

# Small Cap Value ESG Strategy

This equity strategy fully integrates ESG risk controls and best practices with behavioral finance-based stock selection techniques in the under-scrutinized and opportunity-rich small cap value equity style.

## The Opportunity

*“When you invite trouble, it is usually quick to accept.” – Anonymous*

Bailard believes that companies whose products, services or behaviors create negative externalities contain risks that are often not fully reflected in traditional financial metrics. Conversely, based on our research, responsible companies tend to outperform by avoiding reputational, environmental, and event risks.

*“It is human nature to think wisely and act foolishly.” – Anatole France*

We also believe that due to behavioral biases and cognitive errors, investors regularly overreact or underreact to new information in predictable ways.<sup>1</sup> Bailard applies proprietary Behavioral Finance techniques to stock selection and portfolio construction in an effort to capitalize upon the opportunities created by economically irrational behaviors in the small cap arena.

SMALL CAP INVESTING CHALLENGES	OUR SOLUTIONS
 Thousands of Stocks With No Top-heavy Concentration	Systematic methods allow for broader analysis of thousands of companies, identifying potential winners easily missed by more narrowly focused competitors. The nature of the small value investable universe requires a larger portfolio to adequately cover risk exposures.
 Higher Volatility	We hold 250-300 stocks, limiting individual stock risk. We are consistently invested in all 11 economic sectors and all 24 economic subsectors, reducing economic cycle risk. Our ESG Capture® methodology also helps to limit volatility by avoiding companies with significant potential negative externalities and lagging ESG practices.
 Limited Information	In addition to sometimes-limited financial statement data and analysis, we identify more universal behavioral finance anomalies to broaden our alpha opportunities, and employ advanced valuation techniques.
 Higher Bankruptcy Risk	Our earnings quality focus, accounting and auditor red flag screening, credit risk measurement, and factor beta “value trap” identification all help weed out companies with going concern issues.
 Liquidity Constraints	We employ proprietary and often contrarian stock selection factors to avoid crowding. We emphasize characteristics more than individual stocks, allowing for patient, flexible trading. We broadly diversify, limiting maximum position sizes, and have deep trading experience and expertise.
 Limited ESG Data and Poor ESG Vendor Score Coverage	We have proprietary E, S, and G factors with comprehensive small cap value coverage. We also combine ESG scores from multiple vendors to create a comparable composite score with much greater universe coverage.

<sup>1</sup> Barberis, Nicholas, Andrei Shleifer, and Robert Vishny. 1998. “A Model of Investor Sentiment.” *Journal of Financial Economics* 49, no.3: 307-343.

## BAILARD SMALL CAP VALUE COMPOSITE PERFORMANCE SUMMARY<sup>2</sup> as of 12/31/23

	TOTAL RETURN (ANNUALIZED FOR PDS > 1 YR)					
	Quarter	YTD	1 Year	3 Years	5 Years	10 Years
Composite (Gross of Fee)	15.90%	16.68%	16.68%	12.12%	13.53%	8.26%
Composite (Net of Fee)	15.79%	16.26%	16.26%	11.70%	13.11%	7.85%
Russell 2000 Value Index	15.25%	14.64%	14.64%	7.92%	9.97%	6.74%

  

	ANNUALIZED STD. DEV.			SHARPE RATIO		
	3 Years	5 Years	10 Years	3 Years	5 Years	10 Years
Composite (Gross of Fee)	21.42%	24.67%	20.16%	0.47	0.47	0.35
Composite (Net of Fee)	21.41%	24.67%	20.15%	0.45	0.46	0.33
Russell 2000 Value Index	21.75%	25.00%	20.67%	0.26	0.32	0.27

### The Philosophy

Our philosophy is anchored by three beliefs:

**1. Behavioral anomalies provide an enduring source of alpha.**

Market participant irrationality is recurring, predictable, and therefore exploitable.

**2. Less investor scrutiny means greater opportunity in our Bailard Ranking and ESG Capture<sup>®</sup> models.**

Bargains or advantages are rare in places everyone else is looking. Also, small and micro cap stocks are fertile ground for behavioral biases and unidentified ESG opportunities. These can be most effectively exploited through a disciplined and systematic approach.

**3. Avoid unnecessary risk.**

Control for a broad spectrum of risks, including ESG risk, economic sector exposure, bankruptcy risk, idiosyncratic risk, audit and accounting red flags, alpha instability, beta deviation, and false precision in stock selection.

### The Small Cap Value ESG Strategy

The Small Cap Value ESG Strategy is designed to leverage quantifiable characteristics historically associated with company success and stock outperformance. This approach is ideally suited to the unique nature of the small cap stock universe (thousands of companies, little concentration).

This disciplined, repeatable process is designed to exploit behavioral biases exhibited by other investors while minimizing internal biases.

### ESG CAPTURE<sup>®</sup>

ESG Capture<sup>®</sup> is a fully integrated assessment methodology designed to evaluate risks not adequately addressed by traditional financial measures. Drawing from both internally generated and vended sources, our novel process provides statistically sound, comparable, and comprehensive ESG scoring to over 3,000 small and micro cap companies.

