MICROCAP GROWTH

Portfolio Comments
December 31, 2024

Distinguishing Features

GIM builds the Microcap Growth portfolio from the bottom-up; sector weightings are secondary to stock selection. The Microcap Growth strategy has maintained an overweight in Health Care compared to the Russell Microcap Growth benchmark (41% vs. 34%). The portfolio is also overweight Comsumer Discretionary and Consumer Staples and equal weight to the benchmark in Industrials. We are underweight in all other sectors. The portfolio has no exposure to Utilities, Energy, Communication Services, or Materials.

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 Microcap Growth strategy returned -3.8%, trailing the Russell Microcap Growth Index return of +11.6%. For the full year, the strategy was down -9.0% versus the benchmark's +21.9% return. 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**
1. **Universal Technical Inst.** (Consumer Disc, Core Growth)	1. **Edgewise Therapeutics** (Heath Care, Pioneer)
2. **Arteris, Inc.** (Info. Tech., Pioneer)	2. **Stoke Therapeutics** (Health Care, Pioneer)
3. **CEVA, Inc.** (Info. Tech., Special Situation)	3. **BioLife Solutions** (Health Care, Pioneer)
4. **SunOpta Inc.** (Consumer Staples, Core Growth)	4. **Arteris, Inc.** (Info. Tech., Pioneer)
5. **Chefs' Warehouse** (Consumer Staples, Core Growth)	5. **Chefs' Warehouse** (Consumer Staples, Core Growth)

TOP DETRACTORS	
4Q – 2024	**2024**
1. **Keros Therapeutics** (Health Care, Pioneer)	1. **Harvard Bioscience** (Health Care, Special Situation)
2. **Mayville Engineering** (Industrials, Special Situation)	2. **Quanterix Corp** (Health Care, Pioneer)
3. **Syndax Pharmaceuticals** (Health Care, Pioneer)	3. **908 Devices Inc.** (Health Care, Pioneer)
4. **OrthoPediatrics Corp.** (Health Care, Core Growth)	4. **PROS Holdings, Inc.** (Info. Tech., Core Growth)
5. **Kiniksa Pharmaceuticals** (Health Care, Pioneer)	5. **Syndax Pharmaceuticals** (Health Care, Pioneer)

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 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 stocks well positioned for outperformance in 2025. **Ateris** and **CEVA** focus on designing IP primarily for semiconductor companies to hep 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.

It is worth mentioning that today's environment is quite different than 2022 and 2023 when inflation and rates were spiking, and an altered supply/demand cycle (i.e., COVID hangover) caused massive dislocation across industries. The risks today are less extraordinary and resemble factors that are more normal course and ones that we have assessed for decades. Whether the Fed cuts rates by two times or three in 2025 is much less important than the revenue and earnings growth that our portfolio companies deliver in 2025 and beyond. As such, we continue to be focused on the fundamentals of the underlying businesses in which we invest. The shortsightedness we see in the current market creates opportunities for us to leverage short term volatility to a long-term advantage.