

Small/Mid Cap Value

Marketing communication | As of 30 Sep 2024

- **During the third quarter, the Small/Mid Cap Value strategy outperformed its benchmark, the Russell 2500 Value Index**
- **The index rallied sharply in July, but then subsequently remained flat in August, and then rose slightly in September, resulting in near double digit gains for the quarter**
- **Investors appear to appreciate the changing rate trajectory into year end**

Market review

Economic growth continued to expand during the third quarter, although more signs of a slowdown emerged. Second quarter's U.S. gross domestic product (GDP) growth came in stronger than expected at an annualized pace of 3.0%, while full-year growth is tracking just slightly below that rate, underpinning investors' hopes for an economic soft landing. Encouraging headline inflation prints during the quarter led key central banks to lower interest rates, even as core inflation remained sticky. The Federal Reserve (Fed) garnered the biggest headline by kicking off its long-awaited policy easing cycle with a 50-basis-point cut in September, larger than many investors had expected. The Bank of England also began lowering rates while the European Central Bank made its second rate cut of this cycle. The People's Bank of China launched a battery of stimulus measures including rate cuts to help kickstart the country's deteriorating economy and ward off deflation. Meanwhile, the Bank of Japan (BoJ) was the outlier with a surprise increase to the country's key interest rate to help curb the yen's fall versus the U.S. dollar.

The stock market started the quarter on a positive note in July, aided by falling Treasury yields and optimism over approaching Fed rate cuts. By month end, the bullish start had given way to concerns about slowing earnings growth for technology companies, which have powered the market for much of the year. In early August, global equity markets sold off sharply after a disappointing U.S. jobs report fanned recession fears, China's economy showed greater signs of deterioration, and the BoJ's surprise rate hike sparked an unwinding of the yen carry trade. As the month progressed, however, the tide quickly turned as inflation reports showed pricing pressures continuing to ease, corporate earnings remained strong, and Fed Chair Powell indicated the time had come for U.S. rate cuts. Throughout September, various market indexes such as the Dow Jones Industrial Average, S&P 500 Index and Nasdaq Composite notched new record highs as investors anticipated the Fed's cut.



Thomas J. Lavia, CFA
Portfolio Manager



Andrew C. Hwang, CFA
Portfolio Manager, Equity Analyst

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While all major U.S. equity indexes performed well, the market rally broadened out during the quarter with small- and mid-cap stocks and more value-oriented stocks leading the way. Smaller companies, which tend to carry more floating-rate debt on their balance sheets, rallied as the Fed lowered borrowing costs. The small-cap focused Russell 2000® Index returned 9.27% for the quarter but still lags large caps with its 11.17% year-to-date return.

The S&P 500 ended the final day of the quarter at another all-time high, gaining 5.89% for the quarter and now up 22.08% year to date. The defensive utilities sector led the pack as earnings expectations continued to be very high for these companies. Real estate and industrials followed close behind as the market rotated into interest-rate sensitive sectors in anticipation of the beginning of the Fed's easing cycle. Energy was the worst-performing sector, and the only S&P 500 sector in the red, as oil prices fell amid cooling demand from China.

Portfolio review

The Nuveen Small/Mid Cap Value portfolio outperformed its benchmark on a gross of fees and net of fees basis, the Russell 2500 Value, during the third quarter of 2024. The index posted near double digit returns with a sharp rally in July, remained flat in August, and then rose slightly in September to close the quarter. A combination of tame inflation and rate cut anticipations sent the smaller end of the market initially higher in the quarter.

With the exception of energy, all sectors in the index were positive during the quarter with communication services, real estate, and utilities producing the largest gains. The portfolio's outperformance was led by strong stock selection in health care, communication services, and energy. Conversely, our picks in financials, consumer discretionary, and industrials detracted from relative performance.

Contributors

Shares of **ADMA Biologics** continued to outperform during the quarter. The company continues to strengthen its commercial biopharmaceutical portfolio with further plasma-derived products for immunodeficient patients. During the quarter, the company raised its guidance on revenues and profits for both 2024 and 2025.

Shares of **Iron Mountain** performed well in Q3 2024. Its core business, especially in records information management and data centers, continued to exhibit strong growth and pricing power. The company continued expansion of its data center operations, which saw a

significant 20% year-over-year growth, largely fueled by rising demand from sectors like generative AI and digital transformation.

Florida-based bank, **SouthState** had a strong quarter, as shares reacted favorably to good loan growth and commentary on their merger with IBTX (Independent Bank from Texas). The combination of the two banks should create scale in the Southeast United States, and the net interest income should benefit as the Fed begins cutting rates. Additionally, SouthState has focused on maintaining solid deposit franchises and aggressive expansion across the Southeastern U.S., which has helped it stand out during a time when many banks faced headwinds due to rising funding costs.

Detractors

Advance Auto Parts struggled in Q3 2024 due to a combination of operational challenges and market conditions. The company has been facing a prolonged period of weak profitability and declining margins. Despite slight improvements in net sales, the company continues to underperform in terms of earnings, which have consistently missed market expectations. Additionally, the company's recovery has been hindered by increasing competition and issues related to supply chain inefficiencies, which have affected its ability to compete effectively in the automotive parts industry. We exited the position during the quarter.

