



Dale R. Folwell, CPA

INVESTMENT MANAGEMENT

To: North Carolina Supplemental Retirement Board of Trustees

From: Christopher Morris, Co-Chief Investment Officer

Date: May 25, 2023

Subject: Discussion / Action: NC 401(k) and NC 457 Plans: WEDGE Capital SMID Cap Value Recommendation

WEDGE Small/Mid Cap Value Investment Strategy

WEDGE Capital Management (“WEDGE”) has been managing a small and mid cap strategy for the NC Small/Mid Cap Fund in the NC 401(k) and NC 457 Plans (“Plans”) since 2011 and currently manages approximately \$280 million in the strategy for the Plans.

WEDGE Capital Management was founded in 1984 and is based in Charlotte, North Carolina. The organization is 100% employee owned by eight partners. WEDGE employs a well-resourced investment team with significant experience in the industry and at the firm. The Small/Mid Value strategy is a 50/50 blend of WEDGE Small Cap Value and Mid Cap Value portfolios. The investment approach is a fundamentally based, value-oriented discipline, employing up front quantitative screens and qualitative analysis. Quantitative screens search for attractive value and quality characteristics to define a pool of candidates; fundamental research is then applied to identify attractive unrecognized value opportunities. WEDGE believes they can produce superior long term returns by employing rigorous quantitative research and independent qualitative analysis.

Assets Under Management (AUM)

The amount of assets under management for WEDGE in associated strategies has become a concern over the last several months. Outflows from the fundamental equity complex (SMID Value, Small Value, Mid Value, Micro Cap) slowed considerably in 2022 compared to previous years and the Small/MID Value strategy AUM has held steady over the last five years at approximately \$900 million in assets managed. However, as stated earlier, this strategy is a 50/50 blend of the Mid Cap Value strategy and the Small Cap Value strategy. It is relevant to consider the amount of AUM decline of these products to understand the potential implications for this strategy. In March of 2018 the Small Cap Value strategy reported \$1.6 billion in assets while the Mid Cap Value strategy had \$4.0 billion. As of March of 2023, the Small Cap Value assets have declined to \$331 million, while Mid Cap Value is \$267 million.

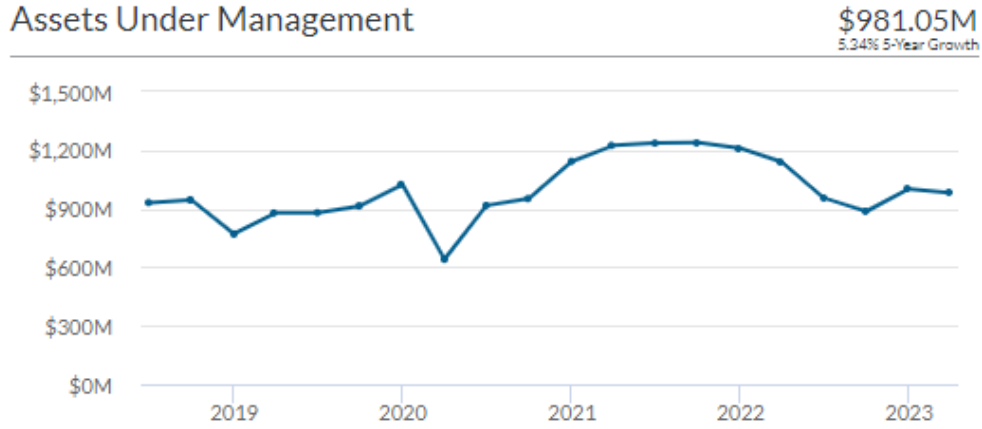
The drop in firm assets under management are primarily a function of client outflows from these two strategies. In March of 2018 the firm reported approximately \$13 billion being managed across strategies. As of March 31, 2023 the firm AUM stands at \$7.9 billion. The primary concern with assets below a certain level is that they may be forced to make difficult personnel decisions in order to preserve profitability.



