Fundametrics® International Small Cap Equity

3Q 2022 Performance Summary and Observations

	3Q 2022	Year to Date	1 Year	Latest 3 Years	Inception to Date (12/31/2019)
Fundametrics® International Small Cap	-11.85	-28.70	-26.18	-	-2.43
Net of Fees Returns	-11.85	-28.70	-26.18	-	-2.43
FTSE Developed ex-US Small Cap Index	-10.16	-31.87	-31.18	-1.67	-5.79

Performance is as of 9/30/2022. All time periods over 1 year are annualized. See attached disclosure for important information regarding returns.

- The Fundametrics International Small Cap Equity strategy returned -11.85% for the quarter, trailing the FTSE Developed ex-US Small Cap Index return of -10.16%.

- Global equity markets have experienced significant downturns this year, but, for the unhedged US investor, international returns have been particularly impacted by the US dollar hitting multi-decade highs relative to some currencies.

- With recession risks increasing, an unusual factor profile led for the quarter. Investors focused on high beta, strong price momentum, and growth attributes, highlighting the current factor profile of Energy stocks.

- Alpha Composite results were favorable this period. Buys (-7.17%) beat Sell-rated stocks (-10.07%). The Financial Warnings overlay also helped the portfolio, particularly during September when markets saw their biggest declines. Buy candidates that passed all screens or Safe (-7.5%) beat Fail-rated (-8.3%) stocks.

- International small-cap stocks' valuation multiples suggest that investors have high expectations of a recession as they trade at extremely attractive multiples compared to their history.

3Q 2022 Performance Analysis

CornerCap's Fundametrics International Small-Cap Equity Composite returned -11.85% for the third quarter ending September 30, 2022, trailing the FTSE Developed ex-US Small Cap Index return of -10.16%.

Even though every International Small Cap (ISC) market was down this quarter, there were geographical areas that fared much worse than others. The United Kingdom (-16.5%) took the heaviest blow, followed by the rest of Europe (-13.8%). Countries that are not so dependent upon Russia's energy supplies, Japan (-4.6%) and the resource-heavy markets of Australia (-3.3%) and Canada (-6.1%), were among the countries down the least.

Using equal-weight returns, each ISC sector experienced negative returns. Energy and Industrials were down the least—quite unusual given the rising risk of recession, but the war in Ukraine is keeping energy prices high. Sectors typically seen as defensive and having low beta, such as REITs (-13.9%), Utilities (-15.5%), and Staples (-12.8%) were down the most after being a relative haven for the first half of the year. Stock selection was the key driver of underperformance relative to the benchmark, and the portfolio's holdings in those defensive sectors were a meaningful drag on performance.

Sector allocation was slightly positive for the quarter, mainly due to an overweight to Energy and underweight to Real Estate. The portfolio's overweight to Technology slightly offset the positive contributions.

Investors looking for safety have impacted the US Dollar, putting extreme pressure on international returns. The USD appreciated 6.1% this quarter (14% YTD) against a basket of currencies—many of which are trading at multi-decade lows to the dollar (Exhibit 1). The sentiment is a clear reflection of the different policy moves taken by central banks and governments.

Exhibit 1: US Dollar Appreciation vs World Currencies (%)
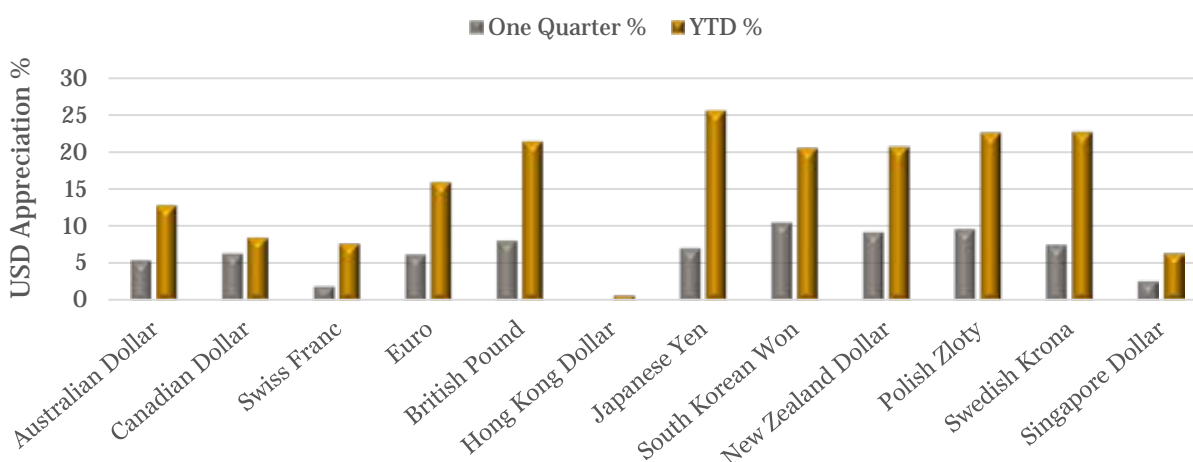
Source: S&P Global Capital IQ. CornerCap Fundametrics Research System.

The US Federal Reserve continued its aggressive stance on inflation by raising rates while the Bank of Japan has kept its monetary policy ultra-loose. Notably, the yen stands at a 32-year low to the dollar. In addition to policies battling current high inflation, the UK's government under new Prime Minister, Liz Truss, spooked markets by proposing tax cuts and a new energy package, triggering a massive market selloff in September that saw the pound crash below $1.11 for the first time since 1985. The market's expectations are that this kind of stimulus would only add to inflation and debt.

Factor Performance

High beta, momentum, and growth factors were a focus for investors during the quarter (Exhibit 2). All three exhibit a heavy overweight to Energy and Industrials, to a lesser degree. On the other side, Health Care and Communications sectors are in the low beta and weak momentum categories and were among the worst performers.

Monthly results were mixed, however, as July and September saw different profiles driving returns. For a quick snapshot of monthly factor performance, check out our Monthly Style Points.

**Exhibit 2:** **3Q 2022 Factor Alpha Profiles – 13 Weeks Ending 9/30/2022**
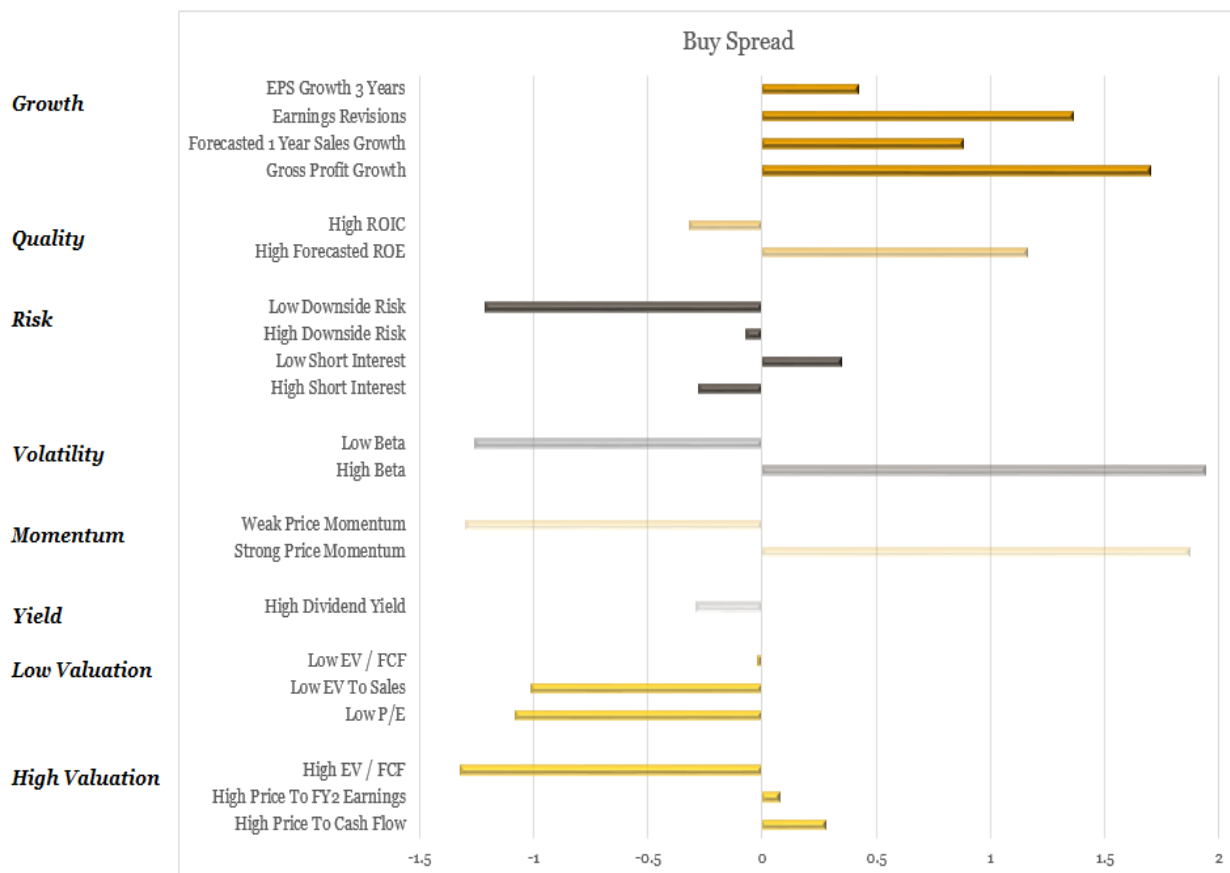
Source: CornerCap Fundametrics Research System. Buy Spread is the factor's top 30% of each region compared to equal-weight universe.

Valuation

Judging by valuation multiples, investors have elevated expectations of a global recession. Since April 2021, price-to-earnings multiples have sharply contracted, now trading even with the quick and deep contraction during March 2020 and reaching a level below two standard deviations from the historical average (Exhibit 3). As background, we divide our international small-cap universe into two halves based on their market valuation multiples. Given the Fundametrics research process, the more attractively valued bottom half is more relevant than the top half, which consist of the most expensive stocks and those with negative earnings. With the bottom half of companies, we can use the current multiples to compare how the stocks have historically traded as a group.

Exhibit 3: Valuation Multiples Point Toward Recession

International Small Caps Price-to-Earnings Ratio
Deciles 1-5 (50% with Lowest Valuation)
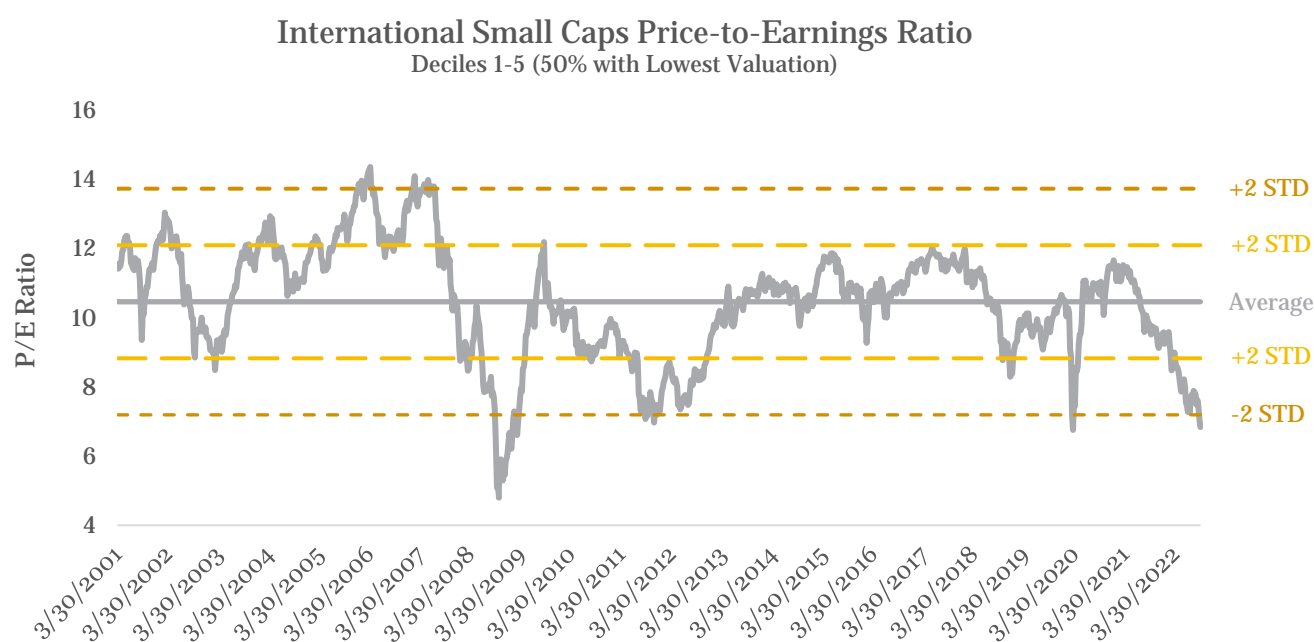
Source: CornerCap Fundametrics Research System. Earnings in the price-to-earnings ratio is a blend of both trailing and 1-year estimates measured on a per share basis.

