 3.4% in 2025. If this view holds, this suggests additional rate cuts of 25-50 bps cut by year-end 2024 and 100 bps more in 2025.[5]

The economic data continues to support further Fed cuts. The PCE, a favored metric of this Fed board, rose 2.2% for August y/y, decelerating from 2.5% in July and close to the Fed's 2% target. Evidence of a 'soft-landing' economic scenario continued to build as well, with final 2Q GDP reported at 3%. Moreover, the Atlanta Fed GDPnow forecast is calling for 2.8% GDP growth in 3Q24. We see these datapoints as fuel for the Fed to "recalibrate" its interest rate outlook and to cut rates in 2024 and 2025, allowing it to focus on the second part of its dual mandate, the labor market.[6,7,8]

A Rotation to Small and Smid-Cap Value

We see palpable neglect and under-ownership of small and smid cap value stocks by most investors who have gravitated to larger and growthier companies since the Fed began raising rates in 2022. Indeed, since the Fed's first hike of the current cycle on 3/15/22 through 9/18/24, the S&P 500 returned 37.1% vs. 16.7% for the Russell 2500 Value.[9] As we wrote in our 2Q24 letter, if investors were to rebalance just 1% of their holdings in the S&P500 into the R2500 Value Index, this would represent buying over 10% of the index. Said differently, the move to small and smid cap value stocks could turn into a stampede.[10]

Why Active Beats ETFs in Small and Smid Value

Ironically, some pundits still warn against a rotation into small-cap value, citing concerns about non-earners in these indices. We see this argument as noise but agree that smaller-cap ETFs are not an ideal way to invest in small cap securities.

A deeper analysis shows that of the 1871 securities in the R2500 value index, a whopping 666 have negative earnings. We agree that these companies could present increased investment risk, and thus present a negative feature of index investing. However, we strongly disagree that this is an argument to avoid the sector. In the same vein, 1205 companies in the R2500 value index have positive earnings.[11] This group of 1205, plus thousands of other profitable small and smid companies that are not index members, in our view present a fertile hunting ground for investment ideas.

An active selection approach can help to remove the risks some investors fear in the small cap universe. Our investment philosophy of 1) Financial Strength, 2) The Ability to Grow and 3) Valuation, presents a framework for identifying small and smid cap companies that are financially sound and that can outperform on their individual merits, in addition to a potential tailwind of rate cuts and a soft landing.

We see substantial opportunities for investors willing to look beyond ETFs with fundamental analysis.

Portfolio Highlights

We have built our RAM Smid portfolio based on our 3-pronged investment philosophy of 1) Financial Strength, 2) The Ability to Grow and 3) Discounted Valuations.

Six of our composite holdings have net cash on the balance sheet and fourteen others have net debt to EBITDA less than or equal to 2.0x. Twelve holdings are trading at less than 1.5x book. At quarter-end, our RAM Smid cash level averaged 2.5. Turnover was light, as we added just one and sold one position from the portfolio.[12]

Lifeway Foods (LWAY) was our top percentage gainer in the quarter, up an astounding 103%! We often write about how the power of investing in neglect is equally important to investing in low valuations, and LWAY demonstrated this point in 3Q24. We purchased LWAY in 2Q24 as shares sold off despite a strong quarter that demonstrated continued revenue growth and margin expansion, despite a slight 'miss' to street EPS estimates. In our view, there was nothing bad about 2Q24, other than inaccurate sell side models. On August 13th, LWAY blew away these low expectations with a strong FY3Q report, where revenues grew over 25%, surpassing $50 million in a quarter for the first time. Shares further surged on Sept 23rd, when Danone, the global dairy company that owns 23.36% of the company, made an unsolicited bid for the company at $25 per share. While we think a deal may eventually get done, we think this first offer of $25 is too low.[13]

Intest (INTT) was our largest detractor in the quarter, as the share price fell 26.11%. Investors reacted negatively to the severe slowdown in INTT's front-end semi-conductor manufacturing equipment segment, which produces induction heating elements used to grow Silicon Carbide and Gallium Arsenide wafers. While this ordering pause will likely take one to two quarters to abate, we think the reaction in the share price has been far too negative, as these semi offerings still have tremendous long-term growth potential due to their low heat characteristics. Further, the 'other' 85% of the company remains on track, and the company has a strong financial position with essentially no net debt.[14]

Kyndryl Holdings, Inc. (KD)

We continue to see significant neglect and undervaluation in shares of Kyndryl (KD), a position that shows 94% upside to our AFV price target of $44.60 per share.

Kyndryl is a $5.5 billion market cap designer, builder, manager, and modernizer of mission critical, i.e., backbone, information technology infrastructure systems, including public, private, and multi-cloud environments. KD was spun out of IBM in November of 2021. Since the spin, KD has been aggressively repositioning its business by shedding unprofitable legacy IBM driven contracts, partnering with leading technology companies including MSFT, GOOGL, AMZN, SAP, VMW, ORCL, etc., signing new contracts at significantly higher margins, and optimizing its cost structure. Today's KD bears little resemblance to its pre-spin form where IBM neglected profits in the unit to secure large hardware sales in separate divisions.

