**SMID Select Opportunities**

**Portfolio Comments**

**March 31, 2021**

## Distinguishing Features

GIM builds the SMID Select portfolio from the bottom-up; sector weightings are secondary to stock selection. As of 3/31/2021, the SMID Select portfolio continues its significant overweight position to the consumer discretionary sector versus the Russell 2500 Growth benchmark, 23% compared to 13%, and also continues a substantial underweighting in healthcare, 17% versus 26%. The overweighting in the info tech sector has increased slightly, now 37% versus 28%. In the energy sector, the portfolio remains at 3% versus <1% for the benchmark. The industrials (14% to 13%) and communication services sectors (2% each) are both near equal the benchmark weighting. Several sectors are slightly underweight compared to the benchmark: financials (2.5% to 4%), real estate sector (<1% to 2.5%), and materials (<1% versus 3%). The portfolio continues to have no exposure to the consumer staples and utilities sectors, where the benchmark weightings are 3% and 1%, respectively.

## Commentary

### Market Environment

Following the depths of the market downturn last March, the technology and healthcare bias of the Growth Indices drove exceptional outperformance versus their Value brethren as the pandemic suddenly changed companies' day-to-day operations and procedures. In a reversal, in Q1, the Russell 2500 Value Index posted one of its best quarters, returning +16.8%, and significantly outperforming the Russell 2500 Growth's return of +2.5%. Financials, energy and industrials stocks, a large component of Value Indices, surged based on the rise in interest rates and signs of inflation.

### Performance Discussion

In this environment, the Granahan SMID Cap Select composite significantly outperformed its Russell 2500 Growth benchmark, returning +15.6% net-of-fees versus +2.5% for the Index, with several holdings in the Special Situation LifeCycle category driving much of the outperformance.

Outperformance in the quarter was a result of strong broad-based stock selection, particularly in the information technology and healthcare sectors. The overweighting in info tech slightly offset the strong selection here, while our underweight position in healthcare boosted relative performance. Consumer discretionary, industrials, financials, communication services, and real estate also showed positive selection. Our significant overweight position consumer discretionary boosted the relative return here. Selection in energy weighed on performance, though our overweighting of this top performing sector for the Index more than offset the weak selection. Our underweight position in materials hurt relative performance, as did our lack of exposure to consumer staples. No holdings in the utilities sector was a slight plus.

All three LifeCycle categories outperformed the benchmark in the quarter, led by an especially strong showing from the Special Situation category, as five of the top ten relative contributors in the quarter were Special Situation holdings. **Magnite** (consumer discretionary, Pioneer) led performance, followed by two info tech names – **Digital Turbine** (Core Growth) and **Kulicke & Soffa Industries** (Special Situation). Two healthcare names round out the top five: **Ligand Pharmaceuticals** (Core Growth) and **Evolent Health** (Special Situation) round out the top five.

On the negative side, the largest detractor in the quarter was **Nautilus** (consumer discretionary, Special Situation). Two Core Growth info tech stocks were also in the bottom five: **Cloudera** and **Euronet Worldwide**. Two healthcare names round out the detractors – **Quidel Corporation** (Core Growth) and **Karypharm Therapeutics** (Pioneer).

**Positioning**

As the end of 2020 was approaching, many financial pundits were calling for a reversion to value where investors will again favor value stocks after a decade that saw stocks of high growth companies lead the market. In the first quarter, we saw this prediction come to fruition as value stocks had one of their best quarters ever relative to growth stocks. This is not surprising, as the economic outlook has improved so much that 2021 GDP growth forecasts are now well above 5% for the US economy. Work from respected small cap strategy provider, Furey Research Partners, tells us that over long periods of time, when economic growth is slow, growth stocks outperform, and when growth is abundant, value stocks outperform. It is our view that this dynamic occurs because many industries need a strong economic tailwind to produce high enough levels of growth to attract the marginal investor. That tailwind is now in play.

During the first quarter of 2021, we started to see many low-growth industries show signs of improving growth, but we continue to be most impressed with the strength in the semiconductor industry and more cyclical technology hardware. With the Select strategies, we are always attracted to dynamic change, especially when it is underappreciated by the market. This is what we continue to see with info tech sector holdings **Kulicke &Soffa Industries, Western Digital, Flex Ltd.,** and new position **Silicon Motion**. Through our investments in these securities, and other new names in the Special Situations category, we continue to increase our exposure to this LifeCycle category, and exposure to lower valuation companies that are more dependent on cyclical growth.

Throughout the last few years, our Special Situations stocks have been a material detractor to performance compared to our positions in the other two lifecycles (Pioneer, Core Growth). Even during that period, we maintained diversification by LifeCycle, and exposure to Special Situations names. When the day came for more cyclical growth to perform well, we were in position to take advantage and rotate further into the group as we saw attractive opportunities. The LifeCycle diversification tool is integral for us to execute well for our clients in most markets, and in the last six months particularly, as the Special Situation category has been our most successful and helped the portfolio nicely outperform its benchmark.

**Outlook**

As vaccinations proceed, GDP growth forecasts continue to rise. At the beginning of the year, US economists were forecasting a 4.5% GDP growth rate for 2021, and upward adjustments now have it at 6%. Productivity growth is forecasted at 1.8%, up from the 1.4% annual growth that we have had since 2006. The shift to digitization is expected to fuel much of this increase, as companies continue their investments in automation that were initiated by spending in the pandemic to enable remote work and contact-free environments.

In the mid-1970's, as the economy moved out of recession, interest rates and inflation rose precipitously. In that period, companies that helped other enterprises with cost-saving, productivity-enhancing technologies did extremely well. We believe similarly situated companies will do well in the current environment as interest rates rise and signs of inflation emerge. In addition, smaller cap companies tend to be more nimble and able to pass along cost increases than their large cap brethren, and well-positioned Special Situation companies are poised to perform well in this type of environment. Stock selection drives performance for the GIM strategies, particularly, stocks of innovative, financially sound, and agile companies that provide the necessary tools and products for businesses to stay relevant in the changed, post-pandemic world.

*It should not be assumed that any of the securities transactions or holdings discussed were or will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein.*