SMALL CAP ADVANTAGE

Portfolio Comments
September 30, 2023

Distinguishing Features

GIM builds the Small Cap Advantage portfolio from the bottom-up; sector weightings are secondary to stock selection. As of September 30, 2023, the Small Cap Advantage portfolio was overweight its Russell 2000 Growth benchmark in Technology and Health Care. We are equal weight in Financials, Real Estate, Utilities, Consumer Discretionary and Basic Materials and underweight the benchmark in all other sectors. The portfolio continues to have no exposure to Consumer Staples.

Commentary

Market Environment

It was a rough quarter for the stock market. All Indices suffered losses this quarter, battered by surging oil prices and fears that the Fed's higher-for-longer rates strategy means another hike this year. Also weighing on investor minds was the US government shutdown, which is now temporarily resolved.

There are many concerns creating a wall of worry for stocks to climb, but inflation could continue to decline in favor of higher oil prices, a stabilizing China, and a temporarily averted government shutdown. So far, we have had a resilient US consumer, but this consumer now has to deal with higher mortgage rates, student loan paybacks, higher gasoline prices, and the UAW strike perhaps driving the price of cars higher. The massive spending and subsidies from the Federal government targeted at upgrading the nation's roads and bridges, expanding domestic manufacturing of semiconductors, and modernizing the electrical grid could blunt a downturn from the recession that the consensus believes is likely. The big questions today are: 1) will the Fed continue to raise rates 2) will the Fed lower interest rates next year and 3) will the Fed conquer inflation without triggering a recession?

Performance

The Granahan Small Cap Advantage strategy returned -10.3% in Q3, lagging the -7.3% return of its Russell 2000 Growth benchmark. Selection in Health Care, Basic Materials, Financials and Technology contributed positively for the quarter along with our underweight in Telecommunications. We were penalized by stock selection and allocation in Energy and Industrials, and the largest detractor for the quarter came from stock selection in Consumer Discretionary.

With respect to LifeCycles, Core Growth, Pioneer, and Special Situation categories all underperformed the benchmark this quarter.

The largest contributors to the strategy this quarter were **Sprout Social** (Technology, Pioneer), **Repligen** (Health Care, Core Growth), **Texas Capital** (Financials, Special Situation), **Guidewire Software** (Technology, Core Growth), and **Castle Biosciences** (Health Care, Pioneer).

Top detractors during the quarter were **Topgolf Calloway** (Consumer Disc., Core Growth), **BioLife Solutions** (Health Care, Pioneer), **OrthoPediatrics** (Health Care, Core Growth), **Magnite** (Technology, Core Growth), and **Paycom Software** (Technology, Core Growth).

Outlook

Valuation on our portfolio has come down. In many cases, but not all, reported earnings have been better than expected. It is almost always the case that misses are hurt disproportionately versus the gains that stocks realize when they beat expectations. Response to earnings was extreme in this regard. There were modest positive moves in stocks on very strong earnings and brutal stock moves downward on misses. We even saw a number of stocks report strong earnings, only to go down in their wake. While there are more headwinds to growth broadly, the companies in the GIM portfolios are ones we believe can sustain strong secular growth.