

# 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)	0.98	-2.32	-2.32	12.48	-	-	12.48
Small Cap Quality Strategy (gross)	1.17	-1.58	-1.58	13.33	-	-	13.32
S&P 600	1.70	6.02	6.02	10.17	-	-	8.58
Value Add	-0.72	-8.33	-8.33	+2.31	-	-	+3.90

### MAJOR PERFORMANCE DRIVERS

The US market rose in the fourth quarter, supported by ongoing optimism around AI and a steady economic environment. The S&P 500 rose 2.7% in the quarter while our benchmark, the S&P 600, rose 1.7%. The Small Cap Quality portfolio underperformed the benchmark for the quarter.

During the quarter, our sector selection was neutral, with our overweight to Consumer Staples a headwind, offset by our overweight to Information Technology. Our stock selection drove our underperformance, with stock selection within IT and Industrials the largest headwinds. We did not own AI beneficiary Sandisk, in part because by the beginning of the fourth quarter, it was already too large for our mandate. Its rapid run-up in the quarter before exiting the Small Cap S&P 600 explains more than 100% of our stock selection weakness. This was a very difficult quarter for our broader small cap quality universe, which significantly underperformed the benchmark throughout the quarter. Fortunately, our stock and sector selection within the small cap quality universe were both favorable, offsetting most of the factor pressures we experienced.

Our weights in Globus Medical, Fabrinet, and the New York Times were the largest positive contributors to our relative returns, while our investments in Trex, Aeon, and Ollie's Bargain Outlet Holdings were our largest detractors.

Globus Medical is a manufacturer of spinal surgery equipment. After a weak start to the year, the company's stock was bolstered by its return to strong market share gains and a successful integration of its recent acquisition, Nevro, a manufacturer of spinal cord stimulators.

Fabrinet is an outsourced manufacturer of optical networking equipment; Nvidia's networking division is its largest customer today. The stock performed well on strong earnings, share gains, and rising excitement on strong demand for optical equipment, driven by AI-related use cases.

### RISKS

Risks associated with investing in the Strategy may include: (1) Management and Operational Risk: the risk that GMO's investment techniques will fail to produce desired results, including annualized returns and annualized volatility; (2) Market Risk - Equities: the market price of equities may decline due to factors affecting the issuer, its industries, or the economy and equity markets generally. Declines in stock market prices generally are likely to reduce the net asset value of the Fund's shares; and (3) Smaller Company Risk: Smaller companies may have limited product lines, markets, or financial resources, lack the competitive strength of larger companies, have less experienced managers or depend on a few key employees. The securities of companies with smaller market capitalizations often are less widely held and trade less frequently and in lesser quantities, and their market prices often fluctuate more, than the securities of companies with larger market capitalizations. This is not a complete list of risks associated with investing in the Strategy. Please contact GMO for more information.

Composite Inception Date: 31-Aug-22

**Performance Returns:** Performance for the year of inception is less than a full calendar year. 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 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. Gross returns are presented gross of management fees and any incentive fees if applicable. These returns include transaction costs, commissions, withholding taxes on foreign income and capital gains and include the reinvestment of dividends and other income, as applicable. If management and incentive fees were deducted performance would be lower. For example, if, before fees, the strategy were to achieve a 10% annual rate of return above its hurdle rate each year for ten years, and an annual advisory fee of 1% and incentive fee of 20% of net returns above the hurdle rate were charged during that period, the resulting average annual net return (after the deduction of management and incentive fees) would be approximately 7.20%. **GMO LLC claims compliance with the Global Investment Performance Standards (GIPS®). A Global Investment Performance Standards (GIPS®) Composite Report is available at [www.gmo.com](http://www.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 actively-managed, is not managed relative to a benchmark and uses an index for performance comparison purposes only and, where applicable, to compute a performance fee.

# QUARTERLY INVESTMENT REVIEW

## MAJOR PERFORMANCE DRIVERS CONT.

The New York Times is the leading traditional news site in the U.S. It has seen strong growth in both subscribers and ARPUs, with signs of acceleration in its advertising business.

Trex manufactures composite decking boards and other outdoor lifestyle building products. The stock was badly impacted by weak third-quarter results, as demand for composite decking products deteriorated, while competitors became more promotional, and Trex was forced to respond with rising marketing spending.

Aaon manufactures semi-custom, high-end HVAC equipment and, several years ago, bought BasX, a manufacturer of HVAC equipment for data centers and clean rooms. Despite improving fundamentals after a difficult ERP implementation earlier this year, anemic HVAC demand has pressured the stock.

Ollie's Bargain Outlet Holdings is a retailer of close-out merchandise. The stock fell from recent highs as revenue growth decelerated from exceptional levels through the quarter.

This quarter was another difficult quarter for small cap quality stocks, and our portfolio held up reasonably well given the environment. Over time, we believe that focusing on high-quality businesses will lead to outsized returns with less downside risk. 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 focus on identifying companies benefiting from strong competitive advantages, healthy balance sheets, and good management teams that are available at attractive valuations.

Portfolio weights, as a percent of equity, for the positions mentioned were: Sandisk (0%), Globus Medical (4.5%), Fabrinet (2.2%), New York Times (4.2%), Trex (2.4%), Aaon (3.1%), BasX (0%), Ollie's Bargain Outlet Holdings (3.2%), and Nevro (0%).

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## 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.

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## 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

\*\*Representative Office

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