Small Cap Growth Market Update

The Echo of the Great Tech Bubble

We launched the Renaissance Small Cap Growth strategy at the beginning of 1996. At that time, the seeds for the great Tech Bubble of the late-1990s were just sprouting. Any money manager or avid individual investor who lived through the Bubble and the burst that followed it would likely remember all kinds of crazy anecdotes from the time.

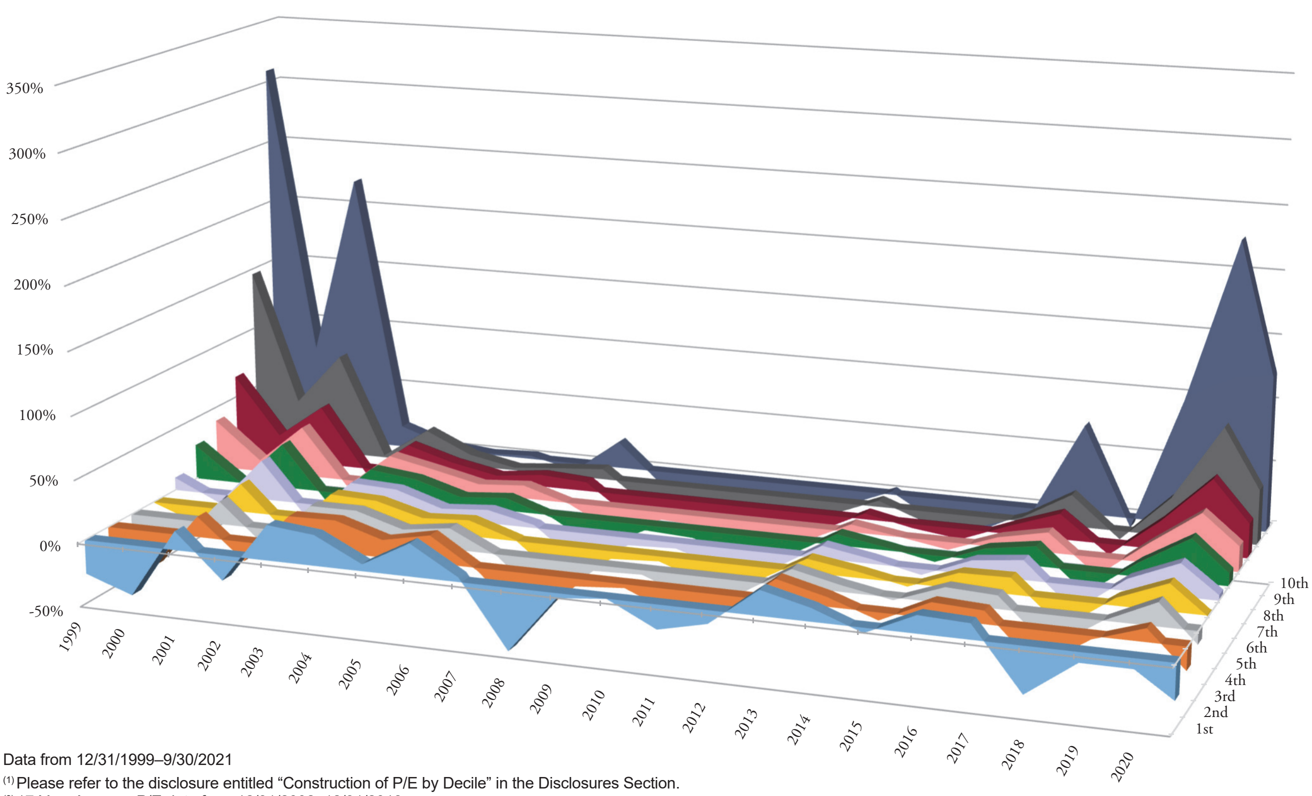
As a portfolio manager, I recollect that in 1998, I began to witness some stretched valuations in technology stocks. I expected to see some normalization in 1999. Suffice it to say, I was not prepared for what happened instead! Alan Greenspan, the Fed Chairman at the time, will forever be remembered for his description of the Technology sector as exhibiting “excessive exuberance”.

In the years since then, I thought I’d never see a bubble like that again. To be clear, we haven’t, but we have come close!

Chart I illustrates the universe of profitable companies in the Russell 2000 Growth Index broken down into 10 deciles based on P/E on FY2 earnings estimates. For each year-end starting in 1999, we calculated the P/E for each stock in the universe and placed it in its appropriate bucket from cheapest to most expensive. We then calculated the average for the group and repeated this process for each year-end through the present.

Notably, the similarities between year-end 2020 relative to year-end 1999 are striking. The most expensive decile (the tenth decile in Chart I) reached a P/E multiple of 196.8 as of 12/31/2020, which was exceeded only by the record of 246.9 set on 12/31/1999. It is also worth noting that not all stocks became more expensive. In fact, at the polar opposite end of the spectrum, the cheapest decile traded at only 7.5x earnings on 12/31/2020, which is virtually identical to the multiple afforded this decile at the end of 1999. Some who lived through the Tech Bubble of the late

CHART I: UNIVERSE DECILE P/E RELATIVE TO 17-YEAR AVERAGE P/E[(1)(2)]



Data from 12/31/1999–9/30/2021

(1) Please refer to the disclosure entitled “Construction of P/E by Decile” in the Disclosures Section.
(2) 17-Year Average P/E data from 12/31/2002–12/31/2018.

