TRIBUTARY
CAPITAL MANAGEMENT

SMALL CAP EQUITY MARKET COMMENTARY

PORTFOLIO MANAGERS: MARK WYNEGAR & MICHAEL JOHNSON

FIRST QUARTER 2024

	Quarter	Year to Date	1 Year	3 Years	5 Years	10 Years
Tributary Capital Management (Gross of Fees)	4.0%	4.0%	17.6%	8.3%	10.4%	9.4%
Tributary Capital Management (Net of Fees)	3.8%	3.8%	16.6%	7.4%	9.5%	8.5%
Russell 2000 Index	5.2%	5.2%	19.7%	-0.1%	8.1%	7.6%
Russell 2000 Value Index	2.9%	2.9%	18.8%	2.2%	8.2%	6.9%

MARKET REVIEW

Small caps started out the new year with a solid 5.2% return for the Russell 2000 Index in the first quarter. Large caps triumphed, however, with the S&P 500 returning 10.6%, clawing back much of the strong relative performance that small caps achieved from the market bottom on 10/27/23 to the end of 2023. The Tributary Small Cap Equity Strategy return for the quarter of 4.0% (gross return) trailed the Russell 2000 but topped the return from the Russell 2000 Value of 2.9%.

A discussion of the Russell 2000 benchmark return and a comparison to our portfolio is a bit more complex than usual. Two stocks in the Russell 2000 Index were responsible for approximately 35% of the 5.2% index return – Super Micro Computer (SMCI) and MicroStrategy (MSTR). Neither stock fits within the spirit of small cap based on their respective market capitalizations. Nonetheless, they are in the Russell 2000 Index. SMCI began the quarter at an approximate market capitalization of $16 billion and ended the quarter at $56 billion due to a 255% return. MSTR began the quarter at an approximate market capitalization of $11 billion and ended the quarter at nearly $29 billion due to a 170% return. Excluding them from the benchmark would have resulted in a return of approximately 3.4% for the Russell 2000 and the Tributary Small Cap Equity portfolio would have outperformed.

Style-wise, the Russell 2000 Growth's 7.6% return was considerably better than the Russell 2000 Value at 2.9%. However, both SMCI and MSTR reside in the growth benchmark and the combination added approximately 370 basis points to index's quarterly return. Excluding these two stocks, the Russell 2000 Growth returned approximately 3.9%, only 100 basis points greater than the Russell 2000 Value return.

SMCI has become the largest weight ever in the Russell 2000[1] and SMCI and MSTR together became the largest combined weight ever in the benchmark[2]. As of this writing, SMCI and MSTR will exit the Russell 2000 Index upon reconstitution by the end of June of 2024 based on market capitalization.

Performance drivers in the market were a mixed bag. However, higher quality factors recovered somewhat after last quarter when low quality shined once the market bottomed on October 27th. For the first quarter, better returns were found in companies with larger market caps, positive projected earnings, higher returns (ROE and ROA) and no/low dividends.

The strongest sector returns for the Russell 2000 in the first quarter of 2024 were cyclically-oriented sectors such as information technology at +13%, energy at +12%, industrials at +9% and materials at +6%. The information technology sector return was heavily influenced by SMCI and MSTR. Excluding those two stocks would have resulted in a negative return of approximately 1% for info tech.

The weakest sector returns for the Russell 2000 in the first quarter of 2024 were in communications services at -5%, utilities at -4%, real estate at -2% and financials at -1%. These sectors were likely impacted by hotter than anticipated inflation data that resulted in expectations for rate cuts being pushed out to later in the year.

On a relative basis, the Tributary Small Cap Equity portfolio's top two economic sectors outperforming the Russell 2000 during the quarter were financials and energy. In financials, banks in the Russell 2000 were down 6% while Tributary's banks were only down 3%. Additionally, all three insurance industry holdings in our portfolio generated strong returns, beating the average return for insurance holdings in the benchmark. The energy sector likely benefitted from the 17% rise in oil prices over the quarter from approximately $72 to $84. Our portfolio's energy companies nearly doubled the Russell energy sector return of 12%, led by strong quarterly results from SM Energy and Permian Resources.

On a relative basis, the two economic sectors underperforming the Russell 2000 the most during the quarter were information technology and healthcare. Our relative performance in information technology was negatively impacted by the big gains of SMCI and MSTR as mentioned earlier. However, even when excluding SMCI and MSTR from the benchmark, our information technology performance was still below the benchmark. Our sizeable weighting and underperformance relative to the benchmark in the semiconductor and semiconductor capital equipment industry was the primary cause. Most of our companies in this area continue to deal with excess inventory issues, a problem that should be remedied over time. Additionally, in the software industry, portfolio holding Blackbaud gave guidance for 2024 that disappointed investors due to higher investment spending and taxes. In healthcare, biotech stocks continued to rally following the low-quality stock market run at the end of 2023. Also, Omnicell and AMN Healthcare Services provided weak 2024 guidance which caused them to underperform.

