Global Small Cap Opportunities

Portfolio Comments

September 30, 2021

Distinguishing Features

GIM builds the Global Small Cap portfolio from the bottom-up; country and sector weightings are secondary to stock selection, with the US allocation at least 50% of the overall portfolio. As of 9/30/2021, the Global Small Cap portfolio continues its underweight for the US versus its MSCI World Small Cap (net) benchmark, 50% versus 57%. The portfolio is also underweight Japan (6% versus 11%), the best performing developed region in the benchmark for the period. The portfolio is overweight Canada (8% versus 3%) and Israel (3% versus 1%). European holdings (excluding UK) are overweight the Index (17% versus 14%) with higher portfolio weightings in Germany, Netherlands, and Norway, all driven by stock selection. We are now slightly overweight the UK, 7% versus 6%.

With respect to sectors, the portfolio continues its substantial overweight position in information technology, now 29% versus 13% for the benchmark. Strong performance for our industrials holdings led to an increase in our overweighting, now 23% versus 18%. Healthcare (15% versus 12%) remains overweight relative to the Index. The portfolio's communication services weighting increased over the quarter, and is now a slight overweight, 4% versus 3%. The largest underweight position continues to be in real estate (2% to 10%). The portfolio is also underweight in the following sectors: materials (1% versus 7%), consumer discretionary (10% versus 14%), financials (11% versus 13%), and consumer staples (3% versus 4%). We continue to have no exposure to energy (benchmark weighting 4%) and utilities (benchmark weighting 2%).

Commentary

Market Environment

Mounting concerns over higher inflation, and the threat of a more contagious COVID variant spreading around the world, weighed on the markets this quarter with some areas seeing their first downturn since the start of the pandemic. Supply chain issues have caused uncertainty, and coupled with the disarray in Washington D.C., has prompted investors to harvest some profits. Developments in governments outside the US, including the surprise resignation of the Japanese Prime Minister and change of party control in Germany, impacted sentiment in those regions. In China, regulatory crackdowns, potential systemic financial risks (e.g., Evergrande), and power shortages spooked the market to some extent. Global markets were down this quarter, and the MSCI World Small Cap Benchmark ended the quarter in the negative, -1.4%, with international equity markets outperforming the US. The Index performance in September erased market gains in July and August.

Performance Discussion

In this environment, the Granahan Global Small Cap composite soundly outperformed its MSCI World Small Cap (net) benchmark, returning +3.7% net-of-fees versus -1.4% for the Index. Year-to-date, the composite net-of-fee return is now ahead of the benchmark, +17.2% versus +13.2%.

Outperformance in the period was driven by very strong selection, with many of the portfolio's sectors showing positive absolute returns where the benchmark returns were negative: industrials, info tech, consumer discretionary, communication services, consumer staples, and materials. Good selection in real estate was more than offset due to our significant underweighting. Healthcare was neutral to performance in the period. Financials weighed on performance in the quarter, and it was the portfolio's only sector where stock selection was negative. Our lack of exposure to energy was also a negative. On a regional basis, the portfolio delivered positive stock selection in all developed markets except for Canada which detracted slightly.

With respect to LifeCycles, all three categories outperformed the overall benchmark return, led by very strong performance from the Core Growth holdings. Two of the largest contributors in the quarter were US Core Growth info tech holdings: **Perficient** and **Pure Storage**. Two additional Core Growth holdings made the top five: **Casella Waste Systems** (industrials, US) and **Open House Co.** (consumer discretionary, Japan). Pioneer holding **S4 Capital** (communication services, UK) rounds out the top five.

On the negative side, two US Special Situation info tech holdings were among the largest detractors in the quarter: **Airgain** and **AXT, Inc**. Two healthcare names also were in the bottom five: **Health Equity** (Core Growth, US) and **Olink Holding AB** (Pioneer, Sweden). Core Growth holding **LendingTree** (Financials, US) rounds out the bottom five.

Positioning and Outlook

Despite many crosscurrents, the global economic picture remains strong. Corporate earnings are robust though the Delta variant spike has created pockets of economic volatility. While economic growth is rebounding globally, commodity prices are surging, supply & logistic constraints are abundant, and wages are rising – all contributing to higher levels of inflation. Interest rates have risen in response to many of these factors. The political landscape remains unpredictable with the potential for significant fiscal, monetary, and tax implications. We anticipate that these dynamics will lead to increased volatility for the balance of the year. While we do monitor the changing economic, social, and political dynamics and how they might affect our individual holdings, our investment process remains focused on innovative companies that we believe can outperform in most market environments. Regardless of what happens in Washington DC over the next couple of months, we will continue to seek opportunities to add or initiate new positions in dynamic, high-growth companies. For example, **Olink Holding** (Pioneer, Sweden) provides next generation equipment that can accurately detect proteins from a single sample. We believe a deeper understanding of proteins will propel personalized medicine capable of tailoring treatment to each patient rather than a one size fits all. We continue to focus on areas of innovation, which is evident by our overweight positions in technology, healthcare and industrials, while we maintain underweight in financials, real estate, energy, and materials.