



## SMALL CAP DISCOVERIES

### Portfolio Comments

March 31, 2024

#### Distinguishing Features

GIM builds the [Small Cap Discoveries](#) portfolio from the bottom-up; sector weightings are secondary to stock selection. Since last quarter, the Small Cap Discoveries portfolio has maintained its significant overweight in Health Care and is modestly overweight Consumer Staples versus the Russell Microcap Growth benchmark. The portfolio is equal weight in Materials underweight in all other sectors. The portfolio has no exposure to Utilities, Real Estate, or Energy.

#### Market Environment

Recent economic data highlight that the U.S. economy remains resilient. Commodity prices and yields have increased in response to the underlying strength of the economy. Geopolitical risks have risen as trade tensions with China have increased and the continuation of conflicts in Ukraine and Israel cause trepidation. These dynamics have created volatility within the financial markets especially as investors debate the Federal Reserve's position on inflation, and when and whether they will cut rates. Strong economic growth and a solid job market have lowered expectations regarding the timing and magnitude of rate cuts by the Fed. While small caps saw a meaningful recovery off the October lows, we expect continued volatility until there is more clarity on the macro environment.

#### Performance Discussion

In the first quarter, the Granahan Discoveries strategy returned +0.3%, underperforming the Russell Microcap Growth Index return of +6.6%, and the +7.6% return of the secondary Russell 2000 Growth benchmark.

With regards to LifeCycles this quarter, Core Growth, Pioneer, and Special Situations all underperformed the Index.

#### Top Contributors

1. Stoke Therapeutics (Health Care, Pioneer)
2. Edgewise Therapeutics (Health Care, Pioneer)
3. Vericel (Health Care, Core Growth)
4. Chefs' Warehouse (Cons Staples, Special Sit)
5. SunOpta (Cons Staples, Core Growth)

#### Top Detractors

1. Harvard Bioscience (Health Care, Special Sit)
2. SI-BONE (Health Care, Pioneer)
3. 908 Devices (Health Care, Pioneer)
4. Douglas Dynamics (Industrials, Special Sit)
5. Health Catalyst (Health Care, Core Growth)

#### Themes

In the Health Care sector, we remain excited about the underlying fundamentals and secular drivers that make this area very compelling, despite this quarter's performance. **Stoke Therapeutics** reported data from its clinical trial that showed meaningful reductions in seizures in patients with Dravet Syndrome. We believe STK-001 could become the first disease modifying therapy for this devastating condition potentially leading to further upside for the stock. Despite Stoke's appreciation in Q1-2024, we think the street hasn't fully discounted the value of Stoke Therapeutics' underlying science. In terms of detractors, **Harvard**



**Biosciences**, a life sciences company, was weak in the quarter due to a sharp drop in sales to its Chinese customers. The company has technological leadership in the academic lab sector, but several new product launches will expand the company's business directly to commercial biotechnology, contract research organizations, and pharmaceutical companies. The company's Chinese exposure is now greatly reduced, and we expect improved financial results to serve as a catalyst for the stock. We also saw meaningful pressure on several stocks that we believe was largely attributable to fears of rising interest rates, as the companies have strong underlying fundamentals. **SI-BONE** and **OrthoPediatrics** came under selling pressure despite solid earnings reports and positive guidance for the full year. We have used the weakness as an opportunity to increase our weighting given the compelling valuation, strong competitive positioning, and robust growth outlook for both companies. Granahan will continue to focus on high-quality franchises offering products and services that improve health care delivery in a cost-effective manner.

Generative AI is a disruptive force that will significantly alter how we learn, work, and interact. We invest in many small cap companies that are driving the buildout of AI across hardware infrastructure. **PDF Solutions**, **Veeco Instruments**, **Arteris IP** and **CEVA, Inc.** serve next generation AI chip manufacturing. Software companies are introducing AI copilots and assist agents. As users find value in these features, **PROS Holdings** should benefit through its pricing analytics offerings that allow businesses to be more efficient with its pricing and cost inputs.

## **Outlook**

Since Granahan's inception in 1985, relative valuation of small cap companies versus large has only been lower one other time, which was at the bottom of the Covid bear market. Despite the recent rise in yields adding pressure to small cap growth stocks, fundamentals in the companies we own remain compelling, with the prospect of normalizing interest rates and improving financial conditions providing an additional tailwind for performance. Based on current valuations, should the earnings come through as expected, we believe the portfolio should generate attractive returns.

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