SMID SELECT

Portfolio Comments
December 31, 2022

Distinguishing Features

GIM builds the SMID Select portfolio from the bottom-up; sector weightings are secondary to stock selection. At quarter-end, the SMID Select portfolio was overweight in Technology and Communication Services versus the Russell 2500 Growth benchmark. We are nearly equal weight the benchmark in Consumer Staples and underweight in all other sectors. We have no exposure to Real Estate or Utilities.

Commentary

Market Environment

The economy has shown signs of slowing, with inflation easing from a summer peak. On the labor market front, initial jobless claims, the unemployment rate, and non-farm payrolls continue to look strong. The recent declines in job openings indicate that the labor market is adjusting, with the jobs-workers gap declining towards the level that may be necessary to prevent the labor market from overheating. US retail spending and manufacturing weakened in November and December. The Federal Reserve (Fed) raised its benchmark interest rate 0.5% to a 15-year high and signaled that it would continue lifting rates through the spring of 2023. Fed officials have increased rates at the fastest pace since the 1980's in an attempt to cool inflation. Many companies, and even individuals, are acting strategically - planning for a road ahead that may be more difficult to traverse, with higher interest rates, the housing slump, ongoing inflation, and the possibility of a recession.

Performance Discussion

The Granahan SMID Select strategy returned +1.9% in the 4th quarter, trailing the +4.7% return of its Russell 2500 Growth benchmark.

Strong stock selection in Communication Services and Consumer Staples attributed to the strategy's positive performance this quarter. Challenges in Q4 were tied to our underweight in Energy and selection in Financials, Industrials, and Technology. With respect to LifeCycle categories, the Core Growth category nicely outperformed the benchmark. Special Situations and Pioneers underperformed during the quarter.

The largest contributors were four Core Growth names: **Magnite** (Comm Svcs), **Array Technologies** (Technology), **Axon Enterprises** (Industrials), and **Euronet Worldwide** (Technology). Pioneer **Veracyte** (Health Care) rounds out the top five.

The largest detractors during the quarter were **Indie Semiconductor** (Technology, Pioneer), **Silvergate Capital** (Financials, Core Growth), **Evolent Health** (Health Care, Special Situation), **Chart Industries** (Industrials, Special Situation), and **Kornit Digital** (Industrials, Core Growth).

Positioning

The fourth quarter was a true up and down quarter, and highly unusual from a relative perspective as well. Through the first week of November, we experienced headwinds from an especially tough earnings season. Towards the end of reporting season, we had a couple of big winners emerge in **Digital Turbine** and **Magnite** that boosted performance meaningfully. This coincided with lower-than-expected inflation data being released. Unfortunately, both the market and our relative performance turned for the worse for the remainder of the year, with tax loss selling and continued hawkish remarks from the Fed. The market relinquished a healthy chunk of its gains, and we gave up more.

That said, we do feel good about our positioning and the direction of key macro indicators. With regards to our Life Cycles, the past quarter was a positive proof statement of our positioning. Core Growth stocks were up close to 10% for the quarter while Pioneer and Special Situation stocks were down by almost 10% each. As the year progressed, we gradually moved our weighting from Pioneer and Special Situation stocks to Core Growth holdings that were trading at what we believed to be unusually compelling valuations. This effectively increased our Portfolio P/E as the lower valuation Special Situation stocks and the (no P/E to calculate) Pioneer stocks were sold. We felt that our Core growth stocks represented the best long-term risk reward potential, and so far, we believe this has been the right tactical change.

We continue to believe that this the macro environment will in many ways dominate the investment picture going forward in 2023 as well. One of our favorite recent macro slides is included below. You'll see in in the middle cell that the worst case scenario for small cap performance, both on an absolute basis and a relative basis compared to large cap stocks, is when inflation is above 3% and increasing. This is the environment we have largely been in for the last two years. The good news, however, is that we believe we are moving up into the next cell, where inflation is above 3% and decreasing. Historically, over the last 70 years, this is the best-case scenario of the four provided for small cap stocks both on an absolute and relative basis.