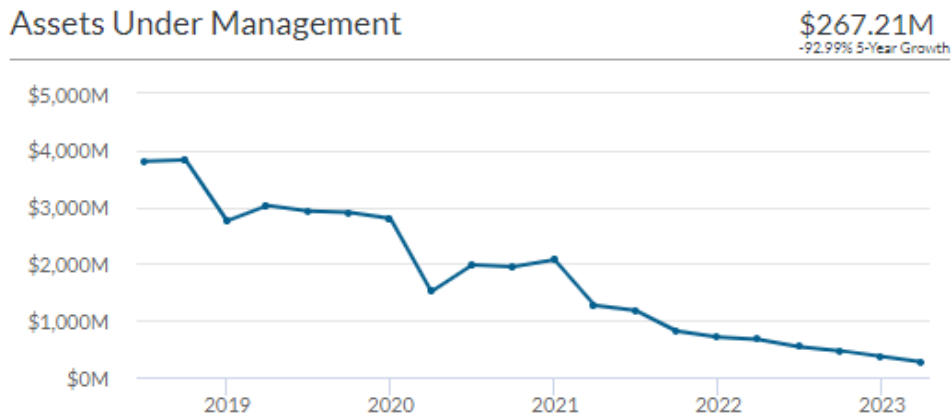
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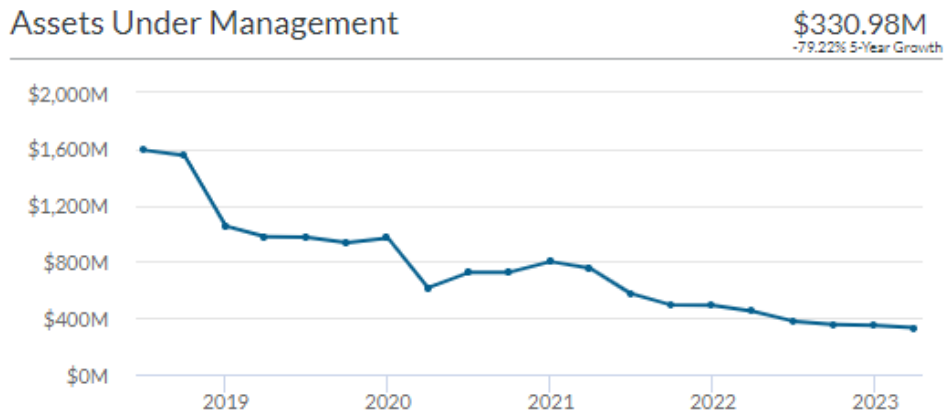
WEDGE Small/Mid Value



WEDGE Mid Value



WEDGE Small Value





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Organizational Changes

There have been a steady stream of personnel changes over the past three years. In 2020, the co-lead of Mid Cap research stepped away. In April of 2022 an equity analyst left the firm. The position was not replaced and his coverage was largely absorbed by another equity analyst.

Most recently, WEDGE announced two departures: a client portfolio manager and an analyst on the small cap team will be departing WEDGE by June 30, 2023. Both individuals are partners and June 30 was the separation date to allow time to wind down their partnership shares. Notably, this is the second analyst to depart whose position will not be replaced. The Small Cap team now has four professionals.

As the team has slimmed down over time, the analyst coverage has converted from a specialist structure to a generalist structure. Team members have always covered the universe by sector. Only time will tell if this is a viable structure for WEDGE going forward and if people are positioned to succeed.

Performance

The WEDGE Small/Mid Cap Value strategy was initially placed on the watch list in the fourth quarter of 2018 due to challenged rolling three-year underperformance. WEDGE performance was first tested in the fourth quarter of 2016 when higher risk, lower quality securities performed very well following the election. This time period negatively impacted shorter term results, while longer term results remained compelling. This was followed by lackluster performance in 2018 when an underweight to REITs as well as stock selection in consumer durables and utilities caused the strategy to lag. A notable detractor within utilities was PG&E, which was sold in mid-January 2019 prior to the bankruptcy filing. In 2021, the rise of the meme stocks in small cap value also led to challenging performance relative to the Russell 2500 Value Index.

Staff and Callan believed WEDGE had the opportunity to turn the corner on performance as quality stocks generally rebounded in most of 2022 and early 2023. However, WEDGE faces another near-term setback with what was a 1.2% position to Signature Bank as of year end 2022. The strategy had about 0.70% of exposure (via performance) around the time the stock was de-listed. The team did not purchase or sell shares during periods of extreme stock price volatility. In light of the many recent setbacks, there was less margin for error in this most recent mistake.

The WEDGE Small/Mid Cap Value strategy continues to struggle versus its benchmark and compared to peers over the 3 year and 5 year time periods. The strategy underperformed its benchmark by 0.48% annualized for 3 years and by 1.56% annualized for 5 years (Table 2). The portfolio ranked in the 77th percentile over 3 years, and in the 88th percentile over 5 years compared to the Callan Small/Mid Cap Value universe (Table 3).



