SMALL CAP CORE GROWTH

Portfolio Comments
December 31, 2023

Commentary

Despite stock markets being up in 2023, smaller companies struggled as valuations and earnings were significantly impacted by higher interest rates and inflation. For the fourth quarter, the Russell 2000 Growth Index returned +12.8% and the Granahan Small Cap Core Growth strategy was up +13.2%. The positive attribution from the quarter was not enough to offset lagging performance for the year, with the strategy returning +12.5% vs. +18.7% of the Russell 2000 Growth Index.

Pioneer and Health Care companies were the main drivers of positive performance this quarter. Our top five holdings were:

- **908 Devices** (Health Care, Pioneer) is a life science tools company focused on miniaturized mass spectrometry devices that bring powerful chemical analysis capabilities to the point of need. The company's handheld devices are being used by first responders to detect drugs like fentanyl and other dangerous substances directly at the point of contact. The significant long-term market opportunity is in utilizing the technology in the production of next-generation drug therapies. Optimizing cell culture in the manufacturing of biologic therapies can lead to significantly improved yields and more efficacious therapies. We added to our position in the quarter given the strength of the company's underlying technology and attractive long-term growth profile.
- **Olink** (Health Care, Core Growth) emerged as the leading company in the high-plex segment of the proteomics market, which focuses on the role of proteins to better understand diseases. The company was acquired by Thermo Fisher in October, and we sold out of the stock.
- Technology company **Porch Group** (Financials, Pioneer) reported a strong quarter with better profitability in its home insurance division. We are holding the stock.
- Metastatic breast cancer drug provider **ImmunoGen** (Health Care, Pioneer) was purchased by AbbVie at a nearly 100% premium. We sold out of the stock.
- **Edgewise Therapeutics**' (Health Care, Pioneer) stock performed well in Q4, benefiting from improved sentiment toward small-cap biotech and solid progress in advancing the company's pipeline of rare disease drugs. We are managing the position size down modestly as risk/reward becomes less favorable.

Laggards this quarter were broadly represented in lifecycle categories and industry sectors.

- **Confluent** (Technology, Pioneer) is a leader in data streaming infrastructure software. Cloud spending slowed this quarter, and they also shifted their model to a consumption-based model. We added to the position.
- **Chart Industries** (Industrials, Special Situation) is a manufacturer of equipment used in the production, storage and end-use of hydrocarbon and industrial gases. General industrial activity remains somewhat depressed and is weighing on sentiment, however, the delay in large liquefied natural gas (LNG) projects

is to blame for the significant selloff post-Q3 results. The projects are lumpy, and timing can move from quarter to quarter; it is the nature of the business. Nevertheless, we are encouraged by the strength in bookings. While the stock recovered a good portion of the initial selloff, the valuation discount continues to underappreciate the significant long-term growth opportunity tied to LNG. We are holding the stock.

- **Bluebird Bio** (Health Care, Special Situation) was down due to balance sheet concerns and skepticism regarding the commercial uptake of its FDA-approved gene therapies. The company received FDA approval for its sickle cell anemia drug at the same time as a competitor, but BLUE announced pricing 50% higher than the competition, killing the FDA approval rise in their stock price. Certainly, pricing will be adjusted, and we have continued to build the position as we believe the underlying value far exceeds that implied in the current stock price.
- Core Growth company, **Array Technologies**, a provider of solar ground tracking systems, is experiencing project delays from developers restructuring financing. Management expects the business to recover as the year progresses and we are holding our position.
- **Kinsale** (Financial, Core Growth) delivered a very strong quarterly report with some of the best metrics in the P&C insurance industry. Investors were concerned because Gross Written Premium growth slowed to 33% down from 40%+ in recent quarters. The company's move into the property segment of the market could lead to more volatility in premium growth, but we believe pricing and the forward-looking opportunity remain very attractive. We increased our position meaningfully during the quarter.

Detractors for the year include three names we have eliminated: **Silicon Valley Bank, Digital Turbine** and **James River Group** and two Pioneer Biotechology names we have added to: **Kezar** and **bluebird bio**.

