Focusing on High-Quality Companies with Sustainable Growth Trends

Strategy Overview
Actively managed small cap growth 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.

Portfolio Review
For the quarter ended September 30, 2020, the strategy underperformed its benchmark, the Russell 2000 Growth index, due to unfavorable stock selection. Stock selection within the capital goods and health care equipment and services sectors detracted the most from performance. An underweight allocation to and stock selection within the pharmaceutical and biotechnology sector contributed the most to performance. Strong stock selection within the commercial services sectors also added value.

Key detractors from quarterly performance were SunRun Inc., Strategic Education, Inc. and iRhythm Technologies, Inc.

Within the utilities sector, not owning SunRun, Inc. (RUN) detracted from results. RUN has benefitted 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. While the company strongly beat earnings per share (EPS) expectations due to better than expected margins, shares traded off because of 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 iRhythm Technologies, Inc. (IRTC) was a headwind during the period. Shares advanced over 100% during the quarter following the Centers for Medicare & Medicaid Services’ release of its calendar 2021 Proposed Medicare Physician Fee Schedule which removed a reimbursement overhang for the stock.

The main individual contributors to performance were Generac Holdings Inc., Caesars Entertainment Inc., and NovoCure Ltd.

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. 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 ultimately closed on July 20, 2020, for $17.3 billion; ERI will take the Caesars name going forward as the largest casino owner in the world.

Owning a non-benchmark position in NovoCure Ltd. (NVCR), a global oncology company with a proprietary platform technology that uses electrical fields to disrupt solid tumor cancer cell division, generated strong performance during the period. The stock was rewarded for a strong 2Q20 earnings report and increased focus on the company’s collaboration with Merck, which is seen as a validation of NVCR’s technology. Shares continued to move higher following the Gilead and Immunomedics deal, which highlighted enthusiasm for companies focused on cancer treatment.

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, owning small-cap companies with robust balance sheets is more important than ever. As long-term, disciplined investors we remain committed to our investment approach of focusing on high-quality companies with strong free cash flow and solid balance sheets. 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.

Holdings Detail

Companies mentioned in this report – average percentage of Fund and Portfolio investments, as of 9/30/20: SunRun Inc. 0%, Strategic Education, Inc. 0.77%, NovoCure Ltd. 0%, Generac Holdings Inc. 0.71%, Caesars Entertainment Inc. 2.03%, iRhythm Technologies, Inc. 0%; 0% indicates that the security is no longer in the Fund. Portfolio holdings are subject to daily change.
The Russell 2000 Growth Index is an unmanaged index that measures the performance of securities of smaller U.S. companies with greater-than-average growth orientation. 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. In exchange for higher growth potential, investing in stocks of Smaller Companies may entail greater price volatility and less liquidity than investing in stocks of larger companies. 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, Portfolio Turnover Risks and Securities Lending 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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Variable investments, of any kind, are not guaranteed and are subject to investment risk including the possible loss of principal. The investment return and principal value of the security will fluctuate so that when redeemed, it may be worth more or less than the original investment. In addition, there is no guarantee that any variable investment option will meet its stated objective. All guarantees are based on the financial strength and claims paying ability of the issuing insurance company, who is solely responsible for all obligations under its policies.

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