SMALL CAP SELECT

Portfolio Comments
December 31, 2023

Distinguishing Features

GIM builds the Small Cap Select portfolio from the bottom-up; sector weightings are secondary to stock selection. At quarter-end, the Small Cap Select portfolio was overweight in Health Care, Technology, Energy, and Consumer Staples versus the Russell 2000 Growth benchmark. The portfolio is equal weight the benchmark in Telecommunications and underweight in all other sectors. We have no exposure to Real Estate or Utilities.

Market Environment

Despite stock markets being up in 2023, smaller companies struggled as valuations and earnings were significantly impacted by higher interest rates and inflation. It is important to note that the S&P 500 and the Russell 2000, on an equally weighted basis, both hit lows in October from their peaks in 2021. This suggests we have been in a bear market for most stocks for two years despite strong performance coming from some of the largest market cap stocks. While there are plenty of macro uncertainties still in the mix, we see noteworthy positives. In the middle of December, the Fed signaled a more dovish stance on interest rates and lower inflation data points have also been encouraging.

Performance & Attribution

For the fourth quarter, the Granahan Small Cap Select strategy returned +7.7%, lagging the +12.8% return of its Russell 2000 Growth benchmark. Strong selection in Technology and Financials weren't enough to offset selection challenges in Industrials, and we were hurt by our selection and overweight in Energy. For the full year, the strategy returned +4.0% compared to the index return of +18.7%.

With respect to LifeCycle categories for the quarter and the year, Pioneers nicely outperformed the benchmark while Special Situation and Core Growth names lagged.

TOP CONTRIBUTORS	
4Q – 2023	**2023**
1. **Porch Group** (Technology, Pioneer)	1. **VitaCoco** (Consumer Staples, Core Growth)
2. **Indie Semiconductor** (Technology, Pioneer)	2. **Indie Semiconductor** (Technology, Pioneer)
3. **Castle Biosciences** (Health Care, Pioneer)	3. **Quanterix** (Health Care, Pioneer)
4. **Magnite** (Communication Svcs, Core Growth)	4. **Castle Biosciences** (Health Care, Pioneer)
5. **Evolent Health** (Health Care, Special Situation)	5. **ThredUP** (Consumer Discretionary, Pioneer)

TOP DETRACTORS	
4Q – 2023	**2023**
1. **Array Technologies** (Technology, Core Growth)	1. **Digital Turbine** (Technology, Core Growth)
2. **Chart Industries** (Industrials, Special Situation)	2. **SVB Financial** (Financials, Core Growth)
3. **Bluebird bio** (Health Care, Special Situation)	3. **Ameresco** (Industrials, Core Growth)
4. **Ameresco** (Industrials, Core Growth)	4. **Magnite** (Technology, Core Growth)
5. **Kornit Digital** (Industrials, Core Growth)	5. **Array Technologies** (Energy, Core Growth)

Positioning

It was another highly volatile quarter for small cap growth and the Small Cap Select portfolio. The quarter started very poorly, following a tough August and September. The benchmark was down 4-6% in each of these months, and the Small Cap select strategy was down significantly more. The narrative affecting the market was "higher for longer," as the Fed's battle against inflation ushered in a period of rapidly rising interest rates, creating a challenging environment for small cap growth companies. Fortunately, inflation appears to be stabilizing, and both Jerome Powell and Janet Yellen successfully calmed the bond market. Investor optimism returned, and the markets rallied to close the year. The last two months of the year were stronger for the strategy, which is hopefully a sign of things to come, as inflation continues its path downward and valuations recover.

We took advantage of the volatility during the quarter to significantly add weight to two companies in the portfolio, **Chef's Warehouse** and **Gentherm**. **Chef's Warehouse** is a premier distributor of specialty food products to independent restaurants that delivers quality products and service to over 30,000 locations. Chef was down almost 40% given concerns about the impact GLP-1s (newest class of weight-loss drugs) would have on its business. We believed the fears of how GLP-1s would impact restaurants and companies like Chef Warehouse were overblown, providing an attractive opportunity to increase our weighting given their attractive long-term growth outlook. In **Gentherm**'s case, investors became fearful that the United Auto Worker strike would continue endlessly and essentially ignored a very strong showing in long-term bookings from the company.

We would characterize both of these stocks as lower valuation, lower volatility, and lower Beta, although they did not exactly act that way in 2023. We felt like we were buying very stable, well-run companies where business was relatively sound, and the long-term outlook was stable or improving. The market did not believe in any of those things in the Fall, and both companies ended up going materially lower - similar to where they were at the peak of the COVID fears in 2020.

We feel these additions are great examples of what we were trying to execute as the year progressed - reducing some of the volatility of the strategy without compromising our ability to bring outsized returns. It turns out both companies were in fact outperformers in the last two months of the year and they both are actively looking at share repurchases as a way of creating shareholder value.

In short, we are glad to be putting 2023 behind us. We continue to feel that we have tremendous upside potential in the strategy's highest conviction names, and we look forward to what should be a better year for small cap growth stocks.

Outlook

Earnings for small cap companies, as measured by the Russell 2000, are estimated to increase almost 20% in 2024 following two years of declining EPS. According to both Lori Calvasina from RBC and Steve DeSanctis of Jefferies, balance sheets of Russell 2000 companies have near-record levels of cash. We believe our portfolio valuations are at extremely low levels, and a handful of our portfolio companies are trading at or near cash levels. While it is not possible to predict outcomes, this combination of low valuations and expected growth in earnings leaves us optimistic regarding the outlook for our portfolios.

<u>Disclosure:</u> The information provided in this commentary should not be considered a recommendation to purchase or sell any particular security. There is no assurance that any securities discussed herein will remain in an account's portfolio at the time you receive this report or that securities sold have not been repurchased. The securities discussed do not represent an account's entire portfolio and, in the aggregate, may represent only a small percentage of an account's portfolio holdings.

It should not be assumed that any of the securities transactions or holdings discussed were or will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein.