

4Q 2021

Algert Global: The Evolution of Small Cap Investing

No small matter.

EXECUTIVE SUMMARY

- **U.S. small cap equities are often noted as being a less followed market segment. While we agree with this notion, we also believe it is a data-rich portion of the global equity market**
- **The U.S. small cap market segment is no exception to the significant growth of passive investing, we assess the potential impact this may have on small cap-centric mispricings**
- **Renewed popularity in quantitative investing has raised concerns about crowded factors and positions. We discuss our approach in mitigating the risks associated with crowded exposures**
- **Recent outperformance of U.S. large cap equities relative to small cap has led to increased concentration within the domestic equity market and a narrowing universe of firms, whereas small cap securities continue to provide a high breadth universe for active management**

The landscape for active investing continues to evolve. Changes in regulation and policy, technological advancements, investor preferences and easier access to vast amounts of relevant data are areas experiencing notable changes during the last decade. This evolution requires continued investment in research and technology

to keep up, or ideally ahead of, the changing landscape. At Algert Global, there are various areas we have focused our research efforts as it relates to U.S. small cap equities. First, we assess how a broad set of new data and the tools available to interpret this data has been a catalyst for innovative research. Second, we consider how the shift in investor sentiment away from active investing towards passive investing has influenced price discovery in U.S. small cap equities. We also consider whether crowded exposures are cause for concern amongst U.S. small-cap stocks. Finally, we consider how the dominance of large cap firms over the last ten years has led to an increasing narrowness of the U.S. equity market and how investing in small cap stocks may help offset this concentration.

DATA AND TECHNOLOGY ADVANCES

The ability to process and interpret new data sources has evolved and grown over time. As a quantitative, data-driven investment manager, we consider information sources as valuable inputs to our models. The combination of a broad and diverse universe of publicly traded companies, rigorous regulatory filing and disclosure requirements, vibrant capital markets information and unstructured data sets all leads to a growing information ecosystem for us to evaluate. The emergence of analytical tools to evaluate this ever-growing trove of data is not confined to investment management. It has become an integral part of industries like retail, healthcare, manufacturing, and insurance to mention a few.

TABLE 1 | **EXAMPLES OF DATA ITEMS FOR ALGERT GLOBAL'S U.S. SMALL CAP EQUITY UNIVERSE**
(APPROXIMATELY 1,700 NAMES)

Type	Number	Date/Period
Company Earnings Calls	10,858 calls	2019
SEC 8K	21,509 filings	2019
SEC 10K	1,744 filings	2019
SEC 10Q	5,313 filings	2019
News stories	160,420 releases	2019

Sources: Algert Global LLC, CapIQ, SEC

Over the last several years, the manner in which corporate regulatory filings and conference call transcripts are published has changed. Increasingly, reporting has moved away from formats that are challenging to process, such

as PDFs, to text friendly web-based formats such as XML. This transition towards a more interactive data format has facilitated new opportunities for highly scalable information consumption and analysis. This transformation, combined with advancements in Natural Language Processing (NLP), has allowed quantitative managers to process vast amounts of documents and evaluate them on a variety of measures. Concurrently, the availability and costs of computing power to deploy on these data sets have to a large extent been democratized by various cloud vendors as well as the overall decline in the expense of computing power.

Given processing costs and data availability are less of a hurdle today, the ability to identify and exploit unique sources of stock mispricings is increasingly reliant on novel data interpretation and implementation. Despite using the same data sets, it is possible to arrive at different

Below is an illustrative example of a conference call transcript with color coding on items that might be picked up by a NLP algorithm:

Wingstop Inc.

