ESSEX

The Essex Exchange

Winter 2022

ESSEX INVESTMENT MANAGEMENT COMPANY, LLC

Inside this issue:

We're on to 2023... 1-3

By: Robert J. Uek

Essex Strategies 4

Investment Team

- Joseph C. McNay
- Nancy B. Prial
- Robert J. Uek
- William H. Page
- Saralyn Sacks
- Marcy R. Carlin
- Anne Marie McMichael
- Elizabeth Giroux
- Martin P. Cournan
- Jack Lloyd

125 High Street
Suite 1803
Boston, MA 02110
617-342-3200

Please see our website www.essexinvest.com for updated insights from our portfolio management and research team.

We're on to 2023...

By: Robert J. Uek - Co-CEO & Senior Portfolio Manager

2022 was a year that started with rosy expectations. The stock market was near all-time highs. Unemployment was near all-time lows. Inflation was under control. Real estate was booming. Cryptocurrencies were on the verge of being accepted as an institutional asset class (and had recently been adopted as legal tender in El Salvador). Interest rates and mortgage rates were near the lowest in our lifetimes. And we were looking forward to an economic surge fomented by the long-awaited COVID re-opening.

Well…it's probably an understatement to say that the market's enthusiasm waned significantly as the year progressed. Things as it turned out were too good.

For the full year, nearly all asset classes posted substantial declines in value. Stocks, bonds, real estate, private equity, venture capital all ended the year lower (in many cases, substantially lower) than they began. Commodities was the only major asset class with a positive return in 2022.

Within equities, the price of the S&P 500 Index declined 19.4% for the year. It felt worse. Ten of the eleven sectors in the Index were down for the year, with Energy being the sole sector to post a positive return in 2022. Growth-style investing, our area of focus, performed far worse than value investing and small cap underperformed large cap.

While the first half of the year was all about re-calibrating valuations based on rising rates, the second half of the year seemed almost as if fundamentals didn't matter. The market was almost entirely focused on macro factors (inflation, interest rates, Ukraine) and technical trading.

We couldn't even muster a "Santa Claus rally" to close out the miserable year. We suspect that the poor stock market performance at the end of the year can be attributed to some very heavy tax loss selling which could lead to a strong "January Effect" this month.

We're on to 2023…

By: Robert J. Uek - Co-CEO & Senior Portfolio Manager

We're on to Cincinnati

In short, it was a brutal year. Following his team's disastrous early season loss to the Kansas City Chiefs in 2014, New England Patriots Head Football Coach Bill Belichick repeatedly (and rudely) answered nearly all reporters' questions about the debacle with the now famous line, "We're on to Cincinnati." He meant, of course, that the past is history and it's now time to prepare for the following week's Bengals game. No amount of hand-wringing, criticism, or reflection will change the outcome of last week's game -- time moves forward and we must look ahead.

Turning to 2023

As we look ahead to 2023, it seems that the U.S. is on the verge of the most widely anticipated recession that we can remember, with news pundits, armchair economists and corporate leaders all predicting an economic downturn. This is unusual. Meanwhile, some traditional measures of economic strength (mainly the unemployment rate) seem remarkably resilient, thereby prompting the Fed to remain aggressively hawkish.

Amidst this backdrop, we currently find opportunity in four broad buckets:

- Small cap companies
- visible, predictable, self-funded growth
- beneficiaries of recent government initiatives
- middle America

Small cap companies

Small cap stocks have now underperformed large cap stocks for six straight years, one of the longest losing streaks we can remember. Valuations of small cap stocks trade at a meaningful discount to valuations of large cap stocks. History would suggest that small cap stocks perform better than large cap stocks when coming out of bear markets and in the early stages of an economic recovery. According to Jeffries Strategist Steve DeSanctis, the last time that the cumulative performance gap between large cap stocks and small cap stocks was this wide was 2002, which lead to seven years of outperformance for small cap stocks versus large cap stocks. We like the outlook for small cap growth stocks.

