# GLOBAL SMALL CAP

**Portfolio Comments**
**March 31, 2024**

**Distinguishing Features**

GIM constructs the Global Small Cap portfolio from bottom-up; prioritizing stock-specific fundamentals over sector or regional weightings. Our disciplined approach typically leads to structural overweights in innovative sectors such as Information Technology, Health Care, and Industrials, where disruptive small-cap opportunities are abundant.

**Market Environment**

Inflation concerns that dominated the headlines in 2024 have evolved into broader fears of stagflation, contributing to a more cautious investment environment. What initially appeared to be a promising environment for accelerating revenue and earnings growth in small-cap companies has quickly shifted toward a heightened risk of a global recession. At the same time, the newly imposed tariffs have already led to declining business and consumer confidence. The Trump administration actions to cut government spending to reduce the deficit, has raised additional concerns about a potential economic slowdown. Shifting tariffs and their potential impact on supply chains and prices have made “uncertainty” the dominant theme in U.S. equity markets. Geopolitical instability, including U.S.-China trade tensions and conflicts in Eastern Europe and the Middle East, are adding to market volatility. In this environment, shifting policy narratives are likely to sustain a higher level of volatility, making it more challenging to forecast the near-term impact on corporate earnings.

As investors question whether this could be the start of the end for US exceptionalism, Western Europe is finally showing signs of life. Germany’s $1 trillion stimulus package marks a historic pivot from austerity to growth, catalyzing renewed interest in Europe. The policy shift that is focused on re-shoring, defense autonomy, and energy security has reversed investor skepticism, as evidenced by a significant shift in asset flows into European equities. Along the same lines, Japan has become more compelling from an investment perspective. The country’s economic and political stability, attractive relative valuation and corporate governance reforms aimed at enhancing shareholder value have led investors to view Japan has an attractive option for capital flows.

**Market Environment**

In the first quarter, the Granahan Global Small Cap strategy returned -9.9% underperforming the Core Index return of -3.7%. Stock selection drove 401bps of detraction while a negative allocation effect added 206bps to underperformance. Poor stock selection was primarily in Industrials (-140bps), a function of macro-related sentiment (e.g., tariffs) and idiosyncratic factors, some of which are discussed below. The negative allocation related to our overweight in Technology (-117bps) explained most of the underperformance while sectors that the portfolio consistently avoids or underweights further impacted results; Financials (-26bps), Materials (-26bps), Utilities (-25bps), and Real Estate (-17bps).

The United States was the region with the most negative impact to performance (-285bps), a function of stock-specific factors (e.g., Columbus McKinnon) as well as tariffs and AI-related sentiment (e.g., DeepSeek).

Canada (-121bps), with similar headwinds as the US, and Japan (-71bps) represented large detractors as well. Japan has been raising interest rates to combat inflation, albeit more moderate than other regions, which is weighing on the appetite for secular growth companies. From a LifeCycle standpoint, all categories detracted from performance; Core Growth (476bps), Special Situations (359bps) and Pioneers (136bps).

**Top Contributors:**

- **Baycurrent (6532 JP)** continues to invest and deliver strong growth. As a consultant focused primarily on digital transformation with a structural competitive advantage relative to multinationals, Baycurrent is benefiting from solid demand for cloud migration and, increasingly, AI. After a period of aggressive hiring that drove weaker utilization and lower consultant fees, the fundamentals are beginning to accelerate, including the recently reported results. The company remains one of our top holdings.
- **Fortnox AB (FNOX SS)** The company has been a good contributor to performance since initiating our position in March 2022. The company was taken private by the private equity firm EQT this quarter.
- **Nutanix (NTNX US)**, a developer of enterprise cloud platforms, delivered strong stock performance in the quarter, driven by robust subscription growth and sustained demand for hybrid cloud infrastructure. The company's shift to a software-based, recurring revenue model continues to enhance margins and visibility. With increasing enterprise adoption of multi-cloud strategies, we believe Nutanix is well-positioned for long-term growth.
- **CTS Eventim AG (EVD GR)**, a German ticketing platform and event promoter (i.e., the German Ticketmaster/Live Nation), is benefitting from strong slate of content in the live events space, particularly concerts. A robust summer line up this year drove better than expected results in Q4, the period in which most ticket sales occur for the following summer. We continue to own the stock and believe it benefits from strong network effects, a good competitive position, and a market with compelling underlying supply/demand characteristics.