Q2 2020 Earnings Call – Michael Skipworth, Chief Financial Officer

Thank you, Charlie. As you just heard, we **delivered** another **strong** quarter across the board, including **31.9%** same store **sales growth**, **44.7%** on a 2-year basis. Despite the **challenging** backdrop of COVID-19, we opened 23 net new restaurants, resulting in 1,436 system-wide restaurants at the end of the second quarter, which represents a **10.2% growth** rate. **Royalties** franchise fee and other **revenue increased** by **\$6.7** million to **\$27.9** million for the second quarter, driven primarily by our domestic same-store **sales growth** and 132 net franchise openings since the year-ago comparable period. Advertising fees and the related **income increased** **\$6.4** million to **\$19.9** million, due primarily to a **37% increase** in system-wide **sales** compared to the second quarter in 2019. Our company-owned restaurant **sales increased** **\$4.4** million to **\$18.3** million for the second quarter. This **increase** is due primarily to same store **sales growth** of **24.7%**, the acquisition of one franchise restaurant and the opening of 2 company-owned restaurants since the second quarter of 2019. The **cost** of **sales** as a percentage of company-owned restaurant **sales decreased** by 300 basis points¹ compared to the second quarter of last year. This **decrease** was primarily due to a **22.7% decline** in the **cost** of bone-in chicken wings and our ability to **leverage costs**. This was partially offset by **higher** labor **costs** due to performance-based bonuses and incentive pay associated with COVID-19 for our team members and within the restaurant...

...Given the ongoing **uncertainty** with COVID-19 and the broader impact on the U.S. economy, we are not providing fiscal 2020 guidance with the exception of our estimate for net new restaurant development. Our Wingstop business model has demonstrated its resiliency as we have navigated in this crisis and are thankful to all of the Wingstop team members and brand partners for their hard work and dedication during these **challenging** times. We remain focused on our vision of becoming a top 10 global restaurant brand, and we believe we are well positioned to **grow** our global market share, both during and after this pandemic. As we look **ahead** to the second half of 2020 and beyond, our long-term strategy remains unchanged, anchored by our 3 main **growth** pillars: sustained same-store **sales growth** by **growing** brand awareness; maintaining **best-in-class** unit economics for our brand partners; and continuing to **expand** our global footprint. With that, we're happy to take your questions. Operator, please open the line for questions.

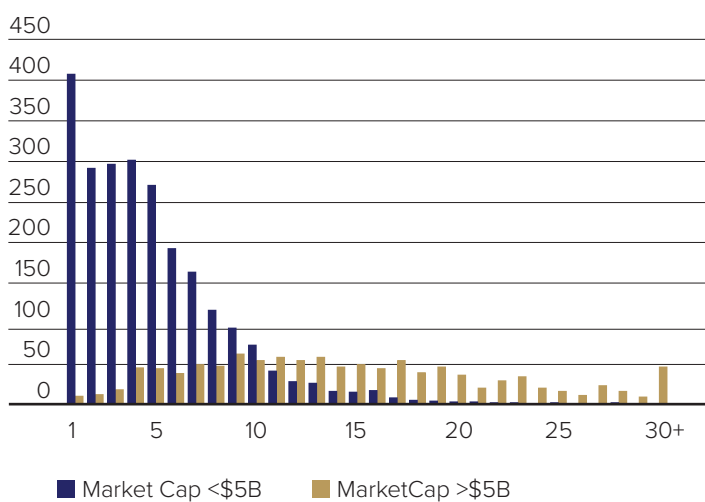
Source: CapIQ, Algert Global LLC. References to company names are for illustrative purpose only and should not be construed as investment advice or an investment recommendation for any of those companies. Other company call transcripts vary and this example is not reflective of all past or future call transcripts that Algert Global may rely upon. Future call transcripts will vary from the above example.

1 Basis points: Are a commonly cited unit of measure for interest rates and other percentages in finance. One basis point is equal to 1/100th of 1%, or 0.01%, and is used to denote the percentage change in a financial instrument.

conclusions. In our experience, the most innovative, differentiated and successful outcomes tend to be at the intersection of robust quantitative analysis, a healthy dose of skepticism, awareness of data mining risks, and new data sets. One example of this interaction is to blend well understood and time-tested fundamental valuation metrics with information sources from company conference calls using NLP techniques. We believe this forms a more holistic and comprehensive view as it is based on multiple information sets and processing techniques.

While these data sets are available across the U.S. market capitalization spectrum, small cap securities tend to be less followed by market participants when compared to large cap securities. One proxy for how investor attention varies across the market capitalization spectrum is to measure how sell-side analyst coverage differs across large and small cap securities. The chart below illustrates the variability of the number of IBES estimates by capitalization range. This reduced analyst footprint within small cap securities provides a backdrop for less efficient price discovery and increased alpha² opportunities.

