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

- In the third quarter of 2024, equity markets showed varied performance, with a notable broadening of returns. Small- and mid-cap stocks led the way, while emerging markets benefited from a strong rebound in China. Falling interest rates boosted bond returns, and value stocks outperformed growth stocks, driven by defensives, cyclicals and banks. Although technology saw a slight uptick in September, its sector returns were muted compared to the first half of the year. Artificial intelligence (AI) continued to be a significant driver, with companies involved in AI development and integration being rewarded.
- Looking ahead to the remainder of 2024, the equity market outlook is cautiously optimistic despite expected volatility. Uncertainties surrounding U.S. Federal Reserve policies, upcoming elections and rising geopolitical tensions are likely to cause continued market fluctuations. However, positive signals include potential buying opportunities in large-cap stocks and a generally favorable reaction to recent rate cuts. Additionally, a strong labor market could further support equities.
- Small cap growth stocks, as measured by the Russell 2000 Growth Index, were positive for the quarter. The valuation discrepancy of small cap growth stocks relative to large cap growth stocks remains a compelling data point. This should narrow in coming quarters as investors recognize the positive impact of an easing Fed and the resulting bottom-line benefits from the reduction in the cost of capital for small caps.

Portfolio review

For the quarter ended September 30, 2024, the Voya Small Cap Growth Strategy underperformed the benchmark, the Russell 2000 Growth Index (the Index) on a gross- and net-of-fees basis, due to combination of individual stock selection and allocation. Key contributions resulted from stock selection in the health care, consumer discretionary and financial sectors.

Top individual contributors to performance included Champion Homes, Inc., SiTime Corp. and Exact Sciences Corp.

Champion Homes, Inc. (SKY), a manufacturer and seller of mobile homes and manufactured housing, was the top contributor for the quarter. Housing fundamental factors continue to improve with order rates expecting to accelerate into the back half of 2024 and beyond in both the retail and community channels. Deflation should also lead to incremental margin improvement. After adding to the position during the quarter, and following a nice move in the stock, we are maintaining our current weighting as of quarter end.

SiTime Corp. (SITM), a producer of micro-electromechanical systems (MEMS) based timing solutions, was one of the portfolio's top contributors for the quarter. After previously owning this stock in 2022, we bought back the name earlier this year on expectations of normalizing inventory levels and increased demand resulting from anticipated inventory restocking. This was evident in their top-line beat and raise for 2Q24, which resulted in significant positive stock price appreciation (37%) during the most recent quarter, specifically driven by SITM's communication and enterprise datacenter division.

Exact Sciences Corp. (EXAS), a cancer screening and diagnostics company focused on early detection and prevention of colorectal cancer, was a contributor. Despite the recent payment determinations by the Centers for Medicare and Medicaid Services (CMS) to not implement a 25% price increase for EXAS's next generation test, Cologuard Plus, the stock benefited from increased demand (frequency of testing), current market share positioning and the anticipation of additional diagnostic testing capabilities in the future.

Key detractors from performance included stock selection in information technology, materials and industrials sectors. Allocation also contributed negatively across various sectors, including an underweight in the financials and zero exposure to real estate sectors as well as an overweight to the information technology and energy sectors. The largest individual detractors were Silicon Motion Technology Corp., Simulations Plus, Inc. and Churchill Downs Inc.

Silicon Motion Technology Corp. (SIMO), a manufacturer of semiconductor products for the electronics market, underperformed for the quarter. The stock has struggled post 2Q24 as the market is concerned about memory demand as most of SIMO's sales are directed to consumer driven products (personal computers and smartphones). The mature growth is not expected to expand until the second half of 2025 as consumers and enterprises await the incorporation of AI into these devices. We continue to hold the name and believe SIMO will continue to gain market share and capitalize on new product innovation centered around AI.

Simulations Plus, Inc. (SLP), a provider of modeling and simulation software and consulting services to the pharmaceutical and biotechnology industry, was a detractor for the quarter. While investors continued to digest SLP's strategic acquisition of Proficiency during the quarter, we remain cautiously optimistic regarding forward pharma as well as biotechnology research and development spending and the positive impact on SLP financial results. We continue to hold SLP.

Churchill Downs Inc. (CHDN), an operator of pari-mutuel horse racing and casino gaming, best known for their trophy asset The Kentucky Derby, underperformed for the quarter despite posting solid 2Q24 results and expected earnings before interest, tax, depreciation and amortization (EBITDA) growth for the remainder of the year. CHDN, in our opinion, is a case of "a good house in a bad neighborhood" resulting from the perceived slowdown in regional gaming and low-end consumer exposure. We continue to hold this position and monitor as appropriate.

Current strategy and outlook

We expect mixed economic data and macro news to persist for the remainder of the year. However, the trend appears to point toward declining inflation and moderating unemployment. The initial 50 basis points cut that came late in the quarter, the first since tightening began in June 2022, benefitted small caps, especially those reliant on capital markets who immediately saw their cost of capital decline. This economic expansion is unique in that we typically see the Fed ease to "grease the wheels" and get the economy moving. Certainly, low-end consumers are under enormous amounts of stress and certain segments of the economy are slowing, but overall corporate profitability and growth remains solid, albeit slowing. We believe the Fed will continue to be cautious in their forward approach and are managing the current environment effectively.

It is in this environment that active management and close detail to fundamental investing is paramount. The Voya Small Cap Growth year to date performance has been strong, largely due to positioning that was done six to nine months ago focused on higher growth, strong cash-flow generating companies. We remain cognizant of the risk versus reward balance within the portfolio and at the individual company level. Heading into an anticipated lower rate environment, we have added several names to the portfolio that should benefit. As an example, more cyclical interest rate sensitive plays tied to housing such as direct homebuilders (Century Communities), construction (SiteOne Landscape Supply and Installed Building Products) and mortgage financing (Western Alliance Bancorp). 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 (roughly 36% as of 9/30/2024). Although a "higher for longer" environment could delay small cap stocks' outperformance, prudent and disciplined bottom-up stock selection should show strong relative returns.

Effective January 1, 2022, Voya Investment Management acquired the investment advisory business and certain other assets of Tygh Capital Management (TCM). Accordingly, asset under management, performance and characteristics prior to 12/31/21 predate the acquisition and are reflective of the strategy as managed by TCM.

The **Russell 2000® Growth inde**x 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.**

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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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