Small Cap Discoveries

Portfolio Comments

June 30, 2020

Distinguishing Features

GIM builds the portfolio from the bottom-up; sector weightings are secondary to stock selection. As of 6/30/2020, the Small Cap Discoveries portfolio's significant overweight position in the producer durables compared to that of the Russell Microcap Growth benchmark continues and increased due to the annual re-balancing of the Russell indices; currently 21% versus 8%. Technology continues its overweighting to the benchmark, now 21% versus 19% for the Index, where the weighting increased after the re-balance. Consumer discretionary and materials are both within 2% of the Index, 10% versus 8% for consumer and 2.5% versus 2% for materials. Energy has also moved to nearly equal-weight to the Index at 1%. Healthcare continues as the largest underweight position compared to the benchmark, 40% versus 52%. Financial services remains underweighted to the Index, 3% versus 6%. The portfolio has no exposure to the small utilities and consumer staples sectors.

Commentary

Market Environment

The second quarter of 2020 is one for the record books, as the Russell Microcap Growth logged an impressive +38.8% net-of-fee return while the Russell 2000 Growth returned +30.6%. To combat the economic effects of the coronavirus pandemic, governments and central banks around the world have pumped $7 trillion into the global economy. Improving economic trends from the horrendously low levels reached in late March have also helped to buoy the markets.

Performance Discussion

In this strong 2nd quarter, the Small Cap Discoveries portfolio's net-of-free return of +38.9% was in line with the Russell MicroCap Growth Index's return. The strategy's secondary benchmark is the Russell 2000 Growth, and in the quarter, the Discoveries portfolio ended ahead of the Russell 2000 Growth's return of +30.6%. Year-to-date, the portfolio's net-of-fee return of -1.7% lags the Russell Microcap Growth benchmark's return of +1.9%, though is ahead of the Russell 2000 Growth's YTD return of -3.1%.

For the 2nd quarter, overall, relative performance to the Russell MicroCap Growth Index was due to sector allocation. The portfolio showed good stock selection in consumer discretionary, materials and financial services. Relative performance in both consumer discretionary and materials was buoyed by our overweight positions here, and relative performance in financial services was assisted by our underweighting of the sector. Producer durables had strong selection, but this was partially offset by the negative impact of our overweighting in the sector. Our lack of exposure to the consumer staples and utilities sectors was also a positive. On the negative side, healthcare stock selection hurt performance in the quarter. Selection in the technology and energy sectors also weighed somewhat on performance, though our overweight position in technology nearly offset the negative stock selection.

With respect to LifeCycles, the Pioneer LifeCycle category soundly outperformed the Index, while the Core Growth and Special Situation categories lagged. The quarter's top five relative contributors represented all three LifeCycle categories, including two Special Situation holdings in the consumer discretionary sector –

MarineMax (HZO) and **Sonic Automotive** (SAH). Two technology names were also in the top five – **Digital Turbine** (APPS, Pioneer) and **GAN Limited** (GAN, Core Growth). **Kornit Digital** (KRNT, Core Growth, producer durables) rounds out the top five.

The five largest detractors in the quarter also included all three LifeCycles. Three healthcare names were in the bottom five – **NeoGenomics** (NEO) and **Cardiovascular Systems** (CSII), both Core Growth, and **Enanta Pharmaceuticals** (ENTA, Pioneer). Two Special Situation producer durables holdings were also in the bottom five – **Luxfer Holdings** (LXFR) and **Douglas Dynamics** (PLOW).

Outlook

The uncertainty surrounding the economic impact of the pandemic along with the massive stimulus has created an interesting juxtaposition. So far the stimulus is propelling the market higher; how the markets react to company earnings reports released in late July could prove interesting. At GIM, we remain focused on executing our process as tightly as possible – separating companies from stocks as we seek strong well-positioned companies and use our tools to invest in the stocks of these companies when risk/reward is attractive. As bottom up investors, stock selection drives performance across sectors and LifeCycles in most all market environments.