Adirondack Small Cap Fund (ADKSX)

Data as of March 31, 2024

Quarterly Commentary

Dear Fellow Shareholders,

During the Fund's 2024 fiscal year The Adirondack Small Cap Fund (ADKSX) gained 17.05% versus an 18.35% gain of the iShares® Russell 2000 Value ETF (IWN). The Fund's annualized return for 5 year and 10 year was 9.73% and 5.65%, respectively.* As of March 31, 2024, the portfolio held fifty-three positions, with the top ten holdings representing 32.4% of Fund assets. The top overweight sectors as compared to the IWN were Materials and Technology, with meaningful underweights in Consumer Discretionary and Real Estate. In line with historical averages, annualized portfolio turnover was 33% and driven by profit-taking in Insurance and Energy stocks.

We enjoyed solid stock picking in sectors like Financials, Utilities and Energy, and combined those picks provided more than four hundred basis points of alpha. However, we struggled against the benchmark (IWN) in Healthcare and Consumer Discretionary. Healthcare saw an underperforming sector combined with company specific issues unrelated to business fundamentals. In Consumer Discretionary, stocks related to housing performed exceptionally well, while other industry components were at best hit or miss. Expecting mean reversion, we leaned into several soft goods producers whose shares performed poorly in 2022. But unfortunately, our industry turnaround call proved to be premature. We are confident in the steps these companies are taking to right their respective ships. Despite unpredictable setbacks, these businesses are executing well and marching toward better days. In time we expect that patience will be well rewarded. The negativity surrounding certain segments of Healthcare and Consumer Discretionary offer attractive risk/reward going forward.

Going into last fiscal year, versus the IWN the Fund was overweight Insurance Companies, underweight Banks and underweight Real Estate Investment Trusts (REITs). That allocation worked exceedingly well, given that higher rates benefitted the investment portfolios of Insurance Companies but were headwinds for borrowers like Banks and REITs. As the Fed tames inflation by slowing the economy, we expect them to slowly reduce rates. We are actively looking to allocate more capital to rate relief beneficiaries. We recently began acting on this thesis by reducing insurance exposure by 28% (12.2% of Fund assets at 3/31/24 (CNO (2.20%), GNW (3.27%), SPNT (3.18%), TIPT (1.82%), and UFCS (1.82%))) while more than doubling REIT exposure (4.4% of Fund assets at 3/31/24 (BRX (1.01%), HR (2.52%), and JBGS (0.86%))). While Banks also profit from lower funding costs, we remain concerned about the credit health of Banks given their exposure to the more challenging areas of commercial real estate. As regulators increase scrutiny of commercial real estate, we see bankers responding by materially reducing exposures. Such a transformation should provide opportunities for debt and equity REITs. We continue to search around the public REIT sector as it has significantly underperformed over the past ten years despite material increases in development costs.

With the possibility of a Fed easing looming, we recently added Healthcare Realty Trust (HR; as of 3/31/2024 HR represented 2.52% of the portfolio), one of the country's largest owners of class-A medical office space. Their shares have suffered from integration issues after a merger with Healthcare Trust of America (HTA) that tripled its size in 2022. Large mergers are never easy, but compounding the challenge was the aggressive activist campaign (led by Elliott Investment Management) calling for the sale of HTA. This caused employees to leave. When the deal finally closed, nine months after Elliott's campaign started, many key employees responsible for asset management had already left HTA. Poor timing added to the challenge as interest rates doubled in the following months. Now in 2024 HR's shares fetch around $14 versus the $31.75 all-cash offer that competitor, Welltower (WELL) made for them in 2022. We suspect a fair number of long-term shareholders are selling out of frustration. Hindsight being 20/20, HR's board erred by not entertaining Welltower's overture. However, HR at these levels represents an exceptional opportunity for those willing to look past this misstep. Last year, HR retrenched by selling properties in smaller markets and using the proceeds to reduce their overall risk profile. They also increased their focus on improving tenant relations at former HTA properties. Recent third-party research points to solid progress in that regard with notable improvement in tenant satisfaction scores.

