



SMALL CAP DISCOVERIES

Portfolio Comments

June 30, 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 overweight in Health Care and Consumer Staples and has added to its overweight in Information Technology versus the Russell Microcap Growth benchmark. The portfolio is equal weight in Materials and Communication Services and underweight in all other sectors. The portfolio has no exposure to Utilities or Energy.

Market Environment

The current market environment continues to be dominated by macro related factors, especially a hyper focus on U.S. inflation data. The year started out with higher-than-expected inflation data that supported a far more cautious approach to start of the rate cuts. Late in 2023 Federal Reserve Chair, Jerome Powell postulated that three rate cuts would occur in 2024, and the market was convinced even a higher number which could be implied from market data. With the negative surprise to inflation in the early part of the year, we are only now seeing the start of lower inflation. The Fed needed to have more of these data points in the first half of the year to feel confident in a rate cut at all in 2024. Now the debate with investors is the path of rate cuts going forward. While this is clearly still an unknown, we do feel that the pressure on inflation is likely to continue to subside as the economy grows at a more subdued pace than it did in 2023. We are seeing this clearly in the consumer space where bellwether companies like Nike and Levis's announced lackluster results late in June. McDonald's has seen consumer pushback on prices and as a result introduced a new lower priced \$5 value menu. While these are just anecdotes, it shouldn't surprise anyone that when our debt takes a bigger piece of our budgets, there is less money to buy things, especially at these higher prices. As we approach the back half of the year, the inflation data will continue to be in focus and be a key determining factor in sentiment, particularly in small cap stocks and Pioneer companies.

Performance Discussion

In the second quarter, the Granahan Discoveries strategy returned -11.3%, underperforming the Russell Microcap Growth Index return of -5.6%, and the -2.9% 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. Veeco Instruments (Tech, Special Sit.)
2. Mayville Engineering (Industrials, Special Sit.)
3. BioLife Solutions (Health Care, Pioneer)
4. Bel Fuse (Tech, Special Sit.)
5. PDF Solutions (Tech, Special Sit.)

Top Detractors

1. Quanterix (Health Care, Pioneer)
2. Alta Equipment (Industrials, Special Sit.)
3. CryoPort (Health Care, Pioneer)
4. Harvard Bioscience (Health Care, Special Sit.)
5. Portillo's (Consumer Disc, Core Growth)



Top Contributors in Q2:

- **Veeco (VECO)** is a diversified supplier of semiconductor process equipment. The company's products have limited competition that help customers lower power consumption and manufacturing costs. AI is also a part of the company's business and that has been recognized by investors as the stock has seen both an increase in earnings expectations and valuation. We have trimmed the position on recent strength but expect robust fundamentals to continue.
- **Mayville Engineering (MEC)** is the largest metal fabricator in the country providing tooling, coating, assembly, and aftermarket services to equipment OEMs in the construction, agriculture, powersports, and commercial vehicle markets. We increased our position given the company's ability to gain market share as more OEMs outsource this type of work. MEC's financial results are resilient relative to its end markets and there is attractive growth and profitability relative to the stock's current valuation.
- **Biolife Solutions (BLFS)** is a leading provider of bioproduction tools to companies developing next generation cell and gene therapies. BLFS' products are critical in maintaining the health of biologic source material and finished therapies during manufacturing, storage, and distribution. While the stock reacted positively to signs of a recovery in the company's business, the main catalyst was due to the sale of a discontinued business that had materially underperformed. Moving forward, we expect BLFS to see a resurgence in revenue growth and a highly attractive profitability profile.
- **Bel Fuse (BELFB)** designs and manufactures a broad array of products that power, protect and connect electronic circuits. The company has exposure to many end markets like data networking, aerospace, EVs, general industrial, defense, etc. The stock rebounded after a sell off last quarter that we believed was overdone given the current attractive valuation and outlook for accelerating revenue and profitability over the next year.
- **PDF Solutions (PDFS)** is a leading provider of yield improvement technologies for the Integrated Circuit manufacturing process. The company's technical software is used by foundries and fabless chip companies to drive higher yields. A recent stabilization of bookings and stronger results last quarter point to improved growth for the rest of the year.

Top Detractors in Q2:

- **Quanterix (QTRX)** is a life sciences company with a goal of advancing the science of precision health. The company's technology detects biomarkers, biological molecules that can indicate disease conditions, that are unmeasurable by other technologies. This higher level of sensitivity can be achieved non-invasively and much earlier in disease progression than current methods allowing therapies to treat patients when they could be most impactful. The company made meaningful progress over the past several quarters in advancing its technology and tests for use in Alzheimer's disease. Despite the progress, the stock sits at historic lows creating an attractive opportunity, in our opinion. We increased our weighting given several upcoming catalysts that should highlight the company's strong competitive position in this explosive market opportunity. The consensus estimate



for 2024 revenue has been revised upward by 14% over the past year yet the stock is down 50% for the year.

