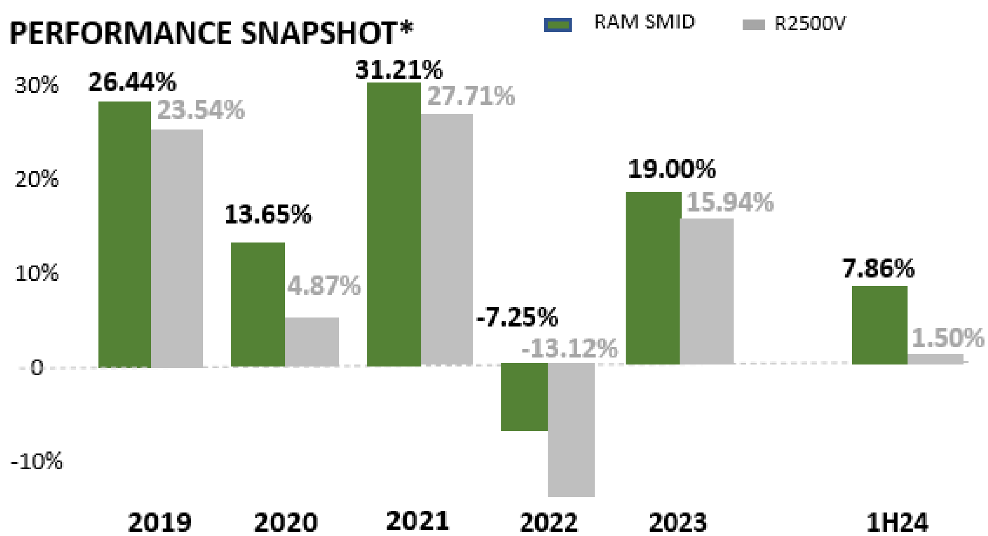
July 2024

The equity markets put up a solid return in the first half of 2024, overcoming economic and geopolitical uncertainty, as the potential for an elusive soft economic landing became more likely.

We were pleased with the performance of our RAM Smid Composite, rising 2.75% in 2Q24 and 7.89% year-to-date, compared to the Russell 2500 Value index which fell 4.31% in 2Q24 and is up 1.50% YTD. We continue to see exciting individual investment opportunities and believe the general investor rush towards indexing is creating more individual security neglect and valuation opportunities.

The concentration of large cap technology in the S&P 500 continued to push that index higher, rising 4.28% in 2Q24 and 15.29% YTD. The impact of the top weighted names (the magnificent 7 representing 32.07% of the index) is seen in the more modest return of the equal weighted S&P 500 (SPW) down 2.63% in 2Q24 and up 5.07% YTD, trailing our RAM Smid composite return.[1,2]



Source: Rewey Asset Management, Index returns sourced from Bloomberg 06/28/2024.

**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.*

The Economy and Inflation are Cooling – When Weakness is Perceived as a Positive

The other major driver of stock market performance, in 2Q24 besides large technology, was fluctuating investor expectations around the potential for a FED rate cut. Contrary to investor expectations entering the year for four to six rate cuts for 2024, persistently higher than expected inflation reports dampened rate cuts hopes. For example, as seen in the June 12th 2024 Fed Dot Plot summary, Fed expectations for a rate cut have cooled significantly since March.[3]

Percent Range	2024		2025		2026		Longer Run	
	March projections	June projections	March projections	June projections	March projections	June projections	March projections	June projections
2.13 - 2.37								
2.38 - 2.62					3	1	9	6
2.63 - 2.87			1		1	1	2	4
2.88 - 3.12				1	5	2	3	4
3.13 - 3.37			2		6	7	1	1
3.38 - 3.62			1		2	3	2	2
3.63 - 3.87			5	1	1	3	1	2
3.88 - 4.12			6	2				
4.13 - 4.37			1	9		1		
4.38 - 4.62	1		2	4				
4.63 - 4.87	9							
4.88 - 5.12	5	8		1	1	1		
5.13 - 5.37	2	7						
5.38 - 5.62	2	4	1	1				

In general, in 2Q24 on days when economic indicators such as employment or PCE inflation were reported on the stronger side of expectations, the market, contrary to what might be normally expected, fell as investors pushed out their rate cut expectations, and conversely, when economic data was reported weaker than expectations, the market rose.

We do not base our investment decisions on forecasts of short-term interest rates, or any other economic measures, but prefer to focus on company specific factors over a 2 to 3-year time frame. That said, if the Fed does end up cutting rates in 2025, 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.

An Elusive Soft Landing?

