Madison FUNDS®

# MADISON SMALL CAP FUND

## 4Q 2023 Investment Strategy Letter

Tickers: BVAOX | MSCIX | MASMX | MSCRX

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Industry since 1999

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After a benign inflation report in October, the small cap market surged in the fourth quarter, with the Russell 2000 Index rallying 14%. Dogs became darlings and leaders slowed to laggards. The best performing stocks were the worst performers heading into the report at the expense of former market leaders. Small caps finally outperformed versus large cap and mega cap tech stalled after a booming year. The proverbial "dash for trash" went unabated into year-end while high quality and the generals took a back seat. The better-than-expected inflation data led to Treasury yields falling precipitously, which sent stock prices soaring, particularly in rate sensitive areas of the economy, and put an end to what had been a very narrow market. And so, after leading the Russell 2000 for most of the year, it was difficult for the Madison Small Cap Fund to keep pace with this low-quality rally. The Fund (Class Y) delivered an 11.2% return, underperforming the benchmark return of 14.0%. For the full calendar year 2023, the fund returned 16.1% while the Russell 2000 was up 16.9%. The broader Russell 2500 Index returned 13.4% for the quarter and 17.4% for the full year.

### PORTFOLIO REVIEW

Except for Energy, which was down approximately 6%, all other sectors were positive for the quarter. The top performing sectors in the Russell 2000 Index were Financials, Healthcare, and Consumer Discretionary. Not surprisingly, these were the most beating down sectors heading into the benign inflation report. Within Financials, the strongest performers were rate sensitive regional banks and REITs, and although our investment in Western Alliance was up an astonishing 44% in Q4, our underweight in the sector, coupled with other non-bank Financial investments, which are principally focused in insurance, lagged significantly. Healthcare, which was the second-best performing sector in our benchmark, was largely driven by biotech, a subsector that generally doesn't fit well with our process. Our largest position in Healthcare, EHC, was flat for the quarter and up 12% for the year. This hurt our relative attribution in the fourth quarter. Our conviction in this core position is unchanged. We believe that the stock simply wasn't in favor during the quarter as investors went hunting for laggards.

From a relative return perspective, our best performing stocks were in consumer discretionary, led by OneSpaWorld (OSW), Shake Shack (SHAK), and Ollie's Bargain Outlet (OLLI), all of which were supported by strong fundamentals. Conversely, our worst performers were in Consumer Staples.

All but one of our consumer staples stocks lagged, even though fundamentals were either stable or improving, reflecting a lack of appetite for defensive stories. These included Hain Celestial (HAIN), Primo Water Corporation (PRMW), and Edgewell Personal Care (EPC).

Our investment in GOGO was a material detriment to our relative performance. GOGO is a ground-to-air internet service provider for private jets. Unfortunately, GOGO's subscriber numbers were hurt by a significant number of planes grounded for deferred maintenance in 2023. During these maintenance periods, GOGO typically pauses the subscription for its clients. GOGO also pushed back its rollout of 5G service, a key strategic initiative for the company and the stock, due to an error in its chip design from one of its suppliers. We believe these issues are transitory and the stock could recover meaningfully as these issues are resolved by the second half of 2024.

Our best performing stock on an absolute basis for the year was SAIA, which benefited greatly from its improving return profile. The company has made admirable progress in improving its margins and growing capacity. While the transportation market slowed from an overheated 2022, 2023 held up better than expected and SAIA's results exceeded expectations. SAIA also benefited from the bankruptcy of one its larger competitors, which tightened the market and helped expand SAIA's multiple by almost 10 points.

## PORTFOLIO ACTIVITY

In the fourth quarter, we sold five stocks (Fox Factory Holding Corp., Magnite, New Relic, Robert Half, and Xometry) and initiated five new investments (LegalZoom.com, Confluent, Chord Energy, AMN Healthcare Services, and Moelis & Company).

Software vendor New Relic was acquired by a private equity consortium for an 18% premium. We decided to sell the position prior to the deal closing to fund the purchase of a new software investment in Confluent (CFLT). Confluent's software provides the plumbing that connects a company's various cloud infrastructure architectures to its proprietary data, making the dream of real-time data transfer and decision making a reality. Confluent has no competition and boasts a cash rich, debt free balance sheet, is profitable, and generates free cash flow. We believe CFLT is a strategic asset and has the potential to be a materially larger company. we conservatively assess its private market value (PMV) at $28.

