

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.

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Key takeaways

- Second quarter returns for small cap growth stocks, as measured by the Russell 2000 Growth Index (the Index) on a net asset value (NAV) basis, continued their upward trend for 2023 on the back of strong employment trends, resilient consumers and steady corporate earnings. However, performance was driven by the lowest ROE, nonearners and no sales companies relative to companies with resilient revenue, cash flow and earnings. Small cap growth stocks lagged relative to their larger capitalization counterparts during the second quarter.
- Following the volatility of 1Q23, the most recent quarter was comparatively subdued, as consensus favored the “soft landing” narrative on the heels of a U.S. Federal Reserve pause in June.
- The euphoria surrounding artificial intelligence pushed technology stocks higher, as investors positioned portfolios toward beneficiaries of the potentially “game changing” technology while simultaneously analyzing the negative impact on business models of certain companies.

Portfolio review

For the quarter ended June 30, 2023, the Voya Small Cap Growth Fund underperformed the Index, due to individual stock selection. The healthcare, consumer discretionary and industrials sectors detracted the most from performance. The Fund did see positive contributions within the consumer staples, materials and financials sectors. Sector allocation was also a positive contributor.

Key contributors to performance included Celsius Holdings, Inc., Axcelis Technologies, Inc. and Sterling Infrastructure, Inc.

Celsius Holdings, Inc. (CELH), a specialty beverage company, was the largest positive contributor for the quarter. The company continues to see accelerating sales growth as the benefits of their domestic distribution partnership with PepsiCo continue to bear fruit. Celsius has roughly 3x the market share in areas it has been established for more than 5 years, which gives the company a substantial runway for growth. Additionally, the company plans focus on international expansion in 2024 and beyond which should provide further upside. We continue to maintain our weighting in the stock although we are being mindful of the higher valuation embedded in the stock.

Axcelis Technologies, Inc. (ACLS), a supplier of semiconductor manufacturing equipment and a leader in ion implant equipment, continued its outperformance from 1Q23 into 2Q23. The company continues to see strong growth stemming from their exposure (25%

of revenue) to the Silicon Carbide (SiC) electric vehicle power device market. Expectations are also improving for ACLS's cyclical memory business. However, despite expecting solid fundamental factors, we recently trimmed the position because of elevated near-term expectations and limited upside to our price target.

Sterling Infrastructure, Inc. (STRL), a leader in the engineering and construction market for e-infrastructure solutions, transportation solutions and building solutions, was a strong positive contributor for the quarter. STRL has seen sizable growth in their e-infrastructure solutions business and will likely continue to see strength given the recent push to bring manufacturing back to the United States. Additionally, the residential housing exposure the Company has through its building solutions biz has continued to show resilient trends. That said, the stock has had significant price appreciation YTD, driven predominantly by multiple expansion, so the risk-reward is more balanced now than at the beginning of the year.

Key detractors from performance included WNS Holdings, Ltd., Xponential Fitness, Inc. and Super Micro Computer, Inc.

WNS Holdings, Ltd. (WNS) was the largest detractor of performance for the quarter. WNS, a business process management company providing accounting, analytics, customer service and human resources services, came under pressure during the quarter from the perceived threat of artificial intelligence (AI) to their business model. While we believe that the long-term risk to the business is low (<15% of revenue), we have trimmed the position as we assess ongoing valuation pressure from the AI theme.

Xponential Fitness, Inc. (XPOF), a boutique fitness franchisor with multiple brands such as Club Pilates, Pure Barre and StretchLab, underperformed for the quarter. Following a short report released in late June by Fuzzy Panda Research, the stock traded off significantly. Management held a conference call to address the issues raised in the report. The company will likely have to demonstrate strong fundamental execution over the next several quarters in order for the stock to recover. After listening to management's response, we remain confident in the company's ability to execute and meet key metrics and thus maintain our current position in the stock.

Super Micro Computer, Inc. (SMCI), a manufacturer and distributor of information technology solutions which includes servers, GPUs and motherboards, was a detractor from performance for the quarter. With AI becoming a dominant theme during the quarter, our team identified SMCI as a beneficiary of the explosive demand for AI infrastructure components. SMCI has historically had volatile revenue and operating margin trends but the company's visibility into future growth has improved dramatically as a result of the new AI secular tailwinds. Given SMCI was a benchmark holding since the beginning of the quarter and performed well prior to our purchase of the stock, it was an underperformer relative to the benchmark for the quarter.

Current strategy and outlook

Despite gains in both small cap growth and large cap growth stocks for the quarter, the relative valuation discount favoring small cap growth stocks continues to be attractive and near multi-year highs. For the past 12-18 months the consumer has remained resilient in the face of the unprecedented pace of Fed rate hikes. The anticipated lagging effect of these hikes has all eyes on the upcoming earnings season to gauge consumer and corporate resilience and market direction for 2H of '23. The small cap growth team remains focused on companies that can continue to grow revenue and earnings in a slowing economic environment and remains overweight the industrials and healthcare sectors and neutral weighted to technology. As stated in prior quarters, our investment philosophy of identifying companies with double digit revenue and earnings growth that are trading at sustainable valuations should continue to serve investors well throughout a full economic cycle.

Holdings detail

Companies mentioned in this report – percentage of portfolio investments, as of 06/30/23: Celsius Holdings, Inc. 1.89%, Axcelis Technologies, Inc. 1.15%, Sterling Infrastructure, Inc. 1.19%, WNS Holdings, Ltd. 1.17%, Xponential Fitness, Inc. 0.60% and Super Micro Computer, Inc. 0.91%; 0% indicates that the security is no longer in the portfolio. Portfolio holdings are subject to daily change.

The **Russell 2000® Growth Index** is an unmanaged Index that measures the performance of securities of smaller US 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.

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