



KayneCast

A Podcast Series by Kayne Anderson Rudnick



Episode 77

First Quarter 2019 Review of the Small Cap Core Portfolio

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Intro: Hello, you're listening to Kaynecast, a podcast that provides commentary on the economy and financial markets every quarter by the Kayne Anderson Rudnick investment management team.

Jordan: Hello this is Jordan Greenhouse, Managing Director with Kayne Anderson Rudnick and with me today I have Jon Christensen, Senior Portfolio Manager of the Kayne Anderson Rudnick Small Cap Core Portfolio and today we're going to take a look back to discuss the first quarter of 2019.

Jon: Hey Jordan. Happy to be here.

Jordan: Jon, we've seen quite a reversal in the broader markets to start the year out in 2019. Can you walk us through some of the performance for the Small Cap portfolio that you saw during the first quarter along with comparatives for the index performance?

Jon: Absolutely. After a very tough Q4, where the Russell 2000 Index was down about 20%, we had a big bounce back in the market for Q1 2019. The Russell 2000 was up 14.5% in Q1. January and February making up most of the gains. So overall a very very strong market. We were able to outperform by over 600 bps in the quarter. It was overall, I would characterize it as a low-quality market but we were able to overcome that with some pretty strong stock selection.

Jordan: As we take a deeper dive into Small Cap Core, what were some of the key contributors you saw for the strategy during the first quarter?

Jon: Yeah. The biggest contributor in terms of stocks to the portfolio this quarter was Autohome. Autohome is the holding company for several Chinese-based websites focused on the consumer automotive industry. Users of Autohome's websites can research professional and user-generated reviews of private passenger vehicles sold in China. Continued healthy business results, despite weak new car sales in China, along with improved economic data in March spurred an increase in Autohome's share price.



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Jordan: And Jon, on the flip side, what would you say were some of the detractors you witnessed for the Small Cap Core Portfolio during the first quarter?

Jon: Sure. The biggest detractor from performance this quarter was RBC Bearings. So RBC Bearings designs, manufactures, and markets highly engineered plain, roller, ball, and other specialty bearings to a broad base of industries including aerospace, defense, and mining equipment. Shares lagged (though they were really only down about 3% in the whole quarter) following the company's reports of weaker than expected results and near-term outlook driven primarily by production bottlenecks at subcontractors which RBC relies on for highly specialized processes. RBC remains a solid free cash flow generator, and the company's balance sheet has improved further with year to-date debt repayment having exceeded their annual target.

Jordan: Jon, the last question I have for you is as we look back at Q1 2019, can you explain what impact stock quality from a characteristics perspective, things like S&P rating, Debt Levels, along with stock Beta had in the overall performance of the portfolio, as well as the impact on the index?

Jon: Now we typically expect to underperform in the market we saw in Q1, as I said given its strength as the low quality tailwinds. We combine this forecast with attribution showing it was indeed a low quality driven market as companies with low S&P Stock rankings, low credit ratings, high betas, and had high debt outperform their counterparts. However, stock selection can sometimes overcome these situations and that's indeed what happened in Q1. Superior stock selection in Financials and Producer Durables helped. We also had only one stock go negative for the quarter and that was only by 3%. When you are a high conviction manager like us and certain names do well, it can overcome the headwinds we faced of a low quality driven market.

Jordan: Once again, I've been speaking with Jon Christensen, Senior Portfolio Manager of the Kayne Anderson Rudnick Small Cap Core strategy. Thanks, Jon for your time and valued insight you bring to the table and bring to our KayneCast listeners. Thank you.

Jon: Thanks for having me, Jordan.