



MARCH 31, 2022

CAMPBELL NEWMAN

SMALL CAP GROWTH

1Q 2022 COMMENTARY

MARKET OVERVIEW

Small cap stocks continued to lag their larger counterparts in the quarter as financial markets reacted to a volatile, headline-driven environment. To wit, the Russell 2000 Growth Index's quarterly performance of -12.63% was over eight percentage points behind that of the large cap bell-weather S&P 500's -4.60% return.

Fueling the downturn was the Fed's signaling of a significantly more hawkish monetary policy to curb inflation, which rose to 7.9% in February, up from January's 7.5%. Indications are now for 0.50% increases to the Fed Funds target rate in both May and June, following the 0.25% increase to 0.25%-0.50% on March 16. Consequently, the 10-Year U.S. Treasury closed the quarter at 2.32% after starting it at 1.52% and the yield curve flattened substantially as the 2-Year U.S. Treasury yield rose to 2.28% from 0.73% at the beginning of the year. The 10-Year's rise caused the average 30-year fixed-rate mortgage rate to increase by approximately 50%, from 3.11% to 4.67%, in the quarter.

Adding to volatility was the lead up to Russia's invasion of Ukraine on February 24 and then the multiple false starts in peace negotiations, as was watching the great humanitarian crisis unfold real time and fears of broader global conflict. The war in Europe laid bare the fragility of the world's energy complex and the real-world consequences of the rapidity of the implementation of the green agenda, as the price of oil spiked to \$119/bbl on March 8 from \$75 at year-end. In the near-term, the war has broadened and further complicated supply chain issues.

Energy was the only Russell 2000 Growth sector to record a positive quarterly return at 36.02%, although Materials came close with performance of -0.16%. Also outperforming the index in the quarter were the usual suspects given the environment: Consumer Staples (-9.17%), Industrials (-9.24%), Communication Services (-9.42%), Utilities (-10.92%) and Real Estate (-12.28%). Interestingly, Health Care, which one may expect to hold up better in difficult conditions, underperformed with a -14.86% return. This is



explained by the fact that the majority of small cap health care companies are in the developmental stage and, consequently, are unprofitable. In the Russell 2000 Growth index, 81% of the sector's 437 companies are unprofitable.

PORTFOLIO REVIEW

The Small Cap Growth portfolio outperformed its Russell 2000 benchmark by 210 bps with a net of fees return of -10.53%. Stock selection provided all of the relative difference with a lack of exposure to the Index's best performing sector, Energy, accounting for the majority of the negative effect (102 bps) from sector allocation.

Stock selection in Healthcare added 267 bps of relative return with portfolio performance of only -1.75% vs. -14.86% for the benchmark sector. The strategy's profitability requirement again proved its worth as the portfolio's stocks held up in a negative environment with the portfolio's Top Three Contributors coming from this sector: Pacira Biosciences (PCRX, 26.84% return), LHC Group (LHCG, 22.86%) and Corcept Therapeutics (CORT, 13.74%).

Stock selection in Information Technology added 125 bps to relative return with performance of -10.87% vs. -14.87% for the benchmark sector. The return was bolstered by holdings such as technology solutions integrator, ePlus (PLUS, 4.05% return), process management and analytics company, ExlService Holdings (EXLS, -0.81%) and high-performance power management solutions provider, Monolithic Power Systems (MPWR, -1.40%).

TOP CONTRIBUTORS

Pacira Biosciences, Inc. (PCRX) a leading manufacturer and provider of non-opioid pain management for surgeons and anesthesiologists reported 22% growth in revenues for the fourth quarter. Despite challenges in the marketplace due to COVID-19, its flagship product EXPAREL increased product sales by 12%. In addition, the company was issued additional patents on EXPAREL which will extend its exclusivity to 2041. We remain bullish in our long-term expectations of double-digit revenue growth.

LHC Group, Inc. (LHCG), a national provider of in-home healthcare services, agreed to merge with Optum, a diversified health services company for \$170 per share,

causing the stock to provide a 23% return in the quarter. The acquisition is expected to close in the second half of 2022.

