

SMALL CAP QUALITY STRATEGY

Quarterly Investment Review

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.

MAJOR PERFORMANCE DRIVERS

U.S. equity markets rose sharply in the second quarter as the war in Iran showed signs of winding down. The S&P 500 rose 15.2%, while our benchmark, the small cap S&P 600, rose 19.7%. The rally was led by strength in IT names, particularly semiconductors, largely due to optimism around demand from the AI infrastructure build-out.

The Small Cap Quality portfolio considerably underperformed our benchmark, as the environment for quality stocks remained notably difficult. The small cap quality factor delivered extremely weak results—we meaningfully outperformed our internal measurement of factor performance—but the drag was too large to overcome.

Sector selection was modestly favorable in the quarter, while stock selection detracted considerably from performance. Our IT overweight was a notable positive, along with our Energy underweight, partially offset by our overweight in Consumer Staples and Materials. Stock selection within IT represented almost half of our overall stock selection weakness: while our IT stocks outperformed the benchmark considerably, they did not outperform the dramatic rise in small cap IT more broadly. This pattern is common for quality portfolios when a given sector takes off: the quality names in the sector outperform the benchmark but lag the most volatile names in the sector, leading to poor stock selection.

Our positions in Onto Innovation, AAON Inc., and Veeco Instruments Inc. were our strongest drivers of relative return, while The New York Times Company, Ollie's Bargain Outlet Holdings, and FTI Consulting Inc. were our largest detractors.

Onto Innovation is a manufacturer of semiconductor capital equipment; its stock rallied on expectations of rising demand from the memory chip end market.

AAON is a manufacturer of HVAC equipment. During the quarter, it performed well as 1Q results demonstrated strong data center demand and improving operational performance.

Veeco Instruments is a manufacturer of semiconductor capital equipment. Accelerating demand and emerging potential for expanded use cases for its equipment in the manufacture of optical transceivers drove upside in the quarter.

The New York Times Company, owner of both the New York Times and The Athletic, performed poorly in the quarter along with other media peers, though underlying trends remained broadly healthy.

Ollie's Bargain Outlet, a discount "close-out" retailer, declined as unfavorable weather and low-income consumer weakness drove a slowdown in sales trends.

FTI Consulting, a consultancy whose largest businesses are focused on restructuring and litigation, declined due to rising investor fears of how AI might impact the consulting sector.

Though we were pleased to outperform small cap quality more broadly, we were frustrated by the considerable drag on our portfolio from factor weakness. 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: Onto Innovation (5.2%), AAON (3.4%), Veeco Instruments (2.5%), The New York Times Company (2.9%), Ollie's Bargain Outlet (3.0%), and FTI Consulting (2.7%).

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PRELIMINARY ANNUALIZED RETURNS (USD, %) (QUARTER-END)

	Quarter-End	YTD	1-Year	3-Year	5-Year	10-Year	Since Inception
Small Cap Quality Strategy (net)	11.80	15.92	19.30	10.92	-	-	15.14
Small Cap Quality Strategy (gross)	12.01	16.35	20.20	11.76	-	-	16.00
S&P 600	19.70	23.90	37.50	16.04	-	-	13.62
Value Add	-7.90	-7.98	-18.19	-5.12	-	-	+1.52

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

***Preliminary Performance: Final performance numbers are generally available on GMO's website within fifteen business days after month end. Investors should not rely on preliminary numbers to make investment decisions.**

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. **Performance data quoted represents past performance and is not indicative of future results.** 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 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.

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.

For private bank intermediaries in Singapore and Hong Kong, these materials are intended for institutional and Accredited/Professional Investors Use Only.

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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