For the third quarter of 2024, BAM's strategy returned 8% gross and 7.7% net of fees versus 10.1% for the Russell 2000 Value. Year to date, BAM returned 5.6% gross and 4.9% net versus 9.2% for the Russell 2000 Value.

Performance		Yearly Returns								Annualized Returns*		
		2017	2018	2019	2020	2021	2022	2023	2024 YTD	3 Yrs	5 Yrs	Inception
Ballast Portfolio[1]	Gross	13.5%	-2.2%	16.1%	12.5%	41.8%	-13.3%	18.6%	5.6%	4.5%	13.0%	12.1%
	Net	12.4%	-3.2%	15.0%	11.4%	40.4%	-14.2%	17.4%	4.9%	3.5%	11.9%	11.0%
Russell 2000 Value[2]		7.8%	-12.8%	22.4%	4.6%	28.2%	-14.5%	14.6%	9.2%	3.8%	9.3%	9.4%
Alpha (net of fees)		4.6%	9.6%	-7.4%	6.8%	12.2%	0.3%	2.8%	-4.3%	-0.3%	2.6%	1.6%

*Anualized 3-Year, 5-Year and from Inception returns reported through 9/30/24

Our short-term underperformance in the recent beta rally is neither unusual nor cause for alarm – it is simply a side effect of not overoptimizing in a futile attempt to squeeze returns out of nearly random short-term price fluctuations. Instead, we estimate reward-to-risk based on medium-term, directional forecasts of business performance. Admittedly, that task is only slightly easier than precisely forecasting stock prices over any term.

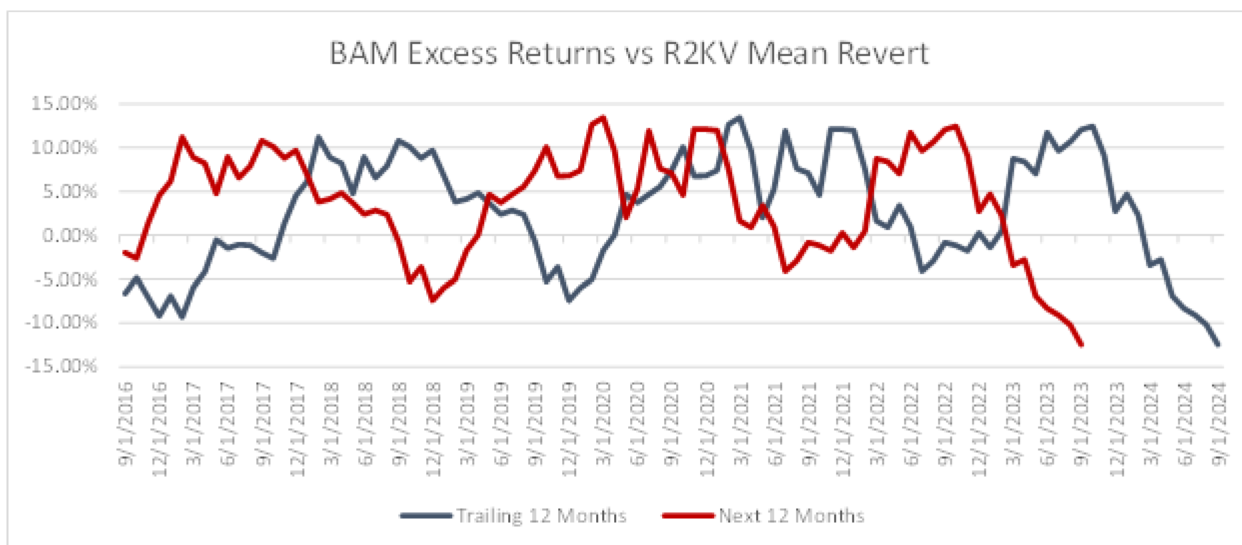
We aim to be robust in bear markets, and to outperform over a market cycle by selecting underappreciated, quality companies that are cheap on reward-to-risk basis. Our companies must have superior business models, solid competitive advantages, sustaining high capital returns coupled with strong balance sheets, and management teams with strong operating and capital allocation credentials.

