



## SMALL CAP DISCOVERIES

### Portfolio Comments

December 31, 2024

#### Distinguishing Features

GIM builds the [Small Cap Discoveries](#) portfolio from the bottom-up; sector weightings are secondary to stock selection. As of 12/31/24, the Small Cap Discoveries portfolio is overweight its position in Consumer Discretionary, Industrials, Consumer Staples, and Materials versus the Russell Microcap Growth benchmark. The portfolio's Health Care weighting moved from an overweight position versus the Index to an underweight position (28% versus 34%). The portfolio is also underweight to the benchmark in Financials, Information Technology, and Real Estate and equal weight in Communication Services. The portfolio has no exposure to Energy or Utilities.

#### Market Environment

Following a promising shift in policy last quarter, the Federal Reserve tempered expectations for rate cuts considering stronger economic data and its potential inflationary effects. Yields climbed meaningfully during Q4 2024 due to better economic data, particularly job growth, and continued rising government debt levels, fueling concerns about resurgent inflation. While the fluctuating narratives regarding rates, inflation and economic growth continue to swing sentiment, the market dynamic is clearly more constructive heading into the new year than it has been in the last few years, particularly for small caps because of the return of strong projected revenue and earnings growth.

#### Performance Discussion

For the fourth quarter, the Granahan Discoveries strategy returned -3.0%, underperforming the Russell Microcap Growth Index return of +11.6%, and the +1.7% return of the secondary Russell 2000 Growth benchmark. For the full year, the strategy returned -9.0%, while the Russell Microcap Growth Index had a return of 21.9%, and the Russell 2000 Growth returned +15.2. In terms of LifeCycles, all three categories lagged the benchmarks for the quarter and 2024. A major detractor for both 4Q and the year has been the extreme concentration of the market. In fact, during 4Q24 over 70% of the micro cap benchmark return came from just 10 stocks. For the year, fully two-thirds of the benchmark return was due to just 15 stocks. As fundamental investors, we focus on core investment criteria balanced with an attractive valuation and conviction in long-term earnings projection. Many of these stocks that drove the benchmark's performance fell outside of our criteria for an attractive investment.



TOP CONTRIBUTORS	
4Q – 2024	2024
<ol style="list-style-type: none"> <li>1. <b>Universal Technical Inst</b> (Consumer Disc, Core Growth)</li> <li>2. <b>Arteris, Inc</b> (Info. Tech., Pioneer)</li> <li>3. <b>CEVA, Inc.</b> (Info Tech., Special Situation)</li> <li>4. <b>SunOpta Inc.</b> (Consumer Staples, Core Growth)</li> <li>5. <b>Vita Coco Company</b> (Consumer Staples, Core Growth)</li> </ol>	<ol style="list-style-type: none"> <li>1. <b>Edgewise Therapeutics</b> (Health Care, Pioneer)</li> <li>2. <b>BioLife Solutions</b> (Health Care, Pioneer)</li> <li>3. <b>Stoke Therapeutics</b> (Health Care, Pioneer)</li> <li>4. <b>Vericel Corporation</b> (Health Care, Core Growth)</li> <li>5. <b>Arteris, Inc.</b> (Info Tech., Pioneer)</li> </ol>

TOP DETRACTORS	
4Q – 2024	2024
<ol style="list-style-type: none"> <li>1. <b>Mayville Engineering</b> (Industrials, Special Situation)</li> <li>2. <b>Syndax Pharmaceuticals</b> (Health Care, Pioneer)</li> <li>3. <b>Keros Therapeutics</b> (Health Care, Pioneer)</li> <li>4. <b>OrthoPediatrics Corp.</b> (Health Care, Core Growth)</li> <li>5. <b>Kiniksa Pharmaceuticals</b> (Health Care, Pioneer)</li> </ol>	<ol style="list-style-type: none"> <li>1. <b>Harvard Bioscience</b> (Health Care, Special Situation)</li> <li>2. <b>Quanterix Corp</b> (Health Care, Pioneer)</li> <li>3. <b>PROS Holdings</b> (Info. Tech., Core Growth)</li> <li>4. <b>908 Devices Inc</b> (Health Care, Pioneer)</li> <li>5. <b>Syndax Pharmaceuticals</b> (Health Care, Pioneer)</li> </ol>

## Positioning

Rising interest rates over the course of both the quarter and year negatively impacted long-duration assets, particularly a number of the portfolio’s healthcare stocks. Additionally, the potential implications of the Trump administration’s healthcare policy led to an across the board sell-off in the sector towards the end of the year. The healthcare sector has been particularly challenging over the last several years. In fact, less than 20% of healthcare stocks have even beaten the market over the past 2 years.

While the healthcare sector has materially underperformed since 2021, we continue to maintain a large exposure to these companies. The sector is bursting with companies that are investing in potentially disruptive treatments for some of the most debilitating medical conditions. **Stoke Therapeutics (STOK)** is developing a differentiated treatment for a severe form of epilepsy known as Dravet Syndrome. The company has continued to demonstrate promising data for its therapies and recently finalized trial protocols with the US Food and Drug Administration (FDA) and other global regulatory bodies on the design of its Phase 3 trial starting this year. **SI-BONE (SIBN)** is an orthopedic company focused exclusively on sacropelvic disorders. The company is the market leader in this emerging segment with superior technology and attractive reimbursement that we believe will continue to deliver high-teens revenue growth and strong operating leverage. Despite an eventful year of new product launches and strong financial results, the stock underperformed and sits at the lowest valuation since its IPO in 2018. We believe these companies at current valuation levels make compelling investment opportunities and we continue to hold positions in them.

Our technology stocks trailed the benchmark primary due to a couple detractors while also missing out on some of the benchmarks largest weightings that did exceptional well. Despite the performance challenges, we have increased our weighting in what we believe are compelling stocks positioned for outperformance in 2025. **Ateris** and **CEVA** focus on designing IP primarily for semiconductor companies to help improve interconnectivity of their products that power next generation devices. Artificial Intelligence is a large opportunity for both companies that should meaningfully accelerate growth for both companies. While investors have rewarded just a few small cap AI infrastructure stocks to date, we believe that will broaden out and companies like CEVA and Arteris will continue to do well. **PROS Holdings (PRO)** was negatively



impacted by its exposure to travel related companies in 2024 but we believe its AI-based pricing products will see solid traction this year in both non-travel and travel-related customers.

## **Outlook**

Concerns over a potential recession have been replaced by expectations related to the degree to which revenue and earnings growth will accelerate in 2025 and 2026. In that respect, small cap companies are well-positioned with revenue and earnings growth anticipated to be better than large cap for the first time in the last several years. “Higher for longer” in terms of rates is not necessarily a significant negative if it happens in the context of stronger economic growth as valuation compression over the last three years has been substantial. Stronger economic growth is fueling the stronger small cap revenue and earnings growth estimates for 2025 and beyond. The severe narrowness of the market seen over the course of 2024 is gradually giving way to more breadth, a positive dynamic for active investing.

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