TABLE 2 | **FY1 ESTIMATES BY SELL SIDE ANALYSTS (SOURCE IBES)** (AS OF 10/31/2021)



*The Institutional Brokers' Estimate System (IBES) is a database used by brokers and active investors to access the estimates made by stock analysts regarding the future earnings of publicly traded American companies.

2 Alpha: Alpha is a term used in investing to describe an investment strategy's ability to beat the market, often referred to as "excess return," above that of a stated index or benchmark.

ROLE OF PASSIVE INVESTING IN CREATING SECURITY MISPRICINGS

Passive investing, and the significant growth it has experienced over the past 20 years, has transformed the investing landscape. Additionally, the definition of passive investing has evolved significantly over time. Initially, passive investors would typically buy (or short) index funds based on the risk and return of the aggregate index return rather than a return expectation for the underlying stocks within the index. While passive investing historically was synonymous with investing in indices that were based on the market capitalization of the underlying stocks, today indices have been created to track an increasingly varied set of exposures.

There are a many different data points around index investing we find of interest.

For example, let us look at the example of a single stock; Nektar Therapeutics (NKTR)². Nektar today is a constituent in approximately 300 different indices. It also is a constituent of 56 U.S. based ETF's (<https://www.etfchannel.com/symbol/nktr/>), whose aggregate holdings account for over 17% of the market capitalization of NKTR. Table 3 illustrates the growth in ETF ownership for NKTR and could be considered a proxy for the overall growth of passive investing.

TABLE 3 | **U.S. LISTED ETF'S HOLDING NKTR**

Year	# of ETF's holding NKTR	% of market cap held by ETFs
2012	40	9.3%
2021	56	17.5%

In our view, this would imply that an increasing proportion of the capital invested in NKTR is from passive investors, largely indifferent to the underlying risk and return expectations for the stock. As a result, mispricings may subsequently arise relative to a stock's underlying fundamentals given the growing footprint of passive ownership. In addition, the price of individual stocks has become more sensitive to index related activities such as rebalancing and index flow-based trading. Traditionally, mispricings may have arisen from investor behavioral biases, fundamental mispricings and time-varying risk premiums. While those mispricing sources may still be prevalent, we believe inefficiencies related to

passive investing are growing in importance. For example, passive funds are focused on matching their corresponding index and are largely indifferent to the relative attractiveness of the underlying prices or fundamentals for the stocks within the index. Academic research shows that the prices of stocks can experience large swings predominately driven by index related trades rather than any major fundamental changes for the underlying stocks. (Source: Israeli, D., Lee, Data from eVestment Alliance illustrates the significant role passive investing has within this segment of the market as the majority of the largest U.S. Small Cap funds are now passively managed. C.M.C. & Sridharan, S.A. Rev Account Stud (2017) 22: 1048.

The rise of passive investing has resulted in many active managers trying to exploit what may be characterized as uninformed flow-based trading generated by price insensitive buyers or sellers. Conceptually, in the short term, active managers may attempt to trade with the flow as it pushes prices over short time horizons. Over longer horizons, active managers may favor stocks whose price may deviate from underlying fundamentals due to accumulated passive flows. In our view, the growth of index investing has created an attractive backdrop for passive flow-related mispricings.

GROWTH OF SMART BETA³ STRATEGIES AND CROWDED TRADES

The increased AUM in quantitative funds in recent years and the popularity of various factor or smart beta strategies has led many to question whether this has resulted in increased crowding into similar exposures. As Morningstar estimates that over \$860 billion is now invested in various smart beta strategies, (<https://www.morningstar.com/>

articles/992082/did-strategic-beta-products-pass-the-test) the risk of crowded trades has grown notably, in our view. To help address these risks, Algert Global has implemented processes seeking to mitigate the impact of crowding at the individual stock and factor level. An important aspect of our investment process seeks to limit the amount of common factor exposures in our portfolios, as these tend to be implemented by a broad array of smart beta strategies and generally lead to crowded exposures and increased volatility. At the individual stock level, positioning and trade flow information from equity, fixed income and options markets may help identify crowded stocks and inform portfolio positioning through various risk controls and penalties.