**RBC Bearings (RBC US)**, a manufacturer of highly engineered precision bearings and related components for industrial, aerospace and defense applications, was a top performer in the quarter, benefiting from accelerating demand in its Aerospace and Defense segment and meaningful margin expansion. We believe the company has a favorable long-term outlook based on its backlog and its history of disciplined acquisitions and ongoing operational efficiencies. **Top Detractors:**

- **Columbus McKinnon (CMCO US)**, a manufacturer of material handling products, underperformed due to investor concerns around tariff-related cost pressures and a major strategic acquisition that was poorly received. Despite near-term headwinds, the company's large backlog and focus on automation and motion control solutions remain compelling to us. At current valuation levels, we believe the stock presents a potential recovery opportunity as integration benefits unfold from the acquisition.
- **Boot Barn (BOOT US)**, a dominant retailer of western wear and workwear with production in Mexico and China, reported better-than-expected results for Q4 2024. The stock has since sold off due to tariff fears and concerns related to depressed consumer spending. The company managed Trump Tariff 1.0 well through a combination of price increases and pressure on suppliers, and we expect the same with this round of tariffs. As the leading player with 50% market share in a highly

fragmented market, we believe Boot Barn is positioned to weather the storm better than the rest of the industry and likely gains market share. The ability to flex the mix of branded products with their own exclusive brands is an advantage.

- **Pure Storage (PSTG US)** provides flash-based data storage. The stock was weak this quarter due to investor concern about AI-infrastructure stocks after the release of the DeepSeek language model. We believe the company remains a compelling long-term investment by being uniquely positioned as a key enabler of AI infrastructure through its high-performance, all-flash storage solutions. With growing demand for scalable, low-latency data platforms to support AI workloads, Pure Storage stands to benefit meaningfully as enterprises accelerate AI adoption.

- **SunOpta (STKL US)** is a producer of natural and organic foods. The company lagged in the quarter due to temporary gross margin pressure from supply chain disruptions and ongoing investments. However, the company continues to gain market share in the fast-growing organic and plant-based foods space. With a long-term focus on premium health and sustainability trends, SunOpta remains a strategic holding in the consumer staples space.

- **Docebo (DCBO CN)** provides a cloud-based SaaS learning management platform with a differentiated position on external training (e.g., AWS Certification Program). The company reported in line results for Q4 but provided 2025 guidance that was shy of expectations, partly due to foreign currency. The slightly weaker guide and slowing in certain metrics relate to a more challenging macro environment and a client renewal. The selloff was overdone, in our opinion, and we view the risk/reward as compelling at this level. As such, we continue to own the stock but trimmed our position as we wait for the return of positive earnings estimate revisions.

A few themes worth discussing:

1. **Europe is Back…Potentially** – The development in Germany cannot be understated as it relates to the narrative around investing in Europe, although it remains to be seen the timing and ultimate impact of the announced spending initiative. For years, European governments have been reluctant to change policies even when there has been clear evidence or pressure to do so. This policy inertia and maintaining outdated fiscal and monetary frameworks have frustrated investors and reduced the attractiveness of investing in the region. The $1 trillion stimulus package, announced in March, represents a philosophical and policy shift toward strategic autonomy, including onshoring of critical manufacturing, defense independence, and energy diversification away from the US and Russia. For years, Europe, and Germany, in particular, have been characterized by fiscal conservatism, often favoring stability and low debt over aggressive growth policy. With an increasingly combative and uncertain United States, Europe has begun to transform into a better functioning and more investable region and recent fund flows confirm this inflection. In the first quarter of 2025, US investors poured $10.6B into ETFs focused on European stocks, **seven times** the inflows recorded a year earlier (source: Blackrock, Reuters).

2. **Our Take on DeepSeek** – DeepSeek made waves in January 2025 with the launch of DeepSeek-R1, a free, open-source reasoning model that rivals leading AI systems but was developed at fraction of the cost of its U.S. counterparts. While its debut initially sparked concerns of reduced hardware demand and triggered a broader market sell-off, the longer-term implications are more nuanced.

