Denali Network Value Small
3Q 2021 Commentary

- The delta variant wave of Covid-19 slowed economic re-opening. Expectations of prolonged monetary support pulled down interest rates and boosted equities, especially large Technology and Growth stocks. The passing of the delta peak and accumulating evidence of persistent inflation changed expectations again in September, pushing up rates and pressuring high-valuation stocks. Volatility in Value vs. Growth and large vs. small cap performance remains very high.
- Our **Network Value Small** composite gained 0.93% in Q3 gross of fees (0.82% net), while the Russell 2000 Value benchmark lost 2.98%, a 3.91% gross excess. The strategy has returned 24.38% (gross) year-to-date, vs. 22.92% for the benchmark.
- In a sign of normalization, stocks with higher earnings for the past year relative to their prices straightforwardly out-performed those with lower earnings, while the 40% of small cap Value benchmark stocks reporting losses for the past year significantly lagged. Our position favoring stocks in higher E/P quintiles and avoiding loss makers accounted for about 310 bp of our active gain.
- Our overweight in smaller cap (lower liquidity) stocks also helped, producing around 55 bp of our active performance.
- Our Network Value Index*, focused on stocks with both higher earnings and lower liquidity, gained 0.54% for Q3, accounting for about 90% of our outperformance.
- Reflecting this performance, the stock-level Network Value forecast was quite successful in Q3. Our Detailed Estimates forecast also had good predictive performance. Characteristics Trend model results were neutral amid continuing factor return volatility. Intrinsic Value model results were negative, reflecting difficulty for stocks with high growth forecasts.
- As in Q1 and Q2, linear attribution shows exposure to higher forecast E/P had the most positive factor contribution, while higher reported E/P turned positive in Q3. Other valuation ratios (Cash Flow, Sales, Book Value) were also beneficial, as was higher ROE and lower volatility and liquidity. Unusually, our higher sales/assets ratio detracted from performance, as did lower average momentum and higher exposure to dividend payers.
- GICS sector allocation had a small positive impact; higher exposure to Financials was beneficial while underweighting Energy detracted. Selection within sectors was most successful in Materials, Industrials (transportation), Health Care, Communications (no AMC), and the Consumer sectors. Selection results were negative only within Technology.

Market Outlook

The delta variant wave of Covid-19 infections slowed economic re-opening in the U.S. and abroad during the quarter. The consensus estimate compiled by Bloomberg for U.S. GDP growth in Q3 fell from 7% at the beginning of the quarter to 4.8% now. Spreading supply chain constraints also contributed to slowing growth. Unemployment fell to 5.1%, but this has been accompanied by continuing low labor force participation rates. Quarterly profit growth for the S&P 500 is estimated at a low single-digit percentage for Q3, with Q4 earnings forecast about 5% above Q2 levels, and no further growth predicted for Q1 of next year. Expectations of prolonged monetary support pulled down interest rates, with the 10-year Treasury yield falling as low as 1.2% in July and August. This boosted equities, especially large Technology and Growth stocks. However, the passing of the delta peak and accumulating evidence of persistent inflation changed expectations again in September, pushing up rates and pressuring stocks, particularly those with high valuations. In the end, the U.S. equity market showed little net movement for the quarter, with the Russell 3000 Index losing 0.1%, but up 15% for the year to date.

Growth outperformed Value by 1.9% in the large cap Russell 1000 in the quarter, but Value outperformed by 2.7% among the small cap Russell 2000, while the small cap index trailed the large cap by 4.6%. Volatility in the relative performance of the Russell style indexes and in the relative performance between large and small caps remains very high. We expect this heightened volatility to continue, while over time we expect to see Value taking two steps forward and one step back vs. Growth. Partly this is because we are seeing the winding down of extreme accommodation in monetary policy. With economic growth running into various supply constraints (labor, energy, semiconductors), inflation is accelerating, with CPI rising at about 5% and the Fed's preferred core measure approaching 4%. The FOMC has signaled tapering of their asset purchases in the current, and short-term interest rate increases will likely begin next year. Inflation expectations and interest rates turning up from very low levels will continue to benefit Financials (heavily represented among both Value and small cap stocks) and pressure high valuation multiples. The historically very high valuation differentials between Growth and Value and between large and small cap stocks that had persisted for several years before this recent accelerated market cycle have only just begun to revert toward normal levels. Normalizing markets have generally been friendly to valuation-oriented strategies.

Denali Network Value Small GIPS Composite Report

Returns are presented gross and net of management fees and include the reinvestment of all income. Actual investment management fees are used to calculate net of fees returns unless otherwise noted in the composite specific disclosures. Past performance is not indicative of future results.

Denali Advisors, LLC claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Denali Advisors has been independently verified for the periods April 1, 2007 through June 30, 2020. The verification report is available upon request. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report. Denali is an independent registered investment advisor. Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Denali was established in 2001 and manages equity and alternative assets for primarily institutional clients. The U.S. dollar is the currency used to express performance. The annual composite dispersion presented is an asset-weighted standard deviation calculated for the accounts in the composite the entire year. Leverage is not used. Additional information regarding Denali's policies and procedures for valuing portfolios, calculating performance and preparing GIPS Reports available upon request. The firm's list of composite descriptions is available upon request. Please contact Anne Erickson at Anne@DenaliAdvisors.com.

Denali Network Value Small: Composite consists of fully discretionary small cap portfolios. Results are compared against the Russell 2000 Value and intend to outperform that benchmark while maintaining similar sector, industry and security characteristics. The Denali Network Value Small Composite inception and creation date is June 01, 2013. As of February 18, 2016, the secondary benchmark Russell 2000 was removed as it is no longer representative of the strategy. The NV Small portfolio construction is based on the analysis of earnings, liquidity and other characteristics of selected companies from the Russell 2000 index. The composite was comprised of 100% non-fee-paying accounts for periods presented through March 31, 2019, net returns were calculated by reducing gross monthly returns by a model management fee of 1%. As of April 1. 2019 the net returns have been calculated using actual management fees. The management fee for this product is 1.00%. Client returns will be reduced by advisory and other expenses the client may incur. There is a marketing minimum of $1 million.

Denali Network Value Small		Composite Assets		Annual Performance Results				3-Year Annualized Standard Deviation*	
				Composite					
Year End	Total Firm Assets (millions)	US Dollars (Millions)	Accounts in composite	Gross	Net	Russell 2000 Value	Composite Dispersion	Composite	Benchmark
2020	729	197	Five or Fewer	3.60%	3.19%	4.63%	N.A.	25.65%	26.49%
2019	1,338	116	Five or Fewer	24.01%	23.42%	22.39%	N.A.	15.16%	15.90%
2018	1,401	Less than a million	Five or Fewer	-5.89%	-6.85%	-12.86%	N.A.	14.93%	15.98%
2017	1,311	Less than a million	Five or Fewer	5.83%	4.79%	7.84%	N.A.	14.67%	14.17%
2016	762	Less than a million	Five or Fewer	28.85%	27.64%	31.74%	N.A.	16.48%	15.72%
2015	476	Less than a million	Five or fewer	-2.58%	-3.56%	-7.47%	N.A.	N.A.	N.A.
2014	357	Less than a million	Five or Fewer	8.53%	7.47%	4.22%	N.A	N.A	N.A
6/01/2013 - 12/31/2013	323	Less than a million	Five or Fewer	24.60%	23.94%	17.12%	N.A.	N.A.	N.A.

*3-Year Annualized Standard Deviation and Composite Dispersion is calculated using gross of fees returns. N.A. means an insufficient number of portfolios or insufficient number of periods.