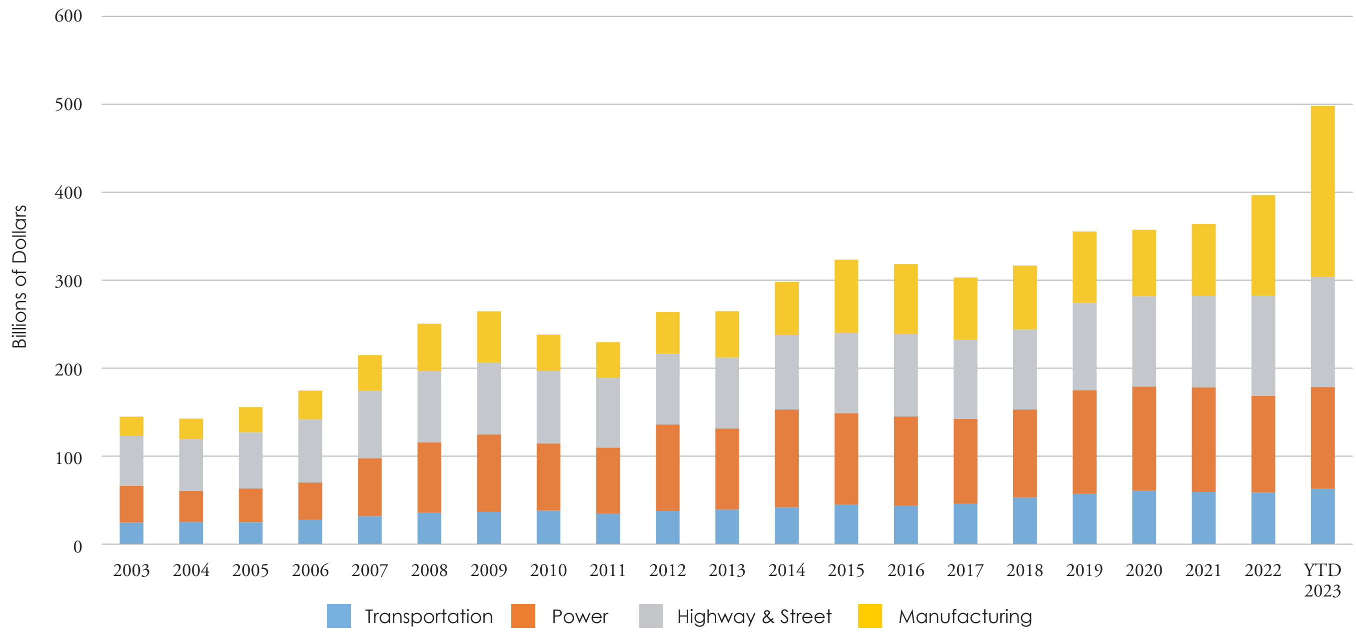
Small Cap Growth Market Update

Small Cap Growth Provides Ample Opportunities To Invest in the Industrial and Infrastructure Spending Boom

Over the last 20 years, non-residential construction has grown at an annualized rate of 4.5%, with the largest increases in infrastructure and manufacturing facilities. Chart 1 breaks down the annual spending in the U.S. for infrastructure (transporation, power, highway & street) and manufacturing facilities. These categories in aggregate have grown by a 6.5% annualized rate over the past 20 years, bolstered by a 9% increase in 2022 and a 25% jump thus far in 2023.

Chart 1: Infrastructure and Industrial Construction, Seasonally Adjusted



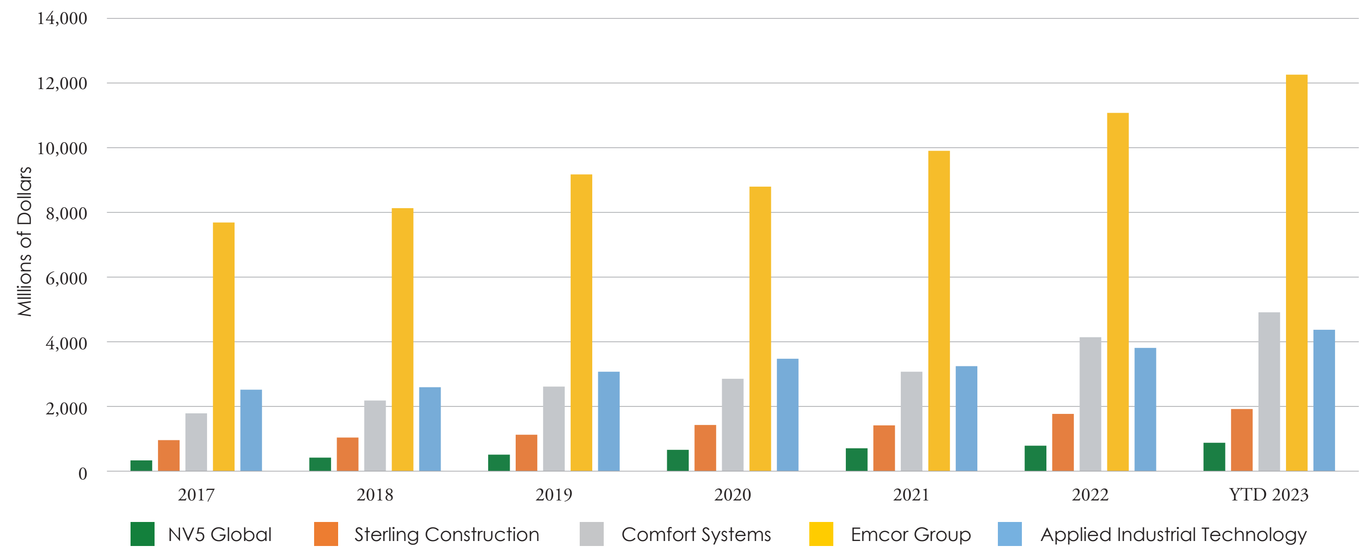
Data from 12/31/2003–6/30/2023
Source: FactSet

