



JUNE 30, 2019

CAMPBELL NEWMAN

# SMALL CAP GROWTH 2Q 2019 COMMENTARY

## MARKET OVERVIEW

Despite rather volatile monthly performance of 3.05%, -7.42% and 7.70% for April, May and June, respectively, the Russell 2000 Growth logged a 2.75% return in the second quarter. Improved prospects for a trade deal with China and a Fed rate cut(s?) later this year caused stocks to reverse following May's steep 7.42% sell-off and close the quarter on a positive note. The market's breadth was generally strong with all the major Russell style indices recording positive returns. As a potential sign of weakening market internals, the small-caps underperformed their mid and large-cap counterparts. For example, the Russell 2000 Index, logged a 2.10% return in the period compared to the Russell Midcap and Large Cap Index returns of 4.13% and 4.25%, respectively.

The breadth of Russell 2000 Growth was more narrow than that of the larger cap indices with only 8 of its 11 economic

sectors posting positive returns in the quarter. Additionally, there was a 20-percentage point difference between the top (Industrials at 9.91%) and bottom (Energy at -10.04%) sector returns. Other than the Industrials, the outperforming sectors were: Utilities at 5.60%, Financials at 4.30% and Information Technology at 3.71%. In addition to Energy, the underperforming sectors were: Materials at 2.18%, Consumer Discretionary at 1.93%, Consumer Staples at 1.16% and Real Estate at 0.05%, Health Care at -0.22% and Communication Services at -3.99%.

As we turn our focus beyond the second quarter, the month of July will mark the beginning of the longest economic expansion in history at 121 months, surpassing the previous record of 120 months established during the March 1991 to March 2001 expansion.



## PORTFOLIO REVIEW

The Small Cap Growth composite outperformed its Russell 2000 Growth benchmark in the quarter by 85 bps. The positive impact to relative performance from stock selection overwhelmed the negligible negative impact from the allocation effect in the quarter.

The greatest positive impact (108 bps) to relative performance was derived from stock selection in the Consumer Discretionary sector, which recorded a 10.22% return compared to the Russell 2000 Growth's sector return of 1.93%. Texas-based housing developer LGI Homes, Inc. (LGIH) was the top performer in the sector, at 18.58%. Pool Corp. (POOL) and Funko, Inc. (FNKO) were other notable positive contributors with returns of 16.13% and 11.17%, respectively.

The Real Estate sector contributed positively to relative performance (35 bps) as the portfolio's sector return of 9.60% compared favorably to the 0.05% return of the benchmark sector. The two portfolio sector holdings, CoreSite Realty Corp. (COR) and CyrusOne, Inc. (CONE), exhibited strong returns in the quarter, 8.76% and 10.95%, respectively.

The portfolio's Industrial sector posted the strongest quarterly performance (15.94%). Engineering and consulting solutions firm NV5 Global, Inc. (NVEE) and specialty telecom contractor Dycom Industries, Inc. (DY) posted strong quarterly returns, 37.13% and 28.15%, respectively.

The portfolio's lack of exposure to the underperforming Energy (-10.04%) and Communication Services (-3.99%) sectors contributed a total of 46 bps to relative performance. Note that portfolio sector weights are a reflection of where the team is finding the most attractive issues within the strategy's parameters.

On the negative side, the portfolio's Information Technology sector underperformed the benchmark sector, -0.28% vs. 3.71%, respectively, detracting 98 bps from relative performance.

## TOP CONTRIBUTORS

Engineering and consulting solutions firm, **NV5 Global, Inc. (NVEE)**, reported record results across all financial metrics in 1Q 2019 that were a welcome relief from mixed results in the

prior quarter. Gross revenues increased 24%, EBITDA increased 34% and net income increased 29%. Backlog also increased by 43%. NV5's core business and acquisition pipeline keep the company well positioned for the remainder of 2019.

Life science and semiconductor manufacturing automation solutions firm, **Brooks Automation, Inc. (BRKS)**, reported solid 2Q operating results with 26% year-over-year revenue growth. BRKS' two operating units, Life Sciences and Semiconductor Solutions, both reported revenue growth ahead of expectations. The second quarter marked a transformative milestone with 43% of revenue coming from Life Sciences.

**MarketAxess Holdings, Inc. (MKTX)**, an operator of electronic platforms for fixed-income trading, set record trading volumes across its core products in the quarter. The trend to automated execution is gaining momentum in fixed income putting MKTX in a strong position to capitalize on its technology and global client network.

## BOTTOM CONTRIBUTORS

Shares of wireless medical technology company, **BioTelemetry, Inc. (BEAT)**, reacted negatively to an inline first quarter of double-digit earnings and revenue growth after producing four consecutive quarters of positive earnings surprises. The outlook for cardiac monitoring and diagnostic devices for the company remains favorable.

Information technology consulting firm, **ePlus, Inc. (PLUS)**, reported fiscal 4Q results that were negatively impacted by the transition being undertaken by its clients' purchasing behavior toward SAAS (Software as a Service) and ratably recognized revenue. We believe this transition masks the company's move toward selling more consulting, managed and professional services which should result in growing recurring revenue contribution and improving margins.

Shares of pet wellness and medication company, **PetIQ, Inc. (PETQ)**, responded negatively to slower growth in the quarter. Whereas management has stated potential revenue growth in the mid-teens, the last quarter had same-store growth of approximately 3%. Plus, startup costs for new centers are running higher than previously expected. Due to these headwinds, we have sold the stock.



## PORTFOLIO POSITIONING

The Small Cap Growth portfolio's composition changed modestly in the quarter. The portfolio's emphasis remains in Information Technology with a 25.83% weighting (divided among a diverse set of 11 stocks). The Health Care sector accounts for 23.05% of the portfolio (also 11 stocks), followed by Consumer Discretionary (15.25%), Industrials (12.77%) and Financials (10.22%).

During the quarter, Planet Fitness, Inc. (PLNT), an operator and franchisor of fitness centers, was added to the portfolio's Consumer Discretionary sector while PetIQ, Inc. (PETQ) was sold due to headwinds impacting the company's ability to grow and produce returns similar to those it has in the past.

## TOP AND BOTTOM ABSOLUTE CONTRIBUTORS

### 2Q 2019 TOP CONTRIBUTORS

	WEIGHT	RETURN	IMPACT
NV5 Global, Inc.	2.87%	37.13%	90 bps
Brooks Automation, Inc.	3.19	32.46	86
MarketAxess Holdings, Inc.	2.76	30.84	74
Pool Corp.	3.54	16.13	53
Dycom Industries, Inc.	1.61	28.15	41

### 2Q 2019 BOTTOM CONTRIBUTORS

	WEIGHT	RETURN	IMPACT
BioTelemetry, Inc.	2.49%	-23.11	-70 bps
ePlus, Inc.	2.28	-22.14	-55
PetIQ, Inc.	0.84	-20.89	-51
Virtusa Corp.	1.74	-16.88	-33
Horizon Therapeutics	2.77	-8.97	-26

### SMALL CAP GROWTH COMPOSITE PERFORMANCE NOTES:

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