



SMALL CAP CORE GROWTH

Portfolio Comments

June 30, 2024

Commentary

Bets on how many reductions, if any, will be announced this year have been whittled down since January, owing to a string of outsized data and warnings from the Federal Reserve that they want to see strong evidence prices are under control before moving to cut rates. A debate at the end of June with the two U.S. Presidential candidates showed weakness on the Democratic side and has set the stage for possible upward pressure on inflation with a Republican win. The Russell 2000 Growth Index was down 2.9% for the quarter and the Granahan [Small Cap Core Growth](#) strategy was down 4.9%. For the year-to-date the Index is up 4.4% and the Small Cap Core Growth strategy is down 1.6%.

Top Detractors in Q2

Three Pioneers: **Porch Group**, **Quanterix** and **10x Genomics** were the largest detractors to performance in the second quarter.

- Financial company, **Porch Group**, has experienced significant weather events in Texas and the reversal of some of the positive housing market trends seen earlier this year. This has hurt the stock; however, the company has pointed out profit levers going forward, particularly after the reciprocal approval, that will benefit results. We are holding our position.
- **Quanterix** is a life sciences company with technology that 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.
- **10x Genomics** is a biotechnology company that creates tools and technologies for studying biology at a very detailed level. In simple terms, they help scientists look at individual cells, their genetic material and their relationships to other cells to understand how they work. This information is crucial for developing new medical treatments and understanding complex biological processes. Their products have proven to be superior to competitors. Life science tools are the worst performing segment of health care year-to-date; we are adding on conviction 10x will lead the pack into a recovery.
- Core Growth, Consumer name **Portillos** had a weak Q1 as they have been struggling with food inflation and unit economics of new stores. They have been able to raise prices however, and we believe in the strength of the brand and have maintained our exposure.



- Special Situation Health Care company **Evolent Health** flagged on the Q1 call that it saw elevated authorization trends in March in a few geographies, which declined in April. The company will go to their partners for increased payment if these levels persist. We are added to our position.

Top Contributors in Q2

Winners this quarter were not concentrated in any lifecycle or industry. Our best performers this quarter were:

- **Veeco Instruments** (Technology, Special Situation) is a semiconductor capital equipment manufacturer. The company has transitioned to cutting edge technologies and a good string of earnings has validated their success. The stock has been re-rated because of this. We have been trimming into the strength.
- **Magnite** (Technology, Core Growth) helps manage and optimize online advertising. They have been taking share of the digital advertising space, added Netflix as a new customer and added live sports to their roster. We are trimming.
- **TransMedics Group** (Healthcare, Pioneer) makes machines to keep organs alive and working outside the human body for longer periods of time. Their 2024 guidance was raised and drove the stock higher. We trimmed given the valuation.
- **Carpenter Technology** specializes in making advanced materials, particularly high-performance metals and alloys in niche markets that bring high margins. Essentially, they create strong, durable, and sometimes very specialized metals that are needed for making things like airplane parts, medical implants, energy equipment, and car components.
- **Zeta Global Holdings** (Financials, Pioneer) has had strong earnings, and the stock has responded positively, we are trimming. Zeta operates a marketing-technology platform that lets advertisers combine their own internal first-party data with third-party data to attract, retain, and cross-sell customers.

Attribution

According to Alliance Bernstein, healthcare stocks often experience volatility and under-performance in the lead-up to US presidential elections due to political uncertainty and the potential for regulatory changes. This has proven to be true this year although our stock selection and overweight was a heavier burden to overall performance than that of the Index'. The reason for the Healthcare overweight is valuations and opportunities in this sector look very attractive. We are underweight Industrials, Consumer Discretionary, Energy and Financials where stock selection also struggled. Equal weight Consumer Staples, Telecommunications and Utilities detracted from performance as well, but less so than the underweight sectors. Overweight Technology had strong stock selection, with declines seen in the stocks that drove that sector last quarter (SMCI and MSTR), helping to reverse some of their positive impact on the benchmark return. Equal weight Materials and underweight Real Estate also helped performance with very strong stock selection. Pioneers were the worst performing group this quarter, with Core Growth also underperforming the Index. Special Situations outperformed the Index.

For the year-to-date, our two largest overweight sectors, Healthcare and Technology have penalized performance the most, as our stock selection hasn't helped, although Technology has fared better than Healthcare because of the allocation. We are underweight Industrials, Energy and Consumer Discretionary, which also suffered from poor stock selection. Strong stock selection in equal weight Consumer Staples, Telecommunications, Materials and Utilities and underweight Financials and Real



Estate were positives to performance. Pioneers were the detractors for the first six months of the year, with Core Growth performing better, contributing less than that of the Index. Special Situations were the best performing lifecycle.