DESPITE A NARROWING U.S. EQUITY MARKET, SMALL CAP UNIVERSE REMAINS DIVERSIFIED

Partly driven by their enhanced access to capital markets along with a structural trend towards consolidation and scale benefits, U.S. large cap stocks have outperformed their small cap peers. For the trailing 10 years ending September 30, 2021, the Russell 1000 Index has generated an annualized return of 16.76%, compared to 14.63% for the Russell 2000 Index. This recent trend has partly reversed the long-standing outperformance of small cap securities.

While large cap securities have broadly outperformed recently, it is important to note that the performance gap has been driven by a small number of mega-cap firms. As the chart below illustrates, the aggregate U.S. market capitalization has trended towards the largest firms. As of November 2021, securities (stocks and ETFs) with a market capitalization greater than \$100B represented 67% of the total capitalization of the U.S. equity market. The small

TABLE 4 | **SMALL-CAP FUNDS RANKED BY AUM** (AS OF 9/30/2021)

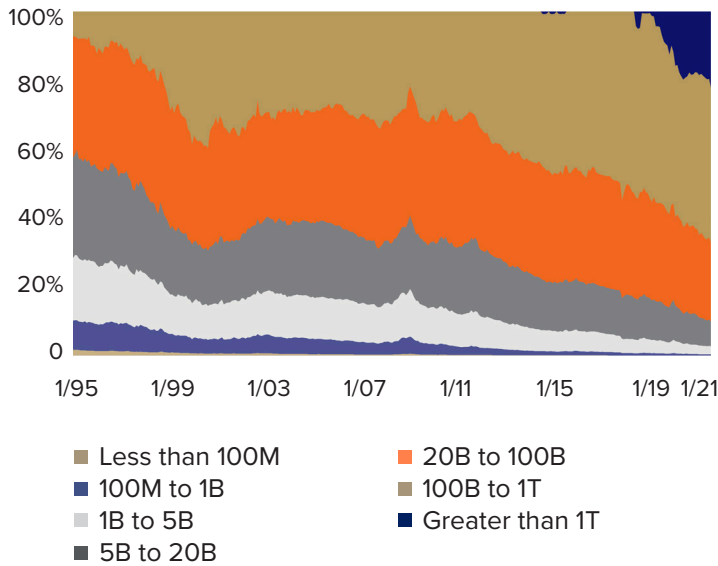
Product	Investment Focus	Geographic Focus	Product AUM (\$USD, Million)
Vanguard Small-Cap Index Fund	Passive	United States	134,389.2
BlackRock Russell 2000 Equity Index Fund	Passive	United States	88,667.3
BlackRock iShares Core S&P Small-Cap ETF	Passive	United States	68,778.8
T. Rowe Price - US Small-Cap Growth I Equity Strategy	Active	United States	50,921.9
State Street Global - Russell Small Cap Completeness Index	Passive	United States	49,297.0
Vanguard Small-Cap Value Index Fund	Passive	United States	47,258.7
Vanguard Small-Cap Growth Index Fund	Passive	United States	36,812.7
DFA - US Small Cap Equity Strategy	Passive	United States	25,761.6
T. Rowe Price - US Small-Cap Core Equity Strategy	Active	United States	25,127.0

Sources: eVestment Alliance

³ **Smart Beta:** Smart beta investing strategies combine passive investing with active investing strategies with a goal of obtaining alpha, lower risk (beta) or increasing diversification at a cost lower than traditional active management and marginally higher than pure index investing.

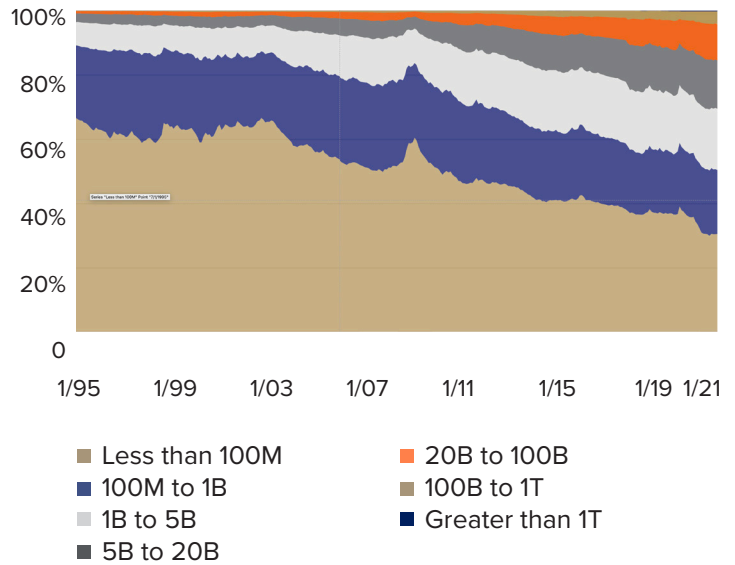
number of securities with a market cap greater than \$1T represented 22% of the U.S. equity market.

