Catalyst

INTEGRITY ASSET MANAGEMENT

PORTFOLIO UPDATE AND MARKET OUTLOOK

September 30, 2024

"I was working in the lab late one night
When my eyes beheld an eerie sight
For my monster, from his slab, began to rise
And suddenly, to my surprise
He did the Mash,
He did the Monster Mash"

– Bobby Pickett, Monster Mash

CELEBRATING 20 YEARS OF INTEGRITY 2003-2023

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Return of the Living Dead

Just in time for Halloween, falling ten-year Treasury yields spurred a rally in the non-earning companies in our benchmarks. The largest impact was in the Russell 2000 Value, where about 16% of the companies don't make money. These "zombie" companies are sometimes the proverbial tail that wags the dog.

We have written volumes on this issue as well as our lack of exposure to these companies. Looking at the following chart of the ten-year Treasury yield, one can see the strong correlation with our relative performance. (Integrity Small Cap Value Composite vs the Russell 2000 Value Index) While this wasn't the sole determinant of our relative performance, the recent yield swings have had a significant impact.

Why don't we own these companies? That is a fair question. We strongly believe that cash flow is a pre-requisite for long-term survival. It is the oxygen of company fundamentals. *(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	0.15	0.15	+0.09	6.52	6.34	-3.63	7.51	6.80	-1.70
Small/Mid Cap Value	1.34	1.34	-0.08	6.89	6.74	-2.73	11.78	11.15	+0.50
Mid Cap Value	1.65	1.65	-0.24	7.92	7.77	-2.16	15.43	14.82	+0.36
Micro Cap Value	-1.14	-1.14	-0.17	8.50	8.32	+0.38	9.16	8.43	+2.84

Source: SEI

Past performance does not guarantee future results. Representative accounts are those of the 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	2.14	5.89	22.08
Nasdaq 100® Index	2.57	2.12	19.97
Russell 2000® Growth Index	1.33	8.41	13.22
Russell 2000® Value Index	0.06	10.15	9.22

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.

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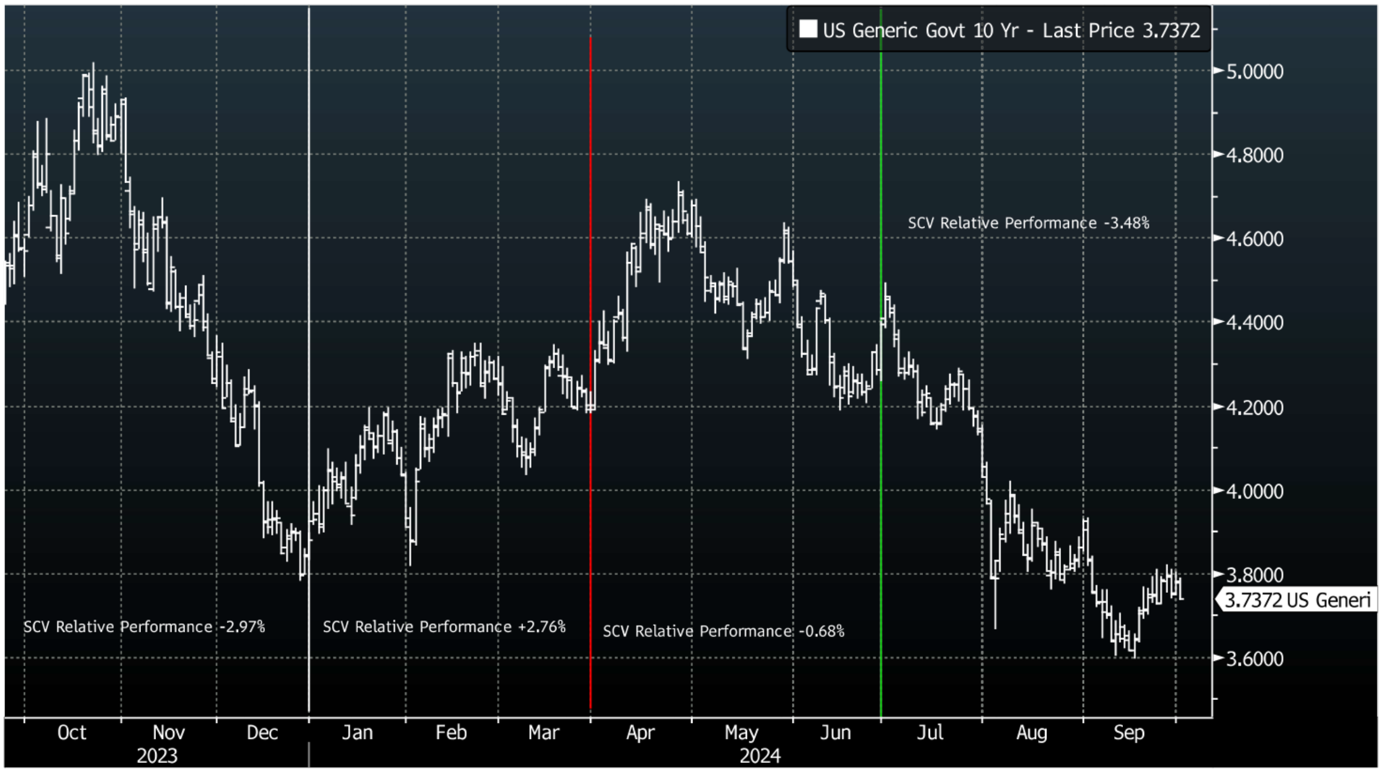
US 10 Year Treasury Yield and Small Cap Value Relative Performance