Immunogen was our biggest winner this year, with **Quanterix** a close second. Fellow Pioneer **Nutantix** in Technology was third. Special Situation Technology company, **Veeco Instruments** and Core Growth Consumer Discretionary company, **Vita Coco** were the other two strong positive positions for the year.

Attribution

We are overweight Health Care, which was very strong this quarter. We'll discuss its strength in the themes section of the commentary below. Energy was a positive contributor as we had a very low weighting that outperformed the Index's negative return. The performance of our companies in overweighted Communications Services and underweight Materials was strong. Our overweighted Information Technology sector performed in line with the Index. The performance of Consumer Staples was equal to that of the Index, but we are underweighted. We are equally weighted in Financials, however our stocks lagged. Our stocks also lagged in the underweight Industrial category.

For the year, overweight Healthcare was the largest contributor to our performance because of strong stock selection, however Healthcare was not a bright spot in the Index, so the overweight was a penalty. Materials had significant outperformance though it was underweighted. Information Technology was overweight and performance was comparable to the Index. Our underweighting in Energy also helped performance. The downfall in performance this year was in overweighted Financials, and both Industrials and Consumer Discretionary where we were underweight and our stock selection lagged. Stock selection in Communication Services also hurt.

Weightings

Industry changes for the quarter were minor shifts with the 1% addition to Consumer Discretionary, Consumer Staples, and Healthcare. Conversely, Financials, Industrials and Information Technology were reduced by 1% each. For year-over-year changes we increased Industrials by 2% and Consumer Discretionary and Staples by 1% each. We reduced Information Technology and Financials by 2% each.

In terms of Lifecycles, Pioneers have increased by 3% quarter-over-quarter largely due to performance and we have seen a reduction of 2% in Core Growth and 1% in Special Situations. For the year-over-year changes, Pioneers are up by 4% and Core Growth is down that same amount.

Themes

During the past couple of years, rising interest rates negatively impacted long-duration assets, particularly many of the portfolio's Health Care stocks. While the sector was among the weakest performers in the Russell 2000 Growth during 2021, 2022, and through 3Q 2023, it was the top contributor to portfolio performance in 4Q23 as several developments drove strong relative performance. Moreover, there have been exciting developments within the industry recently that bode well for improved stock performance during 2024 and beyond.

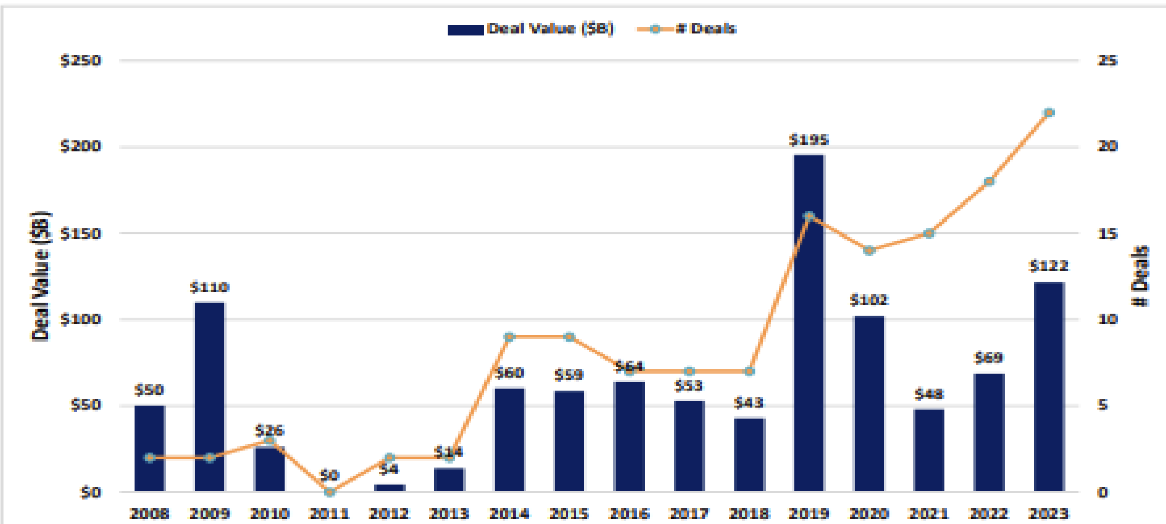
Small cap Health Care is bursting with companies investing in potentially disruptive treatments for some of the most debilitating medical conditions. For example, **Stoke Therapeutics** is developing the first genetically targeted treatment for a severe form of epilepsy known as Dravet syndrome. We see Stoke as a microcosm for the performance of the entire small-cap health care sector during the past few years, and it embodies our approach to investing in the sector. The stock had been bid up to unprecedented levels when growth investing was in favor, only to be severely punished when sentiment reversed in late 2021. It subsequently traded below cash at some points, suggesting the street assigned zero value to Stoke's technology and pipeline. Meanwhile, the company continued to accumulate promising data for its therapies presenting us with an opportunity to build our position. The stock has been a top performer during the recent rally, and we expect its technology will yield tremendous long-term shareholder value. That said, we remain highly cognizant of the risks for companies like Stoke and we manage our position sizes accordingly.