On June 28th, the Core PCE price index (generally believed to be the Fed's favorite measure of inflation) came in at up 2.6% for May, continuing a gradual decline, compared to 2.9% at year-end 2023 and a peak of 5.56% in Feb 2022. Remarkably, this cooling has been accomplished with positive GDP readings (3.7% for 1Q24) and low unemployment rates (4.0% in May). With the median predictions from the Fed for 2.3% core PCE in 2025, 2.0% GDP for 2025 and unemployment only modestly higher at 4.2% for 2025, it looks like the Fed may be able to achieve its desired soft-landing targets. If this outlook holds, it could be a very positive driver for small and smid-cap stock performance into 2025. [4,5,6,7]

Will Investors Rotate?

At quarter end, Nvidia, Microsoft, Apple, Google and AMZN all have total stock market capitalizations that are above the total of the Russell 2000 Small Cap Value index.

The combined weighting of these 5 stocks dominates the S&P 500 (as represented by the SPY ETF) with a 28.5% weighting. The concentration in these stocks continues to build, as 1) investors chase momentum, 2) passive inflows to ETF's buy these names regardless of stock price and 3) active PMs who "closet benchmark" are forced to buy these names to avoid the risk of underperforming the index if they do not match the benchmark weights. Investors "running with the herd" are clearly getting packed closer and closer together.

For now, it all feels good. It reminds us of the game of musical chairs, where everyone is half-dancing to the music while knowing that at some point they are going to have to try to quickly dash for a chair.

Looking through a different lens, the market cap of Microsoft is 65% of the Russell 2500 Value Index and 178% of the Russell 2000 Value Index, while Apple's market cap is 64% and 173% and Nvidia's market cap is 60% and 163%, respectively.

For those who believe, as we do, that buying low-expectation stocks and selling high expectation stocks is as important as buying low valuations and selling high valuations, we offer some statistics as food for thought. If investors reallocate only 1% of the S&P 500 to the Russell 2500 Value Index, they would need to buy 10% of the index. If investors want to allocate this 1% to the Russell 2000 Value index, they would need to buy 27% of the index. We also suggest that when a paradigm shift emerges, investors will look to move more than just a paltry 1% from the top weighted names.[8]

	Total Market Value	1% of S&P 500
S&P 500 Index	$ 50,383,074,451,131	$ 503,830,744,511
Russell 2500 Value	$ 5,084,138,894,582	10%
Russell 2000 Value	$ 1,869,674,185,731	27%

	Total Market Value	% of the Russell 2500 Value	% of the Russell 2000 Value
MICROSOFT CORP	$ 3,321,869,074,628	65%	178%
APPLE INC	$ 3,229,664,350,840	64%	173%
NVIDIA CORP	$ 3,039,084,000,000	60%	163%
ALPHABET INC-CL A + CL C	$ 2,258,693,835,000	44%	121%
AMAZON.COM INC	$ 2,011,080,747,949	40%	108%

Source: Bloomberg and Rewey Asset Management 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 eleven others have net debt to EBITDA under 1.5x. Thirteen holdings are trading at less than 1.5x book. At quarter-end, our RAM Smid cash level averaged 4.8%. We added three new companies to the portfolio in the quarter and sold out two positions.[9]

Lakeland Industries (LAKE) was our top percentage gainer in the quarter. Portfolio activity for LAKE was unusual for us, as we purchased the entire position at $17.05 May 17th and exited the position at $23.64, on June 18th for a total return of 38.7%. While we do have an initial 2-3 year horizon upon investment, position size is driven by our quality vs. risk/reward position sizing matrix. Said differently, we had established a $25 initial price target for LAKE, and we got most of the move in a month! We exited the position, as the upside vs. downside tradeoff on holding the shares was no longer attractive for us.[10]

Notably, Richardson Electric (RELL) which we featured in our 1Q24 letter, was up 29.8% in the quarter. We continue to see tremendous potential upside for RELL, drive by the bottoming of the semi-conductor equipment cycle. RELL noted it thought 1Q24 was the trough. We also think investors still don't appreciate RELL's new "whitespace" near-term growth into the aftermarket for wind turbine battery replacement with its ultracapacitors, combined with longer-term opportunities to replace batteries in diesel locomotive starting units.[11]

