Seeking a More Favorable Risk/Return Trade-off

Key Takeaways

- For the quarter, the strategy outperformed its benchmark, the Russell Midcap Growth index, primarily due to stock selection.
- The economy continues to recover, albeit more slowly than before. The Federal Reserve is committed to providing economic and financial market stability, but fiscal stimulus also will be needed to sustain the recovery.
- In this environment, we believe owning mid-cap companies with robust balance sheets is more important than ever.

Current Strategy and Outlook

After five straight months of gains, stock markets felt the pull of gravity in September as coronavirus cases resurged and confidence in the economic outlook faltered. Nevertheless, strong gains in July and August offset the September downdraft, resulting in net increases for the quarter. Expectations for further fiscal stimulus, optimism about progress in developing a coronavirus vaccine, positive economic momentum and better-than-expected corporate earnings were among the widely cited market drivers.

The economy continues to recover, albeit more slowly than before. The Federal Reserve has been resolute in its commitment to provide economic and financial market stability; but fiscal stimulus also will be needed and may not be possible until after the November elections. As a disciplined manager, we remain true to our investment process regardless of the unpredictable market environment, investing in companies with strong fundamentals and attractive relative valuations.

In this environment, we believe owning mid-cap companies with robust balance sheets is more important than ever. As a disciplined manager, we remain true to our investment process regardless of the unpredictable market environment, investing in companies with strong fundamentals and attractive relative valuations. Going forward, we believe the portfolio is well positioned, as we think that investors will begin to focus on companies’ fundamentals due to ongoing economic uncertainty.

Portfolio Review

For the quarter, the strategy outperformed its benchmark, the Russell Midcap Growth index, due to stock selection effects. Selection within the health care and information technology sectors contributed the most to performance. Selection within the communication services sector, and to a lesser degree, the real estate sector, detracted the most from performance.

Stocks that contributed most to the quarter’s performance were Immunomedics, Inc., Horizon Therapeutics PLC and NovoCure Ltd.
An overweight position in Immunomedics, Inc. (IMMU) generated significant alpha. The stock price advanced following the announcement that Gilead Sciences Inc. (GILD) will acquire IMMU for $21 billion in an all-cash deal ($88/per share), representing a premium of 108%.

An overweight position in Horizon Therapeutics Public Limited Company (HZPN) generated strong results. The company reported earnings ahead of consensus and raised its full-year guidance meaningfully above expectations. HZNP is executing well on the launch of its thyroid eye disease drug, Tepezza, and the size of the market opportunity continues to increase.

An overweight position in NovoCure Ltd. (NVCR) — a global oncology company with a proprietary technology that uses electrical fields to disrupt solid tumor cancer cell division — generated strong performance. The stock was rewarded for strong 2Q20 earnings and increased focus on the company’s collaboration with Merck, which is seen as a validation of NVCR’s technology. Shares continued to grind higher following the GILD/IMMU deal, underscoring enthusiasm for companies focused on cancer treatment.

Key detractors for the quarter were BioMarin Pharmaceutical Inc., Roku, Inc. and RingCentral, Inc.

An overweight position in BioMarin Pharmaceutical Inc. (BMRN) negatively impacted performance. The company received an unexpected complete response letter from the FDA for Roctavian, its gene therapy treatment for Hemophilia A, despite positive long-term Phase l/ll data. The FDA action was a significant disappointment leading to a two-year delay of a decision and increasing the uncertainty for approval of Roctavian.

Not owning Roku, Inc. (ROKU) detracted from results. The stock price advanced in response to the well-received announcement that the company had reached a deal with Comcast Corporation’s (CMCSA) to put Peacock on the Roku platform. Some investors were concerned that not having Peacock and HBO Max — which still has not reached a deal with Roku — would prompt users to switch away from the Roku platform. Even though specifics weren’t disclosed, it was taken as a positive when Roku reached a deal.

An overweight position in global enterprise cloud communications and collaboration solutions company, RingCentral, Inc. (RNG), detracted from results during the quarter. Shares traded off earlier in the period following the announced partnership between ServiceNow, Inc. (NOW) and Zoom Video Communications, Inc. (ZM) which was viewed as a competitive threat to RNG’s enterprise segment.

**Holdings Detail**

Companies mentioned in this report — percentage of portfolio investments, as of 9/30/20: Immunomedics, Inc. 0.57%, Horizon Therapeutics PLC 3.09%, NovoCure Ltd. 1.31%, BioMarin Pharmaceutical Inc., 0.98%, Roku, Inc. 0%, RingCentral, Inc. 2.35%; 0% indicates that the security is no longer in the portfolio. Portfolio holdings are subject to daily change.
The Russell MidCap Growth Index is an unmanaged index that measures the performance of those companies included in the Russell MidCap Index with relatively higher price-to-book ratios and higher forecasted growth values. The Index does not reflect fees, brokerage commissions, taxes or other expenses of investing. Investors cannot invest directly in an index.

Principal Risks: All investing involves risks of fluctuating prices and the uncertainties of rates of return and yield. Foreign Investing poses special risks including currency fluctuation, economic and political risks not found in investments that are solely domestic. Investing in stocks of Mid-Sized Companies may entail greater volatility and less liquidity than larger companies. The Portfolio may use Derivatives, such as options and futures, which can be illiquid, may disproportionately increase losses and have a potentially large impact on Portfolio performance. Other risks of the Portfolio include but are not limited to: Growth Investing Risks, Market Trends Risks, Other Investment Companies’ Risks, Price Volatility Risks, Liquidity Risks, Securities Lending Risks and Portfolio Turnover Risks. Investors should consult the Portfolio’s Prospectus and Statement of Additional Information for a more detailed discussion of the Portfolio’s risks. An investment in the Portfolio is not a bank deposit and is not insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board or any other government agency.

The strategy employs a quantitative model to execute the strategy. Data imprecision, software or other technology malfunctions, programming inaccuracies and similar circumstances may impair the performance of these systems, which may negatively affect performance. Furthermore, there can be no assurance that the quantitative models used in managing the strategy will perform as anticipated or enable the strategy to achieve its objective.

The strategy is available as a mutual fund or variable portfolio. The mutual fund may be available to you as part of your employer sponsored retirement plan. There may be additional plan level fees resulting in personal performance that varies from stated performance. Please call your benefits office for more information.

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