FDA drug approvals in 2023 were very strong with 59 approved applications, the highest level since 2018 and above the 5-year rolling average of 51. Importantly, many of these approvals were for novel technologies, including antibody drug conjugates (ADCs), cell & gene therapies, and even the first CRISPR-based gene editing therapy. The portfolio includes biotech companies that directly benefited from these approvals. For example, **Immunogen** received FDA approval for its ovarian cancer drug Elahere and **Blueprint Medicines** won approval for Avakit, the first precision medicine for a debilitating immunologic condition known as indolent systemic mastocytosis. Both drugs enjoyed rapid commercial uptake, underscoring the benefits of our investing approach, which seeks to identify products addressing major unmet needs.

We also hold stocks of companies that help bring these drugs through the clinical development process and into the commercial market. As novel therapies are approved, there are incremental services required to deliver treatments to patients. For example**, Repligen** develops consumable equipment used specifically in the manufacturing of biologics, and cell & gene therapies. **BioLife Solutions** focuses on specialized products that enable the development, manufacturing, and delivery of therapies. These products are essential as they maintain cell viability critical for the effectiveness of therapies.

We were encouraged by increased healthcare M&A activity during the quarter, which implies strategic value and attractive valuations in the sector. In the biotech arena, M&A further accelerated in 2023 with over 20 announced deals for over $120 billion in deal value. As we head into 2024, SMID-cap biotech stocks trade near all-time lows, while large cap pharma holds plenty of cash to bolster their pipelines and address looming patent expirations through M&A and business development.

In the fourth quarter, **Mirati Therapeutics** and **Immunogen** received takeover proposals from large pharma companies at substantial premiums. The portfolio also benefitted from the acquisition of **Olink Holdings**.



Source: Company Reports, Jefferies Research.

Finally, we'd be remiss not to mention what is arguably the most disruptive force to have emerged in the history of Health Care -- GLP-1 drugs. By now, names like Ozempic, Wegovy, and Mounjaro have become widely recognized as mega-blockbusters poised to transform medicine, consumerism, and beyond. Wall Street even created a new disease modality known as "diabesity" to describe the myriad benefits of the drugs, including weight loss and glucose lowering. August 2023 marked an inflection when Novo Nordisk's Semaglutide (active ingredient in Ozempic & Wegovy) demonstrated improved cardiovascular outcomes, followed by a subsequent study showing benefits in kidney disease. The ensuing months saw a basket of "GLP-1 at-risk" stocks created by Goldman Sachs decline nearly 30%. This included everything from medical device stocks to restaurants. While we are carefully considering small-cap companies poised to benefit fundamentally from the GLP-1 wave, we are not chasing the countless companies seeking to cash-in with imitation versions of GLP-1s. Likewise, we will continue to delineate between companies at true fundamental risk from GLP-1s versus those being unduly punished as part of a Wall Street narrative. Above all, we remain on the lookout for franchises with GLP-1-like disruptive potential before they are widely recognized as such.

Macro

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.

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 combined leaves us optimistic regarding the outlook for our portfolios.