- **Alta Equipment** (ALTG) is one of the largest equipment dealership platforms in the country that sells, rents, and provides parts and support for material handling and construction equipment. The equipment supply chain has normalized and excess equipment at dealerships has resulted in a modest reduction in the financial expectation for this year. We trimmed our position given the near-term softness but believe the long-term opportunity for the company remains very compelling.
- **CryoPort** (CYRX) provides cryogenic logistics solutions to the life sciences industry. We eliminated our position during the quarter given our concerns about the growth outlook for the company for the next couple of years. A large portion of revenue is generated from capital equipment, and we believe that will remain under pressure for the next several quarters.
- **Harvard Biosciences** (HBIO) remains one of the portfolio's largest positions given a compelling valuation along with expectation for a meaningful increase in revenue growth and profitability. The stock has come under pressure along with other stocks in the overall life sciences tools market; however, we expect much improved growth during the second half of the year to serve as a catalyst for the stock.
- **Portillo's** (PTLO) owns and operates fast casual restaurants in the Midwest and Sunbelt states. We believe the company has an excellent long-term growth outlook given a unique concept and strong brand recognition. The stock has been pressured this year given its expansion in Texas, Arizona, and Florida. These investments are pressuring short-term financial results and there is skepticism on the success in these new locations. We continue to hold the stock given its compelling valuation and our expectation for success in its expansion strategy.

Themes

AI will be hugely transformational, but it is still in the early innings. While investor focus has centered primarily on those companies benefiting from infrastructure spending, we believe the most compelling opportunities are in companies that will thrive with AI over the long-term. Companies like **CEVA**, **PROS Holdings**, **PDF Solutions** and **Arteris** are very attractive with investors giving almost no credit for long-term AI benefits.

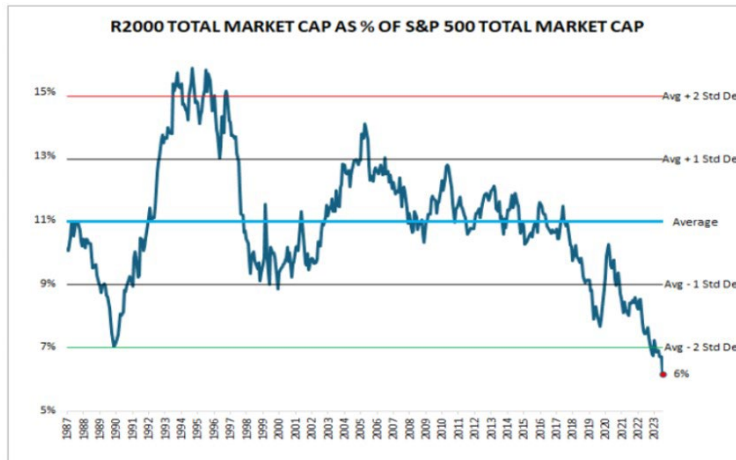
Another area of focus is on companies that are executing very well but the market simply does not care now. In fact, these stocks have come under selling pressure for reasons other than underlying fundamentals. We expect a shift in sentiment towards these stocks as strong secular drivers, historic low valuations, and robust earnings growth ultimately drive long-term appreciation. Companies like **OrthoPediatrics**, **SunOpta**, **Columbus McKinnon** and **SI-Bone** remain large positions in the portfolio.

Outlook

The second quarter of 2024 proved to be a challenging period for small cap growth companies. The headwinds of historic interest rate increases, persistent levels of inflation, political uncertainty, and numerous concerns about macro weakness all have pressured small cap growth stocks. While the broader



market indices such as the S&P 500 continued to show advance on the backs of the AI related stocks, the performance of the Russell 2000 Growth index was more subdued. Small cap stocks have lagged large cap by 12.5% in the first half of 2024, the widest spread since 1973. The Russell 2000 total market capitalization is now just 6% of the S&P 500 total market capitalization, well below the historical average of 11%, representing a new low. Small cap valuations compared to large cap valuations are in a territory that we have seldom seen.



Source: Furey Research Partners and FactSet. Data as of 6/28/24.

The market has become extremely narrow with leadership concentrated in the Magnificent 7 and a handful of select stocks leading to a short list of stocks that are “Haves” and a much longer list of “Have Nots”. While investors have increasingly become short-sighted, we believe there are a significant number of our companies operating very well with long-term secular drivers that have extremely compelling growth prospects and valuations. Over GIM’s 39-year history, we have demonstrated compelling returns buying long-term growth stocks where valuations are meaningfully disconnected from their earnings power.

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