Model Performance: Alpha Composite and Financial Warnings

The International Small-Cap model has two final rankings for each stock: the Alpha Composite and Financial Warnings overlay. The Alpha Composite combines the ranks of each stock within its region and within its CornerCap-defined Peer Group while the Warnings overlay is designed to screen out stocks with characteristics that typically lead to underperformance.

Quarterly results for the total Regional Composite (Exhibit 4) were positive with the Buy group (+1.3%) outperforming the Sell group (-1.6%). These are relative-return numbers and are calculated compared to the equal-weight universe of stocks of each group. The individual Regional composite models had success in all regions except Canada.

Exhibit 4: Regional Composite Performance for 3Q 2022
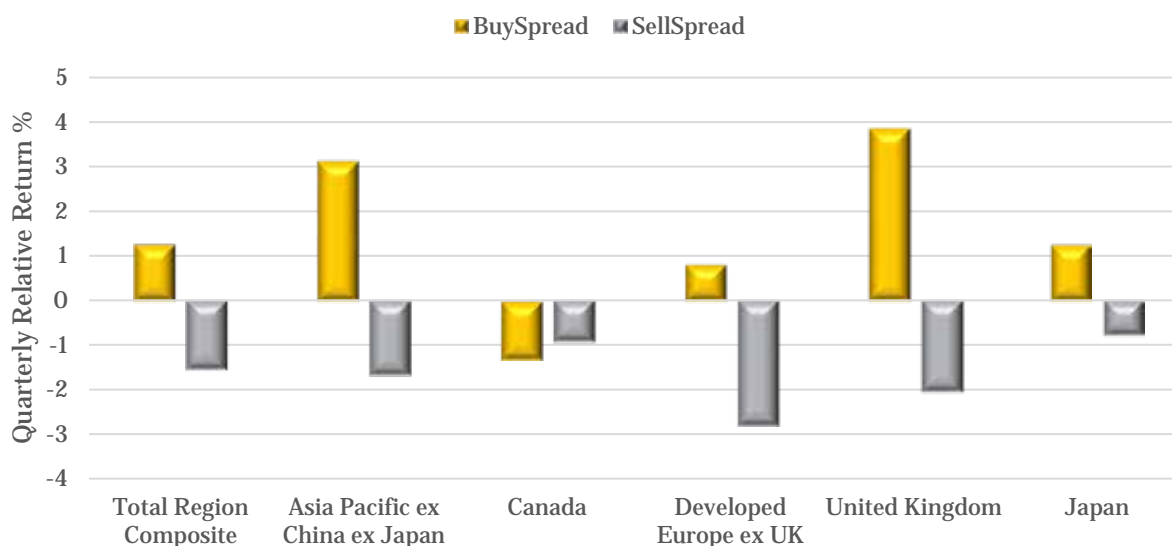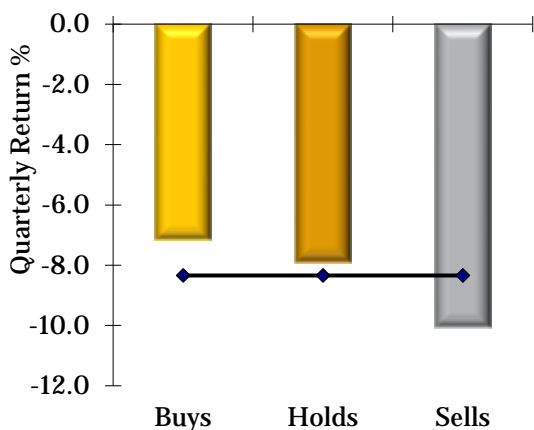

