

Mesirow Equity Management: Market commentary summary and outlook

As of 8.31.2022

Equity markets pull back after a significant 8-week bounce

Russell 2000 Value -12.2%, Russell 2500 Value -11.5%, Russell 2000 -17.2%, and Russell 2500 -16.0% YTD

- Inflation, after touching 40-year high, appears to be peaking but remains elevated; Fed policy expectations for terminal rate moves lower from ~4.0% to (3.5% -3.7%)
 - Expectation of another 125-150bps of rate hikes drives fear of Fed mistake, causing an economic recession
 - Russia/Ukraine conflict is stagnant, reducing growth in the Eurozone though the impact on inflation has somewhat stabilized
 - Lower China demand and potential increase in supply from Iran could affect energy prices
 - The market recovery has lost steam as the Fed's language on inflation (at Jackson Hole) caused rates to reverse from a recent downtrend
 - Value continues to lead growth YTD
 - Inflation related sectors and broader defensive characteristics provide leadership with higher-quality metrics also outperforming YTD
1. Energy, Utilities, and Consumer Staples are leaders reflecting inflation / defensive factors
 2. Consumer Discretionary, Communication Services, and Healthcare are laggards YTD though Healthcare did lead during the market bounce

Strengths and opportunities for small cap value

- Nominal GDP growth weakening for 2022 with expectations slowing on the margin; Employment formation and spending continue to show strength
- Small/small-mid value is the most discounted equity category
- Considerable excess savings; increased bank lending should support growth as liquidity transmits into the real economy
- Energy prices are slowing quickly and could help boost the consumer

Threats to the market

- Valuation multiples have recovered somewhat as peaking rates are incorporated; another 20%-25% downside from current levels in a recessionary scenario
- Earnings revisions are moving lower; global growth starting to weaken; a potential slowdown/recession in 2023 is no longer "priced-in" after the market recovery
- Increased volatility until growth and recession fears abate; wider high-yield spreads and flatter yield curve reflects more uncertainty
- Inflation, though peaked, is increasingly problematic; elevated levels through 2022–23 will force the Fed to keep rates higher for longer and pressure equity markets
- Supply disruptions are beginning to mitigate but there's concern about a pull forward of orders on longer-term demand and the extension of disruptions through 2023

Sources: Russell, eVestment, Mesirow Equity Management

Benchmark Definition

The Russell 3000 Index® measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market.

The Russell 2000 Index® offers investors access to the small-cap segment of the U.S. equity universe.

The Russell 2000 is constructed to provide a comprehensive and unbiased small-cap barometer and is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true small-cap opportunity set. The Russell 2000 includes the smallest 2000 securities in the Russell 3000.

The Russell 2500 Index® measures the performance of the 2,500 smallest companies in the Russell 3000 Index®, with a weighted average market capitalization of approximately \$4.3 billion, median capitalization of \$1.2 billion and market capitalization of the largest company of \$18.7 billion.

The Russell 2500 Value Index® measures the performance of the small to mid-cap value segment of the US equity universe. It includes those Russell 2500 companies with relatively lower price-to-book ratios, lower I/B/E/S forecast medium term (2 year) growth and lower sales per share historical growth (5 years).

The Russell 2000 Index® is a small-cap stock market index that makes up the smallest 2,000 stocks in the Russell 3000 Index. It was started by the Frank Russell Company in 1984. The index is maintained by FTSE Russell, a subsidiary of the London Stock Exchange Group.

The Russell 2000 Value Index® offers investors access to the small-cap value segment of the U.S. equity universe. The Russell 2000 Value is constructed to provide a comprehensive and unbiased barometer of the small-cap value market. Based on ongoing empirical research of investment manager behavior, the methodology used to determine value probability approximates the aggregate small-cap value manager's opportunity set.

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