Companies with visible growth and strong balance sheets

We are focused on finding companies with visible growth that can be sustained even in advance of an economic slowdown. We believe that companies providing solutions for healthcare, the energy transition and domestic infrastructure fit this bill. Valuations matter as do strong balance sheets that can be used to fund growth initiatives. In this market, reliance on external funding for growth is a dicey proposition, and there is no better example of this than Chart Industries. Chart, a company that has very strong demand for its products (they make equipment for natural gas processing facilities), has seen its stock price cut in half in a number of weeks from an all-time high in November following a proposed acquisition that required a meaningful external capital raise.

Beneficiaries of recent government initiatives

We think the Inflation Reduction Act (IRA) and the CHIPS and Science Act are two watershed pieces of legislation that will have meaningful impacts on certain industries and companies. Specifically, the CHIPS Act provides about $280 billion in funding for semiconductor research and manufacturing in the United States, while the Inflation Reduction Act, among other things, will provide funding of nearly $400 billion for energy security and domestic infrastructure. We generally aren't enthused about huge sums of government spending, but it's about time that we started to reinvest in our domestic infrastructure and economy to help reinforce our continued competitiveness

We're on to 2023...

By: Robert J. Uek - Co-CEO & Senior Portfolio Manager

in the decades to come. We are further encouraged about the potential effectiveness of these actions after witnessing the outrage of international companies and governments in reaction to these programs. Many companies that we have met with in the past several months are very enthused about the opportunities ahead due to these significant initiatives. Beneficiaries include auto manufacturers, electrical grid infrastructure providers, battery manufacturers, HVAC manufacturers and semiconductor companies among others.

Middle America

The past several decades have been dominated by venture funding which has typically been funneled into technology companies located on the East and West coasts of the United States. Annual venture capital funding in US companies has boomed from less than $10 billion per year before 2000 to a record $330 billion in 2021 (source: PitchBook). Middle America has been largely left out of this investment boon. Despite being one of the worst performing sectors last year (down more than 28.9%), tech remains overrepresented in the market as illustrated by its 25.7% weight in the S&P 500 Index at December 31, 2022, a weight that is even higher when you consider stocks such as Alphabet, Meta and Netflix that are considered tech companies by most but are technically included in the Communication Services sector. Further, market history tells us that new bull markets that emerge following meaningful market pullbacks are rarely led by the same sector leadership as the last bull market.

We believe that companies outside of the tech sector (and away from the Coasts) will be attractive investments moving forward as they exhibit many of the characteristics that highlighted above, specifically, attractive valuations and strong balance sheets. Further, a number of these middle-America companies should exhibit good growth, benefitting from broad trends such re-onshoring, recovery in oil and gas spending, and buildout of the electric vehicle eco-system, as well as from spending initiatives and incentives in the IRA and CHIPS Act.

In closing

Entering 2023, the macro environment remains cloudy with continued uncertainty around economic strength and the future outlook for inflation and interest rates. Despite the gloominess and near-widespread stock market skepticism, we see a few silver linings. We think that inflation will continue to moderate for four main reasons, thereby allowing the Fed a constructive backdrop to slow future rate hikes:

- The recent re-opening of China following COVID lockdowns
- Continued normalization of supply chains
- Easing of tight employment in the US
- A continued cooling of the housing market

Global economic growth should start to recover with China's emergence from COVID and a renewed focus on stimulative policies. After a tough year for most asset classes, we believe that much bad news is priced into assets, particularly some of the cheaper growth stocks and small cap stocks.

Following Belichick's terse "on to Cincinnati" press conference after the early season Kansas City drubbing, the 2014 New England Patriots went on to win the Super Bowl at the end of that season. Sometimes when things look gloomiest and panic has set in, the seeds of future success are being sown. Ultimate success requires discipline and a focus on what one does best.

We're on to 2023 and hopefully rosier outcomes. We remain focused on what we do best, identifying growth opportunities in the market.