Source: CornerCap Fundametrics Research System

The Alpha Composite exhibited favorable discrimination this quarter (Exhibit 5), where the Buy-rated stocks beat the Holds, which beat the Sells. Most of its effectiveness came from the down months of August and September. Months like July, when investors buy growth at any price, are typically a challenge for a valuation-focused and fundamentally driven process like Fundametrics, but the Buys only trailed the Sells by 20bps.

Like our US Small-Cap Model, it is unusual to see positive discrimination from the Alpha Composite and the portfolio underperform the benchmark. The main contributor: stock selection. The portfolio implementation process is designed to continually move the portfolio closer to the profile of the Buy-rated stocks in the Alpha Composite. However, to maintain diversity and mitigate turnover, there is always exposure to Hold-rated stocks, which detracted from performance.

The Financial Warnings Overlay provided only a small advantage for the overall quarter, but worked best when it typically does, in the extreme down market of September (Exhibit 6). In July and August, however, the Safe buys—stocks passing all Warnings tests—underperformed the Fail-rated stocks, which typically have more than one risk warning. For the quarter, our growth and debt warnings were positive contributors while sentiment-related warnings such as momentum and short interest were a drag on performance.

Exhibit 5: Alpha Composite – 13 Weeks Ending 9/30/2022

Source: CornerCap Fundametrics Research System

Exhibit 6: Alpha Composite Buys with Financial Warnings Overlay - 13 Weeks Ending 9/30/2022
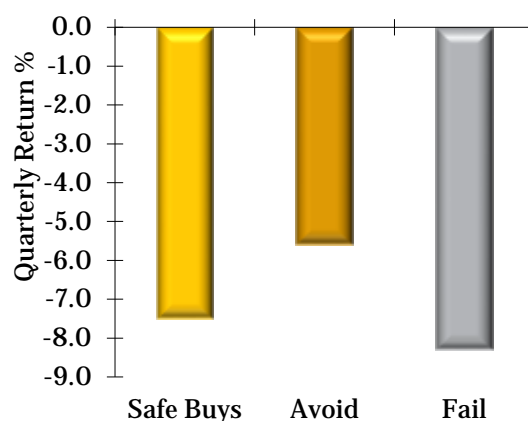
Source: CornerCap Fundametrics Research System

Bottom Line

Central banks' struggles to reign in soaring inflation have delivered a heavy blow to global equity markets this year. Energy and food prices have hit areas in Europe particularly hard. The strong US dollar has negatively impacted international returns, but there is usually a reversion to the mean in exchange rates. The difficulty lies in predicting the catalyst that causes the reversion and when it may revert, but we do know that metrics do not stay at extremes forever.

Fundametrics research models act on quantifiable inputs based on empirical research. Highlighted in Exhibit 3, the models see a measurable opportunity in valuation multiples reaching two standard deviations below the average. The International Small Cap strategy will continue to invest in a portfolio of companies that fit the profile that we believe gives us the best chance of success long-term relative to the benchmark.

Past performance is no guarantee of future results, and CornerCap's strategies, like most investment strategies, involve the risk of loss. Different types of investments involve varying degrees of risk, and there can be no assurance that any specific investment will be profitable. All investors are advised to fully understand the risks associated with any kind of investing they engage in.