Commentary | 3Q20

Voya Small Company Strategy

Focusing on High-Quality Companies with Sustainable Growth Trends

Strategy Overview
Actively managed small cap core strategy driven by bottom-up fundamental research seeking high-quality companies with strong balance sheets and cash flow characteristics that are beneficiaries of sustainable growth trends.

Key Takeaways
- For the quarter, the strategy underperformed the Russell 2000 index
- Underperformance resulted from stock selection within the health care equipment and services and capital goods sectors
- We view the sell-off as an opportunity to add to positions that we like, while reducing exposure to the most negatively impacted market segments
- As long-term, disciplined investors, we remain focused on high-quality companies with strong free-cash-flow and solid balance sheets

Current Strategy and Outlook
The economy continues to recover, albeit more slowly than before; with the pandemic intensifying – and now even the President infected – it remains an open question whether the recovery is sustainable. The Federal Reserve has been resolute in its commitment to provide economic and financial market stability, but central bank action alone may not be enough to sustain the recovery. Fiscal stimulus also will be needed but passing another stimulus bill has proven difficult in the current U.S. political climate, 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 addition, in this environment — where declining business activity creates an enormous burden for companies with little liquidity (small and medium businesses) — owning companies with robust balance sheets is paramount.

Portfolio Review
The portfolio underperformed the index for the quarter ending September 30, 2020, due to stock selection effects. Selection within the health care equipment and services and capital goods sectors detracted the most from performance. A combination of stock selection within, and an underweight allocation to, the pharmaceutical and biotechnology sector generated the greatest outperformance. Stock selection within the commercial services sector also added value.

Key detractors from performance were Sunrun Inc., Strategic Education, Inc. and Penn National Gaming, Inc.
Within the utilities sector, not owning Sunrun Inc. (RUN) detracted from results during the quarter. RUN has benefited from the secular tailwinds of residential solar demand in the United States, as well as its proposed acquisition of Vivint Solar Inc. (VSLR) which investors believe has the potential to further establish RUN’s presence in the industry.

Owning an overweight position in educational services company, Strategic Education, Inc. (STRA), was a headwind during the period. While the company reported a strong earnings per-share (EPS) beat due to better-than-expected margins, shares traded off due to a noted deceleration in enrollment growth. Further, STRA’s revenues were temporarily impacted by its move to provide payment flexibility and relief to students and employer partners amid the pandemic.

Not owning Penn National Gaming, Inc. (PENN), a company that owns and manages gaming and racing facilities and video gaming terminal operations, detracted from performance during the quarter. The stock has benefited from the increase in popularity in sports betting and iGaming, namely through its recent Barstool Sportsbook application. Furthermore, investors see longer-term opportunity in its brick and mortar operations as they have begun to re-open year-to-date.

The main individual contributors to performance were Generac Holdings Inc., Caesars Entertainment Inc and Bloomin’ Brands, Inc. Owning a non-benchmark position in Generac Holdings Inc. (GNRC) contributed favorably to performance. The stock price advanced largely due to strong 2Q20 earnings results. Management cited a sharp increase in stand-by generator demand, an improvement in commercial and industrial demand and better-than-expected margins within its residential segment.

An overweight position in Caesars Entertainment Inc (CZR) contributed to performance during the period. After trading down significantly during the coronavirus sell-off, shares advanced as investors gained greater clarity and confidence in Eldorado Resorts Inc.’s (ERI) acquisition of CZR. The deal which ultimately closed on July 20 for $17.3 billion, and ERI will take the Caesars name going forward as the largest casino owner in the world.

An overweight position in Bloomin’ Brands, Inc. (BLMN) added value during the period. In addition to Florida’s lifting of dine-in capacity limits at the end of the month, the stock was rewarded for management’s ability to effectively control costs during the pandemic and foster greater confidence in its ability to preserve those efficiencies and improve margins moving forward. BLMN’s test launch of a delivery-only fried chicken concept, Tender Shack, also peaked investor interest. Tender Shack’s leverage of BLMN’s existing partnership with Doordash, its limited operational complexity and unique menu relative to BLMN’s other brands has the potential to generate high incremental margins.

**Holdings Detail**

Companies mentioned in this report – percentage of portfolio investments, as of 9/30/20: Sunrun Inc. 0.00%, Strategic Education, Inc. 0.54%, Penn National Gaming, Inc. 0.00%, Generac Holdings Inc. 0.71%, Caesars Entertainment Inc 1.65%, Bloomin’ Brands, Inc. 1.05%, 0.00% indicates that the security is no longer in the portfolio. Portfolio holdings are subject to change on a daily basis.
The Russell 2000 Index is an unmanaged index that measures the performance of securities of small U.S. companies. The Index does not reflect fees, brokerage commissions, taxes or other expenses of investing. Investors cannot invest directly in an index.

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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.

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