Catalyst

INTEGRITY ASSET MANAGEMENT

PORTFOLIO UPDATE AND MARKET OUTLOOK

February 29, 2024

"Everybody got to elevate from the norm."
– Rush Vital Signs

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I recently read an academic paper titled Underperformance of Concentrated Stock Positions by Antti Petajisto (SSRN, 6/30/2023). The paper was interesting considering Integrity's views on diversification. In addition, the paper sheds some light on the potential outlook for the market's Magnificent Seven.

We have been strong believers in diversification since we started managing money together over twenty-five years ago. We sometimes receive pushback of being too diversified. We believe understanding and diversifying risks in the portfolio increases our chances of being a good, consistent performer over the long term. Reducing the risk that one decision significantly impacts yearly results helps us achieve that goal. It may (or may not) limit short-term performance. However, investing success, in our opinion, comes from the power of compounding returns over time.

The research paper referenced above shows that "since 1926, the median ten-year return on individual U.S. stocks relative to the broad market is -7.9%." The author finds that a few stocks tend to drive market performance. We believe working to avoid losers through our quantitative and qualitative analysis, while owning more companies from the remaining opportunity set increases our chances of holding the stocks that outperform. Obviously, if we could just pick the winners and hold those few stocks, we could have outsized performance. However, if we get that wrong then we have outsized underperformance. *(continued on page 2)*

Preliminary Performance (%)

Representative Accounts

	MTD			QTD			YTD		
	Gross	Net	vs. Benchmark*	Gross	Net	vs. Benchmark*	Gross	Net	vs. Benchmark*
Small Cap Value	2.95	2.95	-0.32	0.04	-0.04	+1.46	0.04	-0.04	+1.46
Small/Mid Cap Value	4.58	4.58	+0.57	3.08	3.00	+1.99	3.08	3.00	+1.99
Mid Cap Value	5.44	5.44	+0.67	4.59	4.52	+1.69	4.59	4.52	+1.69
Micro Cap Value	3.47	3.47	-1.34	-1.32	-1.40	-1.71	-1.32	-1.40	-1.71

Source: SEI

Past performance does not guarantee future results. Representative accounts include: Integrity Small Cap Value Equity Strategy, Integrity Small/Mid Cap Value Equity Strategy, Integrity Mid Cap Value Equity Strategy, Integrity Micro Cap Value Equity Strategy. Performance is preliminary and subject to change. Benchmark comparison is versus gross performance.

Market Returns (%)

	MTD	QTD	YTD
S&P 500® Index	5.34	7.11	7.11
Nasdaq 100® Index	5.41	7.40	7.40
Russell 2000® Growth Index	8.12	4.66	4.66
Russell 2000® Value Index	3.27	-1.42	-1.42

Past performance does not guarantee future results. Indices represent different segments of the market and are not correlated to the strategies above, with the exception of the Russell 2000® Value Index, which is the benchmark for Integrity Small Cap Value Equity.

Again, we believe consistency and compounding are the keys for long-term performance. You can't brush your teeth only one day out of six months, no matter how many hours you spend on it that day and expect a good check-up. We believe investing is similar. It's not about how much return we can achieve in a year, it's how much yearly return we can achieve that is sustainable over the long term.

There has been a lot of coverage on the Magnificent Seven and their outsized contribution to the S&P 500 returns. Petajisto points out some historical context that may give investors pause when considering these stocks today. These stocks are outside our expertise, and we have no opinion on them, but the historical context is interesting.

The author points out that "for stocks that have been among the top 20% [of] performers over the previous five years, the median ten-year market-adjusted return falls to -17.8%, underperforming by 1.94% per year. Since the end of World War II, the median ten-year market-adjusted return of recent winners has been negative for 93% of the time."

As believers in reversion to the mean, these results make sense to us. Furthermore, we preach buying undervalued companies with a catalyst, not just great companies. We work to discern both the business attributes and the valuation when looking for investments. One need only look at Cisco Systems (CSCO), to show this point. CSCO by almost any metric is a great company. It was a darling of the tech bubble. Unlike several other darlings that no longer exist, CSCO is alive and well and still a leader in its industry. Had you bought CSCO on 3/1/2000, your total return to date (2/29/2024) would've been 7.38%. That's underperformance of over 400% relative to the return on the S&P 500 over that period.

Today, NVIDIA has a market capitalization greater than the size of the Canadian economy. That's certainly a lot of poutine. How will that work out going forward? Time will tell. History doesn't seem to be on the side of the "Magnificent Seven." Maybe it's different this time.

Buffett Likes Small Caps

Ok so that's not exactly what he said. We did find it interesting in his shareholder letter that he said there aren't any companies that could move the needle for Berkshire that are attractively priced. To us, he's saying large companies look expensive.

Attribution:

U.S. equities rallied to close out the best February monthly returns for the tech heavy Nasdaq (+6.2%) and the S&P 500 (+5.3%) in nearly a decade. Both indices outpaced the Russell 2000 Value Index which was up 3.3%. Stocks rose at month end after inflation data matched estimates and fueled investors to further speculate that the Federal Reserve will cut rates as early as June. For the month, value underperformed growth across all four of our benchmarks. Two of our four strategies, small/mid cap value and mid cap value, outperformed their respective benchmarks for the month of February.

Composite Performance (%) *as of December 31, 2023*

	1 Year		5 Year		10 Year	
	Gross	Net	Gross	Net	Gross	Net
Small Cap Value	18.87%	17.69%	13.78%	12.65%	8.72%	7.64%
Small/Mid Cap Value	15.38%	14.23%	14.06%	12.92%	8.90%	7.81%
Mid Cap Value	13.51%	12.55%	13.49%	12.55%	9.40%	8.50%
Micro Cap Value	16.14%	14.99%	11.99%	10.87%	8.95%	7.86%

Returns for periods greater than one year are annualized. Returns reflect the reinvestment of dividends and other earnings and are expressed in U.S. dollars. Gross-of-fees returns for the representative account are presented before management and custodial fees but after all trading expenses.

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All investments carry a certain degree of risk including the possible loss of principal, and an investment should be made with an understanding of the risks involved with owning a particular security or asset class. Interested parties are strongly encouraged to seek advice from qualified tax and financial experts regarding the best options for your circumstances.

Each representative account serves as the model against which all accounts in each respective strategy are managed. The representative accounts are actual portfolios and the information provided, including performance, will vary for other accounts. The representative accounts are being used solely as tools to help demonstrate how performance can be attributed to the investment policies applied in the management of each strategy.

Net-of fees returns reflect gross performance less investment management fees, which are calculated by deducting 1/12 of the highest tier of the standard fee schedule in effect for the period noted (the model fee). The composite model fee for each period is either the highest tier of the current fee schedule or a higher value, whichever is required to ensure the model composite net-of-fee return is lower than or equal to the composite net-of-fee return calculated using actual fees. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size. The firm's fees are available on request and may be found in Part 2A of its Form ADV.

*The Integrity Small-Cap Value Equity Strategy is benchmarked to the Russell 2000® Value Index. The Integrity Small/Mid-Cap Value Equity Strategy is benchmarked to the Russell 2500™ Value Index. The Integrity Mid-Cap Value Equity Strategy is benchmarked to the Russell Midcap® Value Index. The Integrity Micro-Cap Value Equity Strategy is benchmarked to the Russell Microcap® Value Index.

Index returns reflect the reinvestment of dividends and other income but do not reflect advisory fees or any other expenses. Indexes are unmanaged and one cannot invest directly in an index.

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