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Recommendation

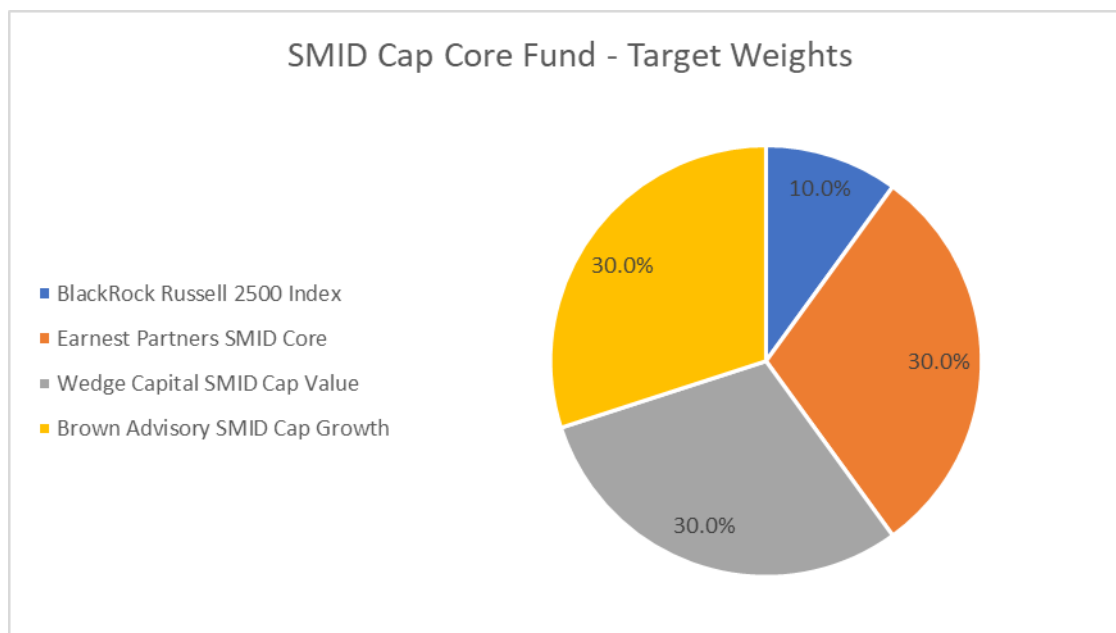
In recognition of the risks posed by declining assets under management, investment team changes, and declining conviction in long-term performance capabilities, Staff and Callan recommend the Board consider the following:

1. Perform a search to replace WEDGE with a strategy complementary to the existing managers in the SMID Cap strategy.
2. When the search process is complete, Callan and Staff will offer a recommendation for replacement.

Table 1

Small Mid Cap Core Equity Fund total assets: \$959.8 million (as of 3/31/23)

	Value (3/31/2023)	Current Weight	Target Weight
SMID Cap Core Fund	959,848		
BlackRock Russell 2500 Index	95,380	9.9%	10.0%
Earnest Partners SMID Core	290,092	30.2%	30.0%
Wedge Capital SMID Cap Value	279,875	29.2%	30.0%
Brown Advisory SMID Cap Growth	294,457	30.7%	30.0%





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INVESTMENT MANAGEMENT

Table 2

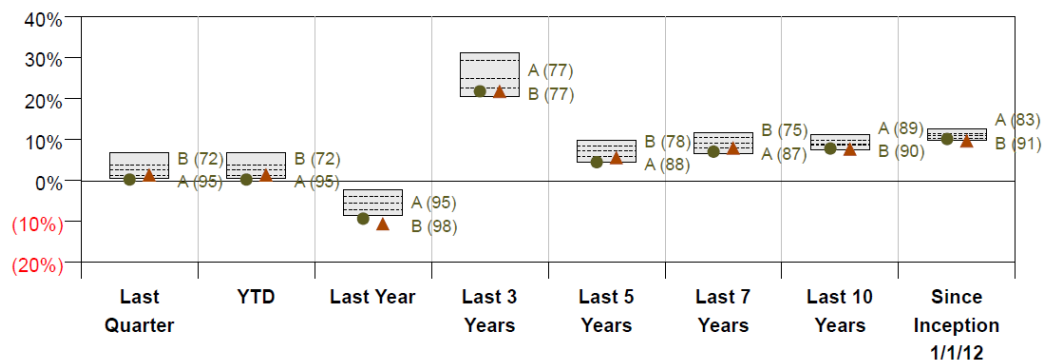
Below is the historical performance for the WEDGE Small/Mid Cap Value portfolio (net of fees).