Ann. Inflation vs. SmCap % NOM. Return (1950-2021)

Rate of Change	Starting Level: Below 3%	Above 3%	All
Decreasing	17.0	22.4	18.9
Increasing	15.7	5.6	14.8
All	16.5	16.9	16.6

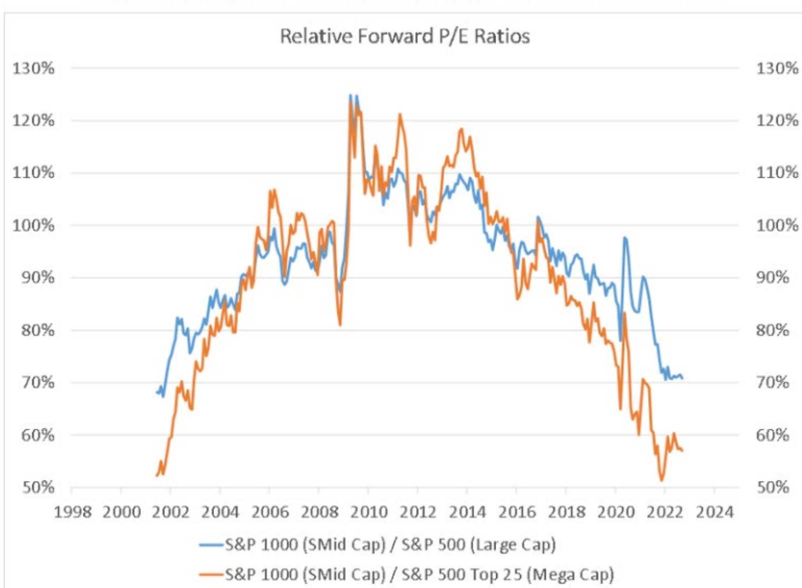
Ann. Inflation vs. SmCap % REL. Return (1950-2021)

Rate of Change	Starting Level: Below 3%	Above 3%	All
Decreasing	0.2	6.1	3.2
Increasing	-2.1	-8.7	-4.1
All	0.0	3.3	0.5

Source: Furey Research

We also observe that small cap has underperformed large cap for most of the last twelve years, and small caps are now trading at historically low valuations compared to large caps (see below).

SMID Relative Valuations Are at Historic Lows



Source: Furey Research

This makes us unusually optimistic, assuming inflation continues to abate and results prove consistent with historical trends. When will we enter a bull market again for small caps? That is too tough to answer precisely, but we believe the more obvious it becomes that inflation is decreasing, the more likely we are to be in a better market environment. It's even possible that this prospective bull market gets off to a good start, even while forward earnings estimates are being lowered in this slower-growth recessionary period. It's also very possible that the improvement to valuations is much more meaningful than the long-term earnings risk and negative earnings revisions. While the economic pressure on earnings is evident, we are focusing our investments on companies that can grow through this environment or at least have a very meaningful acceleration potential in the near future. Our goal is to find the companies with best long-term prospects for growth that also have the potential to be re-rated meaningfully higher in a better market environment. We saw a glimpse of this in the middle part of the fourth quarter and remain hopeful that it will be even more evident as we navigate 2023.

Outlook

The strategy leverages our team of experienced portfolio managers who are also sector specialists. We remain committed to our process for finding great long-term growth opportunities by identifying companies early in their lifecycle with disruptive products addressing large markets. The value creation process for these types of companies plays out over years, making patience and opportunistic position-sizing key components of our investing process. Currently we are seeing valuation metrics for our portfolios that are at historic lows. Earnings estimates have come down, however, growth rates for our companies are expected to far outweigh that of the general economy.

While the strategy's performance during the fourth quarter and year of 2022 was disappointing, we believe our process will yield relative outperformance on a multi-year basis. Against a backdrop of unprecedented moves in Treasury yields during the past few years, we are not in a position (nor have we ever been) to predict near-term market performance. We do however have much higher conviction that as we enter 2023, the risk-reward tradeoffs for our holdings are more attractive than they have been in years, affording us the opportunity to tilt the portfolio modestly toward names with value-creating catalysts on the near-term horizon.

As always, we appreciate the support from our clients, particularly in these tough economic times. We are focused on our processes to lead us to the strong, innovative businesses that will lead out of this downturn.