KD has maintained a very strong financial profile through its transition and has ample financial flexibility as it moves forward to a future that is likely to show strong revenue, earnings and free cash flow growth. KD's net debt is very reasonable at $1.97 billion ($1.26 bil. cash, $3.24 bil. debt), approximately 79% of FY2025 expected EBITDA. KD's financial strength is further amplified by its investment grade rating at all three agencies, and as it has not drawn down any of its $3.15 billion revolver.

We see palpable neglect in KD shares, as quantitative investment strategies have likely been avoiding the company, since screens will show that it has had negative revenue growth since its spin. What these screens overlook is that KD has walked away from or re-negotiated low or no margin legacy IBM business, while signing new business at double-digit EBITDA margins (very high single digit pre-tax margins). On its FY1Q25 earnings call, KD reiterated that in addition to expecting to generate $300 million in free cash flow in FY2025, it expects its FY4Q25 (March '25) quarter to mark its inflection to reported revenue growth. Indeed for 2025, the pre/post IBM spin business mix of revenues is expected to be 50%/50%, rising to 67% and 85% post-spin revenues in FY2026 and FY2027. We think this revenue inflection, margin improvement, strong FCF profile and incredibly cheap valuation will catch the attention of investors who have not yet done the work on Kyndryl.

KD has multiple revenue growth drivers that should propel revenue higher over at least the next several years. Since the spin, KD has partnered with several leading third-party technology companies (listed above) and this has provided opportunities to help transition its clients from a legacy IBM infrastructure to a state-of-the-art backbone environment that encompasses on-premises, cloud, or hybrid solutions, depending on the client desires. One unheralded strength of KD is its 90,000+ workforce, a critical differentiator in an environment where many companies are scrambling to recruit talent. KD has quickly moved to accredit its workforce on these third-party offerings, and thus is in a strong position to help clients migrate to and operate modern and AI driven environments.

KD has amplified its growth rate through its AAA initiatives - Alliances, Advanced Delivery and Accounts, all three new programs post spin. For Alliances, KD generated $210 million in revenue in FY1Q25 and is on track to meet its $1 billion goal of cloud and hyperscaler revenues for FY25. For Advanced Delivery, KD is driving its AI enabled KD Bridge offering to reduce costs through automation and free up labor hours to increase productivity. KD has already been able to re-task 10,500 employees through this initiative and has achieved an annualized $650 million in revenues, on track for its $750 million FY25 goal. Through its Accounts initiative, KD has walked away from or early renewed many legacy IBM contracts that were low, no, or negative margin business. KD has added an annualized $725 million in revenue in this initiative and is on track for is FY25 goal of $850 million. These AAA initiatives have been successful, and the targets expanded through introduction. Indeed, on its FY1Q25 report, KD pointed to the strength of its AAA's in raising its EBITDA margin forecast and its EBT income outlook for FY25.

We believe investor neglect and broader tech sector weakness has resulted in the severe undervaluation of KD shares, creating a compelling opportunity, just as its reported metrics are slated to turn positive. Due to the incumbent nature and critical infrastructure nature of its business, KD has not been as negatively affected by the slowdown in true project based I.T. consulting that has roiled the sector in 1H24. Whether due to screening issues, analysts who are still unfamiliar with the new KD or even sector driven investors who are avoiding the space, the severe investor neglect has left KD woefully undervalued at a paltry 2.6x EV/EBITDA at 9/30/24's closing price of $22.98. As KD is guiding for future revenue growth, margin expansion and free cash flow growth, we think even the 5x EV/EBITDA target we are using for our AFV which yields a $44.60 price target (up 94%!) could be low.

While KD does not currently pay a dividend, we see an initiation as an upside catalyst over the next 2-3 years. Further, while not a part of our current investment thesis, we think KD could be an attractive takeover candidate for a larger firm looking, given KD's annuity like client base and large workforce.[15]

Looking Forward

We believe the cooling inflation and the current likelihood for a soft landing could be very positive for small and smid-cap stocks, due solid economic activity, further potential rate cuts and a likely rotation/rebalancing into small and mid-cap names. We see extreme concentration at the top of large-cap indices and believe that expectations around small and mid-caps have become too negative.

Our investment cases, however, do not rely on rate cuts or economic acceleration as the main pillar for our investment thesis. On the contrary, we believe our portfolio companies possess attributes that can lead to outperformance without an economic or rate cut tailwind. Having a strong investment case and a long-term view creates time as a powerful ally for value creation.

We appreciate your trust and support. As always, please feel free to contact us to discuss our commentary or to share your thoughts on the market and stocks.