TABLE 5 | MARKET CAPITALIZATION MSCI BARRA GEM4 US UNIVERSE JAN 1995 - NOV 2021



When viewing the U.S. equity universe by the number of securities within the same market cap range, securities with a market cap less than \$20B represented nearly 85% of the approximately 20,300 listed securities. Conversely, securities with a market cap greater than \$100B made up approximately 4% of the numbers of names within the U.S. equity universe. Given the increasing concentration and narrowness of the U.S. equity market overall, we believe the small cap portion of the market provides a good backdrop for active management given the sheer breadth of securities available to investors.

TABLE 6 | NUMBER OF STOCKS, BY MARKET CAP RANGE MSCI BARRA GEM4 US UNIVERSE JAN 1995 - NOV 2021



SUMMARY

The pace of change in the U.S. small cap investment landscape continues to present opportunities and challenges for active managers. Given increasingly varied data sets, enhanced technology capabilities, evolving sources of security mispricings and the changing composition of the equity market, we believe the opportunity set for active management within small cap securities is robust.

About North Square

Founded in 2018 and headquartered in Chicago, IL, North Square Investments is an independent, multi-boutique investment firm dedicated to delivering differentiated active investment strategies to the market. With an experienced senior management team, a board composed of industry veterans including John Amboian, Neil Cummins and Brian Gaffney, and backed by Estancia Capital Partners, North Square is a leader in aggregating best-in-class active managers and delivering select, in-demand investment strategies to financial intermediary partners for the benefit of their clients.

About Algert Global

Algert Global is a San Francisco-based leader in systematic investment strategies founded in 2002. Algert takes an active, fundamentally driven approach to exploit inefficiencies in global equity markets resulting from investor behavioral biases. The firm currently sub-advises the North Square Dynamic Small Cap Fund.

Principal Risks of Investing: Risk is inherent in all investing, including an investment in the Fund. An investment in the Fund involves risk, including the following principal risks, among others: Equity Risk, ETF Risk, Foreign Investment Risk, IPO Risk, Liquidity Risk, Management and Strategy Risk, Market Risk, Portfolio Turnover Risk, Preferred Stock Risk, Real Estate Investment Trust (“REIT”) Risk, Reliance on Technology Risk, Small Cap Company Risk, and Value-Oriented Investment Strategies Risk. Summary descriptions of these and other principal risks of investing in the Fund are described in the Fund’s prospectus. Before you decide whether to invest in the Fund, carefully consider these risk factors and special considerations associated with investing in the Fund, which may cause investors to lose money. There can be no assurance that the Fund will achieve its investment objective. An investment in the Fund is not a deposit of the bank and is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Please see the Fund’s prospectus for additional risk disclosures.

The Portfolio is actively managed and current holdings and characteristics may be different. The holdings listed should not be considered recommendations to buy or sell any particular security listed. The Russell 2000® Index is a measure of the performance of small-cap U.S. stocks. Indices are unmanaged and their returns assume reinvestment of dividends and, unlike mutual fund returns, do not reflect any fees or expenses associated with a mutual fund. The volatility (beta) of an account may be greater or less than its respective benchmark. It is not possible to invest directly in an index.

The Russell 1000® Index is a subset of the larger Russell 3000 Index and represents the 1000 top companies by market capitalization in the United States. It is considered a bellwether index for large cap investing.

Before investing you should carefully consider the Fund’s investment objectives, risks, charges and expenses. This and other information is in the prospectus, a copy of which may be obtained by calling 855-551-5521 or visiting northsquareinvest.com. Read carefully before investing.

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As of December 31, 2021, Wingstop Inc. represented 0.36% of the North Square Dynamic Small Cap Fund’s portfolio, while Nektar Therapeutics represented 0%.

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