ESSEX

ESSEX INVESTMENT MANAGEMENT COMPANY, LLC

Client Service and Support:
Essex is fortunate to have great clients whom we are more than happy to assist. Please feel free to contact any of the following Essex personnel below should you need assistance or have questions:

Michael S. McCarthy
Chief Operating Officer
Phone: 617-342-3245 or mmccarthy@essexinvest.com

Carly Semerjian
Senior Executive Administrator
Phone: 617-342-3202 or csemerjian@essexinvest.com

Sue Bathalon
Operations Manager
Phone: 617-342-3204 or sbathalon@essexinvest.com

Client Service & Support Fax Machine: 617-342-3280

DISCLOSURE

The opinions and analyses expressed in this newsletter are based on Essex Investment Management Company, LLC's research and professional experience, and are expressed as of the date of our mailing of this newsletter. Certain information expressed represents an assessment at a specific point in time and is not intended to be a forecast or guarantee of future results, nor is it intended to speak to any future periods. Essex makes no warranty or representation, express or implied, nor does Essex accept any liability, with respect to the information and data set forth herein, and Essex specifically disclaims any duty to update any of the information and data contained in this newsletter. The information and data in this newsletter does not constitute legal, tax, accounting, investment or other professional advice. Certain information contained herein has been obtained from third party sources and such information has not been independently verified by Essex. No representation, warranty, or undertaking, expressed or implied, is given to the accuracy or completeness of such third party information

Essex Strategies

LONG EQUITY STRATEGIES

Micro Cap, Small Cap and SMID Cap Equity Growth Strategies are managed by our all-women investment team based in Evanston, Illinois, which is focused exclusively on long-only growth equity strategies and has worked together for more than 15 years. The team manages three equity strategies that each share a common investment philosophy and process:

Micro Cap Growth Strategy: We look for under-followed, under-owned, under-appreciated companies & industries in early stages of acceleration.

Small Cap Growth Strategy: The strategy focuses on identifying companies in an inefficient sector of the market at an inflection point where their growth rate is improving.

Small/Mid (SMID) Cap Growth Strategy: Our approach is to execute a systematic, fundamental process to find companies whose future growth prospects are not fully reflected in the price of the stock.

Essex Research Strategy is managed by a team of investment professionals seeking growth equity opportunities across an all-cap universe. By employing fundamental top down economic and sector analysis with bottom-up stock picking skills, the strategy provides the investment team a wide framework in which to identify growth candidates regardless of market capitalization restraint. Individual client portfolios are offered in two risk profiles: aggressive growth or growth and income.

Essex Global Environmental Opportunities Strategy (GEOS) is a thematic, all-cap global stock strategy that invests in clean technology and clean energy companies that help solve the world's environmental problems. The Strategy is focused on nine environmental technology themes and invests with a long investment horizon, typically holding about 40 companies. GEOS is clean technology and energy infrastructure-focused, with companies that exhibit generally high growth rates. ***This strategy is available as both a separate account and mutual fund.***

LIMITED PARTNERSHIP HEDGE FUNDS

Essex Performance Fund is an ultra-aggressive equity strategy which primarily aims to uncover small and mid-sized companies that exhibit the potential for meaningful growth over time. Seeks to maximize returns by utilizing both fundamental and technical analysis with an emphasis on thematic investing and tactical market positioning. The strategy will use leverage to enhance returns.

Essex Evolution Long/Short strategy is a hedged equity strategy that aims to provide competitive risk-adjusted returns by utilizing both fundamental and technical analysis with an emphasis on thematic investing and tactical market positioning. Specifically, we aim to understand key themes within dynamic sectors to capture the growth in those trends and utilize short positions to both hedge portfolio risk and exploit specific mispriced stock opportunities. The fund generally has an equity exposure less than that of the overall market.

Please refer to our firm's website at www.essexinvest.com for more information about Essex, the strategies we manage and important disclosures.