We expect the next 12 months to be particularly strong given our historical pattern of returns, consistent personnel and processes, and current portfolio characteristics, although past performance is no guarantee of future performance. Quality tends to underperform in strong beta markets but more than catch up over the course of a market cycle. Our returns show a similar pattern. Since inception (October 2015) to September 2023, the last period for which we know the next 12-month return:

- BAM's excess return net of fees geometrically averaged 3.2% per year.
- When R2000V was up more than 15% LTM, BAM averaged 2% excess return NTM, lagging in 27 of 96 overlapping periods or about 28% of the time.
- When R2000V returned 15% or less LTM, BAM averaged 6.1% excess return NTM, lagging in only 17 periods or about 18% of the time.

We have tended to outperform more when the market is drawing down – our excess returns have been negative 13% correlated with the Russell 2000 Value's absolute returns. This is important for at least two reasons. First, moderating downside is key to mitigating the psychological wrong-footing that happens in hard selloffs and part of why we were able to act fast to capitalize on the COVID-19 crash. If you know your businesses are in aggregate still creating economic value, it is a lot easier not to panic. Second, moderating drawdowns is extremely important given the asymmetry of compounding, e.g., it takes an

11.1% return to recover from a 10% drawdown, a 25% return to recover from a 20% drawdown and 43% return to recover from a 30% drawdown.



Source: Bloomberg and Ballast Asset Management

It might feel counterintuitive, but historically the best time to allocate new money to our strategy is after a 12-month period of underperforming. Because our returns have been mean-reverting, our periods of strong excess returns were followed by weak periods, followed by strong again and so on. In the past, after periods in which BAM's trailing 12 months net return lagged the Russell 2000 Value's:

- Over the next 12 months, BAM's excess return averaged 7.7% net of fees.
- For the 24 months, including the initial trailing 12 months of underperformance, BAM's cumulative net excess return averaged 3.7% and trailed the index in only four periods – less than 5% of the time.
- For the 36 months, including the initial trailing 12 months, BAM's cumulative net excess return averaged 9.3% and lagged in just two periods – less than 3% of the time.

Owning Companies not Stocks

Despite weak relative stock price performance over the prior 12 months, the portfolio's business fundamentals have been quite strong. BAM's position-size weighted revenue increased 3.6% and Return on Equity increased 195bps to 22.2%. For comparison, Russell 2000 Value revenue fell 1% and ROE declined 215bps to 1.8%, a lower return than you would get on a savings account. Our fundamentals also compare favorably with the S&P 500, which saw revenue increase 3.5% and ROE improve 20bps to 17.8%. Additionally, Ballast's portfolio is more attractively valued with a 10.9% FCF Yield versus 1.2% for the Russell 2000 Value and 3% for the S&P 500.

Our factor exposures are the result of bottom-up security analysis (not top-down portfolio tilts), which can sometimes hurt our relative performance. Our companies skew smaller, with lower dividends, lower volatility, and lower leverage than the index, basically the opposite of factors that worked over the last 12

months. Our portfolio heavily tilts toward companies with higher FCF/EV, asset turns, ROE, ROIC, growth and credit quality – factors with long histories of correlation with material excess returns.

We cannot say for certain when divergences between our fundamentals, valuations, and stock returns will close, but eventually they always have. In the meantime, we have high confidence in the ability of our companies to compound economic value at above market rates, which should boost returns well above those warranted by potential multiple expansion alone.

Structured and Private Credit Offer Bonus Liquidity with Risks

Corporate credit conditions, despite QT, could be much looser than official data suggests. Including leveraged loans and direct lending, private credit outstanding amounts to $2-3 trillion and growing fast, according to Bloomberg. It is more opaque than traditional bank lending and not as well captured in official data.