Weights

Changes to the sector weights from Q1 to Q2 in the portfolio are nominal. Versus a year ago we added 1% to Consumer Staples and 2% to Health Care. We have lowered Financials by 1% and Energy by 2%. Changes to the Russell 2000 Growth Index from the rebalancing are significant with HealthCare up 3.5%, mostly from the increase in Biotech by 2.6%, Industrials are up 2% and Technology is down 4%. Lifecycle weights also remain similar to last quarter.

Themes

Historical data indicates that healthcare stocks tend to underperform the broader market during election years, as they are highly sensitive to political developments and regulatory change. Within the Russell 2000 Growth, Health Care has lagged year-to-date (+1.9% vs. +4.4% for R2KG) and within Health Care, Biotech is flat YTD lagging both the broader Health Care sector and the Russell 2000 Growth. In terms of what is driving the lackluster returns, we are seeing bifurcated performances among biotech in our portfolio holdings and more broadly in the benchmark. Several of our holdings are up 50%+ year-to-date with a few up 100%+, while several have been beaten down 25% or more. While there are myriad drivers of the wide disparities in performance, the outperformers seem to largely share a common attribute which is that they reported strong clinical study data against a backdrop of skepticism and ambivalence toward the sector broadly and the stock specifically. For example, **Insmmed**'s successful Phase 3 study for its respiratory drug Brensocatib led to a one-day share price gain of 120%. Leading up to the data release, the stock had been soggy and certainly did not resemble that of a company about to hit a transformational value inflection. Why? The macro remains unaccommodating toward cash-burning biotech's and Insmmed was burning a lot of cash to conduct its Phase 3 studies. The company had a disproportionate amount of debt that could have sunk the equity had Brensocatib failed. This is not a setup for the faint of heart and we ourselves maintained a position size that factored in the massive downside risk for the stock. However, because we had done our work and understood the magnitude of the commercial opportunity should Brensocatib succeed, we were in a position to add to the stock post the binary event and are pleased to see our thesis playing out as the stock continues to rise. Insmmed may be an extreme case, but it is not an isolated one in biotech currently. In fact, many of our underperforming biotech holdings resemble to varying degrees Insmmed pre-Brensocatib data. As with Insmmed, we believe, based on our diligence, our conviction in the fundamentals, adjusting for risk and the market's ongoing ambivalence toward the sector, we can deploy capital thoughtfully and reap commensurate reward.

Despite the robust investment activity taking place from government, utilities and consumers, public equity prices for decarbonization and alternative energy-focused stocks have continued to disappoint. We note that the underperformance of the past six months comes on the heels of a disappointing 2022 and 2023 as well. Part of the challenge, we believe, relates to uncertainty regarding the trajectory of future policy, especially as we prepare for the November 2024 election cycle. We also believe that public markets are spooked by China's export-led economic growth strategy, which is particularly evident in markets like solar power equipment, energy storage and electric vehicles. Currently our weighting in Energy is only 1.3% but we are watching for opportunities.

We are overweight with software and our companies have done better than those in the Index, and better than overall performance, but there is a headwind over the last year about AI disrupting the industry that is now reaching a fever pitch. Time to market for new code, the obsolescence of code



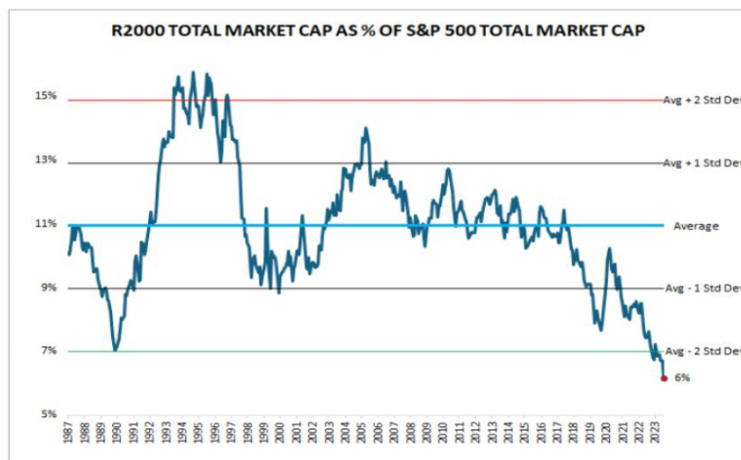
written just a couple of years ago, shifting budget from enterprise customers to AI infrastructure spend and the easier ability of new businesses to form are among the lengthening list of reasons there is incremental negativity about the group. Some companies are facing stock price declines if they invest heavily in AI without immediate returns, causing investor concern over high expenses and uncertain ROI. Overall, AI has the potential to drive significant growth and innovation in the software sector, but currently there is a headwind to traditional software companies.

Macro

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.

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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