### PORTFOLIO CHARACTERISTIC COMPARISON<sup>3</sup>

	Composite	Russell 2000 Value Index
BRM Score	81.1	53.0
ESG Capture <sup>®</sup>	65.0	55.6
Price/Book Value	2.5x	2.0x
Price/Earnings (trailing 12 mo.)	20.8x	35.4x
Price/Cash Flow	13.3x	16.0x
Return on Equity	10.8%	5.3%
Debt to Capital	46.9%	41.8%
Number of Holdings	322	1431
Avg. Market Cap \$MM	\$2,957	\$2,750
% Micro Cap Stocks	26.1%	18.8%

<sup>2</sup> The Bailard Small Cap Value Composite (the "Composite") includes a Bailard portfolio that is invested solely in small and micro capitalization U.S. equities which exhibit value characteristics. Please see page 4 for important disclosures. The Small Cap Value ESG Strategy is implemented within the Bailard Small Cap Value Composite. Sources: Bailard, Bloomberg. <sup>3</sup> Sources: Bloomberg, Bailard. The information presented on this page, while representative of the Bailard Small Cap Value ESG Strategy, should not be solely relied on as it can differ from client to client and could vary over time. Data regarding the portfolio characteristics of the Composite reflect ownership information as of September 30, 2023 and are not intended to represent any past or future specific investment recommendations. Portfolio characteristics are subject to change without notice.

## BAILARD RANKING MODEL (BRM)

The BRM is a proprietary, multi-factor stock selection tool. A variety of factors in three key categories – quality, valuation, and behavioral – determine which of the Strategy’s investable universe of over 3,000 stocks are believed to provide the best mispricing opportunities. These models cover a spectrum of behavioral biases including expectations bias, overconfidence, anchoring bias, availability bias, and hype.

The most promising stocks identified by the BRM are then scrutinized for qualitative behavioral anomalies to help ensure quality and conceptual appropriateness for portfolio construction.

## Risk Management

The Strategy employs stringent risk controls in an effort to limit volatility and minimize unexpected outcomes. Environmental, social, and governance risks are addressed through our ESG Capture® process. More traditional risks such as economic cycle exposure is controlled by limiting sub-sector deviation to the benchmark Index. Stock specific risk is contained by holding a broadly diversified portfolio with a maximum position size of approximately 1%. Default (bankruptcy) risk, auditor and accounting red flags, historical factor efficacy, alpha instability, and beta deviation are all measured and constrained as well. Factor exposures are continually monitored and attributions calculated in an effort to eliminate any unwanted bets.

## Small Cap Value ESG Equity Team

**Thomas J. Mudge III, CFA**, SVP and Director of Equity Research, is a portfolio manager of the Small Cap Value ESG Strategy. Tom earned his BA at Northern Michigan University and has also completed the certificate program in Investment Decisions and Behavioral Finance at Harvard University’s John F. Kennedy School of Government. Tom joined Bailard in 1987.

**Blaine Townsend, CIMC®, CIMA®**, EVP and Director of Sustainable, Responsible and Impact Investing, joined Bailard in 2016 and serves as a portfolio manager of the Small Cap Value ESG Strategy. Blaine started his career in SRI/ESG in 1991 at the Muir Investment Trust. From 1996 through 2009, he led the California office for Trillium Asset Management, followed by 8 years as ESG asset management firm Nelson Capital Management. Blaine currently serves as an Advisory Board member for *The Journal of Impact and ESG Investing*. He holds a BA from the University of California, Berkeley.

## BAILARD’S CORPORATE ENGAGEMENT

Northwestern | Kellogg  
THE MOSKOWITZ PRIZE



**Osman Akgun, Ph.D., CFA**, VP of Domestic Equities, serves as a portfolio manager for the Small Cap Value ESG Strategy. After receiving his Ph.D. in Industrial Engineering and Operations Research at the University of California, Berkeley, Osman joined Bailard in 2012. Osman also holds a Masters' Degree in Statistics from the University of California, Berkeley. Prior to his graduate work, he received a BS in Industrial Engineering from Bogazici University, Turkey.

**Annalise Durante**, Senior ESG Analyst and Investment Counselor, contributes to ESG/SRI research, thought leadership, and corporate engagement, as well as manages client relationships. Prior to Bailard, Annalise spent two years at Citi Private Bank working with ultra-high-net-worth clients. Annalise earned a Bachelor’s degree in Finance from the University of Miami.

## GOOD TO KNOW

Bailard’s Small Cap Value ESG Strategy is available as a standard or customizable separately managed account. It is also available as a sub-advised institutional mutual fund.

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## Risks

The Bailard Small Cap Value ESG Strategy is not by itself a complete investment program and is best suited for investors who can accept the above average risk generally associated with small cap and micro cap stocks. These companies may face greater economic cycle risk, credit risk, geographic risk, product, and customer concentration risk than that faced by larger companies. Small cap and—to a greater extent—micro cap stocks are more volatile and less liquid than larger cap stocks and may be more difficult to trade. There are times when the small cap value equity style underperforms other equity investment styles.

