



## SMID Select Opportunities

### Portfolio Comments

September 30, 2019

## Distinguishing Features

GIM builds the [SMID Select](#) portfolio from the bottom-up; sector weightings are secondary to stock selection. As of 9/30/2019, the portfolio continues its overweight position in the healthcare, now 30% versus 22% for the Russell 2500 Growth benchmark. Information Technology has moved to an overweight position at 30% versus 25% for the Index. The overweight position in Energy has been reduced slightly, now 5% versus <1%. Communication Services is also overweight versus the Index, 6% to 3%. Industrials has moved from an overweight position to the largest underweighting, 10% versus 18% for Index. Consumer discretionary continues its underweighting, 10% versus 14%. Financials are 3% underweight the Index, at 3% versus 7%. The portfolio has no exposure to the materials, consumer staples, and utilities sectors, where the benchmark weighting are 4%, 2% and 1%, respectively.

## 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 -3.18%. The year-to-date return is +19.97%.

### Performance Discussion

For the quarter, the SMID Select strategy composite, while down, outperformed the benchmark with a return of -1.87% net-of-fees. Year-to-date, the strategy is slightly behind the benchmark with a return of +19.66% net-of-fees. In the quarter, strong stock selection in the healthcare, information technology, and consumer discretionary sectors drove the outperformance, though our overweight position in healthcare modestly dampened the selection effect. Selection in financials and communication services also assisted relative performance. The portfolio's large overweight position in energy was a negative, as was selection, resulting in energy as the largest drag to performance in the quarter. Selection in industrials and real estate also weighed on performance, with OUR overweighting of the industrials sector also a negative.

With respect to LifeCycles, the portfolio's Pioneer holdings led performance with a strong showing, while Core Growth names also outperformed the overall benchmark. Special Situations lagged the benchmark, primarily due to the energy holdings. Three Pioneers were among the top five in the quarter: Medicines (healthcare), Rubicon Project (consumer discretionary), and Cloudera (info tech). Two Core Growth holdings rounded out the top five: Enphase Energy (info tech), and Insulet Corporation (healthcare).

On the negative side, two Special Situation energy holdings detracted in the quarter: Ring Energy and ProPetro. Other holdings in the bottom five for the quarter include ABIOMED and Exact Sciences (both healthcare, Core Growth), and 2U (info tech, Pioneer).



## Positioning

Throughout 2019, as the economy has shown signs of slowing and economic uncertainty has risen, we have consistently reduced our exposure to more cyclical companies where we see reduced growth rates. This has been accomplished primarily by reducing our Special Situations LifeCycle weighting, and eliminating some holdings in the Industrials sector. Many of the affected stocks were originally purchased in 2017 and 2018 as their respective businesses were improving, helped by an acceleration of economic growth, particularly in the United States. As these stocks no longer met our original investment criteria given the changing economic picture, they have been reduced or eliminated. The Special Situation category ended the quarter with a 22% weighting, compared to 26% at the end of the second quarter and 36% at the beginning of the year. We have re-allocated proceeds of the sales to Pioneer holdings in particular, where we see strong growth. In hindsight, this has been a good decision thus far, as the Pioneer holdings led the portfolio in the quarter, while those in the Special Situation category lagged by a large margin.

With the end of the quarter, we also reclassified one of our largest positions in the Pioneer LifeCycle category, Kornit Digital, to the Core Growth category. We have owned Kornit for several years, and in that time it has demonstrated its ability to be a profitable market leader in the emerging category of digital textile printing. The reclassification increases our Core Growth weighting while reducing the Pioneer weighting.

## Outlook

According to small cap strategist, Furey Research Partners, U.S. small caps have significantly underperformed large caps, and the relative valuation is now at a 20-year low. Having said that, within the small cap sector, growth has significantly outperformed value for several years – until just recently. Much has been written about the recent market moves as a possible rotation from growth to value. However, historically, such a rotation needs much stronger GDP growth, higher interest rates, and rising inflation ... or a recession. We believe the current economic environment continues to be positive for well-positioned growth companies, and that the macro-economic backdrop, while relevant, is not as important as our adherence to our proven processes.

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. As we evaluate the stocks of these well-positioned companies, we continue to make portfolio adjustments based on valuation, conviction, risk/reward, and portfolio diversification, including across LifeCycles.

### Disclosure:

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