We sold temporary staffing and consulting company Robert Half to fund the purchase of healthcare staffing company AMN Healthcare Services. Although both businesses are valued attractively, AMN's business is much less cyclical and its valuation slightly more attractive. We believe healthcare staffing is in a cyclical lull post the pandemic but has the long term secular tailwinds to outperform in the medium term.

We placed Magnite on watch after disappointing Q3 guidance, and after tepid Q3 results, we sold the stock. We sold Xometry due to our concern about the cyclical nature of its services in the current economic environment. Both Magnite and Xometry held promise given the size of the opportunity for each of their respective platforms, but we ultimately soured on their ability to capitalize on the opportunity economically.

We have been following Moelis & Company (MC) and LegalZoom.com (LZ) for a few years now and bought both stocks in the fourth quarter. MC is an independent investment advisor with an approximately 75%/25% split between M&A and Restructuring. MC's 2023 comp ratio of 80% is well above peers due to a recent hiring spree to capitalize on a recovery in M&A activity. Although this has depressed earnings, we believe MC is poised to capture outsized share as markets and rates have stabilized, portending a return to M&A activity.

Legal services is an under-digitized market in the early days of becoming an online opportunity and LegalZoom is the market share leader. The legal and regulatory aspects of running a business are still mostly managed through offline law practices, which are costly and inefficient for simple tasks. Much like Intuit did with TurboTax in the tax preparation market, LegalZoom aims to enable small businesses to complete certain legal transactions themselves through software that guides them through the process. Further, the company provides access to attorneys and accountants through monthly subscription plans that enable small business owners to get their legal and tax questions answered in an efficient and cost-effective manner. The company has a strong, cash rich balance sheet with zero debt. Our assessment of PMV is $17.

After carefully scouring the landscape for almost two years, we initiated a new position in Energy company Chord Energy (CHRD). Chord is an exploration and production company and the product of a recent merger between Oasis and Whiting Petroleum. We have history as shareholders in the past in Whiting Petroleum and new management has already demonstrated its commitment to a shareholder return business model. We think the return to a single basin operating model plays to CHRD's strength, as it enables the company to fully take advantage of its scale and size in the Bakken. The company is in a strong position to capitalize on upcoming value-enhancing opportunities in terms of basin consolidation, and so we expect CHRD to generate significant free cash flow over the next three years to fund an attractive 3% plus dividend yield. As we discussed earlier, Energy underperformed meaningfully in 2023 and so we exploited this opportunity to make our first energy investment in several years. We believe CHRD can generate positive economic returns with oil above $55, giving us a significant downside cushion to the commodity. From a portfolio perspective, we like the hedge Chord provides in a volatile geopolitical climate. Finally, Chord's strong position in the Bakken makes it an attractive takeover target for larger integrated energy companies.

## OUTLOOK

Before we turn our sextons toward 2024, we'd like to point out how wrong so many economists and macro analysts were regarding 2023. The most widely anticipated recession never panned out. Sticky inflation moderated and even led to deflation in certain categories. Instead of higher for longer, the Fed is now expected to begin cutting rates. Mortgage rates spiked yet home prices rose in aggregate! We see the same obvious risks and opportunities as everyone else. There's no shortage of geopolitical risk both domestically and abroad. A much tamer inflation outlook and the very real possibility of the elusive "soft landing" is a higher probability event than many had forecast, including us. However, the biggest takeaway from 2023 is that macro predictions and big picture economic analysis is only worth so much. To paraphrase Peter Lynch: "If you spend 13 minutes a year on macroeconomics you wasted 10 minutes." Despite the furious rally led by small caps in the last two months of the year, we still believe relative valuations continue to be more attractive for small caps than other domestic equity asset classes

Here's a different take on a similar idea we've shared with our readers in the past from Bespoke Investments. "Historically, small-caps have traded at a premium to large-caps, but that has been flipped on its head in the post-COVID world. Now the question is when (if ever) will it revert?"

*Faraz Farzam* *Aaron Garcia*

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The Russell 2500 Index combines a portion of midcap stocks with small cap stocks – forming a “SMID” (small/mid) cap segment of stocks from the Russell 3000®.