The application of various environmental, social and governance screens as part of a socially responsible investment strategy may result in the exclusion of securities that might otherwise merit investment, potentially resulting in higher or lower returns than a similar investment strategy without such screens or other strategies that use a different methodology to exclude issuers or evaluate ESG criteria. Investors can differ in their views of what constitutes positive or negative ESG characteristics. As a result, the strategy may invest in issuers that do not reflect the ESG beliefs and values of any particular investor.

In evaluating a security or issuer based on ESG criteria, we are dependent upon certain information and data from third party providers of ESG research, which may be incomplete, inaccurate or unavailable. As a result, there is a risk that we may incorrectly assess a security or issuer. There is also a risk that we may not apply the relevant ESG criteria correctly or that the strategy could have indirect exposure to issuers that do not meet the relevant ESG criteria used by the strategy. We do not make any representation or warranty, express or implied, with respect to the fairness, correctness, accuracy, reasonableness or completeness of such ESG assessment. There may be limitations with respect to availability of ESG data in certain sectors, as well as limited availability of investments with positive ESG assessments in certain sectors. Our evaluation of ESG criteria is subjective and may change over time.

The market value of an investment will fluctuate as the securities markets fluctuate. There can be no assurance that this or any investment strategy will achieve its investment objectives. All investments have the risk of loss.

## Small Cap Value Composite Performance Disclosures

The Bailard Small Cap Value Composite (the “Composite”) includes a Bailard portfolio invested solely in small and micro capitalization U.S. equities that exhibit value characteristics. The Small Cap Value ESG Strategy is implemented within the Bailard Small Cap Value Composite. As of December 31, 2023, the Composite consisted of a single mutual fund which Bailard has been managing in an advisory or sub-advisory capacity since 2001 with a market value of \$101.3 million, which represented 1.7% of the total assets under Bailard’s management. The ESG Capture component was explicitly introduced to the portfolio in December 2019. Prior to 2006, the Composite had less consistent and lower overall exposure to micro cap stocks. The Composite’s returns are total returns presented as labeled, either net of, or both gross and net of management fees (“net of fees”) payable to Bailard, and assume reinvestment of dividends and other earnings. The returns do not reflect a fiduciary fulfillment fee payable to Bailard (where applicable), or custody and other account expenses not payable to Bailard. The return of this Composite is not the NAV return of the mutual fund.

Both gross of fee and net of fee returns are taken directly from Bailard’s portfolio accounting system, and net of fee performance was calculated by netting down the gross return by actual

management fee paid by the mutual fund client to Bailard as of the date paid. Composite returns do not reflect a fiduciary fulfillment fee payable to Bailard (where applicable), or custody and other expenses not payable to Bailard which the composite account incurred.

The Firm’s annual fee schedule for new accounts is: 0.90% of the first \$25 million, 0.70% of the next \$25 million, 0.60% on the next \$50 million, and 0.50% on assets over \$100 million. The Composite’s complete return history and a list of Bailard’s composites are available upon request.

## Benchmark Definition

The Russell 2000 Value Index shown in this presentation is different from a managed account in that it is unmanaged, uninvestable, and does not reflect transaction costs. The Russell 2000 Value Index is a commonly used index that measures the performance of the small-cap value segment of the U.S. equity universe. It includes those Russell 2000 Index companies with lower price-to-book ratios and lower forecasted growth values. Unlike the Russell 2000 Value Index, the Composite account can acquire stocks in initial public offerings and can hold cash equivalents and exchange-traded funds. The Composite account’s stock holdings may differ materially from those of the Russell 2000 Value Index, as the Composite: 1) can invest in stocks that are not in the index; 2) will tend to hold a higher percentage of micro cap stocks (defined as stocks in the bottom 1% of major U.S. exchange-traded securities when measured by market capitalization) than the index; and 3) may omit securities that may otherwise merit investment due to the application of various environmental, social and governance screens. The Small Cap Value ESG Strategy’s model portfolio holdings will differ materially from the index due to the model portfolios’ selection of only a portion of the index’s securities. The Small Cap ESG Strategy’s hypothetical returns differ materially from that of the index. As a result, the index is not indicative of the past or future performance of the model portfolios.

**Past performance is no indication of future results. All investments have the risk of loss.**

## Other Disclosures

The information in this publication is based primarily on data available as of December 31, 2023 has been obtained from sources believed to be reliable, but its accuracy, completeness and interpretation are not guaranteed. Bailard undertakes no duty to update any of the information contained herein. In addition, this publication contains the opinions of the authors as of that date and such opinions are subject to change without notice. We do not think this publication should necessarily be relied upon as a sole source of information and opinion. This publication is not a recommendation of, or an offer to sell or solicitation of an offer to buy any particular security or investment product. It does not take into consideration the particular investment objectives, financial situations or needs of individual clients. Bailard cannot provide investment advice in any jurisdiction where it is prohibited from doing so.

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