



DECEMBER 31, 2022

CAMPBELL NEWMAN

# SMALL CAP GROWTH 4Q 2022 COMMENTARY

## MARKET OVERVIEW

Most of the major stock indices sold off by 20% or more in the first nine months of the year, as the rapid ratcheting up of interest rates necessitated adjustments in valuations. By October, more palatable valuations and fairly oversold technical conditions set the stage for a rally, resulting in all of the Russell style indices reporting positive 4Q returns. With the Fed Funds target rate rising from virtually zero at the year's start to 4.25%-4.50% in December and an inverted yield curve recession signal flashing, the tone of the rally was different than that of the free-money era. Actual profitability and a good line of sight into future earnings growth, along with more rational valuations, drove leadership. In this environment, Small caps underperformed Large caps and Growth underperformed Value.

The Small Cap Growth's benchmark, the Russell 2000 Growth (R2G) Index, recorded a 4.13% 4Q return. Nine of the Index's 11 economic sectors were positive in the quarter, with the top performers being Energy (17.72% return), Consumer Staples (11.45%), Real Estate (9.37%),

Industrials (7.75%) and Materials (7.13%). Sectors with negative returns were Financials (-1.07%) and Health Care (-2.74%).

## PORTFOLIO REVIEW

The Small Cap Growth portfolio's 11.08% net of fees return outperformed its R2G benchmark by almost seven percentage points. Stock selection accounted for all the relative outperformance with sector allocation a modest detractor.

In total, stock selection added 799 bps relative with the greatest contributors being:

- Information Technology at 281 bps (14.57% portfolio sector return vs. 4.21% for the benchmark)
- Health Care at 237 bps (6.42% vs. -2.74%)
- Financials at 149 bps (15.58% vs -1.07%)
- Consumer Discretionary at 90 bps (12.51% vs. 4.99%)



Stock selection in the Materials sector was the greatest detractor in the quarter, costing 45 bps due to the portfolio's sector performance of -11.06% vs. 7.13%. Also, relative underweights to the two strongest benchmark sectors, Energy and Real Estate, cost 43 bps and 11 bps, respectively.

## TOP CONTRIBUTORS

**Horizon Therapeutics plc (HZNP)**, a pharmaceutical company, entered into a definitive agreement to be acquired by Amgen, Inc. for \$26.4 billion in December, resulting in 80%+ price appreciation in the quarter. Because there is always a risk that a deal may not close (closing expected in 2Q 2023) and the stock's rapid appreciation took the company's market capitalization to the high end of the allowable range for this small cap portfolio, HZNP was sold to lock in the gains.

**Medpace Holdings, Inc. (MEDP)**, a global contract research organization providing Phase I-IV clinical development services to the biotechnology and pharma industries reported strong results in the quarter. Request for proposals (RFP) which the company described in the second quarter as weak, recovered in the third quarter. Revenue in 3Q increased over 30% and new business awards were \$471 million, representing a 1.23 book-to-bill ratio. The company is maintaining its revenue guidance for 2022 of \$1.46 billion and gave a positive 2023 revenue forecast of \$1.68 billion to \$1.74 billion.

**Fabrinet (FN)**, an optical packaging and electronic manufacturing services company, posted strong fiscal 1Q results supported by strong demand drivers across its Telecom, Datacom and Industrial end markets. Robust gross margin performance showcased that execution remains solid, enabling strong flow-through of the revenue upside to earnings in the coming year. The combination of the aforementioned demand drivers, easing of supply chain issues and positive fiscal 2Q guidance, support the sustainability of double-digit earnings growth.

## BOTTOM CONTRIBUTORS

**Pacira BioSciences, Inc. (PCRX)**, a pharmaceutical company focused on non-opioid pain management, reported 3Q 2022 top-line growth of 30% year-over-year, driven by growth in EXPAREL and the acquisition of Flexion Therapeutics. Earnings though missed due to higher expenses as the company is seeking FDA approval for its new manufacturing facility. The company remains bullish in the long-term outlook but remains cautious near-term due to disruption from Covid and nursing labor shortages which are negatively impacting elective surgeries.

