Voya Small Cap Growth Strategy

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.

Key takeaways

- Market performance was mixed during the quarter as investors navigated macro uncertainties. U.S. large cap growth was up while international, small caps and value lagged. The rally in U.S. growth was dominated by semiconductors, technology hardware and media and entertainment industries as the artificial intelligence trade once again led markets.
- Despite challenges, the U.S. economy remains resilient. Inflation remains a key focus, with the U.S. Federal Reserve holding interest rates steady to curb its impacts. Economic and Fed data continue to call for “status quo” equity positioning. However, we anticipate a regime shift as the market gains confidence in the next phase of Fed policy.
- Small cap growth stocks, as measured by the Russell 2000 Growth Index, were negative for the quarter. However, the valuation discrepancy of small cap growth stocks relative to large cap growth stocks remains a compelling data point that bodes well for the asset class.

Portfolio review

For the quarter ended June 30, 2024, the Voya Small Cap Growth Fund outperformed the benchmark, the Russell 2000 Growth Index (the Index) on a gross- and net-of-fees basis, largely due to individual stock selection within the information technology, industrials and financials sectors. The largest detractor from performance was from allocation, specifically, a zero percent weighting in consumer staples.

Top individual contributors to performance included FTAI Aviation Ltd., Natera, Inc. and Aspen Aerogels Inc.

FTAI Aviation Ltd. (FTAI), a manufacturer and lessor of aircraft engines and aftermarket engine components to the aviation and aerospace segments, outperformed for the quarter. After announcing their acquisition of an engine maintenance facility from Lockheed Martin in May 2024, expectations for volume increases will lead to incremental earnings before interest, tax, depreciation and amortization (EBITDA) growth by 2025 and beyond. Combined with the aviation leasing segment, which has seen lease rates rise 20–40%, should bode well for continued upside and we are maintaining our current position in the stock.

Natera, Inc. (NTRA), a diagnostics company specializing in prenatal genetic testing, continues to perform well and remains for the second quarter in a row a top three holding. NTRA has seen strong Signatera testing volume growth driving continued revenue growth with better-than-expected gross margins. The company guided to 2024 revenue growth of

23% at the midpoint of its guidance and while we consider these numbers conservative, we are mindful of lofty expectations implied by the elevated valuation. With a changing risk versus reward scenario, we have trimmed the position.

Aspen Aerogels, Inc. (ASPN), a designer, developer and manufacturer of aerogel insulation, was a top performer during the quarter. Following a blowout 1Q24 that saw a significant improvement in revenue and gross margins (nearly 37%), shares of ASPN rallied over 50%. As a supplier of thermal barriers for electric vehicle (EV) batteries and despite headwinds in EV, the company's relationship with General Motors and pipeline continue to grow. With an outsized move during the quarter, we have sold the position.

Key detractors from performance included Sprout Social, Inc., Repligen Corp. and Kura Sushi USA, Inc.

Sprout Social, Inc. (SPT), a provider of online social media management tools, was the largest underperforming stock during the quarter. With an initial positive outlook going into 2024, SPT revised its' guidance down for fiscal year 2024. Sighting the implementation of their new go-to-market (GTM) strategy that, in the near term, has impacted new business acquisition and growth, pushing a potential recovery out into 2H24.

Repligen Corp. (RGEN), a leading provider of bioprocessing technologies used in the drug manufacturing process, underperformed after the announcement of their industry respected CEOs intention to step down after a decade of successfully increasing revenues. Despite this recent development RGEN has produced volatile results for much of 2H24 and the recent 2Q sell-off has been measurable. We continue to view bioprocessing as a key healthcare secular growth area and maintain our position as the industry is likely towards the tail end of working through many post-covid headwinds.

Kura Sushi USA, Inc. (KRUS), an operator of authentic Japanese cuisine using a technology-based model, underperformed for the quarter following sizable outperformance in the first quarter. The company preannounced in late June indicating a weaker demand backdrop in California. In our view, Kura continues to execute on their unit growth plans, which should bode well for revenue growth and continued margin expansion over the long-term. We continue to hold the name and will look to add opportunistically after taking some profits during the first half of 2024.

Current strategy and outlook

With mixed economic data persisting throughout the quarter, expectations for rate cuts in 2024 have moved to the back half of the year. As a result, the rebound in relative performance for small cap stocks has continued to stall, as of this most recent quarter end. In our view, small cap stocks continue to present strong upside potential. Around six months ago, we began adding select new stocks to the portfolio that have higher growth rates and are aggressively reinvesting operating cash flow into their businesses. Many of those positions have sizable outperformance and the current risk versus reward balance has changed. We are cognizant of this balance and have taken the opportunity to trim, or even sell positions at a profit and redeploy into stocks with more favorable growth and valuation metrics. This continues to be done within our philosophy of requiring at least 15% top and bottom-line growth potential, combined with sustainable valuations at time of purchase.

As we have said for several quarters, small cap growth stock valuations are at attractive levels relative to their large cap growth counterparts and continue to trade at a sizable discount on a relative basis (around 37% as of 6/30/2024). Although a "higher for longer" environment could delay small cap stocks' outperformance, prudent and disciplined bottom-up stock selection should show strong relative returns in a soft-landing scenario. Voya Small Cap Growth's proven philosophy of focusing on companies with the ability to generate revenue, cash flow and earnings growth, that are trading at sustainable valuations, is a prudent approach over a full market cycle and year to date has benefited investors in the current environment.