Several federal government programs, including the Infrastructure Investment and Jobs Act (IIJA), the Inflation Reduction Act (IRA) and the CHIPS and Science Act, are providing a tailwind to U.S. construction. In addition, there is an evident onshoring or reshoring of manufacturing in the U.S., driven partly over concern that complicated supply chains are too dependent on countries with unstable geopolitical systems. Actual disruptions to these supply chains over the past two years have provided a true catalyst for action, whereas historically, concerns had seemed more theoretical in nature.

Onshoring of manufacturing capacity has become more attractive over the past ten years as domestic energy supplies have increased, providing a cost advantage relative to most alternatives. Robotics and automation reduce the onerous costs of labor in some applications. For those that require more labor input, locating at the southern U.S. border or in northern Mexico can help to mitigate these costs.

Renaissance's Small Cap Growth Strategy provides ample direct exposure to this boom in spending, as we own five stocks in the portfolio that continue to benefit from the expansion of domestic infrastructure. **NV5 Global** (NVEE) is a construction and engineering firm with an emphasis on the latter. The company is involved in the front-end design and engineering that occurs in the planning stages of many large projects across the U.S. **Sterling Construction** (STRL) began as a company that focused on roads and highway projects but has expanded toward higher value-added projects such as data center construction. Both **Comfort Systems** (FIX) and **EMCOR Group** (EME) build the mechanical guts for manufacturing facilities, including electrical, plumbing, and HVAC systems. Finally, **Applied Industrial Technology** (AIT) is the largest U.S. supplier of repair and replacement services for the domestic industrial complex. Chart 2 provides annual revenue for each company going back to 2017.

Chart 2: Annual Revenues For Industrial Holdings Referenced In This Update[1]



Data from 1/1/2017–6/30/2023
[1] Please refer to the disclosure entitled "Stock References" in the Disclosures Section.
Source: FactSet

Over the last five years, these companies have averaged 13% annualized topline growth.

Here are a few quotes from the management teams at these companies from their first-quarter earnings releases:

> *"During the first three months of 2023, our backlog grew by $300 million despite heavy backlog burn during the quarter. Industrial customers were 51% of total revenue in the first quarter. This is the first time that Industrial customers accounted for more than half of our volume. This sector, which includes technology, food processing and life sciences, remains strong and continues to be a major driver of the growth in our backlog."*
>
> ***—William George, CFO, Comfort Systems***

> *"E-Infrastructure Solutions, our largest, fastest growing and highest margin segment, grew 22% in the first quarter. This reflects high levels of demand from data center and advanced manufacturing customers".*
>
> ***—Joe Cutillo, CEO, Sterling Construction***

> *"We continue to have strong near-term visibility with a healthy project pipeline reflected by our record remaining performance obligations of $7.87 billion which grew 32% over last year. Based on year-to-date performance, current operating conditions and strong near-term visibility, EMCOR is increasing its full year 2023 diluted earnings per share guidance range to $9.25 to $10.00, up 50 cents from our prior guidance".*
>
> ***—Tony Guzzi, CEO, EMCOR Group***

The CHIPS Act has spurred many planned investments in the U.S. by semiconductor companies. Several notable announcements include:

Intel – $40 billion, two new facilities in New Albany, Ohio and Chandler, Arizona.

Texas Instruments – $47 billion, expansions in Texas and Utah.

Taiwan Semiconductor – $40 billion new investment in Phoenix, Arizona.

Micron Semiconductor – $35 billion in total new investments in Boise, Idaho and Syracuse, New York.

Complemented by a timely reinvestment in U.S. infrastructure, we believe that the long-awaited renaissance in manufacturing in the U.S. has finally arrived. We've highlighted several specific projects by the semi-conductor industry, yet the increased investment is broader than this, as noted by several of the quotes above. Mizuho Securities recently

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reported on this topic, citing $600 billion in major manufacturing investments announced since the start of 2021, or approximately triple the level in prior years. This includes investments in all of the industries we've mentioned so far, plus electric vehicles, batteries, renewable energy and liquefied natural gas. Of these projects, only 25% have broken ground, which implies that the majority of the activity is in front of us, even if new investment announcements drift back to historical trendlines.

These investments will undoubtedly continue to benefit many of our holdings. Of the five portfolio holdings we've referenced, only one was initially purchased in 2023. We've owned NVEE for over five years, FIX for over three years, and STRL for more than two. All of the stocks have recently enjoyed increased attention from investors. Yet, they still trade, on average, at a very reasonable 18x forward expected earnings.

The Renaissance Small Cap Growth Team remains dedicated to finding growth at a reasonable price wherever we can. Our quantitative framework and flexible perspective help us uncover hidden gems where others may not look.

To our clients, we thank you for your continued support. To our other readers, we welcome the opportunity to put our skills to work for you.

DISCLOSURES

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