So far this year, nearly $1 trillion of leveraged loans have been originated, mainly for refinancing. Many of these loans are ultimately bought by managers that repackage them into CLOs, basically a corporate credit reboot of a CDO. Recall that CDOs were an important multiplier in the mortgage boom-bust of the 2000s. Instead of mortgages, banks originate leveraged loans, warehouse them, transfer the credit risk to others via structured products, and pocket the fees nearly risk-free. The underwriter gets its principle back in the risk transfer, recycling the capital to do it again.

Anecdotally, weakening creditor protections and spreads that seem too tight suggest that more capital wants in than can be deployed at adequate risk adjusted returns. Not much good happens when lenders compete to see who can originate the most. Two exceptions: First, we suspect some zombie companies, those with too much debt to both pay interest and invest for the future, have gotten a lifeline from private credit, keeping bankruptcies lower than otherwise. With more than 30% zombies, this reprieve probably contributed to the strength of the recent Russell 2000 Value beta rally. Second, faster bank capital turns increase the velocity of money, which may be helping to offset liquidity, drained the Fed's shrinking balance sheet. In other words, easy credit is stimulative, which is not a bad thing as long as it is appropriately invested.

Rather than facing increased competition from private credit, banks are coopting it via partnerships. This can add another layer of leverage on top of the CLO leverage, if the bank capital is really a loan to private credit managers (e.g., rather than using equity to keep skin in the game, managers can use that amount to bank loans to make loans). The potential duration mismatch, with shorter-term borrowing used to fund longer-term loans, could become a liquidity problem in stressed markets.

Greater availability of private market capital may be part of the reason fewer venture capital and private equity companies are going public. Obviously if more private capital is available, the need to raise public equity for growth diminishes. But keeping companies private also makes it easier to delay marking valuations to market. It is a question of incentives and, ironically, free-market competition among VC and PE managers and among real money investors (like pensions, endowments and foundations) may ultimately drive less efficient capital allocation.

Private markets, with fewer participants, fewer transactions, and greater information asymmetries, necessarily have less efficient price discovery than public markets. This gives private capital managers more leeway in marking valuations. If a marked valuation is above what public markets will pay today,

keeping the company private avoids restating returns. It is not clear how prevalent this might be, but it would explain why public exits have dropped and why less capital is being returned to clients.

High returns with low apparent volatility are highly prized by institutional investors and the pressure on PE and VC managers to perform is intense. It must be at least a little tempting to pad returns by setting valuations a little above what could be realized in an arm's-length sale. But that is a slippery slope – to sustain a little fudging today, in a mistaken hope of catching up later, takes even more fudging tomorrow, and evermore fudging for the tomorrows after that.
Why would clients go along? One reason is probably a lack of resources to vet valuations in enough detail to challenge managers' marks. Not to mention that proving returns have been overstated would not be optimal for client executives. As with managers, many executives face tremendous career pressure to generate high returns with low apparent volatility (never mind that volatility is present even if it is hidden behind infrequent price discovery). This dynamic can also extend to the boards that make CIO employment decisions, further mixing up the incentives.

Performance Attribution, Index Agnosticism, and Portfolio Changes

Sector allocation was 405bps drag in the quarter. Because we build our portfolio bottom-up, at times our investment criteria limit exposure to lower returning, highly leveraged sectors such as banks, REITs and regulated utilities. Although we expected lower interest rates to be a tailwind, relying solely on lower rates to make money is not a sandbox we play in. Furthermore, we assessed higher than normal risk of large losses from stress in commercial real estate. As a result, we were about 50% underweight in Financials, Real Estate and Utilities, which cost 380bps of performance. CRE risk may recede under a deluge of capital into private credit, but the risks are not gone.

Energy was our largest overweight and the largest drag on returns at the sector allocation level. Sensitivity to slowing economic growth left energy the only sector to decline in the quarter. In contrast, our energy stock selection was strong, adding 250 bps. This disconnect between our sector and stock performance makes the point that our process is company-specific, bottom-up, rather than a bet on macro conditions. That aside, we do think we are near the bottom of the capital cycle, that underinvestment has left some great assets too cheap, and that restrained supply growth will eventually lead to higher prices both for the commodities and the assets. As a side benefit, energy is a good inflation hedge, which we appreciate given fiscal policy uncertainty. A similar pattern holds for our Technology companies as well. Tech was a large overweight and our second worst performing sector, yet it was the second highest source of returns to stock selection, adding 130 bps.

