



JUNE 30, 2021

CAMPBELL NEWMAN

# SMALL CAP GROWTH 2Q 2021 COMMENTARY

## MARKET OVERVIEW

Positive returns were broad-based across market caps and by style in 2Q 2021, driven by the ongoing “reopening” of the economy and plentiful liquidity. The Small cap indices underperformed the Large caps in the quarter, while Growth bested Value everywhere except among the Small caps. In this environment, the Russell 2000 Growth (R2G) Index posted a 3.92% return, taking its year-to-date return to 8.98%.

As it became evident that the rate of change in economic and earnings growth from March 2020 was peaking, the market rotated away from some of the cyclical stories in the Industrials (-1.58% sector return) and Materials (3.50%) sectors. Energy, however, followed through from last quarter as the Index’s top performer (23.58%), as the price of oil (WTI) increased roughly 24% to over \$73/bbl by June 30. Communication Services had the next best sector return at 8.42%, followed by Consumer Staples (7.68%), Information Technology (6.86%) and Real Estate (6.34%).

Inflation ticked up in the quarter, with the CPI rising from

2.6% in March to 5.0% in May, a level not seen since 2008. It is unclear whether higher inflation is here to stay, as the result of all the monetary and fiscal stimulus, or if it is transitory, largely a result of a shorter-term lag from factories’ rebuilding capacity to catch up to demand growth. It is noteworthy that the yield on the bell-weather 10-Year Treasury declined by 16% in the quarter to 1.45% from 1.74%. However, while changes in interest rates would normally provide clues regarding inflation expectations, we have less confidence in their predictive ability due to the Fed’s ongoing market intervention.

## PORTFOLIO REVIEW

The Small Cap Growth portfolio’s 4.62% net of fees return outperformed its Russell 2000 Growth benchmark by 70 bps. Year-to-date, the Small Cap Growth portfolio’s net of fees performance is 18.57% compared to 8.98% for its Russell bogey.



Both stock selection and sector allocation contributed to the quarter's outperformance. The greatest positive impact (91 bps) was stock selection in Consumer Staples driven by the portfolio's only sector holding, Medifast (MED), which had a 34.26% gross of fees return vs. 7.68% for the benchmark sector. Stock selection in the Consumer Discretionary sector (7.42% gross return vs. 5.36% for the R2G) added another 38 bps, due to housing-related stocks such as Pool Corp (POOL, 33.10%), RH (RH, 13.81%) and Century Communities (CCS, 10.58%).

The greatest negative impact (-90 bps) came from stock selection in the Information Technology sector, which had a gross return of 3.65% vs. 6.86% for the R2G sector. Please see the commentary in "Bottom Contributors" regarding the performance of CEVA (CEVA, -15.76%) and Rackspace Technology (RXT, -17.54%).

## TOP CONTRIBUTORS

**Medifast, Inc. (MED)**, a direct seller of health and wellness products, delivered strong 1Q 2021 results with revenues increasing 91% to \$341 million and earnings increasing 122% to \$3.46 per share. This growth is supported by the strength of its OPTAVIA lifestyle solution and coaching support system, as well as elevated consumer interest in health and wellness products.

**EPAM Systems, Inc. (EPAM)**, a leading global provider of digital platform engineering and software development services, recently announced its commitment to deliver at least 20% organic revenue growth and stable margins over the next three years. Additionally, management expressed its longer-term ambition of achieving \$5.0 billion to \$10.0 billion in revenue from a base of \$2.7 billion today.

**Brooks Automation, Inc. (BRKS)** reported strong fiscal 2Q 2021 revenue and earnings growth of 30% and 145%, respectively. Momentum remained strong across both its Life Sciences and Manufacturing Automation Solutions businesses. Additionally, the company announced its intention to separate into two independent public companies, as each have established their own growth trajectories.

## BOTTOM CONTRIBUTORS

**CEVA, Inc. (CEVA)**, a leading licensor of wireless connectivity and smart sensing technologies, reported 1Q 2021 financial performance generating top-line growth of 8% year-over-year, driven by 56% growth in royalties from base station and IoT product categories. Earnings though missed due to mix that led to a one-time higher-than-expected corporate tax rate which is anticipated to normalize in the coming quarters. CEVA remains a key beneficiary of secular demand for low-power wireless connectivity products.

**Rackspace Technology (RXT)**, a leading pure play end-to-end multi-cloud technology services company, reported 1Q 2021 results that topped expectations. Gross margin though was a little lite due to mix and customer onboarding expenses. Long term, we think RXT is well-positioned as a key partner to support enterprise cloud adoption, which is early and accelerating. Overall, cloud demand is at an all-time high, as companies adopt the cloud to support their post-pandemic digital transformations.

**Dycom Industries, Inc. (DY)**, a leading provider of telecom contracting services throughout the United States, reported fiscal 1Q 2022 results below expectations due to a delay in spending from a larger customer program which is expected to persist through the year. However, we remain optimistic on the upcoming telecom spending cycle as major telecom service providers look to invest in their recently acquired spectrum, while at the same time large customers like AT&T have publicly commented on their fiber deployment plans that call for major expansions.

## PORTFOLIO POSITIONING

The only changes to the portfolio's positioning in the quarter came from market movement since no trades were made during the period. Built through bottom-up stock selection based on fundamental research performed in-house, the portfolio continues to be most heavily weighted in companies operating in the Information Technology (30.9% weighting), Health Care (21.0%), Consumer Discretionary (19.6%) and Industrials (12.2%) sectors. Information Technology and Consumer Discretionary are overweighted relative to the benchmark, while Industrials and Health Care are underweighted—with Health Care roughly 30% underweighted to the benchmark. (Health Care is the largest sector in the R2G with a 29.3% weight.)



Helping to explain the portfolio's relative positioning in Health Care is the strategy's profitability requirement. As most Small cap companies in this sector are in the developmental stage, few have profitable operations and are thus excluded during our initial screening process to establish our research universe. For example, as of June 2021, there

were 459 companies in the Russell 2000 Growth Health Care sector and only 87 (19%) were profitable over the trailing four quarters. For perspective, approximately 50% of the R2G's 1,172 companies were profitable on a trailing four quarter basis.

## TOP AND BOTTOM ABSOLUTE CONTRIBUTORS

2Q 2021 TOP CONTRIBUTORS	WEIGHT	RETURN	IMPACT
Medifast, Inc.	4.53%	34.26%	127 bps
EPAM Systems, Inc.	3.33	28.81	85
Brooks Automation, Inc.	4.95	16.82	73
Pool Corp.	2.41	33.10	69
RH	4.36	13.81	58

2Q 2021 BOTTOM CONTRIBUTORS	WEIGHT	RETURN	IMPACT
CEVA, Inc.	2.16%	-15.76	-40 bps
Rackspace Technology	2.00	-17.54	-39
Dycom Industries, Inc.	1.56	-19.73	-35
Pacira BioSciences, Inc.	1.55	-13.43	-24
ePlus, Inc.	1.51	-13.00	-21

### SMALL CAP TAX-EXEMPT COMPOSITE PERFORMANCE NOTES:

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