



## Small Cap Select Opportunities

### Portfolio Comments

June 30, 2019

## Distinguishing Features

GIM builds the [Small Cap Select](#) portfolio from the bottom-up; sector weightings are secondary to stock selection. As of 6/30/2019, the portfolio continues to have a significant overweight position in the energy sector, now 10% versus 2% for the Russell 2000 Growth benchmark. Info Tech also remains overweight to the benchmark at 21% versus 18%. Industrials moved from an overweight position to about neutral to the benchmark at 19%. A nearly 6% holding in the real estate sector represents about a 3% overweighting to the Index. Consumer discretionary remains the largest underweight to the benchmark, 8% versus 15%. Financials are now underweight the Index, at 3% versus 7%. The portfolio has no exposure to materials, where the benchmark has a 3% weighting. All other sectors are within 2% of the benchmark weighting.

## Commentary

### Market Environment

During second quarter of 2019, the market changed courses each month. April returns were buoyed by the strong corporate earnings reports. May was marked by intensified trade wars with Mexico and China, and the markets were down sharply. June posted a rebound, reflecting strong consumer spending and the possibility of a future interest rate cut by the Fed. The Russell 2000 Growth Index ended the quarter up 2.8%.

### Performance Discussion

For the quarter, the Small Cap Select composite soundly outperformed the Russell 2000 Growth Index, returning 6.6%, net of fees. Year-to-date, the strategy composite is up 27.2% versus 20.4% for the benchmark. In the quarter, strong stock selection in the industrials, info tech, and healthcare drove performance, with our overweight position in each boosting relative performance. Selection in real estate and communication services also assisted relative performance. The portfolio's large overweight position in energy was a negative, as was selection, resulting in energy as the largest drag to performance in the quarter. Selection in consumer discretionary also weighed on performance.

With respect to LifeCycles, the portfolio's Core Growth and Pioneer holdings drove performance. The Special Situations category underperformed the benchmark in the quarter. Core Growth holding Enphase Energy (industrials) was the quarter's top performer, and Core Growth name Exact Sciences (healthcare) was also among the top five. Three Pioneer holdings represented the remaining top five in the quarter: Digital Turbine (info tech), Kornit Digital (industrials), and Medicines Company (healthcare).

On the negative side, two Special Situation holdings detracted in the quarter: Ring Energy (energy) and Sientra (healthcare). Other holdings in the bottom five for the quarter include Evolent Health (healthcare, Pioneer), Stamps.com (consumer discretionary, Core Growth), and 2U (info tech, Pioneer).



## **Positioning**

The market continues to reward high growth stocks. Secular growth, in particular, is highly prized in a low-to-no-growth world. We believe this may persist. We entered 2019 above the high-end of our desired range (20%-40%) for Special Situation stocks, many of which represent companies that exhibit accelerating sales and earnings growth, but not necessarily high levels of either. Special situation holdings, overall, have not done well this year. We have lowered our position in this LifeCycle category to 31% from 46% at the beginning of 2019.

While the Core Growth weighting has increased moderately from 26% to 31%, Pioneers have gained more significantly with several additions, now 36% versus 28% at the beginning of 2019. We have been actively adding to our weighting in Pioneer biotechs, capitalizing on the sector expertise and vast experience of GIM's biotech analysts. Recent additions include argenx SE and Immunomedics. With the biotech weighting now at 12% for the Russell 2000 Growth Index, our 17% position represents an overweighting that we believe will continue given the innovation and prospects this area represents.

## **Outlook**

While growth is generally scarce across the economy, we believe that the outlook for the companies in the Small Cap Select portfolio is very good. These companies are, in general, experiencing excellent growth that we believe can be sustained for the foreseeable future, as they are poised to capitalize on substantial long-term opportunities or are beneficiaries of company-specific dynamics. Companies in the portfolio are market leaders or gaining market share, and many of them are also leaders in terms of innovation and market disruption.

In comparison to small cap value stocks, small cap growth stocks are trading at premium valuations (based on current earnings), and we believe that this may persist for some time given the dynamic opportunities available to many of these companies. Company fundamentals drive our bottom-up excellent stock analysis and decision making, and diversification across the three LifeCycle categories – each with distinct performance drivers – balances the portfolio. Both are important to the long-term consistent performance of the Small Cap Select strategy.

### *Disclosure:*

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