**Performance data quoted represents past performance; past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the Fund may be lower or higher than the performance quoted. Performance data current to the most recent month end may be obtained by calling 888-686-2729, or visiting www.adirondackfunds.com.*

Per the prospectus, the Fund's gross annual operating expense ratio is 1.59% (net 1.48% with fee waiver/expense reimbursement arrangement). The Advisor has contractually agreed to waive fees or reimburse the Fund to the extent necessary to maintain the Fund's total annual operating expenses at 1.48% until August 1, 2024, subject to termination by the Fund on 60 days' written notice.

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They are intent on maintaining their dividend (8.6% yield as of 03/31/24), which represents attractive compensation while HR navigates this turnaround. An aging U.S. population suggests more frequent healthcare visits as the peak baby boomer population nears sixty-five years of age. In fact, recent results from the country's largest hospital operator (HCA Healthcare Inc.) reflected strong volume with 6.2% higher patient admissions and 8.8% outpatient growth. Given a sturdy industry outlook, and a better balance sheet, we see HR's current challenges as manageable. Even if rates stay higher for longer, most of HR's debt matures starting in late 2026 with the largest bonds due in 2030 and 2031.

During the past twelve months, the U.S. economy has shown remarkable resilience in the face of higher rates. The Bureau of Economic Analysis reported the U.S economy grew by 4.9% during Q3 2023 and 3.9% in the final three months of 2023. Public and private sector investment was strong, while the American consumer felt good enough about the economy to dip into savings and spend on non-essentials, partly due to recent advances in stocks and home prices. Many market forecasters called for a recession in 2023 that never came, and few are willing to make that same call for this year. The unusual consistency of 2024 economic forecasts is worrisome, given that similar levels of consensus existed in 1990, 2000 and 2007 shortly before things went downhill. That said, we continue to see strong private and public sector investment nationwide. Technology, decarbonization and now artificial intelligence have recently reinforced an invest or go-broke mentality among U.S. corporations. Augmenting this is a $2.0 trillion government stimulus program supporting new economic initiatives which makes a strong case for continued growth. Despite persistent calls for a U.S. small cap renaissance, they continue to lag U.S. large caps with the former having returned less than a third of the S&P 500 Index over the past several years. Some underperformance is specific to companies burdened by rising debt servicing costs. Higher interest rates disproportionately impact small caps, where most companies have variable-rate debt. In contrast, S&P 500 companies had better debt market access, allowing many to lock in the low rates of 2020 -2022 for seven years or more. It is sensible that this valuation dispersion will close at some point through M&A or portfolio rebalancing.

As the Fund enters its 20th year, we reflect on the core mission of patiently exploiting share price inefficiencies. We endured many obstacles that improved our investment skills over the years. We take pride that, since the Fund's inception, average annualized returns of 8.57% exceeded our benchmark IWN by 129 basis points. While we cannot guarantee future results, we will continue carefully sorting through the small cap space to find situations where pessimism is unwarranted. Thank you for joining us along this investment journey. For the most up-to-date information on your investment, please visit www.adirondackfunds.com.

Regards,

Matt Reiner, CFA®
Portfolio Manager

Greg Roeder, CFA®
Portfolio Manager

Important Risk Information

The Fund invests in smaller companies, which involve additional risks such as limited liquidity and greater volatility. Additionally, value investing is subject to the risk that a company's intrinsic value may never be fully realized by the market.

The Fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The prospectus contains this and other important information about the investment company, and it may be obtained by calling 1-888-686-2729, or visiting www.adirondackfunds.com. Read it carefully before investing.

The iShares ® Russell 2000 Value ETF (IWN) seeks to track the investment results of an index composed of small-capitalization U.S. equities that exhibit value characteristics.

Alpha means the return earned on an investment above that of the benchmark.

The S&P 500 Index is a market value-weighted index of 500 stocks seen as indicators of U.S. equities and reflects large cap performance. You cannot invest directly in an index.

Adirondack Research & Management, Inc.
2390 Western Avenue
Guilderland, NY 12084
www.adirondackfunds.com • 1-518-690-0470

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