

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

- The market finished the year on a high note, capping a strong year for equities. Inflation has begun to subside, and unemployment remains under 4% for the 22nd consecutive week. The underlying economy appears to be stronger than most anticipated.
- Consumer confidence continues to increase, and there is cautious optimism that we can achieve the desired soft-landing scenario and avoid a recession going into the new year.
- Small cap growth stocks, especially those with larger debt burdens and considered longer-duration, performed well following U.S. Federal Reserve comments indicating the potential for easing monetary policy in 2024.

Portfolio review

For the quarter ended December 31, 2023, the Voya SmallCap Opportunities Portfolio underperformed the benchmark, the Russell 2000 Growth Index (the Index) on a net asset value (NAV) basis, largely due to individual stock selection within the industrials sector. The consumer discretionary, technology and energy sectors had meaningful contributions.

Top individual contributors to performance included Natera, Inc., HCI Group, Inc. and SentinelOne, Inc.

Natera, Inc. (NTRA), a diagnostics company specializing in prenatal genetic testing, was the largest positive contributor to performance for the quarter. NTRA has seen strong Signatera testing volume growth driving YoY revenue growth in excess of 25% with better-than-expected gross margins. We expect positive fundamental trends to continue and NTRA remains a sizable position in the portfolio (2.4%), although we are mindful of the recent increase in valuation.

HCI Group, Inc. (HCI), a property and casualty insurance company, was the second largest contributor to returns during 4Q 2023. HCI has consistently increased earthquake insurance premiums and benefitted from favorable legislative changes in Florida driving better loss ratios and earnings growth. In addition, HCI continues to gain policies, largely resulting from the depopulation effort by Florida's state-backed insurance company, Citizens Property Insurance Corp. We are currently maintaining our position.

SentinelOne, Inc. (S), a provider of cyber-security services and software, performed well during the quarter. Following a solid 3Q 2023 beat that saw Annual Recurring Revenue

(ARR) growth of 43%, S raised fiscal year 2024 guidance and looks to expand into data security and cloud based applications. Despite a competitive environment for security driven software as a service (SaaS) application, we like the long-term outlook with expectations S will be cash-flow positive in 2023.

Key detractors from performance included Chart Industries, Inc., Flywire Corp. and Helix Energy Solutions, Inc.

Chart Industries, Inc. (GTLS) a manufacturer of engineered equipment utilized in the infrastructure of the industrial gas and energy industries was the largest detractor of performance for the quarter. Following an earnings before interest, tax, depreciation and amortization (EBITDA) and free cash flow (FCF) miss in 3Q 2023, GTLS traded down well below comparative industrial peers valuation and remains an attractive long-term growth company. GTLS continues to divest less profitable components of its 2022 Howden acquisition and capitalize on increased liquified natural gas penetration into Europe as a result of the Russia and Ukraine war. We continue to maintain our position.

Flywire Corp. (FLYW), a software company specializing in payment enablement within the education, travel, healthcare and business-to-business vertical, underperformed for the quarter. 3Q 2023 results heightened concerns arose regarding FLYW's profitability related to tuition payments made by foreign students and the stock price traded off significantly. We believe there is merit to these concerns and have since exited the position.

Helix Energy Solutions Group, Inc. (HLX), an energy company specializing in construction, maintenance and salvage services to the offshore natural gas and oil industry, was a detractor for the quarter, despite it being the largest contributor in 3Q 2023. Despite the 3Q 2023 revenue and EBITDA beat, FCF missed and 4Q 2023 FCF guidance was lowered driving the stock price lower. We had trimmed the stock during the third quarter given its strong outperformance and now believe estimates for 2024 and beyond are appropriately conservative.

Current strategy and outlook

The expectation for much of the year and going into the fourth quarter was for the Fed to remain diligent in their approach to monetary policy and reach their stated 2% inflation target. How this would impact the economy in regard to employment, wages, growth and overall economic resilience led to much debate and varying views. The bears believed the aggressive nature and anticipated higher for longer stance would result in a "hard-landing", while the bulls leaned toward potential rate cuts in 2024 and a "soft-landing". Following Fed Chairman Powell's comments in December the narrative changed regarding rate cuts from "if to when" in 2024 and firmly positioned the "soft-landing" scenario as the consensus view. Markets were off and running. As it relates to small cap stocks this news was well received, especially by those companies that need to access capital markets, given the reduction in the future cost of capital.

There has clearly been a change in market tone and the small cap team is trimming names in the portfolio that are nearing peak earnings and valuation levels in favor of better risk and reward opportunities. With continued emphasis on company fundamental factors and those with solid revenue growth, currently attractive candidates reside in more interest rate sensitive areas of the market. This includes consumer discretionary, select healthcare trading at depressed valuations and technology companies that can continue to grow revenue and earnings in what is expected to be a slowing economy in 1H 2024. Although we are not out of the woods yet, a soft-landing scenario would continue to benefit small caps. Lastly, as we have said for several quarters, the relative valuation discount favoring small cap growth over large cap growth continues to be attractive and warrants investor attention from an asset allocation perspective.

Holdings detail

Companies mentioned in this report – average percentage of Fund and Portfolio investments, as of 12/31/23: Natera, Inc. 2.84%, HCI Group, Inc. 1.85%, SentinelOne, Inc. 1.24%, Chart Industries, Inc. 1.23%, Flywire Corp. 0% and Helix Energy Solutions Group, Inc. 0.99%; 0% indicates that the security is no longer in the Fund. 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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