Information Services Group (III) was our worst performer in the quarter, down 26.03% to $2.94. III is a technology research and advisory firm, with about half of its business comparable to Forrester Research and half as a technology general contractor, where III will work with companies to determine the scope and execution of technology implementation projects. III has seen its clients take longer to commit to large IT implementation and transformation projects recently, in line with comments from most industry participants, due to general economic concerns and, perversely, the growth of AI - as clients study the best way to deploy AI into their tech spending plans. III has not seen many project cancelations and expects project work and its employee utilization metrics to rise throughout 2024 off 1Q24 lows. III has kept most of its staff in place to meet what it believes will be strong demand from enterprises looking to both control/optimize costs and deploy AI over the next few years. Indeed, III has not backed off its 17% EBITDA margin goal as a potential for late 2025. We see tremendous potential value in III, which is currently trading at approximately 7x EBITDA, yielding 6.16% and repurchasing shares, up to and potentially exceeding our AFV price target of $6.00.[12]

Webster Financial Corp. (WBS)

Webster Financial Corp. (WBS) was one of our detractors this quarter, falling 13.4% to finish at $43.59, recovering a bit into quarter-end off its June 15th low of $39.34. We see tremendous value and neglect in the shares of WBS, as investors have pushed out their rate cut hopes, worried about commercial real estate and, in our view, have not done a deep dive into WBS's credit strength, its diversified deposit strength, or what could be a valuation catalyst in its HSA Bank division.

We see Webster as having tremendous financial strength. Webster has a 10.5% CET1 ratio, well above the 6.5% CECL minimum requirement. Moreover, this level is temporarily depressed due to the just completed acquisition of Ametros Financial Corp. WBS is targeting to rebuild its CET1 ratio to 11% in the near-term. Webster also remains very profitable, with a Bloomberg earnings per share forecast of $5.59 for 2024, and rising to $6.27 in 2025, even with slightly higher reserve building levels. Webster's book value as of 1Q24 is $49.07, and has risen at a 9.9% CAGR since 1Q19 while its tangible book value of $30.22 has risen at a 4.3% CAGR since 1Q19. This is strong book value growth in a period where banks have endured significant headwinds, including Covid, Fed rate hikes, and growing loan competition from private credit funds (see our 6/28/24 Linkedin post [Private Credit – An Exponential Growth Market Mired in the Shadows | LinkedIn]).

Webster also has what we see as significant business structure strength. At the parent level, its loan-to-total deposit ratio is 84.1%, which we see as protecting against potential modest deposit shrinkage (which we do not expect) while also providing firepower to grow loans. Moreover, the diversity of its deposits is a hidden asset and not a well understood competitive advantage for WBS. Only 71% of its deposits come from its traditional banking activities, with 44% from the consumer bank and 27% from the commercial bank. WBS gets 15% of its deposits from its Healthcare Financial Services unit (mainly HSA Bank) where the cost of deposits is a very low 15 bps. WBS also gets 10% of its deposits from its recent Interlink cash sweep acquisition and projects strong near-term deposit growth (movement to WBS) in the near-term.

We think WBS has a strong Ability To Grow. With only an 84.1% deposit ratio, WBS has substantial room to grow loans, and we note that its footprint along the I-95 corridor between New York and Boston is a very attractive, populous and growing market. WBS forecasts total 2024 loan growth of 5%, accelerating off 1Q24's 0.7%, while deposit growth is forecast to be in the range of 5%-7%. With $76 billion of assets, WBS also has considerable room to growth before hitting the $100 billion asset threshold, which would increase compliance costs for stress testing, etc. WBS should also see continued strong growth out of its HSA bank (now Financial Services) unit, as HSA's gain popularity to help consumers manage the rising burden of healthcare costs. HSA's pre-tax net revenue continued to grow strongly in 1Q24, up 19.2%. Moreover, HSA Bank is the #2 HSA account provider, second to Health Equity (HQY) and these two leaders continue to consolidate the market.

We see tremendous neglect in WBS as well. First, WBS, like most regional banks, has been shunned year-to-date by investors who were expecting the Fed to cut rates multiple times in 2024, but now have abandoned the bank trade, which they see as a beneficiary of rate cuts. We see this impact as a non-issue for WBS, as it can grow without a rate cut, while also seeing the potential tailwind of rate cuts in 2025 if they should occur.

We also see neglect in the fears around WBS commercial real estate portfolio, as investors have seemingly "shot first without asking questions." While WBS does have a $20 billion commercial real estate lending portfolio, only $1 billion is in traditional office. None of these loans were on non-accrual status at the end of 1Q24, the loan-to-value (LTV) was 60%, average loan size was $5.6 million and WBS has a $50 million reserve against this book of business. Maturities are well staggered, with $260 million remaining in 2024 and $158 million in 2025. Its rent regulated multi-family portfolio is also well managed. Of the $1.5 billion of loans where rent regulation is over 50%, non-accrual rates are only 0.1%, the LTV is 61%, average loan is $3.5 million and remaining maturities are $99 million in 2024 and $56 million in 2025. While these lending sectors are facing headwinds across the industry, we see WBS's underwriting strength evident in low current non-accrual levels and well staggered maturities.

