Future Pathways

Portfolio Comments
March 31, 2024

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, Information Technology, and Consumer Staples. We remain 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

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. A strong job market and elevated wage inflation could delay the Federal Reserve's first cut in interest rates from current expectations for a June cut. While small caps saw a meaningful recovery off the October lows, we expect continued volatility until there is more clarity on the economy.

Given the economic strength, the strongest performing sectors in the quarter were Technology, Energy, and Industrials. Without a doubt, the most notable storyline this quarter centered around two Technology companies, Super Micro Computers (SMCI) and Micro Strategy (MSTR), representing the largest single-stock weights ever in the Russell 2000 Growth Index and the largest combined weight of any two stocks ever. These two stocks drove about half of the performance of the Index: SMCI driven by AI demand and MSTR a bitcoin play, both with larger market caps. Excluding both companies, the Russell 2000 Growth 1Q24 return would have been + 3.4% versus the actual index return of +7.6%.

Performance & Attribution

The Granahan Future Pathways strategy returned +4.5% in the quarter, lagging the +8.5% return of its Russell 2500 Growth benchmark. Challenges in quarter were largely tied to selection in Technology, Industrials, Energy, and Consumer Discretionary. Selection in Health Care lack of exposure in Communication Services, Materials, Financials, and Utilities was a positive this quarter but not enough to offset the portfolio's detractors. With respect to LifeCycle categories, Core Growth, Pioneers and Special Situation all lagged the benchmark this quarter.

Top Contributors	Top Detractors
1. Pure Storage (Technology, Core Growth)	1. SoundThinking (Technology, Pioneer)
2. Chart Industries (Industrials, Special Situation)	2. Array Technologies (Technology, Core Growth)
3. SunOpta (Consumer Staples, Core Growth)	3. Canadian Solar (Energy, Core Growth)
4. Nutanix (Technology, Pioneer)	4. Shoals Technologies (Industrials, Core Growth)
5. SPX Technologies (Industrials, Core Growth)	**5.** Ameresco (Industrials, Core Growth)

Positioning

The first quarter was another quarter we felt good about our positioning, but we underperformed our Russell 2500 growth benchmark. It is our mandate to have 25%-45% of the portfolio invested in Clean Energy stocks. While we have maintained our minimum weight, this group of stocks has continued to underperform. There is good reason for this as many of the climate change stocks will end up having lower earnings in the first half of this year versus last year. We see this dynamic changing during 2024, and when we feel like there is more certainty of a resumption of earnings growth, we will be adding to our Clean Energy positions. We believe the market is missing what is still a strong long-term growth outlook for clean energy. In fact, we think solar stocks will be one of the prime beneficiaries of the rise in AI. To run AI applications, it requires a tremendous amount of power being generated by data centers. The biggest owners of these data centers (hyperscalers) often have very clear mandates to offset the power consumed at these data centers by purchasing clean energy, like solar, even if it is not directly connected to the data center. We have heard that hyperscalers are already the biggest purchasers of new solar power generation in the United States and we do not see this dynamic changing anytime soon. Meanwhile the stocks in this group are now trading at very low valuations compared to the last few years. Stay tuned, as we are confident that there is not a permanent solar eclipse on clean energy stocks.

As usual during the Spring, we will be publishing our annual report on Future Pathways. We look forward to showcasing our portfolio and all our holdings at that time. We are regularly finding new investment opportunities in companies that offer products and services that promote sustainability objectives. Please look for the links to our individual holdings in this report to understand our rationale for each one of the investments in the portfolio.

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. We believe this supports a strong growth outlook over the next couple of years.