DeepSeek's breakthrough in inferencing efficiency could accelerate AI adoption, consistent with Jevons' Paradox: as the cost of a resource drops, its overall consumption often increases. Supporting this view, major hyperscalers like Microsoft, Amazon, Google, Meta, and Oracle have already signaled increased AI-related capital expenditures in 2025, particularly inferencing infrastructure. One key challenge remains inferencing speed, which limits AI's current capabilities to simple, text-based tasks. As AI evolves toward faster, more multimedia-rich, and agentic outputs, reducing latency becomes critical. This presents investment opportunities in AI connectivity and memory & storage. **Pure Storage** is a portfolio company that is poised to benefit as the company enables faster, higher-capacity AI processing. Despite the indiscriminate market sell-off, we believe these strategic areas offer meaningful long-term upside. In addition, companies such as **Cellebrite**, **Docebo**, and **Raksul**, which are increasingly incorporating AI into their software platforms, will benefit from the lower cost of AI models.

**Commentary**

We added 8 companies to the portfolio during the quarter and sold 8. We sold **Elf Beauty** (mass market cosmetics) and **Fox Factory** (manufacturer of suspensions for high end bikes, recreational vehicles, etc.) due to the challenging consumer spending dynamic and potential impact of tariffs. **RS Group** (UK distributor of industrial products) and **Titan Machinery** (operator of agricultural and construction equipment stores) are industrial companies that were experiencing negative estimate revisions with limited visibility to an inflection in fundamentals. Similarly, **Rapid7** (cybersecurity software) delivered disappointing results. We eliminated our position in **Chefs' Warehouse** (premier distributor of specialty food products) given a full valuation relative to our outlook. **Merus N.V.** (clinical-stage immuno-oncology) was eliminated due to competitive concerns that emerged during the quarter. Finally, **Stevanato Group** (global provider of containment and delivery solutions for biopharma) was eliminated from the portfolio given our concerns about excess inventory

In terms of additions to the portfolio, we added companies that we believe demonstrate solid secular growth attributes. We detail a few of those new positions. **Sigmaroc PLC,** a UK-listed producer of limestone and construction materials, is akin to aggregates businesses which benefit from regional market dominance, pricing power and structural demand in a fragmented and highly localized industry. The barriers to entry are particularly high due to geological scarcity, regulatory/permitting hurdles, and logistical cost advantages. Sigmaroc should be a beneficiary of the recently announced German stimulus, both from steel production and infrastructure spending. **JBT Marel Corp.**, a global leader in food processing solutions for poultry, meat and fish, is capitalizing on a shift in the industry to more automated solutions and increasing focus on food safety and supply chain transparency. The recent merger of JBT (US) and Marel (Iceland) creates meaningful cross-selling potential, material cost synergies and a more significant competitive moat. Finally, **Modine Manufacturing Company** manufactures heating and cooling solutions for commercial, industrial, and vehicular customers. New management has transformed the company by shifting to higher-growth markets and divesting lower margin businesses. Liquid cooling for data centers is an increasingly meaningful part of the business. Given sentiment shift for AI-related stocks post-DeepSeek introduction, the company presented a compelling risk/reward.

**Outlook**

The current investment landscape for small cap growth stocks is characterized by both uncertainty and opportunity. The Trump administration's strategy to address the country's fiscal challenges, centered on reducing government waste, fraud, and unnecessary spending, has introduced a new dynamic into the market, both domestically and abroad. At the same time, the administration's efforts to re-industrialize the U.S. economy, particularly through the use of tariffs, have fostered a more protectionist trade environment, adding volatility to global supply chains and dampening investor sentiment. While these initiatives aim to enhance long-term fiscal health, they also contribute to near-term unpredictability as federal programs and agencies undergo restructuring.

Nevertheless, this uncertain backdrop creates compelling opportunities for small cap growth investors. Many innovative small cap companies continue to demonstrate strong fundamentals, including robust revenue growth, scalable business models, and unique market positions, yet are trading at historically attractive valuations due to broader macroeconomic concerns. Market dislocations can provide long-term investors with the chance to establish and build positions in high-potential businesses before sentiment recovers. As capital begins rotating back into growth-oriented equities in anticipation of economic stabilization, small caps—especially in technology, healthcare, and industrials—could deliver meaningful returns. Accordingly, we remain focused on the underlying fundamentals of the businesses in which we invest and believe that current market volatility presents an opportunity to position the portfolio for long-term success.