



## Small Cap Select Opportunities

### Portfolio Comments

September 30, 2019

## Distinguishing Features

GIM builds [Small Cap Select](#) portfolio from the bottom-up; sector weightings are secondary to stock selection. As of 9/30/2019, the portfolio increased its exposure to the Information Technology sector, now 31% versus 18% for the Russell 2000 Growth benchmark. The portfolio continues to have a sizable overweight position in the energy sector, 7% versus 1% for the Index. Communication services are also overweighted to the benchmark, 6% versus 2%. A nearly 6% holding in the real estate sector represents about a 1% overweighting to the Index. At 27%, the healthcare exposure is neutral to the Index. Industrials moved from a neutral position to the portfolio's largest underweighting at 10% versus 20% for the benchmark. Financials are also underweight to the Index, 3% to 6%. Consumer discretionary continues its underweight to the benchmark, 10% versus 12%. The portfolio has no exposure to consumer staples, materials, and utilities, where the benchmark has weightings of 3%, 3%, and 2%, 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 Small Cap Select composite soundly outperformed the Russell 2000 Growth Index, returning +2.1%, net of fees. Year-to-date, the strategy composite is also up, +29.8%. In the quarter, strong stock selection in the info tech, healthcare, and consumer discretionary sectors drove performance, with our overweight position in info tech boosting relative performance. Selection in communication services and financials 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 also weighed on performance, as did the portfolio's underweight position in this sector.

With respect to LifeCycles, the portfolio's Pioneer and Core Growth holdings drove performance. The Special Situations category underperformed the benchmark in the quarter. Core Growth holding Enphase Energy (info tech) was the quarter's top performer, and Core Growth name Insulet Corporation (healthcare) was also among the top five. Three Pioneer holdings represented the remaining top five in the quarter: Rubicon Project (consumer discretionary), Digital Turbine (info tech), and Medicines Company (healthcare).

On the negative side, three energy holdings in the Special Situation category detracted in the quarter: Ring Energy, DMC Global, and ProPetro Holding. Other holdings in the bottom five for the quarter include Exact Sciences (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 28% weighting, compared to 31% at the end of the second quarter and 46% 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. New Pioneer holdings in the portfolio include Aeri Pharmaceuticals, Akoustis Technologies, Plurasight, Sharpspring and Transact Technologies, all companies with strong open-ended growth opportunities.

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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