Our stake in **Rambus** detracted during the quarter. While the company saw growth in product revenues, particularly from DDR5 memory technologies, it faced a few key challenges. Rambus encountered pricing pressures with its first-generation DDR5 RCDs, which saw a slight price decline, affecting revenue growth. Additionally, the transition from DDR4 to DDR5 has caused slower sales of older products like DDR4 components, contributing to a revenue dip. Additionally, the broader semiconductor industry has been volatile which has caused investor concern.

Shares of **Permian Resources** stock underperformed in Q3 with one major factor being the decline in natural gas prices, which negatively impacted cash flow across U.S. oil and gas firms. Political uncertainties ahead of the 2024 elections also weighed on investor sentiment toward energy stocks. Another challenge was the weak market conditions at the West Texas Waha hub, where negative pricing during the summer led some producers to reduce output. However, the company has strengths, such as efficient cost management and solid free cash flow growth, which could

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present long-term recovery opportunities once market conditions improve.

Portfolio positioning

In the consumer sectors, we largely remain underweight consumer discretionary stocks as persistent inflation and costs weigh on the aggregate spending bucket for many households. Despite the stronger employment picture, it appears that higher earners have largely supported much of the spending, with low end consumers opting to 'trade out' rather than 'trade down'. We initiated a position in Dave & Buster's, where management continues to optimize store operations and renovates stores to revive frequency and improve game profits. We also initiated in Academy Sports, where strong store economics look to improve with a newly implemented warehouse system, loyalty initiatives, and growing private label product. We added to BJ's Wholesale Club, where merchandise growth and benefits of the loyalty card reinforces the company's value offerings.

Following meaning appreciation, we lowered our weights in health care holdings ADMA and United Therapeutics. In portfolio sector exposures, we decreased our weighting in both energy and technology due to less compelling valuations. Global oil demand appears to have stagnated and commodity prices slid for both crude and natural gas in the quarter. We eliminated Transocean and Civitas Resources and rotated some proceeds into Magnolia based on our preference for the energy assets. In technology, we eliminated Alpha and Omega Semiconductor on supply concerns as well as PowerSchool, following the announced acquisition of the company by private equity.

In financials, after a long-anticipated cut by the Fed, we increased our exposure to banks where we see valuations compelling, and trimmed in some names in financial services, where stocks had appreciated meaningfully. Particularly, adds occurred in Prosperity Bank, SouthState, and initiated a position in East West Bancorp. We trimmed Selective Insurance as pressures from social inflation weigh on the company's upside, and eliminated Globe Life, after the stock rebounded from its oversold valuation stemming from a report of its sales practices.

In the industrials sector, we eliminated Stericycle, as Waste Management proposed the acquisition of the company. New holdings Regal Rexnord, and Chart Industries have endured a soft cyclical spend environment, and are poised to benefit from automation initiatives and energy transformation. We remain overweight the sector, with continued exposure to supply productivity and power solutions.

In technology, requirements for the unmet future needs at the data center and AI remain constrained. We remain overweight the sector, with new holding optical component and laser provider Lumentum, where data throughput speeds can be offered with lower power requirements. A slower inventory clearing in industrial and automotive end markets have challenged the typical semiconductor cycle.

Outlook

With the recent first cut by the Fed at 50 basis points, market expectations for an additional 50 basis points by year end is anticipated, along with up to another 100 basis points by midyear 2025. At this time, it appears that peak inflation has passed and a path toward a neutral rate around 2% is within reach. What remains to be seen is if or how these cuts affect business planning, relieve pressures, or liberate shareholder returns.

We have witnessed many smaller cap companies refinance their debt and position themselves to roll over debt at more attractive rates. Should an anticipated 200 basis points of cuts come by midyear, the 'free earnings' growth from lowered rates and a virtuous refinancing cycle will improve profits and can unlock cash flows. Spreads for high yield debt sits at two-year lows and market volatility remains subdued. We expect the market breadth to widen from the exclusive club of mega cap technology companies to small cap companies. For example, the sheer heft of the AI darling, Nvidia, with nearly \$3 trillion of market cap, carries 50% of the value of the Russell 2500 Value index.

With the pending Presidential election, pundits craft the multitude of scenarios and permutations of outcomes constructed by pollsters. Despite media desires for mandates, government gridlock yields a favorable backdrop; regardless of environment, we believe companies that demonstrate strong execution and improving return on capital will outperform. The inflection towards more favorable interest rates and supportive domestic production benefit small cap companies.

Our consistent search for unrecognized and unrealized catalyst rich companies remains at the heart of our process. While broad indexes have attained recent highs, we believe the portfolio remains undervalued and mispriced.

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For more information contact: 800.752.8700 or visit nuveen.com

Minimum investment is \$100,000.

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Glossary

Russell 2500® Value Index measures the performance of the 2500 smallest companies in the Russell 3000® Index. **S&P 500® Index** is widely regarded as the best single gauge of large-cap U.S. equities. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization. **It is not possible to invest directly in an index.** Clients should consult their financial professionals regarding unknown financial terms and concepts.

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