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# Arrowside Capital Q2 2023 Commentary

## Performance Summary

| Q2 2023 Performance | Q2 '23 | YTD '23 | Since Inception |
|---|---|---|---|
| Arrowside Innovation | 11.9% | 28.0% | 32.1% |
| MSCI World | 5.8% | 14.0% | 23.3% |
| Relative Performance | 6.1% | 14.0% | 8.8% |
| | | | |
| Arrowside Small Cap Growth | 6.7% | 18.0% | 18.0% |
| Russell 2000 Growth | 6.8% | 13.1% | 13.1% |
| Relative Performance | -0.1% | 4.9% | 4.9% |

## Market and Economic Commentary

The second quarter of 2023 showed strong returns in the global equity markets. Investors were focused on corporate earnings, which in a lot of cases, were better than feared. There was also a focus on the Federal Reserve policy moves, which appeared to have much less impact than prior quarters.

During the second quarter, the Federal Reserve raised interest rates once in their first meeting by 25 basis points, bringing the targeted rate to 5.00-5.25%. In the second meeting of the quarter, the Fed announced that they were pausing interest rate increases but cautioned that they would likely make future increases to continue to combat inflation. The good news is that inflation continued to decline from elevated levels. The latest reading in May was 4.0%, which is the smallest increase since March 2021.

The prior quarter's bank crisis did not appear to have any immediate other systemic issues for the banking sector or the economy as a whole. The main focus in the quarter was Artificial Intelligence (AI). Chat GPT-4 was released at the end of the first quarter and from the start it had a major impact. Chat GPT-4 gave an indication of how powerful AI can be and what the future could look like. This had a few knock on effects. In the private markets, there was a pick up in investment activity in AI startups, including in Open AI, the creator of Chat GPT-4. In the public markets, the large technology companies all saw increases in their share prices. The market largely believes that the large cap technology companies are the best way to invest in AI right now. While it is not totally clear who the winners will be over the next few years with AI's adoption, it is clear that the pace of innovation continues to increase.

This has led to a large performance differential in equity markets, with the indices largely being driven higher this year to date by the mega cap technology stocks. Other asset classes such as small cap have lagged in performance relative to the large cap technology stocks. The performance of the largest technology companies has been so much better than the rest of the market that Nasdaq has decided to rebalance the Nasdaq 100, something that has not happened since 2011. Many point to enthusiasm about AI as the reason for this dichotomy. Others point to small cap underperformance as an indication that there could be a recession in the near future. Current indications by way of earnings reports indicate that overall economic activity has come off of the highs but is still better than many have feared.

We believe that equity markets are pushing past the bottoming process that began in the fall of 2022. This first leg higher in markets has been driven by the mega cap technology stocks. For this to be a sustainable uptrend, there will need to be a broadening out to other assets classes such as small cap. There continues to be higher levels of dispersion among individual companies' share prices. This increased dispersion presents opportunities for active investors to identify winners and leaders that will lead us out of the downturn.

After downturns, well-managed and strategically positioned companies tend to emerge even stronger. Weaker companies, on the other hand, may struggle due to adjustments made to survive during the downturn. By focusing on the best-in-class companies, we are uniquely positioned to invest in the new leaders that will emerge in the next bull market.

Outlook

As we near the end of this cycle of interest rate tightening, we remain increasingly positive about equity markets. Uncertainty is generally disliked by equity markets, but with inflation peaking or showing signs of sustainable decline, investors can now see a light at the end of the tunnel. This shift in focus puts more emphasis on the individual fundamentals of companies, creating an ideal environment for bottom-up investors.

We are reasonably confident that we have come out of the bottom of this cycle and anticipate a gradual upward trend. We expect some volatility along the way. We also expect the small and mid-cap sectors to start to participate in the market uptrend. To date, the relative outperformance of large cap over mid and small cap can be traced to just a handful of companies. In order for this to be a more sustained uptrend, we expect the small and mid-cap to begin to outperform.

The pace of rapid innovation remains unabated, with companies introducing exciting new products and services. Our long-term outlook is highly optimistic when it comes to investing in transformative change. As we put the bottom behind us and enter a new bull market, we anticipate excellent investment opportunities to arise. For these reasons, we refrain from timing the market and instead stay invested in the best-in-class companies that drive change, allowing us to look past short-term fluctuations and maximize long-term returns.

We appreciate the trust you have in our philosophy and process. Please do not hesitate to reach out with questions or feedback.

Sincerely,

Tucker Walsh
Managing Partner / CIO

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## About

Arrowside Capital is a Boston, Massachusetts based investment company focused on investing in innovative companies that have demonstrated financial discipline. The firm was founded in 2022 by Tucker Walsh, who has more than 30 years of experience in investing in small and midsized innovative companies. Arrowside Capital believes that investing in innovative companies creating change builds the most value over time. The firm's rigorous investment process searches for companies that are both innovative and profitable. Companies in the firm's concentrated portfolios have durable competitive advantages, superior margins and returns on capital, and ample reinvestment opportunities. The combination of great conditions, plus great management behaviors produce the most intrinsic value growth over the long-term. Arrowside Capital favors small and mid-cap companies to take advantage of the market inefficiencies resident in these types of companies.

## Disclosures