Corcept Therapeutics, Inc. (CORT), a provider of treatments for metabolic disorders effected by the hormone cortisol, reported a strong fourth quarter. The company also announced it expects to file a new drug application in 2023 for Relacorilant in Cushing's syndrome which will extend its franchise in that disease for the near future. In addition, the company has advanced its clinical programs of cortisol modulation in ovarian cancer and non-alcoholic steatohepatitis, further expanding its total addressable market.

BOTTOM CONTRIBUTORS

RH (RH), a leading luxury retailer in the home furnishings marketplace, reported a weaker-than-expected fourth quarter earnings result and lowered their revenue growth outlook due to recent macroeconomic volatility impacting near-term demand. However, management remains confident on the growth algorithm and margin expansion potential with several concept launches slated to open as the year progresses both domestically and internationally.

Medpace Holdings, Inc. (MEDP), a global contract research organization providing Phase I-IV clinical development services to the biotechnology and pharma industries reported an in-line quarter but noted a slowdown in request for proposals (RFP). RFP dollar volume was down 10% in the second half of 2021 compared to 2020. Offsetting this weakness is a 27% increase in new business awards entering backlog in the fourth quarter, resulting in 1.49 book-to-bill ratio. The company is maintaining its revenue guidance for 2022 of \$1.45 billion, a strong growth rate of 27% over 2021 total revenue.

Century Communities, Inc. (CCS), a top 10 U.S. homebuilder, reported a solid fourth quarter with EPS of \$4.78, above consensus expectations of \$4.07. The company guided for 2022 closings up 6-16% year-over-year and revenue up 7-21%, both solid relative to expectations. However, as the quarter progressed interest rates increased leading to a significant rise in mortgage rates relative to the beginning of the quarter, impacting housing affordability in the near term. We continue to believe CCS is well positioned to benefit from the country's undersupply of homes and continued strong demand as the Millennial generation enters their peak home buying years.



PORTFOLIO POSITIONING

Portfolio turnover was 4.24% in the quarter resulting in no meaningful changes in portfolio positioning. EPAM Systems (EPAM) was sold because its market capitalization had grown to \$30 billion due to its success. Azenta (AZTA), formerly Brooks Automation, was also sold because the company's Automation business was purchased by a private equity firm, making AZTA a pure play Life Sciences business, which we did not find attractive. The majority of the proceeds from the sales were invested in three existing holdings: ExlService, Onto Innovation and Perficient.

The portfolio continues to be most heavily weighted in companies operating in the Information Technology (30.44%

weighting), Health Care (23.74%), Industrials (14.38%), Consumer Discretionary (14.3%) and Financials (8.2%) sectors. Information Technology and Financials are overweighted relative to the benchmark by approximately 700 bps and 200 bps, respectively. The greatest relative underweights are in Materials (3.89% benchmark weighting), Energy (3.23%) and Real Estate (3.08%) because the portfolio has no exposure to these sectors. However, the team continues to research and debate potential holdings in these areas.

The team believes stocks can continue to grind higher over time. But in the near-term, it is clear the Federal Reserve is determined to drain some of the excess liquidity in the system during 2022, especially as inflation continues to run hot. Conditions like these should favor higher quality over lower quality but could create a volatile backdrop as the market absorbs the Fed's attempts to cool the economy.

TOP AND BOTTOM ABSOLUTE CONTRIBUTORS

1Q 2022 TOP CONTRIBUTORS	WEIGHT	RETURN	IMPACT
Pacira Biosciences, Inc.	3.32%	26.84%	72 bps
LHC Group, Inc.	3.34	22.86	70
Corcept Therapeutics, Inc.	1.49	13.74	17
ExlService Holdings, Inc.	2.33	-0.81	14
Curtiss-Wright Corp.	1.66	8.42	12

1Q 2022 BOTTOM CONTRIBUTORS	WEIGHT	RETURN	IMPACT
RH	2.95%	-39.16	-138 bps
Medpace Holdings, Inc.	4.08	-24.83	-120
Century Communities, Inc.	2.30	-34.29	-90
LGI Homes, Inc.	2.17	-36.77	-89
Syneos Health	3.54	-21.16	-81

SMALL CAP GROWTH COMPOSITE PERFORMANCE NOTES:

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