Q12022 ESG MICRO OPPORTUNITIES STRATEGY

Reopening vs. the Fed vs. the War

By Nathan Fredrick.

In the 2022 outlook letter we talked about increased volatility in 2022 and the first quarter did not disappoint (at least in that respect). While we were cautious coming into the year because of growth slowing into a Federal Reserve hiking cycle, we could not have foreseen the Russian invasion of Ukraine. This sent stocks tumbling in the first quarter only to see the market rally back aggressively just before the end of the quarter.

At the time of writing our last letter the market was only pricing in three rate hikes, and now the Fed has already raised rates once at .25% with the market implying another nine quarter-point hikes. The Russian invasion has pulled forward inflation (think of this at the gas pump and the grocery store), and the Fed is worried it is no longer transitory. They need to be seen as doing something to bring inflation down and therefore have been more aggressive in their language. This creates a difficult situation of having to pull forward rate hikes into a slowing economy. The second quarter will be the toughest growth comparison of the year, plus the market must deal with demand destruction from inflation. There is both good and bad news for the microcap space.

The good news is most microcap companies are entirely based in the United States and don't have exposure to the rest of the world. The bad news is that they are still not immune from inflation. We have seen this as a consistent theme in management meetings where executives highlight their biggest difficulties: inflation, supply chains, and a worker shortage. Hopefully this starts to fade in the second half of the year.

We feel this is not a time to be aggressive given the stock market is only slightly off its all-time highs, and headwinds in the form of tough comps and inflation are coming in the second quarter. We have trimmed most of our more speculative stocks (those that do not earn their cost of capital) and reallocated to more mature cash flow positive companies. We will take advantage of market volatility when it rises. Specific industries that we are interested in are Industrials, Healthcare, and Energy/Commodities. Within those industries we like companies that have under earned during the pandemic and are taking advantage of the reopening.

Our largest contributors to performance for the quarter were A-Mark Precious Metals (AMRK) and Meridian Bioscience (VIVO). AMRK is a precious metals trading company that caters to institutions and retail customers. They benefit from geopolitical uncertainties and volatility in the price of gold and silver and are currently profiting from a structural irregularity in supply and demand for silver coins. This environment where there is not enough supply to meet demand, (unless you have supply, which AMRK does), allows ARMK to take advantage of the large margin between the spot price of silver and silver coins.

VIVO is a life sciences company that sells diagnostic test kits primarily for gastrointestinal and respiratory infectious diseases, and elevated blood lead levels. VIVO had a good earnings report this quarter and will still benefit from Covid test kits they are selling. Also, as the economy continues to open, people will start returning to the doctor's office for care they have deferred over the last two years.

Our largest detractors from performance were Tuesday Morning Corporation (TUEM) and InfuSystem Holdings (INFU). TUEM was already a turnaround story before the quarter with a very experienced management team from Burlington Stores. There was not a lot of room for error here and the continued macro headwinds were too much to handle. We have since sold TUEM because the macro environment changed putting more pressure on the low-end consumer making TUEM's turnaround job much harder. This looks like it could be an example of a great management team being derailed by outside forces. We plan to revisit the company when there is better visibility on the underlying business and consumer. INFU has also been impacted from the healthcare reopening being pushed out further. They had a difficult earnings report this quarter highlighted by a large contract that was delayed into the future. We see this name as a "when not if" story and added to the name on the dip.

We had one addition to the microcap portfolio during the quarter, Mawson Infrastructure Group (MIGI). MIGI is a vertically integrated bitcoin mining and hosting company with operations throughout the U.S. and Australia. While Bitcoin did peak at $60,000 plus in 2021, in 2022 it has held up well in a range of roughly $35,000 - $48,000 as many tech stocks have sold off significantly more. In this range MIGI is very profitable and trades at double digit FCF yield and single digit P/E. This gives us a margin of safety to the downside and optionality to the upside. This year MIGI will be investing in more mining rigs that will continue to increase its hash rate, making it even more profitable. The bitcoin mining industry has received scrutiny from the public about its use of power. MIGI has addressed this by only using excess power from the utilities in its area and is connected into renewable energy sources. Also, they have committed to suspending operations at the request of the utility if power is needed at other sources.

We had an elevated number of sales this quarter that had mostly the same theme, currently losing money with longer term aspirations. The last two years from a stock perspective were very good for investors. We saw many money-losing and story/high growth stocks go to the moon. Now in 2022, the market has pivoted to more stable cash flowing companies, and our microcap portfolio was no exception. While we do like these companies for longer term, there was no margin for error, especially if there is a chance they had to raise additional funds for growth. We sold DarioHealth (DRIO), PowerFleet (PWFL), Wrap Technologies (WRAP), and Tuesday Morning Corporation (TUEM) during the quarter. While we believe in the longer-term prospects for these companies, we were concerned about the potential need to raise capital to fund growth during a time of tightening financial conditions. We remain in contact with these companies and will revisit them when there is better visibility.

The one other company that we sold was Centrus Energy (LEU). We still like this stock for a lot of reasons but there was a change in the underlying business model that could be an existential threat to the company. LEU provides enriched uranium for utilities in the United States and procures its supply of enriched uranium from only a few sources. The largest supplier was Russia. We sold the day of the invasion thinking harsh sanctions would come down on the government putting LEU's supply at great risk. If LEU lost the supply and had to go to the spot market or look elsewhere for more expensive enriched uranium, its profits would evaporate. We decided to part ways with a nice gain in the stock.

To conclude again with our process, the perfect microcap company is one that is at least cash flow breakeven or inflecting in the next twelve months, and also has optionality on other parts of the business that could turn it into a multi-bagger stock. In short, a call option that never expires. As the second quarter plays out, we plan to take advantage of what we believe will be continued volatility and allocate to these underfollowed names with great management teams that could be sold off indiscriminately by the market.

(Chart showing ESG MICRO Strategy Largest Contributors and Detractors on next page).

Disclosures:

Reader should not assume that investments in the securities identified were or will be profitable. Timing differences of purchases and sales may have a modest impact on the actual contribution numbers presented. The holdings identified do not represent all of the securities purchased, sold, or recommended. The calculation's methodology along with details on all holding's contribution to the overall account's performance during the measurement period are available upon request. Past performance does not guarantee future results.

ESG MICRO Opportunities Strategy
Largest Contributors and Detractors - Q1 2022

5 Best - Absolute Contribution				
Ticker	**Company**	**Average Weight**	**Contribution**	
AMRK	A-Mark Precious Metals	3.98%	0.88	bps
VIVO	Meridian Bioscience	2.96%	0.70	bps
FBIZ	First Business Financial Services	3.54%	0.40	bps
UTL	Unitil Corporation	3.38%	0.29	bps
LNDC	Landec Corporation	3.22%	0.12	bps
	5 Best Total	**21.90%**	**2.40**	**bps**

5 Worst - Absolute Contribution				
Ticker	**Company**	**Average Weight**	**Contribution**	
TUEM	Tuesday Morning Corporation	2.49%	-1.75	bps
INFU	InfuSystem Holdings	3.75%	-1.56	bps
MEC	Mayville Engineering Company	2.91%	-1.39	bps
ORN	Orion Group Holdings	2.41%	-1.04	bps
ANIK	Anika Therapeutics	2.61%	-0.95	bps
	5 Worst Total	**14.20%**	**-6.69**	**bps**