**Syneos Health (SYNH)**, a leading integrated biopharmaceutical solutions and contract research organization, reported 3Q revenues of \$1.34B, missing guidance of \$1.36-\$1.4B due to customers pushing out awards from 3Q to 4Q and others electing not to repeat business with SYNH. The weakness in the stock for the quarter was a result of the company stating that it does not expect to hit 7% to 10% revenue growth in 2023 due to recent orderbook trends. While the near-term outlook is below expectations, management noted that orders have already begun to improve in smaller accounts, although this will likely be a gradual process.

**Corcept Therapeutics, Inc. (CORT)**, a pharmaceutical company engaged in the discovery and commercialization of drugs that treat severe metabolic and oncologic disorders by modulating the effects of the stress hormone cortisol, reported a weak quarter with revenues up 6% over last year. Revenue in the quarter was affected by fewer-than-expected physician visits as many physician practices have not returned to pre-pandemic patterns of activity. The company gave a favorable update on its drug pipeline with its next NDA submission in



## PORTFOLIO POSITIONING

Portfolio turnover was 2.27% in 4Q with all purchase and sale activity taking place in the Health Care sector. The turnover was primarily event driven, causing stocks to be sold, as Horizon agreed to be acquired by Amgen and Medpace's strong performance necessitated its position size to be trimmed below our 5% risk control maximum. A position in Lantheus Holdings was added but only using part of the sales proceeds. As a result, Health Care's weight was reduced from 24.64% to 19.09% in the quarter

and cash was slightly elevated at 8.43%. We expect much of that cash to be reinvested in the coming weeks.

Built through bottom-up stock selection, the portfolio's emphasis continues to be in Information Technology (29.34% weighting), Health Care (19.09%), Industrials (13.63%), Consumer Discretionary (12.57%) and Financials (8.94%), with smaller exposures in Energy (3.51%), Consumer Staples (2.40%) and Materials (2.09%).

## TOP AND BOTTOM ABSOLUTE CONTRIBUTORS

### 4Q 2022 TOP CONTRIBUTORS

	WEIGHT	RETURN	IMPACT
Horizon Therapeutics plc	1.92%	81.23%	181 bps
Medpace Holdings, Inc.	4.06	32.15	169
Fabrinet	3.98	34.33	122
MasTec, Inc.	3.70	34.38	110
Five Below, Inc.	2.60	28.47	72

### 4Q 2022 BOTTOM CONTRIBUTORS

	WEIGHT	RETURN	IMPACT
Pacira Biosciences, Inc.	2.76%	-27.41	-92 bps
Syneos Health	1.90	-22.21	-55
Corcept Therapeutics, Inc.	2.00	-20.79	-47
Lantheus Holdings, Inc.	0.61	-16.93	-41
MP Materials Corp.	2.61	-11.06	-29

## PERFORMANCE

	4Q 2022	2022	5 YEARS	ITD
Representative Account (Gross)	11.24%	-20.28%	8.58%	9.67%
Representative Account (Net)	11.08	-20.82	7.99	9.11
Russell 2000 Growth Index	4.13	-26.36	3.51	5.95

### IMPORTANT DISCLOSURES:

Returns greater than 1 year are annualized.

Past performance is not indicative of future results. All investments involve risk, including possible loss of principal. There is no guarantee investment objectives will be met. Gross returns are presented before deducting management fees (and custodian fees) and include the reinvestment of all income. Net returns are presented after the deduction of a model fee based on the highest fee paid then in effect for the period shown and include the reinvestment of all income. Performance returns are calculated using a time-weighted formula with appropriate adjustments for cash flows, and include all dividends and interest, accrued income, and realized and unrealized gains or losses. Indexes are unmanaged and do not incur fees or expenses. It is not possible to invest directly in an index. Portfolio sector weights reflect a representative account and are subject to change without notice. It should not be assumed that an investment in the sectors listed were, or will be, profitable. Portfolio holdings reflect a representative account and are subject to change. Other accounts within the strategy may have different holdings. Portfolio holdings should not be considered a recommendation to buy, hold or sell securities. Current and future portfolio holdings are subject to risk. Past performance does not guarantee future results. The future performance of any specific investment should not be assumed to be profitable or equal to past results. The performance of the holdings discussed above may have been the result of unique market circumstances that are no longer relevant. The holdings identified above do not represent all of the securities purchased, sold or recommended. Securities mentioned should not be construed as recommendation for purchase or sale. Portfolio transactions should not be considered a recommendation to buy, hold or sell securities.

SCGC1222-01