

Focusing on High-Quality Companies with Sustainable Growth Trends

Strategy overview

Actively managed small cap core 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

- The bull market run over the first half of the year took a pause as markets pulled back during the third quarter. The specter of a government shutdown was avoided but that has done little to quell market volatility thus far.
- The Voya Small Company Strategy (the Strategy) outperformed its benchmark, the Russell 2000 Index (the Index), on a net asset value basis, primarily due to strong stock selection and positive allocation impacts from the health care and financials sectors. Stock selection was also strong in the information technology sector.
- There remains a great deal of uncertainty ahead regarding the prospect of slowing economic growth and whether or not inflation has truly been tamed by the unprecedented rate cuts over the past year. It appears that the fed is nearing the end of the rate-hike cycle. We are cautiously optimistic that we can achieve the soft-landing scenario.

Portfolio review

U.S. equity markets reversed course during the third quarter, weighed down by fears of interest rates remaining higher for longer. The S&P 500 Index fell by -3.27% for the quarter. Energy and information technology stocks led while utilities and consumer staples lagged. Growth stocks modestly outperformed value stocks during the quarter, and large caps beat small caps.

The U.S. bond market remained choppy during the quarter. The Bloomberg U.S. Aggregate Bond Index lost -3.23%, while a surprisingly resilient U.S. economy pushed the 10-year U.S. Treasury yield from 3.86% at the beginning of the quarter to 4.59% by quarter-end. In July, U.S. Federal Reserve raised rates by 25 basis points, bringing the Fed funds rate to a range of 5.25-5.50%. Rates were held steady at the September meeting, and Fed Chair Powell's remarks maintained a hawkish tone as he reiterated the central bank's strong commitment to returning inflation to its 2% target.

The Strategy outperformed the Index for the quarter ended September 30, 2023, primarily due to strong selection effects. The strategy benefited from stock selection in the health care sector and selection and the overweight to the financials sector. Selection was also strong in information technology sector, but this was modestly offset by the slight overweight during the quarter. Conversely, the underweight and stock selection in the energy sector had the largest negative impact on performance. Selection was negative in the industrials and materials sectors as well.

The main individual contributors to performance were Permian Resources Corp., Corcept Therapeutics Inc. and NextGen Healthcare, Inc.

The average overweight to energy stock Permian Resources Corp. (PR) was a top contributor. PR, which falls into the Cyclical Special Situations theme, had a modestly positive score driven by its attractive valuation metrics (earnings before interest, taxes, depreciation and amortization (EBITDA) and book-to-price) and higher quality fundamental factors relative to sector peers. The stock price appreciated throughout the quarter, boosted by the market's positive reaction to the announcement of the acquisition of Earthstone Energy and management's ability to properly execute this acquisition and extract synergies.

The overweight to health care stock Corcept Therapeutics Inc. (CORT) was driven by the average rating by the artificial intelligence (AI) models, which view its quality metrics (cash conversion cycle, intangibles and return on invested capital (ROIC)) and momentum, volatility, and dispersion attributes positively. CORT's stock price rose after a strong second quarter earnings beat driven by an increase in sales of the Cushing's Syndrome drug Korlym.

At the start of the quarter, the AI models had a high rating on NextGen Healthcare, Inc. (NXGN) resulting in a slight overweight relative to the benchmark, which generated positive excess returns. The stock's strong rating was driven by its quality metrics and favorable EBITDA valuation. During the quarter, management reported strong fiscal year first quarter earnings combined with an increase in estimates. NXGN, a leading ambulatory healthcare technology company, is also benefiting from an increase in patient volumes and a positive impact from management's shift from a licensing and maintenance business model to a subscription and transaction-based model.

Key detractors from performance included Mueller Water Products, Inc., Shyft Group, Inc. and Peloton Interactive, Inc.

The overweight to industrials stock Mueller Water Products, Inc. (MWA), which produces and sells products used for the transmission, distribution and measurement of water, was a driven by the strong momentum of fundamentals feature in combination with its relatively smaller market cap. Despite the strong view, the stock underperformed during the quarter after disappointing fiscal year third quarter earnings that resulted from water infrastructure destocking. The magnitude of the miss was unexpected as the destocking has lasted for a prolonged period that was not anticipated. The AI models continued to have a positive view of the stock at the end of the quarter.

The overweight position in automobile manufacturing stock Shyft Group, Inc. (SHYF) was driven by the AI model's average ranking of the stock linked to an improvement in its dividend and growth in earnings. During the quarter, the stock underperformed its industry peers after disappointing second quarter earnings and softer demand.

Exposure to Peloton Interactive, Inc. (PTON), which is not in the benchmark, detracted from performance. Results for the well known exercise company were in-line for the quarter on revenues but came in below street estimates on EBITDA and a wary view from investors given the uncertainty in customer demand. The AI models place Peloton in the turnaround theme, and the average weighting was linked to improving quality metrics. The models continued to have a slightly above average view of the stock at quarter end.

Holdings detail

Companies mentioned in this report – percentage of Strategy investments, as of 09/30/23: were Permian Resources Corp. 0%, Corcept Therapeutics Inc. 0%, NextGen Healthcare, Inc. 0%, Mueller Water Products, Inc. 1.29%, Shyft Group, Inc. 0.83% and Peloton Interactive, Inc. 0.72%; 0.00% indicates that the security is no longer in the portfolio. Portfolio holdings are subject to change on a daily basis.

The Russell 2000 Index is an unmanaged index that measures the performance of securities of small U.S. companies. 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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