PORTFOLIO CHANGES

Two positions were added to the strategy in the first quarter. *ESCO Technologies* is a provider of highly engineered products and solutions to diverse and growing end-markets that include the commercial and military aerospace, space, healthcare, wireless, consumer electronics, electric utility and renewable energy industries. A new management team is in place and there is the potential for improvements from the Test segment along with future M&A. *Alamo Group* manufactures and supplies equipment for vegetation management (mowers and woodchippers) and infrastructure maintenance (snow removal, surface sweepers, vacuum trucks) for governmental, industrial and commercial-end customers. New product development and margin expansion are future drivers of success.

Three positions were eliminated from the portfolio in the quarter. *Comfort Systems* was eliminated due to its market capitalization climbing above the upper limit for holdings in the portfolio. *Helios Technologies* was sold from the portfolio due to a lack of confidence in management. Shortly after purchasing the stock, the company lowered guidance after being unceasingly optimistic since the beginning of 2023. The conference call following the published earnings results was not encouraging as the CEO struggled to answer investors' questions. Additionally, the company failed to deliver on promised new client announcements that have necessitated multiple large expansion projects over the last few quarters. *Barnes Group* was eliminated as industrial performance has been underwhelming for multiple years and recently the previously smooth-running aerospace segment has incurred operational difficulties amid restructuring efforts.

Top Contributors

SM Energy, an oil and gas exploration & production company operating in Texas, reported strong fourth quarter cash flow generation due to better-than-expected production in the Permian Basin and South Texas. Shares also benefitted from a 17% upward move in oil prices in the quarter, which was bolstered by OPEC's decision to continue oil production restraints.

Comfort Systems USA, a provider of mechanical and electrical services for commercial and industrial customers, reported another quarter of strong results. Double digit organic sales growth continues to benefit from a firm demand backdrop across most end markets. Generous cash flow generation allows for further acquisition activity, and two bolt-on deals closed in the first quarter.

Integer Holdings Corporation, a medical device outsource manufacturing company, produced good quarterly results. Strong '24 sales and operating profit guidance was somewhat offset by higher than expected tax and interest expense. Also their backlog has grown considerably as medical device manufacturing customers are creating many new products.

Kaiser Aluminum, a downstream aluminum fabricator and processor, had a very strong quarterly print versus low expectations. The company demonstrated admirable operating leverage as strong commercial aerospace demand continued while constructive management comments caused Wall Street's EPS estimates for '24 to increase.

Permian Resources, an oil and gas exploration and production company, reported strong fourth quarter results and offered 2024 production guidance that was above expectations. Integration of the Earthstone Energy acquisition is going very well, and the company has continued to add to its Permian positions. Share prices also benefited from an upward move in oil prices.

Top Detractors

Marcus & Millichap, a commercial real estate broker, continues to face an industry backdrop of weak commercial real estate transaction volumes. The stock rallied in late 2023 in anticipation of a recovery, but easing interest rate cut expectations are pushing the likelihood of an industry recovery further into the future.

Gray Television, the second largest operator of local television stations in the country, missed on EPS and provided guidance that was below consensus. Management indicated that subscriber attrition and a more difficult environment for increasing fee rates from pay television providers were negatively impacting revenue growth for the company.

Omnicell, a medical equipment company specializing in automated pharmaceutical dispensing systems, printed a good quarter but provided weak '24 guidance due to lower-than-expected Advanced Services and Software sales. This surprised investors as these offerings had recently done well.

Blackbaud, a provider of back office financial, analytical and relationship management software solutions for nonprofits and social good-focused businesses, gave guidance for 2024 that disappointed investors due to higher investment spending and taxes.

AMN Healthcare Services, a temporary hospital staffing services provider (nurses, doctors), reported good quarterly results but offered weak first quarter guidance as hospitals prioritize hiring permanent over temporary staff.

Portfolio Outlook

The Federal Open Market Committee meeting in March gave investors more confidence that rate cuts are coming, despite inflation data in January and February that was hotter than expected. Only time will tell if inflation is stickier than anticipated or if the recent data are just bumps along the road. The Fed appears to be in a wait and see mode with a bias toward rate cuts. Given the economy's continued strength and the Fed's expectation that inflation will continue to slow, it seems to indicate that the Fed doesn't believe a recession is necessary to bring down inflation.

Investors were bolstered by this and the increase in the Fed's GDP growth projection for 2024, moving from 1.4% to 2.1%. On this news markets moved higher. The Russell 2000 was up 3% over the next few days following the Fed's press conference. Little known to most investors is that since small-cap stocks bottomed in October of last year, they have outperformed both the S&P 500 and the NASDAQ indices. Despite this strong recent relative performance, the Russell 2000 remains 10% below its high in 2021, while the S&P 500 and the NASDAQ have been notching new highs.

Though widely expected, we anticipate that the first cut in interest rates will be embraced by investors and most vigorously so by small-cap investors. Approximately 30%[3] of debt in the Russell 2000 is floating rate debt, and lower rates will be almost immediately additive to earnings and cash flow. If recession fears continue to fade and the labor force remains strong, this should be more supportive to small-cap stocks. Small-cap earnings are also more sensitive to changes in the economy, so an improving outlook should provide a constructive backdrop. If lower interest rates, a growing economy, and an anticipated earnings recovery come together, it may motivate investors to consider larger allocations to the small-cap asset class and begin narrowing the valuation chasm between large- and small-cap stocks.