Chip

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1. Past performance is no guarantee of future results. The RAM SMID Value Composite schedule of net investment performance of Rewey Investment Management LLC (the "Schedule") represents the activity of separate customer trading accounts managed collectively (collectively the "Accounts") for the annual and cumulative periods from January 1, 2019 through Sept. 30, 2024. 2022-2024 performance unaudited. Please see full Marcum footnotes for RAM Smid composite 2019-2021 at Microsoft Word - {A44BB912-3141-4B59-AE8E-3D695C6B8BD4} (reweyassetmanagement.com). Performance graphic not to scale. The performance results for the period of 1/1/19-11/8/2021 are from accounts managed by Chip Rewey while affiliated with Advisor Services Network.

2,3,9.

- The Russell 2500 Value, the S&P 500 Index and the S&P 500 equal weighted index market cap information and performance levels are sourced from Bloomberg. The Russell 2500 Value, S&P 500 index and the S&P equal weighted indices are each an unmanaged group of securities considered to be representative of the small and mid-cap stock market, and the large-cap stock market in general, respectively. Indexes are unmanaged and do not incur management fees, costs, or expenses.
- The Russell 2500 Value-Dynamic Index® measures the performance of the small to mid-cap value-dynamic segment of the US equity universe. It includes Russell 2500 Index companies with relatively lower price-to-book ratios, lower I/B/E/S forecast medium term (2 year) growth and lower sales per share historical growth (5 years) and relatively less stable business conditions that are more sensitive to economic cycles, credit cycles, and market volatility based on their stability variables.
- S&P 500 Index is a market capitalization-weighted index of 500 common stocks chosen for market size, liquidity, and industry group representation to represent U.S. equity performance.
- The S&P 500® Equal Weight Index (EWI) is the equal-weight version of the widely-used S&P 500.
- It is not possible to invest directly in an index. There are material differences between the RAM SMID Value Composite portfolio and the indexes used for comparison purposes. The RAM portfolio is actively managed and holds concentrated investments in the equity securities of small-mid capitalized companies. An index is generally designed to illustrate the performance of a specific asset class (i.e. small cap) but is not actively managed and the index performance does not reflect the impact of advisory fees and other investment costs.

4. Performance of the Magnificent 7 (Alphabet Inc. (GOOG), Meta (META), Amazon (AMZN), Tesla (TSLA), Apple (APPL), Microsoft (MSFT) Nvidia (NVDA) collectively and individually sourced from Bloomberg and RAM proprietary analysis. Performance of the 'other' 493 S&P constituents collectively sourced from Bloomberg and RAM proprietary analysis.

5. 9/18/24 Federal reserve statement Federal Reserve Board - Federal Reserve issues FOMC statement. 9/18/24 Federal reserve projections Summary of Economic Projections, September 18, 2024 (federalreserve.gov).

6. PCE (U.S. Personal Consumption Expenditure Core Price Index August 2024 y/y, sourced from U.S. Bureau of Economic Analysis via Bloomberg.

7. US GDP for 2Q24 Q/Q data sourced from U.S. Bureau of Economic Analysis via Bloomberg.

8. Atlanta Fed GDP now data sourced from 3Q24 Slide Deck Slide 1 (atlantafed.org)
10. The Russell 2500 Value Index and the S&P 500 Index data and statistics sourced from Bloomberg and RAM proprietary analysis.
11. All portfolio discussion is based off our model RAM Smid portfolio of separately managed accounts. Company financial estimates sourced from Rewey Asset Management proprietary analysis, and Bloomberg BEST company estimates. Historical pricing and company financial data sourced from company 10Q and 10K filings, and Bloomberg. Individual portfolios may hold slight deviations in position sizes, cash levels and positions held. Portfolio statistics discussed are from September 30, 2024. These statistics will likely change over time. Debt/EBITDA ratio comments exclude financial companies due to non-comparability.
12. Lifeway Foods (LWAY) quarterly performance information sourced from Bloomberg. Other LWAY commentary sourced from company earnings releases, 10Q, 10K filings, company presentations, RAM in-person meeting with and discussions with management, Bloomberg and Rewey Asset Management proprietary analysis.
13. Intest (INTT) quarterly performance information sourced from Bloomberg. Other INTT commentary sourced from company earnings releases, 10Q, 10K filings, company presentations, RAM in-person meeting with and discussions with management, Bloomberg and Rewey Asset Management proprietary analysis.
14. All financial ratios, statistics, and projections discussed in the Kyndryl (KD) commentary are sourced from KD 10-K, Proxy, 10Q filings, company press releases, company public conference calls and webcasts, company slide presentations, RAM discussions with management, Bloomberg, KD company webpage and Rewey Asset Management proprietary financial analysis and Rewey Asset Management industry due diligence. Historical share price information sourced from Bloomberg.