Small Cap Quality Growth Portfolio Review – 1Q25

Market Review

- The Russell 2000 Growth (R2G) lost -11.1% for the quarter. Uncertainty surrounding tariffs, persistent inflation, recession worries that accompany those items, as well as declining consumer confidence contributed to the decline. The Russell 2000 lost -9.5% while the Russell 2000 Value gave up -7.7%.
- Small caps led the market to start the year and finished positive for the month of January. February and March saw the positive return swept away as the worries mentioned above crept into the market. The relative performance advantage small built over large through mid-February gave way as small caps yielded more ground than large caps in a volatile, declining market. The first quarter was the 8th worst first quarter for the R2G since its inception in 1979.
- There was little linearity regarding size performance during the quarter as midcaps led, followed by large, broad, smid, megas, small and micros. While small caps did get beat up, micros were severely punished, losing over 14%. Value was the style leader for the quarter.
- Nine of the eleven sectors within the R2G turned in negative returns for the quarter with only Real estate and Utilities generating positive returns. Technology was the weakest sector.
- High-quality led 1Q25: factors that outperformed included larger market caps, reasonable valuation and growth, higher share prices, higher ROIC/ROE, lower leverage, positive cash flow, dividend payers, and lower beta. R2G loss makers took it on the chin as they lost more than -17% during the quarter with the two industries with the largest loss-making population, Software and Consulting and Biotech, losing roughly -24% and -16% respectively.
- The relative valuation of small versus large stocks continues to be at 20-year lows in favor of smaller stocks.

Portfolio Review:

- Small Cap Quality Growth (SCQG) outperformed for the first quarter (-5.2% vs -11.1% for the R2G) and for the prior twelve months, generating a 7.1% return, besting the R2G which lost -4.9%. This marks the 14th quarter of the past 17 that SCQG has beaten its benchmark.
- Price Volatility (our decision to minimize exposure to it) was the strongest contributor to return, factor wise, by far. Profitability was also solidly positive. After performing strongly for the past three quarters, Momentum lagged.
- Security selection was positive for the quarter accounting for 102% of the total return of the portfolio. Asset allocation was slightly negative. Financials and Technology led, contributing 196bps and 176bps to portfolio return, respectively. Only Materials turned in negative security selection, just shy of -50bp.
- Health Care slotted four names into the top 10 contributors to return, two in the top three. The leader, ADMA Biologics (ADMA) had another outstanding quarter and guided metrics higher. Corcept Therapeutics (CORT) reported a successful Phase III result for an ovarian cancer treatment and was rewarded handsomely. StoneX Group (SNEX) rounded out the top three contributors with record revenues and earnings. On the negative side, Radnet (RDNT) struggled because of exposure the Southern California wildfires and Sterling Infrastructure (STRL), as an HVAC vendor to AI server farms, suffered the fallout of the DeepSeek shock.

Outlook:

- Evidence is growing in favor of a size leadership switch from large to small. We have stressed three linchpins for the large to small switch for multiple quarters: the relative **valuation** discount of small cap to large cap – continual trough valuations; the **concentration** of mega-caps as a percent of the total equity market – always a herald of large to small leadership switches; and finally, the **duration** of the large cap leadership cycle is the second longest in U.S. stock market history.
- Add to these three linchpins a healthy high yield market; the resiliency of small caps regardless of winning party in Presidential elections; normalizing, higher for longer rates at the beginning of a rate cut cycle; trough returns for small cap versus large for any annualized period; no more easy money; and a normalizing GDP.
- Sawgrass' risk-conscious Small Cap Quality Growth strategy generates portfolios exhibiting lower price volatility; stable, consistent growth; and attractive valuations. It is built for this market. The rubber band of the "linchpins" is stretched tight. When it snaps, small caps are likely to generate historical **appreciation.**