

## U.S. Small/Mid Cap Growth Strategy

### Representative Commentary — 2Q21

Performance	Annualized					
	2Q21	1YR	3YR	5YR	7YR	10YR
U.S. SMID Cap Growth Composite (Gross)	4.86%	4.29%	42.64%	19.14%	18.46%	12.92%
U.S. SMID Cap Growth Composite (Net)	4.60%	3.77%	41.27%	17.97%	17.30%	11.80%
Russell 2500™ Growth Index	6.04%	8.67%	49.63%	20.13%	20.67%	14.80%

*Please see the important performance and other related disclosures at the end of this Commentary, which are an integral part of this quarterly Commentary Newsletter.*

The global equity markets continued to treat the pandemic's initial economic toll as a passing blip. In the second quarter, there were meaningful gains with many indexes approaching—or well into—double-digit gains for the first half of 2021 (not to mention annualized double-digit gains since the pre-pandemic highs of February 2020). For the quarter, U.S. equities led with gains of 8% compared with 5% for both non-U.S. developed and emerging markets equities. There was a shift in market preferences, with greater rewards accruing to the growth and large capitalization indices in the second quarter, compared with the dominance shown by value and small capitalizations earlier in the year.

Global economic activities continued unabated in the quarter, with the only hindrance from depleted inventories or higher labor costs. Although the rates of growth slowed slightly in June, measures of economic expansion for manufacturing and services worldwide reached peaks mid-quarter that had not been seen in 15 years. The unflagging demand pushed commodity prices to their highest levels since 2014, which included significant price gains for oil and natural gas. Among small-to-mid capitalization growth stocks, it was unsurprising that Energy remained the dominant economic sector. The market also preferred riskier stocks and growth at any price.

Amidst this environment, the portfolio underperformed the Russell 2500™ Growth Index for the quarter. Relative weakness was found in Consumer Staples, Financials, Health Care, and Industrials. That was partially offset by

strength in the Communication Services, Consumer Discretionary, and Information Technology sectors.

In the Consumer Staples sector, a food products distributor **Performance Food Group Co.** slid -16%. The company reported a mixed fiscal third quarter as sales came in above the consensus, though margins were below due to wage inflation in a tight labor market. Management offered encouraging forward guidance. They later announced the acquisition of Core-Mark, one of the largest distributors to convenience stores in North America, in a cash and stock transaction. We believe the concerns associated with this deal were overdone and added to our exposure on price weakness. Shares of warehouse club store operator **BJ's Wholesale Club Holdings Inc.** received a 6% markup. The company reported another strong quarter with earnings handily beating sell-side estimates. Membership trends remain encouraging as renewal rates paced ahead of management's projections.

Within Financials, **RenaissanceRe Holdings Ltd.**, a provider of reinsurance and insurance services, pulled back by -7%. In the company's most recent fiscal quarterly report, RenRe noted an increase in the total value of premiums written, which came from new business and higher pricing for existing reinsurance lines. However, RenRe tends to conservatively reserve a portion of that premium—typically released later in the year—which delays profit recognition in the near-term. Turning to credits, **Signature Bank** scored a 9% gain. This provider of commercial banking services reported robust loan and

deposit growth, plus an expansion into several new business lines. We trimmed the position on this strength.

The strategy's largest detractor was found in the Health Care sector. **ChemoCentryx Inc.** is a biopharmaceutical company focused on inflammatory disorders, autoimmune diseases, and cancer. Its shares retreated -78% following the release of Food & Drug Administration Advisory Committee documents which raised concerns about whether a single phase III trial was sufficient to make a risk/benefit determination for Avacopan in treating autoimmune vasculitis. As such, the path to drug approval is far from certain and we decided to liquidate the position. **Encompass Health Corp.** provides post-acute healthcare services through its inpatient Rehabilitation Centers and Home Health & Hospice segments. First quarter revenues were in line with estimates while earnings were above. While a strategic review of its Home Health and Hospice business is well under way, they continue to make improvements through the appointment of a new business head and the acquisition of Frontier Home Health and Hospice, which expands the segment's footprint in three new states (Alaska, Montana, and Washington). The market seemed puzzled by the timing of this acquisition as the stock traded down by -4%. **Blueprint Medicines Corp.**, a precision therapy company focused on rare diseases and oncology, declined by -10%. Sales of Gavreto for treating non-small lung cancer have been slower than expected and that impacted results for the latest quarter. Management remains confident in Gavreto's market potential. Their Ayvakit therapy is currently used for gastrointestinal stromal tumors and received FDA approval in mid-June to treat adults with advanced systemic mastocytosis (an abnormal accumulation of mast cells in bone marrow). Turning to positives, **Charles River Laboratories Inc.**, a contract research organization serving the biopharmaceutical industry, surpassed Street earnings expectations in the first quarter. The company increased its long-term operation margin goal as well as revenue growth targets for each business unit. This served to lift the stock by 28% and we trimmed the position on this strength. **AtriCure Inc.** produces devices used for the surgical ablation of cardiac tissue as well as instruments used in the repair or replacement of heart valves. Solid overall first quarter results were driven by a robust recovery in the U.S. which offset inconsistent volume trends in international markets. Another piece of good news for the company was the FDA's approval of its Epi-Sense System that is used to treat long-standing persistent atrial fibrillation. These developments boosted AtriCure's stock by 21% and we trimmed the position.