As of March 31, 2023									
	Market Value (\$000)	Month	3 Month	1 Yr	3 Yr	5 Yr	7 Yr	10 Yr	ITD (12/2011)
Wedge Capital SMID Cap Value	279,875	(6.24)	0.19	(9.67)	21.32	4.05	6.54	7.25	9.43
Russell 2500 Value Index		(5.13)	1.40	(10.53)	21.80	5.61	7.97	7.72	9.81
Excess Return		(1.11)	(1.21)	0.86	(0.48)	(1.56)	(1.43)	(0.47)	(0.38)

Table 3

Performance Versus Peers (as of March 31, 2023, gross of fees)

Performance vs Callan Small/MidCap Value



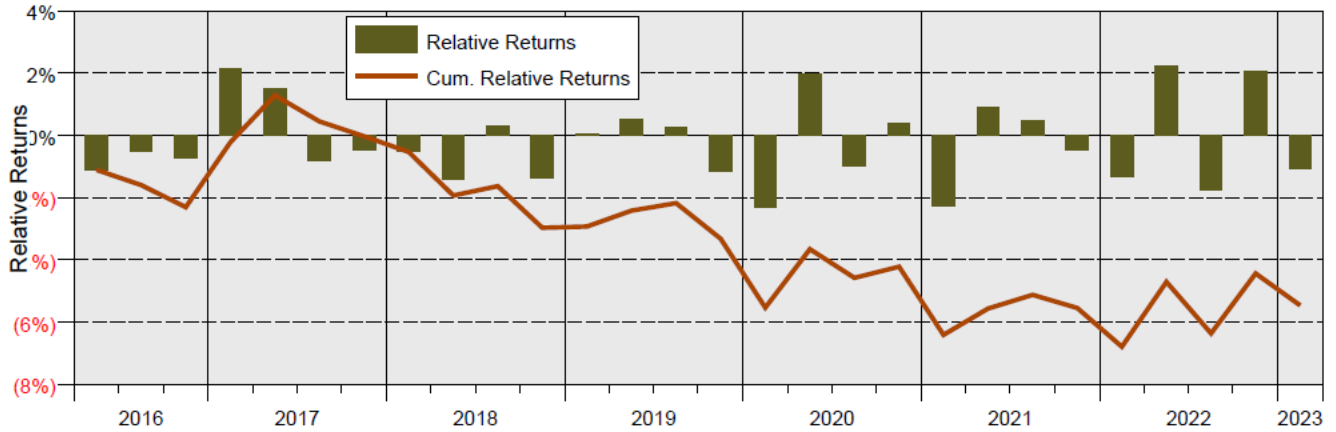
10th Percentile	6.75	6.75	(2.27)	31.15	9.80	11.72	11.26	12.68
25th Percentile	3.94	3.94	(3.73)	29.32	8.54	10.60	9.83	11.61
Median	2.77	2.77	(5.38)	24.92	7.24	9.25	8.98	11.02
75th Percentile	1.27	1.27	(7.15)	22.60	5.91	7.99	8.65	10.44
90th Percentile	0.54	0.54	(8.53)	20.67	4.47	6.69	7.68	9.82
Wedge Small/Mid Cap Value ● A	0.31	0.31	(9.26)	21.83	4.54	7.10	7.89	10.19
Russell:2500 Value ▲ B	1.40	1.40	(10.53)	21.80	5.61	7.97	7.72	9.73



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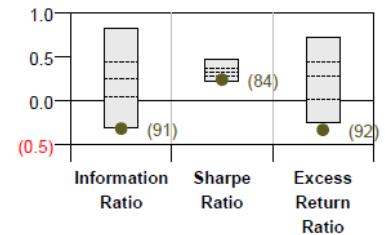
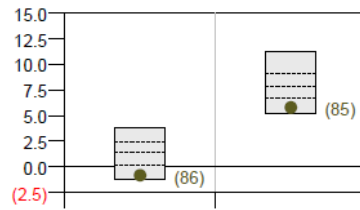
Appendix

Cumulative and Quarterly Relative Returns versus Russell 2500 Value



Risk and Return Statistics

Risk Adjusted Return Measures vs Russell:2500 Value
Seven Years ended March 31, 2023



	Alpha	Treynor Ratio
10th Percentile	3.78	11.26
25th Percentile	2.46	9.06
Median	1.40	7.84
75th Percentile	0.11	6.71
90th Percentile	(1.23)	5.25
Wedge Small/Mid Cap Value	(0.83)	5.79

	Information Ratio	Sharpe Ratio	Excess Return Ratio
10th Percentile	0.83	0.47	0.73
25th Percentile	0.45	0.38	0.44
Median	0.25	0.33	0.28
75th Percentile	0.06	0.28	0.02
90th Percentile	(0.30)	0.22	(0.24)
Wedge Small/Mid Cap Value	(0.31)	0.25	(0.33)