Our bottom five positions cost nearly 300bps of active return that was more than offset by nearly 735bps from our top contributors. We allowed the weight in some of our top contributors to increase through appreciation because the companies are executing well, have excellent prospects, and the stocks are trading below our target valuations. We sold ATKR on a broken thesis. While longer-term prospects appear favorable, we allowed the weight in a number of underperformers to decrease due to near-term headwinds.

Top Contributors	Average Weight	Total Return
Climb Global Solutions	4.4%	58.8%
Solaris Energy Infra.	3.1%	50.2%
Eagle Materials	2.7%	32.4%
Intl. General Insurance	2.6%	35.9%
Cavco Industries	3.4%	23.7%

Bottom Detractors	Average Weight	Total Return
Rimini Street	1.1%	-39.7%
Atkore	1.5%	-36.9%
Bioceres	1.1%	-29.8%
Kosmos	1.1%	-27.3%
America's Car-Mart	1.9%	-30.4%

We exited Sprouts Farmer's Markets (SFM) and Lamar Advertising (LAMR) after significant holding period excess returns rendered reward-to-risk unfavorable. With strong competitive positions, good management and high returns on capital, we would gladly revisit either at the right price.
We started new positions in Turning Point Brands (TPB) and CompoSecure (CMPO), which we believe more than meet our usual criteria and offer excellent reward-to-risk.

In case you wondered...

We do not have much to add about the impending election. According to a model maintained by 538 on its website, both candidates have a 60% chance of winning 300 electoral votes (versus 270 to win). That is simply too close to call and then map policy changes that may or may not happen on to the small cap market with enough certainty to justify the use of our resources. We have examined the potential impacts on our companies, and on average expect it to be a wash over our investment horizon. One obvious exception is a reaction to tax changes broadly impacting equity markets in general.

Regards,

Ballast Asset Management

Important Notes and Disclosures

The investment decisions we make for clients' accounts are subject to various market, economic, and other risks, and there is no guarantee that those investment decisions will always be profitable. Clients are reminded that investing in any security entails risk of loss, which they should be willing to bear. The past performance of the firm or its principal is no guarantee of future results.

Some information contained in this communication was obtained from third-party sources. While these sources are believed to be accurate, that information has not been independently verified.

[1]Account returns are presented both gross and net of management fees. All account returns are net of transaction costs and gross of non-reclaimable withholdings taxes, if any, and reflect the reinvestment of dividends and other earnings. Monthly composite returns are calculated by weighting each account's monthly return by its relative market value. All returns are expressed in US dollars. **Past performance does not guarantee future results.**

The gross performance results presented do not reflect the deduction of investment advisory fees. Actual returns will be reduced by such advisory fees and other expenses as described in the individual contract and, where applicable, Form ADV Part 2A.

Net performance results do not reflect the deduction of investment advisory fees actually charged to the accounts in the composite but do reflect the deduction of a model investment advisory fee of 1.00%, which is the maximum advisory fee rate in effect for the respective time period. Actual advisory fees may vary among clients invested in the strategy. Returns for each client will be reduced by such fees and expenses as described in the individual contract and, where applicable, in Form ADV Part 2A.

[2] The Russell 2000 Value Index measures the performance of the smallcap value segment of the US equity universe includes those Russell 2000 companies with relatively lower price-to-book ratios, lower I/B/E/S forecast medium term (2 years) growth and lower sales per share historical growth (5 years).

Ballast Asset Management, LP claims compliance with the Global Investment Performance Standards (GIPS®) and has been independently verified for the period October 1, 2015 through December 31, 2020. Verification assesses whether (1) the firm has complied with all of the composite construction requirements of the GIPS Standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS Standards. The verification report is available upon request. Verification does not ensure the accuracy of any specific composite presentation. GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. A GIPS composite report can be obtained by calling 469-502-3652.

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