Small Cap Advantage

Portfolio Comments

September 30, 2019

Distinguishing Features

As of 9/30/2019, the Small Cap Advantage portfolio remains overweight the technology sector compared to the Russell 2000 Growth benchmark, with a current 29% weighting compared to 16% for the benchmark. The portfolio's overweight to the Index in producer durables also continues (24% versus 17%). In the energy sector, the portfolio now has exposure, though it is nearly equal-weighted to the Index. All other sectors are underweighted versus the benchmark, with financials continuing as the largest underweighting (3% versus 11%). Healthcare has reduced its underweighting (now 25% versus 27%). Smaller relative underweight positions are also in consumer discretionary (12% versus 14%), materials (4% versus 7%) and utilities (1% versus 3%). As of 9/30, the portfolio continues to have no exposure to consumer staples.

Commentary

Market Environment

During the third quarter of 2019, the US market underwent a significant rotation that might be summed up as "Risk Off." Investors may be worried given the uncertainties about economic issues (trade wars, and whether a recession is imminent) and political issues (US Election, BREXIT). The market ended the quarter down, with the Russell 2000 Growth posting -4.17%. The year-to-date return is +15.34%.

Performance Discussion

In the 3rd quarter, the Small Cap Advantage portfolio gave up some of the year's earlier relative gains with a return of -8.03%, net-of-fees. Year to date, net-of-fee performance remains soundly ahead of the benchmark at +25.78%. Stock selection in the producer durables and consumer discretionary sectors accounted for much of the 3rd quarter's underperformance, though the portfolio's overweighting in producer durables somewhat offset the negative selection. Stock selection in financial services, technology and materials also weighed on performance, plus the portfolio's underweighting in financial services hurt relative performance. Healthcare was the bright spot due to both stock selection and the underweighting of the sector. The portfolio's lack of exposure to the consumer staples sector hurt relative performance this quarter.

With respect to LifeCycles, the Pioneer holdings were the largest drag on performance in the quarter. Core Growth also was a negative, while the portfolio's Special Situation holdings outperformed the overall Index. The quarter's largest detractors included four Pioneer holdings – 2U (consumer discretionary), Carbonite and ShotSpotter (technology), and Fluidigm Corporation (healthcare). Luxfer Holdings PLC (producer durables, Special Situation) rounded out the bottom five.

On the positive side, the quarter's top 5 performers were from all three LifeCycles and represented four sectors: LivePerson (technology, Special Situation) was the top contributor, followed by CoStar Group (producer durables, Core Growth), Medicines Company and Oxford Immunotec Global PLC (both healthcare, Pioneer), and Tower International (consumer discretionary, Special Situation).

Outlook

Investors' fears aside, US GDP growth is reasonable, interest and tax rates are low, corporate cash flows and balance sheets are healthy, and consumer confidence is good. While we have no crystal ball (nor do we believe

that there is a reliable one out there), we are focused on executing our process as tightly as possible. As bottom up investors, stock selection drives performance, so we closely monitor the fundamentals to make sure we aren't missing anything from a company level. On a valuation basis, we continue to make portfolio adjustments based on valuation, conviction, risk/reward, and portfolio diversification, including across LifeCycles.

Disclosure:

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