Future Pathways

Portfolio Comments
September 30, 2023

Distinguishing Features

GIM builds the Future Pathways portfolio from the bottom-up; sector weightings are secondary to stock selection. During the period, the Future Pathways portfolio remained overweight Industrials and Information Technology and underweight the Russell 2500 Growth benchmark in all other sectors. The portfolio has no exposure to Utilities, Communication Services, Financials, Real Estate, or Materials.

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. Will inflation continue to decline despite 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 & Attribution

The Granahan Future Pathways strategy returned -7.5% in the quarter, lagging the -6.8% return of its Russell 2500 Growth benchmark. Strong stock selection and allocation in Health Care, Technology, and Industrials were a positive this quarter. Challenges in Q3 were largely tied to allocation and selection in Energy, and selection in Consumer Staples.

With respect to LifeCycle categories overall, Pioneers and Special Situations outperformed the benchmark this quarter while Core Growth lagged.

The largest contributors this quarter were **Grid Dynamics** (Technology, Special Situation), **Chart Industries** (Industrials, Special Situation), **Castle Biosciences** (Health Care, Pioneer), **Hudson Technologies** (Industrials, Special Situation), and **Array Technologies** (Technology, Core Growth).

- **Grid Dynamics:** The valuation of **Grid Dynamics**, a digital transformation consulting firm, became very compelling after a tough second quarter where margins came under pressure from acquisition-related, benched headcount and foreign exchange headwinds. The company is a beneficiary of AI related projects which is an upside driver to growth. We have trimmed on the rebound in the stock.

- **Chart Industries, a** manufacturer of highly engineered equipment used in the hydrocarbon and specialty gas industries, completed a large acquisition last year that drove the stock down. They have made good progress on debt reduction and have a strong outlook. We have added to the position as valuation in comparison to peers is compelling.

- **Castle Biosciences** is a diagnostics company improving health through innovative tests that guide care decisions for patients with cancer. The company has a portfolio of tests for skin cancers, Barrett's esophagus, and mental health conditions. During the quarter, Castle Biosciences' stock rose as investor concerns eased regarding the reimbursement outlook facing both the company and industry. We increased our position as we are gaining confidence in the significant value Castle's skin cancer tests provide and its attractive long-term growth outlook.

The largest detractors were **Kornit Digital** (Industrials, Core Growth), **Canadian Solar** (Energy, Core Growth), **SolarEdge** (Technology, Core Growth), **Renalytix** (Health Care, Pioneer), and **Insulet** (Health Care, Core Growth).

- **Kornit**, a strong performer last quarter, reported revenues slightly below consensus, though the adjusted EBITDA loss was better than expected. Demand remains muted for their systems as customers hold off purchasing because of the uncertain macro environment. We are holding the stock as the company has a suite of products leading the shift from analog to digital printing in the garment and textile industries.

- **Canadian Solar and SolarEdge:** Higher interest rates delaying residential adoption and our overweight in Clean Energy companies has been a drag on performance this year. We remain convinced that the clean energy push, particularly on the utility level scale, is going to progress forward. We are holding our positions and taking advantage of this downturn to strategically add to the portfolio.

Positioning

Most of the new companies in the portfolio center around industrial exposure. This includes companies with projects associated with new manufacturing in the United States and companies with exposure to data center spending which is very robust. Immense data sets are being processed and analyzed at a scale never seen before. This massive data-driven approach demands expansive computational resources and infrastructure. Data centers are increasingly facing the challenge of meeting the burgeoning demands of energy intensive AI tasks. Our new name, **SPX Corp**, which manufactures cooling systems and power transformers, is a good example of a company helping data centers cope with this explosion in demand.

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.