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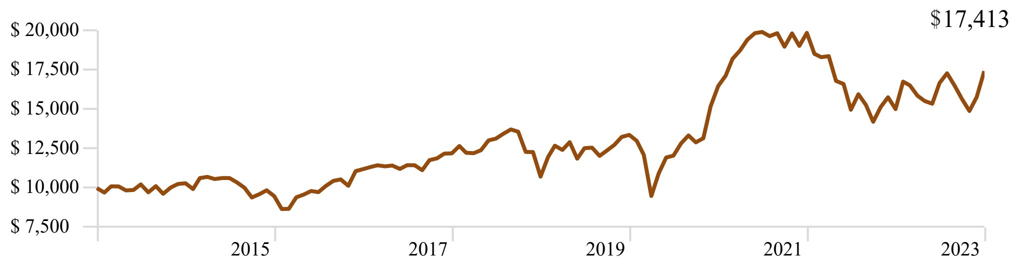
# MADISON SMALL CAP FUND

December 31, 2023

## Growth of $10,000 Class Y Shares, Trailing 10 Years[1,3]




## Average Annual Total Returns[2,3] (%)

| | | Three Months | YTD | 1 Yr | 3 Yr | 5 Yr | 10 Yr | Since Inception |
|---|---|---|---|---|---|---|---|---|
| Class I | | 11.34 | 16.28 | 16.28 | - | - | - | -1.42 |
| Class R6 | | 11.31 | 16.38 | 16.38 | - | - | - | -2.46 |
| Class Y | | 11.24 | 16.05 | 16.05 | 1.90 | 10.18 | 5.70 | 12.46 |
| Class A | without sales charge | 11.33 | 15.97 | 15.97 | 1.67 | - | - | 8.64 |
| | with sales charge | 4.92 | 9.27 | 9.27 | -0.32 | - | - | 7.17 |
| Russell 2000® Index | | 14.03 | 16.93 | 16.93 | 2.22 | 9.97 | 7.16 | - |
| Russell 2500® Index | | 13.35 | 17.42 | 17.42 | 4.24 | 11.67 | 8.36 | - |

## Calendar Year Returns[2,3] (%)

| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|---|---|---|---|
| Class Y | 3.06 | -7.90 | 18.04 | 8.90 | -12.09 | 24.67 | 23.09 | 20.52 | -24.36 | 16.05 |
| Russell 2000® | 4.89 | -4.41 | 21.31 | 14.65 | -11.01 | 25.52 | 19.96 | 14.82 | -20.44 | 16.93 |
| Russell 2500® | 7.07 | -2.90 | 17.59 | 16.81 | -10.00 | 27.77 | 19.99 | 18.18 | -18.37 | 17.42 |

*Performance data shown represents past performance. Investment returns and principal value will fluctuate, so that fund shares, when redeemed, may be worth more or less than the original cost. Past performance does not guarantee future results and current performance may be lower or higher than the performance data shown. Visit madisonfunds.com or call 800.877.6089 to obtain performance data current to the most recent month-end.*

## Characteristics

| | |
|---|---|
| Median Market Cap (billions) | $3.7 |
| EPS Growth Rate (3-5 year) | 11.8% |
| P/E (trailing 12 months) | 18.1x |
| P/E (forward 12 months) | 19.1x |

## 5-Yr Risk Measure (%)

Class Y vs. Russell 2000® Index

| | |
|---|---|
| Standard Deviation | 22.61 |
| Downside Capture | 90.99 |
| Upside Capture | 93.39 |

## Experienced Management

Faraz Farzam, CFA
Portfolio Manager
Industry since 1999

Aaron Garcia, CFA
Portfolio Manager
Industry since 2002

## Fund Features

- Seeks long-term capital appreciation
- Generally 50-90 holdings
- Seeks to purchase companies at a perceived discount compared to potential future earnings

| Class | Ticker | Inception Date | Exp. Ratio |
|---|---|---|---|
| A | MASMX | 8/31/19 | 1.35% |
| Y | BVAOX | 12/16/96 | 1.10% |
| I | MSCIX | 2/26/21 | 1.00% |
| R6 | MSCRX | 2/28/22 | 0.92% |

*Expense ratios are based on the fund's most recent prospectus.*

Distribution Frequency - Annual

1. Growth of $10,000 is calculated at NAV and assumes all dividends and capital gain distributions were reinvested. It does not take into account sales charges (see Note 2) or the effect of taxes.

2. Average annual total returns and calendar year returns assume all distributions are reinvested and reflect applicable fees and expenses. Class A share returns without sales charge would be lower if sales charge were included. Class A share returns with sales charge reflect the deduction of the maximum applicable sales charge of 5.75%. Class Y shares do not impose an up-front sales charge or a contingent deferred sales charge ("CDSC"). Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only, and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance.