Source: Bloomberg. Performance is preliminary and relative to the Russell 2000® Value index.

We dug a little deeper into these non-earners. Instead of just looking at companies losing money this fiscal year, we took a more conservative cut. We screened for companies that had no cash flow from operations last year and have never made money in their history (negative retained earnings). We see these as the true zombies in the graveyard.

Here's what we found: 292 companies that make up about 8% of the weight of the benchmark. Of those companies, 282 show some level of indebtedness. The average cost of that debt is 5.0% with a median cost of 5.1% and a range of 0.7% to 10.5%. We don't know where rates are going, but we would argue it is safe to assume the refinancing rate on this debt is higher, not lower.

Our contention has been, and still is, that we are in a period of normalizing interest rates. The Federal Reserve has cut rates and will likely do so again. We don't know where rates will end up. However, the reaction among the zombie companies suggests that investors are expecting a return to near-zero rates. We strongly believe the rate environment post financial crisis was an anomaly, not normalcy.

When will companies need to refinance or require more cash? To get a sense of this, we compared cash on the balance sheet relative to last year's cash flow from operations. What we found is that over 67% of these companies have two years or less of cash on the books.

What will the new cost of capital be? How long will the market continue to fund these companies now that there is an opportunity cost to money with interest rates being higher than zero? We don't know the answer to these questions, but our guess is that the cost of new capital is higher. If we are right, we also believe there will be less of it available for money-losing speculative companies. Ultimately, companies need cashflow to survive. We see this as a long-term opportunity for relative performance although the path will likely be a little bumpy.

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U.S. equites rallied into the end of the month to post slightly positive returns, with the S&P 500 rising to a record close. After a rough start to the month, markets rebounded after the Federal Reserve cut interest rates. Signs of resilience in the U.S economy also lifted investor confidence. The Russell 2000 Value (+0.06%) underperformed the S&P 500 and Nasdaq 100 which returned +2.1% and +2.6% respectively. Growth beat value across all of our benchmarks in September. Small cap value outperformed its benchmark, while our other three strategies slightly lagged their respective benchmarks.

In the third quarter, according to Morningstar, the Russell 2000 Value Index posted strong performance in the 20th percentile – while the Russell Mid Cap Value Index was in the 26th percentile. This strong index performance coincided with active managers having a challenging time relative to their benchmarks. Only 14% of active small cap value managers and 18% of active mid cap value managers outperformed their respective benchmarks in the third quarter.

INTEGRITY ASSET MANAGEMENT

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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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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