Catalyst

INTEGRITY ASSET MANAGEMENT

PORTFOLIO UPDATE AND MARKET OUTLOOK

August 31, 2023

CELEBRATING 20 YEARS OF INTEGRITY 2003-2023

A bird in the hand is worth two in the bush
– Aesop

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This month's catalyst was heavily inspired by Warren Buffett. I stumbled across a clip from Berkshire's 2000 annual meeting. Listening to it, I thought it was a great example of our small value outperformance premise of "Normal Rates, Normal Relationships." We think the extended period of near zero interest rates after the great financial crisis was unusual. This environment, in our opinion, led to funds being directed toward high-growth companies with little or no cash flow over the traditionally steady, cash generating businesses.

Buffett uses a metaphor to explain investment choices: deciding between a sure thing now (a bird in hand) and potential gains later (two in the bush). The better option depends on how long it'll take to get those potential gains and current interest rates. If it takes five years to realize the potential gains, that translates to about a 14% compound rate of return. Hence, if interest rates are below 14%, the potential gains (two in the bush) are more attractive. If rates exceed 14%, the sure thing (the bird in hand) is preferable. In this analogy, growth investing is like waiting for those potential future gains, while value investing is akin to the immediate reward. Check out Buffett's explanation in this video.

(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	-3.31	-3.33	+1.50	2.97	2.86	+0.60	10.43	9.76	+5.49
Small/Mid Cap Value	-4.02	-4.08	-0.17	0.79	0.64	-1.00	9.71	9.09	+1.99
Mid Cap Value	-3.67	-3.73	-0.13	-0.03	-0.17	-0.70	7.65	7.07	+1.73
Micro Cap Value	-4.81	-4.84	+2.02	3.05	2.93	+2.93	4.56	3.91	+5.29

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 (%)

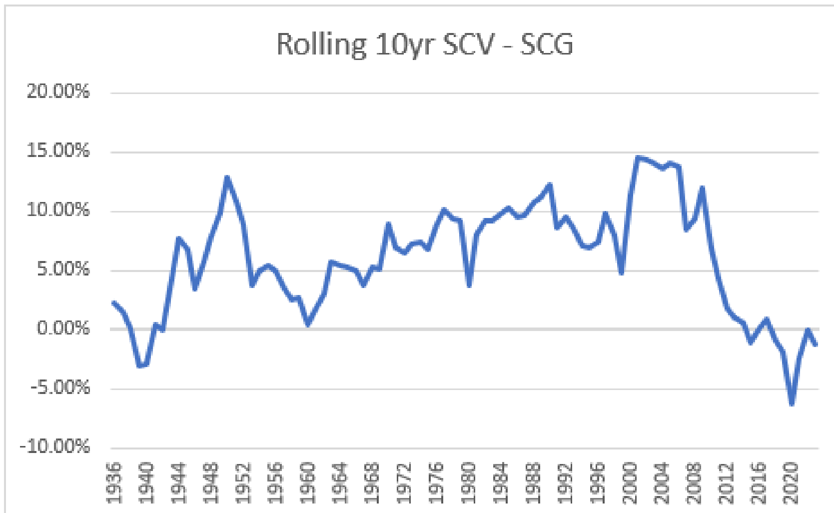
	MTD	QTD	YTD
S&P 500® Index	-1.59	1.57	18.73
Nasdaq 100® Index	-1.50	2.28	42.53
Russell 2000® Growth Index	-5.21	-0.77	12.68
Russell 2000® Value Index	-4.81	2.37	4.94

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.

With rates near zero, investors were more willing to wait indefinitely for potential gains. This almost infinite time horizon explains the strong performance of investments like venture capital, biotechnology, and non-profitable companies in recent years. On the other hand, traditional value investing has lagged behind growth investing during this time.

Steven DeSanctis of Jefferies states that valuation of small cap value ranks in the 18th percentile when compared to small growth (JEF's Valuation Handbook 8/2/2023). The accompanying chart depicts the 10-year performance trends between small value and small growth stocks. Since 1936, small value stocks' typical 10 year outperformance has been 6%. This chart highlights a sharp decline in small value's performance coinciding with the onset of the great financial crisis (2008) and the subsequent drop in interest rates. Although there was a recovery in performance following the post-COVID economic boom and the Federal Reserve's rate hikes, this upward trend has recently plateaued. We speculate this could be because the market anticipates significant rate reductions and possibly a return to a zero-interest rate policy.

If interest rates stabilize and don't return to zero, we think the "bird-in-the-hand" will become more appealing. This might cause small-value stocks to perform better compared to growth stocks, especially when compared to companies that don't have earnings or cash flow. Historically, since 1936, small-value stocks have outperformed small-growth stocks in 89% of all 10-year intervals, with an average lead of 6%. It's important to note that there's no certainty of this trend reversing. However, the recent underperformance of small-value stocks seems as unusual to us as zero interest rates do.



Source: Fama French as of July 31, 2023. Universe includes all NYSE, AMEX, and NASDAQ stocks.

Attribution:

U.S equities retreated during the month of August. A U.S. government credit rating downgrade by Fitch Ratings at the beginning of the month set the tone. The downgrade, along with commentary later in month by the Federal Reserve Chair at the Jackson Hole Economic Symposium suggesting more monetary policy tightening may be coming weighed on investors. The Russell 2000 Value Index, down 4.81%, underperformed both the tech heavy Nasdaq and the S&P 500 which returned -1.50% and -1.59% respectively. For the month, it was a mixed bag for value versus growth in our benchmarks as small cap value and small/mid cap value outperformed their growth peers, while mid cap value and micro cap value underperformed. Our small cap value and micro cap value strategies outperformed their respective benchmarks for the month of August.

Composite Performance (%) *as of December 31, 2022*

	1 Year		5 Year		10 Year	
	Gross	Net	Gross	Net	Gross	Net
Small Cap Value	-6.67%	-7.61%	5.76%	4.71%	10.74%	9.64%
Small/Mid Cap Value	-6.97%	-7.90%	6.75%	5.68%	10.91%	9.81%
Mid Cap Value	-6.04%	-6.84%	7.29%	6.43%	11.69%	10.78%
Micro Cap Value	-10.73%	-11.63%	5.29%	4.24%	11.56%	10.45%

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 particular 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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Advisory services offered by Victory Capital Management Inc., an SEC-registered investment advisor, 15935 La Cantera Parkway San Antonio, TX 78256.

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