SMALL CAP ADVANTAGE

Portfolio Comments
June 30, 2024

Distinguishing Features

GIM builds the Small Cap Advantage portfolio from the bottom-up; sector weightings are secondary to stock selection. As of June 30, 2024, the Small Cap Advantage portfolio was overweight its Russell 2000 Growth benchmark in Technology, Consumer Staples, and Energy. We are equal weight in Basic Materials, Real Estate, Telecommunications, and Health Care, and underweight the benchmark in all other sectors. The portfolio has no exposure to Utilities.

Commentary

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.

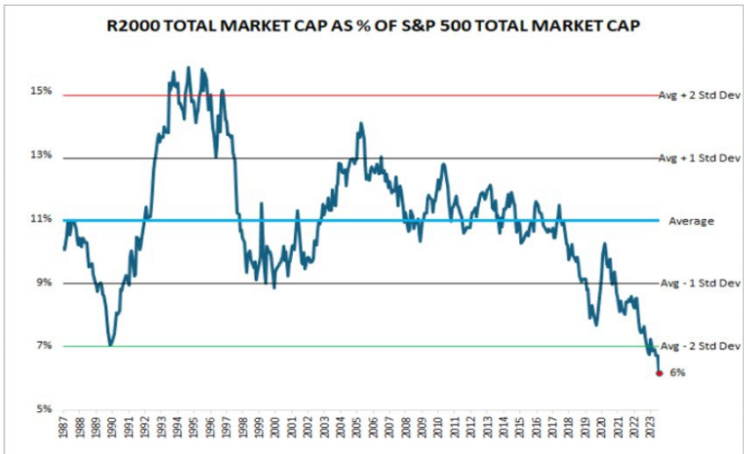
Performance

The Granahan Small Cap Advantage strategy returned -6.8% in Q2, underperforming the -2.9% return of its Russell 2000 Growth benchmark. Selection in Technology, Basic Materials, and Industrials contributed positively for the quarter, but it was not enough to outweigh the penalties from selection in Health Care, Consumer Discretionary, Financials, and Energy. With respect to LifeCycles this quarter, Core Growth and Special Situations outperformed the benchmark, while Pioneers lagged.

Top Contributors	Top Detractors
1. Magnite (Technology, Core Growth)	1. Porch Group (Financials, Pioneer)
2. Carpenter Technology (Basic Mat, Special Sit)	2. Evolent Health (Health Care, Special Situation)
3. Ameresco (Energy, Core Growth)	3. Array Technologies (Energy, Core Growth)
4. Shift4 Payments (Industrials, Core Growth)	4. Indie Semiconductor (Technology, Pioneer)
5. Vita Coco (Consumer Staples, Core Growth)	5. Viking Therapeutics (Health Care, Pioneer)

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.