The outlook for small-cap stocks is attractive; however, just like the NCAA March Madness tournament, there is always the potential for spoilers. If inflation or economic growth continue to surpass the Fed's expectations, they may not deliver the rate cuts that are expected, giving investors a reason to pull back. The presidential election this year could also give investors a reason to pause until economic and regulatory policy initiatives begin to emerge. It is also possible that a current or new international conflict could pull the U.S. into involvement, derailing markets. However, the most likely spoiler is often the one that few investors are seriously considering.

While we are well aware of the domestic and global issues that can move markets, we stay focused on what will drive the intrinsic value of our holdings over the coming years. At the end of the first quarter, the projected 2024 earnings growth for our strategy was 7%, well ahead of the 1% growth expected for small-cap stocks by Jefferies Research. Our stronger expected growth is complimented by a 16.7x forward earnings multiple, which is well below the 18.6x multiple for the benchmark. These forward earnings multiples are inclusive of unprofitable companies. Unprofitable companies make up approximately 18% of the index. Our portfolio is supported by strong fundamentals and an attractive valuation, building blocks of investing that put our portfolio and our clients' capital in a strong position for the future.

Whatever comes to pass over the coming year, be it an advancing economy or an unlikely spoiler, we will adhere to our investment philosophy of finding quality companies, knowing them well, and owning them at a discount to what they are worth. This philosophy has served us and our clients well for more than 25 years.

[1] *Jefferies 3/31/2024*

[2] *Furey Research 4/3/2024*

[3] *Goldman Sachs Global Investment Research*

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Unless otherwise noted, all returns, excluding Tributary Capital Management's strategies, have been obtained from FactSet Research Systems. Sector and security level performance is presented net of fees, using the highest potential fee an investor would pay.

The performance numbers shown above are for the Tributary Small Cap Equity Composite and are expressed in U.S. dollars. The composite includes all discretionary accounts with an initial market value of $500,000 (effective 7/1/20) that are generally invested in a small capitalization equity strategy. The inception date of the Small Cap Equity Composite is June 30, 1996.

The portfolio returns for periods other than those starting and ending with calendar month ends are generated using FactSet attribution software to approximate portfolio performance. They are not official composite returns. They are provided for illustrative purposes only and are presented gross of fees meaning they do not reflect the impact of advisory fees which reduces performance returns.

The Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. The Russell 2000 Value Index measures the performance of the small-cap value segment by including those companies with lower price-to-book ratios and lower forecasted growth values. The Russell 2000 Growth Index is composed of small-capitalization U.S. equities that exhibit growth characteristics. The Standard & Poor's 500 is a basket of 500 stocks that are considered to be widely held. The S&P 500 Index is weighted by market value, and its performance is thought to be representative of the stock market as a whole. The S&P 600 is an index of small-cap stocks that tracks a broad range of small-sized companies that meet specific liquidity and stability requirements. The Russell 1000 Index represents the top 1000 companies by market capitalization in the U.S. It is not possible to invest directly in the Russell 2000 Index, the Russell 2000 Value Index, the Russell 2000 Growth Index, the S&P 500 Index, the S&P 600 Index or the Russell 1000 Index.

Net-of-fees composite returns are calculated using the highest potential fee the investment advisor will charge investors in the composite. Net performance is reported net of investment advisory fees and transaction costs. Capital gains and dividends are reinvested for performance calculations.

Stocks of small companies are subject to market risk and may be more volatile and less liquid than stocks of large companies. Comments are provided as general market commentary and should not be considered investment advice or predictive of any future market performance. Sector performance in commentary is stated gross of fees.

It should not be assumed that an investment in securities identified was or will be profitable or that the investment decisions we make in the future will be profitable or will equal the performance of the securities discussed herein. Holdings are subject to change. The holdings identified do not represent all of the securities purchased, sold or recommended for the portfolio. The holdings listed should not be considered recommendations to purchase or sell a particular security. The "Top Contributors" and "Top Detractors" represented are based on contribution to portfolio return. To obtain the contribution calculation methodology and a complete list of every holding's contribution to the overall portfolio's performance during the quarter, please contact clientservices@tributarycapital.com.

Tributary, an SEC Registered Investment Adviser, is the combined entity of the prior Tributary (formed Jan. 1, 2005) and First Investment Group (formerly a department of First National Bank of Omaha) which merged in May 2010. Tributary is a wholly owned subsidiary of First National Bank, a wholly owned subsidiary of First National of Nebraska, Inc. and manages mutual funds and equity and balanced portfolios. Tributary Capital Management, LLC ("Tributary") claims compliance with the Global Investment Performance Standards (GIPS®). A fully compliant presentation can be requested by emailing clientservices@tributarycapital.com.

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Past performance does not guarantee future results. Investments: Are Not FDIC Insured • May Go Down in Value • Are Not a Deposit