In the Industrials sector, **TPG Pace Beneficial Finance Corporation (TPGY)** is a special purpose acquisition company (SPAC) for the acquisition of leading global provider of smart charging solutions for electric vehicles (EV) **EVBox**. The company provides its customers with an integrated end-to-end portfolio of hardware, cloud services

and support. In June, TPGY announced it had extended the deal deadline to acquire EVBox, and that led its share price down -34% for the quarter. We trimmed our position in light of the current growing uncertainty. **Array Technologies Inc.**, a producer of ground-mounting systems used in solar energy projects, tumbled -46% after reporting a mixed quarter including a beat to revenue estimates as well as misses to gross margins and profits, caused by higher steel and increased freight costs. We decided to exit the position as these inflationary pressures may persist. New to the portfolio this quarter is **Proto Labs Inc.**, a digital manufacturer of custom prototypes and production parts. While first quarter revenues were ahead of expectations, earnings fell short. The 3DHubs acquisition adversely dampened operating margins due to the impact of freight and materials inflation. Its shares retreated -20% and we used that as an opportunity to increase the position. **Axon Enterprises Inc.** produces body cameras and TASER weapons that are used by law enforcement agencies. Its shares climbed 24% after reporting an impressive quarter with revenues well above projections due to strong demand across all product lines. We participated in the initial public offering for **First Advantage Corp.**, a leading supplier of technology solutions for screening, verification, safety, and compliance serving the human capital management industry. The stock rose 30% since it was added.

Within Communication Services, **Bandwidth Inc.**, a supplier of cloud-based communications services to small and mid-sized companies, gained 9%. The company reported a solid quarter, outpacing Street earnings estimates by a substantial margin. Customer net additions led to revenue upside and management increased forward guidance. Another addition to the portfolio this quarter was **Vimeo Inc.**, a provider of software, tools, and technology for creators and businesses to host and distribute video content. Its share price appreciated by 11% after it was added.

In Consumer Discretionary, golf equipment and accessories manufacturer **Callaway Golf Co.** rallied 26%. First quarter results impressively beat across revenues, profits, and earnings. Core golf equipment business continues to see unprecedented demand while soft goods have been able to hold up thanks to ecommerce sales. **National Vision Holdings Inc.**, a specialty retailer of optical products under America's Best an Eyeglass World brands, gained 17%. They reported better-than-expected revenues and earnings for the first quarter as the company's low-priced offerings are generating market share gains. **Ollie's Bargain Outlet Holdings Inc.** is a retailer of closeouts, excess inventory, and salvage merchandise. First quarter results eclipsed estimates on same store sales growth on broad-based category strength. Despite these positives, the stock sold off by -3% as sell-side analysts are concerned about closeout inventory availability. Management has countered that view by

indicating there is an abundant supply. **Gentex Corp.** manufactures and supplies digital vision, connected car, dimmable glass, and fire protection products. Their stock fell -7% as revenues and earnings failed to meet Street projections in the latest quarter due to parts shortages and higher freight costs. Management maintained full year guidance.

The portfolio's strongest contributor was found in the Information Technology sector. **Bentley Systems Inc.**, a supplier of software solutions for infrastructure engineering, advanced 38%. The company delivered revenues and profits above estimates. Its annualized recurring revenues have risen along with customer upgrades to higher-priced E365 subscriptions. Another key area of growth is from a program called Virtuosity that was launched one year ago. Bentley now has 1,000 small to mid-sized customers. **Gartner Inc.** offers technology-related insights to clients through its research, advisory, and conference segments. Their stock soared 33% on the heels of exceptional first quarter results, with accelerations in contract values and a revival of its events business. **HubSpot Inc.** develops Internet marketing software solutions. They posted an impressive quarter with significant growth in billings and subscription revenues. This served to lift the stock by 29% and we trimmed the position. Its recent launch of Operations Hub has generated a high level of interest for its ability to integrate data between applications and analytics. This product represents a new arrow in their quiver for potential cross-selling opportunities. According to HubSpot, 55% of its customers subscribe to two or more Hubs. New to the portfolio this quarter was **EVO Payments Inc.**, a provider of payment technology and services. Overall results were in line for the quarter. While revenues in the Americas held steady, they declined in Europe as a result of continued lockdowns from the pandemic. Higher vaccination since quarter-end bode well for its business moving forward. EVO Payments pulled back -3% since it was added. Shares of **Rush Street Interactive Inc.**, an operator of regulated online gaming sites, dropped -25%. First quarter results were mixed as

revenues were above estimates while profits were below. Management indicated the company is investing aggressively to drive future growth.