We see a compelling valuation opportunity in WBS shares, which closed the quarter at $43.59, down 18.4% from the 12/14/23 high of $53.39. WBS is forecast to earn $5.59 in 2024 and increase earnings to $6.27 per share in 2024, for Price /Earnings ratios of 7.75x and 6.91x respectively. WBS is compelling on a price to book and price to tangible book basis as well, at .87x and 1.41x respectively, especially given the historical growth CAGRs of 9.9% and 4.3% over the last five years.

Our near-term Assessed Fair Value price target for WBS is $60, up roughly 38% from 2Q24 closing levels. This valuation level is under a 10x PE for 2025, which in our view prices in some conservatism for WBS to build reserves if desired. Importantly, any reserve build, in our view, would likely be an income statement impact for WBS, and not a balance sheet issue, and thus we view our PE metrics as very conservative, with upside to a 12x-14x PE ratio if rates are cut in 2025 and CRE fears ebb. Moreover, WBS has the balance sheet strength and the will to keep paying its dividend, which has 3.69% yield.

Lastly, although we don't incorporate sum-of-the-parts catalysts into our AFV targets, we see significant upside potential and immediate strategic need for WBS to do a 19.9% IPO of its Health Care Financial services segment. HQY, HSA's largest competitor, trades at a 28.5x PE multiple on this year's earnings, and it is using its higher priced stock to roll-up smaller HSA competitors. If WBS were to IPO 19.9% of its Health Care unit, it would retain full control of the low-cost deposits, but create a new currency, likely at a significant PE premium to WBS shares, to compete with HQY for acquisitions to grow and defend its market share. Any gain on the sale of these shares would also bolster WBS capital levels, which could be used for share repurchase, reserve building or balance sheet repositioning. While WBS has said it is not an outright seller of this unit, we were intrigued by CEO Cuilla's comments on the 4Q24 call when he answered the HSA spin/sale question as "we continually evaluate" all lines of business to "maximize economic profit of those business lines and whether or not that happens as a wholly owned activity or joint-venture opportunity". In our view, where there is smoke and undervaluation, there is fire.[13]

Looking Forward

We believe the cooling inflation and as of now the likelihood for a soft landing will be very positive for small and smid-cap stocks, due solid economic activity, potential rate cuts and a likely rotation/rebalancing into small and mid-cap names. Positioning at the top of indices has in our view become extremely concentrated and expectations around small and mid-caps has 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 thank you for your trust and support. As always, please do not hesitate to contact us for client service, to discuss our commentary or to simply opine on the market and stocks.

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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 June 28, 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.

2,8. The Russell 2000 Value, 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 2000 Value, 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,espectively. Indexes are unmanaged and do not incur management fees, costs, or expenses. 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.

3,7. The Fed - June 12, 2024: FOMC Projections materials, accessible version (federalreserve.gov)

4. Core PCE inflation statistics sourced from the Bureau of Economic Analysis and Bloomberg.
Atlanta Fed GDPNow forecast sourced from Bloomberg.

5. US 3Q GDP sourced from the Bureau of Economic Analysis and Bloomberg.

6. U-3 Unemployment rate sourced from the Bureau of Labor Statistics and Bloomberg.

9 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 December 29th, 2023.

These statistics will likely change over time. Debt/EBITDA ratio comments exclude financial companies due to non-comparability.

10. Lakeland Industries (LAKE) quarterly performance information sourced from Bloomberg. Other LAKE commentary sourced from company earnings releases, 10Q, 10K filings, company presentations, RAM discussions with management, Bloomberg and Rewey Asset Management proprietary analysis.

11. Richardson Electric (RELL) quarterly performance information sourced from Bloomberg. Other RELL commentary sourced from company earnings releases, 10Q, 10K filings, company presentations, RAM discussions with management, Bloomberg and Rewey Asset Management proprietary analysis.

12. ISG / Information Services Group (III) quarterly performance information sourced from Bloomberg. Other III commentary sourced from company earnings releases, 10Q, 10K filings, company presentations, RAM discussions with management, Bloomberg and Rewey Asset Management proprietary analysis.

13. All financial ratios, statistics, and projections discussed in the Webster Financial (WBS) commentary are sourced from WBS 10-K, Proxy, 10Q filings, company press releases, company public conference calls and webcasts, company slide presentations, RAM discussions with management, Bloomberg, RELL company webpage and Rewey Asset Management proprietary financial analysis and Rewey Asset Management industry due diligence. Historical share price information sourced from Bloomberg.