3. The performance shown for the Small Cap Fund (the "Fund") for periods prior to August 31, 2019, for the Class Y shares are based on the performance of the Broadview Opportunity Fund (the "Predecessor Fund") which was the accounting survivor and reorganized into the Class Y shares of the Fund after market close on August 30, 2019 (the "Reorganization"). Periods prior to November 29, 2013 represents the performance of the FMI Focus Fund (the 'FMI Fund') which merged with and into the Predecessor Fund on November 29, 2013. Prior to November 29, 2013, the Adviser of the Predecessor Fund served as sub-adviser to the FMI Fund.

Performance results prior to August 30, 2019 for the Class Y shares are based on the performance of the Predecessor Fund, which was reorganized into the Class Y shares of the Fund on August 30, 2019. Performance for Class A shares was deemed to be new effective August 31, 2019 as a result of the reorganization. Madison waived 0.04% of the Fund's annual services fee from August 31, 2019 through February 27, 2021. Investment returns reflect this fee waiver, without which returns would have been lower.

Madison lists the performance of the Predecessor Fund and accounting survivor of the Reorganization for the following reasons:

- Continuity of Fund portfolio managers through the Reorganization;
- Substantially the same investment objective and investment strategies between the Fund and the Predecessor Fund;
- Substantially similar investment policies between the Fund and the Predecessor Fund;
- A similar expense ratio (excluding acquired fund fees and expenses).

Madison FUNDS®

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## Total Net Assets

$177.4 Million

## Total Number of Holdings

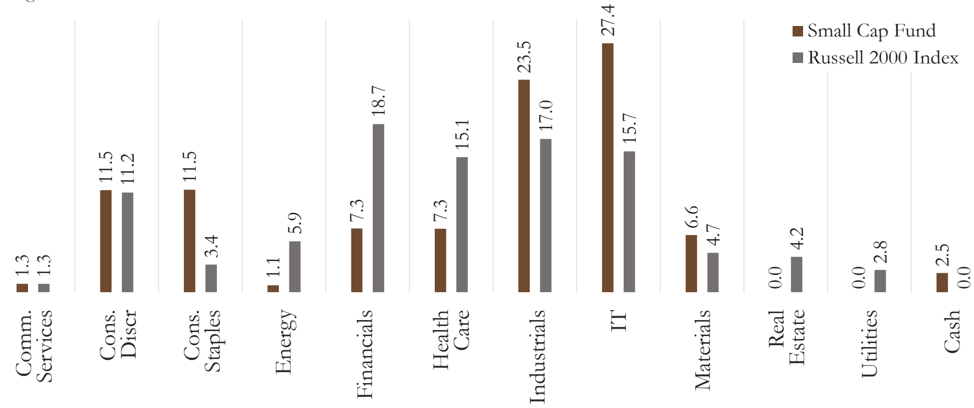
46

## Portfolio Turnover

39%

## Sector Diversification (%)

*Figures are rounded to the nearest 0.1%.*




## Top Ten Holdings (%)

| | |
|---|---|
| ENTEGRIS INC | 4.5 |
| ENCOMPASS HEALTH CORP | 4.2 |
| PRIMO WATER CORP | 4.1 |
| ONESPAWORLD HOLDINGS LTD | 3.8 |
| WILLSCOT MOBILE MINI HOLDING | 3.5 |
| SUMMIT MATERIALS INC CL A | 3.3 |
| AXIS CAPITAL HOLDINGS LTD | 3.1 |
| SHAKE SHACK INC CLASS A | 3.1 |
| CARLISLE COS INC | 3.0 |
| FORMFACTOR INC | 2.8 |

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Standard Deviation: a statistical measurement of dispersion about an average, which, for a portfolio, depicts how widely the returns varied over a certain period of time. Investors may use the standard deviation of historical performance to understand the range of returns for a portfolio. When a portfolio has a higher standard deviation than its benchmark, it implies higher relative volatility. Standard deviation has been calculated using the trailing monthly total returns for the appropriate time period. The standard deviation values are annualized. Downside Capture Ratio measures a fund's performance in down markets relative to its benchmark. It is calculated by taking the security's downside capture return and dividing it by the benchmark's downside capture return over the time period. Upside Capture Ratio measures a fund's performance in up markets relative to its benchmark. It is calculated by taking the security's upside capture return and dividing it by the benchmark's upside capture return over the time period. Market Cap measures the size of the companies in which the fund invests. Market capitalization is calculated by multiplying the number of a company's shares outstanding by its price per share. Growth Rate (3-5 year) is the annual rate at which a company's earnings are expected to grow. P/E (Price-to-Earnings Ratio) measures how expensive a stock is. It is calculated by the weighted average of a stock's current price divided by the company's trailing 12-month (TTM) earnings per share of the stocks in a fund's portfolio.

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