Sources: Renaissance Research, FactSet

1990s may recall that not only were "new economy" stocks revered for the unlimited growth they were to enjoy, but to an equal degree, "old economy" stocks were shunned by investors. Following the peak in the Tech Bubble in March of 2000, we witnessed not only a collapse in the stock prices of the most revered technology companies of the time but a magnificent run-up in prices for the overlooked and undervalued "old economy" stocks as well. During the four years from 2000 through 2003, cumulative returns of our client portfolios were up 70% (net of fees), while the Russell 2000 Growth fell by 27%.

In 2021, we have seen a strong rotation back to fundamentals and reasonable valuation. Through the first three quarters of the year, the highest-ranked quintile of stocks according to our quantitative model has outperformed the lowest ranked quintile by 18.5%. Our model favors companies with strong growth, quality, and momentum characteristics and reasonable stock valuation. In addition, the most expensive decile of stocks in our universe fell from a FY2 P/E of 196.8x to a P/E of 134.2x as of September 30. In the seventeen year-ends from 2002 through 2018, this priciest bucket has had an average P/E on FY2 estimated earnings of 60.4x. If one defines those years as normal, the most expensive decile of stocks in our universe is still 122% higher than normal.

We are enjoying a very strong year, and I'd be remiss if I didn't credit excellent stock selection from our Small Cap Growth Team as a significant contributor to our success—our solid performance is not just the result of tailwinds. Since the end of 2020, we have been actively "pivoting" while benefiting significantly from market mispricing of our fastest-growing stocks. We've sold many positions at extremely attractive prices. We've reinvested these proceeds into underappreciated stocks in which the underlying growth rate of a company and its stock price provides what we believe is noteworthy upside potential.

We are not sacrificing growth in order to maintain a reasonable portfolio valuation. As of September 30, our portfolio holdings have averaged 24.5% growth in earnings over the last five years which compares favorably to the average for the Russell 2000 Growth Index of 14.1%.

If you would like to learn more about Renaissance's Small Cap Growth Strategy, please contact Mary Meiners, Director of Client Services (mcm@reninv.com, 513-723-4553), or Paul Radomski, Lead Portfolio Manager for our Small Cap Growth Strategy (par@reninv.com, 513-607-3496).

DISCLOSURES

This Market Update reflects the thoughts of Renaissance as of November 8, 2021. This information has been provided by Renaissance Investment Management. All material presented is compiled from sources believed to be reliable and current, but accuracy cannot be guaranteed. This is not to be construed as an offer to buy or sell any financial instruments and should not be relied upon as the sole factor in an investment making decision, nor should it be considered a recommendation. The views and opinions expressed are those of the Portfolio Manager at the time of publication and are subject to change. There is no guarantee that these views will come to pass. As with all investments, there are associated inherent risks. Please obtain and review all financial material carefully before investing.

CONSTRUCTION OF P/E BY DECILE

Each P/E decile represents the universe of profitable companies in the Russell 2000 Growth Index as of 12/31/1999 broken down into ten buckets of companies with an equal number of companies in each bucket. The companies were placed in their respective buckets based upon their price-to-earnings ratio on estimated earnings-per-share for fiscal year two. The deciles were then recalculated the next year-end and each year thereafter through 12/31/2020 and for 9/30/2021. For each decile, the average P/E was calculated using a trigonometric mean, throwing out 20% of the outliers.

PERFORMANCE

If Renaissance or benchmark performance is shown, it represents historically achieved results, and is no guarantee of future performance. Future investments may be made under materially different economic conditions, in different securities and using different investment strategies and these differences may have a significant effect on the results portrayed. Each of these material market or economic conditions may or may not be repeated. Therefore, there may be sharp differences between the benchmark or Renaissance performance shown and the actual performance results achieved by any particular client. Benchmark results are shown for comparison purposes only.

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The benchmark presented represents unmanaged portfolios whose characteristics differ from the composite portfolios; however, they tend to represent the investment environment existing during the time periods shown. The benchmark cannot be invested in directly. The returns of the benchmark do not include any transaction costs, management fees or other costs. The holdings of the client portfolios in our composites may differ significantly from the securities that comprise the benchmark shown. The benchmark has been selected to represent what Renaissance believes is an appropriate benchmark with which to compare the composite performance.

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REFERENCED INDEX

(Indices are unmanaged and are not available for direct investment.)

Russell 2000 Growth Index—The Russell 2000 Growth Index is composed of the smallest 2,000 of the 3,000 largest U.S. companies based on total market capitalization with higher price-to-book ratios and higher forecast growth values.