One of our strategy's purchase rules is based on the range of market capitalizations in the **Russell 2500 Growth Index** following its annual reconstitution. After the reconstitution at quarter end, the largest stock in the index had a market capitalization of \$24.9 billion. While the strategy's guideline limits new positions outside the benchmark at the time of initial purchase to less than 75% of the largest name in the benchmark—or \$18.7 billion based on the new benchmark—we will move our limit only to \$12.0 billion from the current level of \$9.5 billion. The lower end of the purchase range remains at a market capitalization of \$300 million.

Though TimesSquare continues to operate remotely outside of our NYC office, we expect to have a gradual return in the fall. In the meanwhile, we are very pleased to announce that Reuben Scherzer joined TimesSquare in June as a Research Analyst. Reuben is responsible for coverage of Europe and other non-U.S. regions within the Developed, Emerging, and Frontier Markets.

Heading into the second half of 2021, market returns continue to anticipate economic growth as their focus turns to 2022 and the pain of 2020 fades. However, the amount of growth already reflected in current valuations is debatable. Higher vaccination rates bolster the outlook, though the appearance of COVID-19's Delta variant generates anxiety. The pace of inflation means the transitory period may last longer than some expect, though the Federal Reserve seemed less concerned about inflation as much as beginning internal discussions on tapering its monetary easing stance. All told, we see the typical mixture of opportunities and risk that we as active investors seek to balance in our bottom-up assessments. As always, we are available for any questions you might have as we endeavor to protect the assets you have entrusted with us.

## **General Disclosure:**

*The holdings discussed represent a particular point in time. It should not be assumed that the securities continue to be held, and/or continue to be held in the same percentage, and/or were held continuously throughout the period. In addition, the holdings of a particular client account may differ from the information provided. Securities discussed do not represent the entire portfolio and, in aggregate, may represent only a small percentage of a portfolio's holdings. Information is subject to change without notice. It should not be assumed that any of the securities discussed were or will prove to be profitable. Past performance does not guarantee future results.*

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## **Composite & Performance Disclosure:**

*Performance is measured against the Russell 2500™ Growth – a market capitalization-weighted index that measures the performance of those Russell 2500™ companies with higher price-to-book ratios and higher forecasted growth rates. All indexes, including the Russell 2500™ Growth Index, are based on gross-of-fee returns. Russell Investment Group is the source and owner of the Russell Index data contained or reflected in this material and all trademarks and copyrights related thereto.*

*This composite invests in stocks with market capitalizations generally between \$300 million and \$8.5 billion at time of purchase. The process is fundamental research driven. The investment style is growth. Portfolios will hold approximately 90-120 stocks. Historical turnover has averaged 57% per year. Composite inclusion threshold \$5mm. Fee basis is 100 basis points. The composite creation date is November 1, 2000.*

*Effective 04/01/2015, TimesSquare removes accounts from this composite when significant cash flows occur. A significant cash flow is defined as an external flow that exceeds 10% of the composite's market value on the day of the cash flow. Effective 01/01/2017, the significant cash flow policy has been removed.*

*In July 2014, TimesSquare modified its purchase capitalization range to match the changes in the small/mid cap market as represented by the Russell 2500™ Growth Index. The purchase range was amended to reflect a range bounded by the approximate value of the smallest security in the index (in most cases) and the approximate value of 75% of the largest security's capitalization. These targets will be maintained for the subsequent 12 months, and may be adjusted based on the above rules each July following the reconstitution. In that manner, the targets would be responsive to higher or lower capitalization profiles of the indexes over time.*

*The performance figures shown are calculated in U.S. dollars on a size-weighted basis and reflect the reinvestment of dividends and other earnings, and the deduction of brokerage commissions and other transaction costs. Performance is provided on a gross basis (before the deduction of management fees) as well as net of the highest management fee of 1.00% charged by TimesSquare to separately managed institutional accounts in this composite. Investment advisory fees generally charged by TimesSquare are described in Part 2A of its Form ADV. This composite may contain some accounts that have used performance based fees. To illustrate performance net of fees, assume \$20,000,000 is placed under management for ten years sustaining 10% compound gross total return. If an advisory fee of 1.00% of average assets under management is charged per year, for each year of the ten-year period, the resulting compound annual return would be reduced to 9.0%. The ending dollar value of the account would be \$47,347,274 compared with the unreduced account value of \$51,874,849.*