

## U.S. All Cap Growth Strategy

### Representative Commentary — 3Q21

Performance	Annualized					
	3Q21	1YR	3YR	5YR	7YR	10YR
U.S. All-Cap Growth Composite (Gross)	5.11%	28.29%	22.88%	24.04%	18.98%	20.41%
U.S. All-Cap Growth Composite (Net)	4.92%	27.35%	21.98%	23.13%	18.10%	19.53%
Russell 3000® Growth Index	0.69%	27.57%	21.25%	22.29%	18.11%	19.38%

*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 markets struggled to find stable footing in the third quarter. While the worldwide interconnected supply chain rattled with continued difficulties, changes were afoot in many economic centers. After only one year in the role, Japan's Prime Minister Suga announced he would step down as his party's leader. While his successor appears to follow the existing political and economic policies, a broader election is planned for November. Germany had a much longer tenure with its leader—Chancellor Merkel was at the helm for 16 years—though she did not seek reelection. As of this writing, it was unclear which coalition of parties would form the new government after the late September election. In another shift, the U.S. Federal Reserve indicated that it might taper its \$120 billion of monthly asset purchases as soon as its November meeting, potentially raising the federal funds rate in mid-2022. Elsewhere in the credit markets, with possible reverberations across other asset classes and geographies, one of China's largest real estate developers—and one of the largest companies globally—teetered on the edge of failing to meet its debt obligations. Meanwhile, global economic activities downshifted their growth pace from midyear, though remained expanding at a faster rate than they had at the start of the year. Nearly universally, struggles with the supply chain—higher commodity prices, labor shortages, or shipment delays—blocked higher activity levels of manufacturing or services.

The collective effect left the developed markets with flat returns (-0.1% for the U.S. and -0.5% for non-U.S.), while emerging markets faltered (-8.1%). Within the U.S., weaker results came from further down the size spectrum. While growth led value among large-to-mid capitalization stocks, the reverse was true for small/mid and small

capitalizations. Stocks with higher quality or lower risk emerged from the quarter with fewer bruises.

Amidst this environment, the portfolio outperformed the Russell 3000® Growth Index for the third quarter. Significant relative outperformance within Information Technology—bolstered by results from Consumer Discretionary and Industrials—was slightly offset by weakness within Financials, and Communication Services.

Slight outperformance was found within Consumer Discretionary, where the index's average sector return finished flat at 0%. Up 10% was **Airbnb, Inc.**, a global online alternative accommodation booking platform, focused on home sharing. The company reported another solid quarter, where revenues beat consensus estimates, as volume growth in nights and experiences booked strengthened considerably during the period. Moreover, longer term stays and non-traditional stays remains elevated versus 2019 levels. Management also reported second quarter operating margins that were well above expectations, driven by stronger revenues and tight cost controls. As a result, we believe the company's strong cost leverage should continue to drive further margin expansion, resulting in profitability ahead of schedule. Less encouraging results came from online retailer and cloud-based service provider, **Amazon.com**. During the quarter, company delivered lighter-than-expected second quarter results, where revenues and operating income fell below analyst estimates. The company noted that softer quarterly numbers were attributed to higher consumer mobility which impacted eCommerce demand. Moreover, management lowered third quarter guidance, as they believe higher mobility and vaccination rates are leading to

more offline shopping, slightly impacting revenue growth in the near term. Shares were down -4% during the quarter.

Within Communication Services, the portfolio struggled to keep pace with the index's average sector return of 2% for the quarter. Image-based social media company **Pinterest Inc.** reported strong revenue and profit growth, however, its monthly active user metric missed by a meaningful amount. While the decline is being driven by Desktop users, who tend to be less engaged and generate lower revenues than the Mobile cohort, this churn level disappointed the market and the stock traded down by -11%. Turning to family entertainment and media giant, **Walt Disney Company**, third quarter revenues and operating profits beat analyst estimates, driven by upside in direct-to-consumer (DTC), parks, and consumer products. Moreover, their DTC business appears to be pushing to profitability ahead of schedule. However, their Linear Networks segment experienced significant margin contraction, which is largely due to the return of programming costs that were absent in 2020. Shares were down -4%, where we added on price weakness during the quarter.

Within Information Technology, significant relative outperformance was driven by strong stock selection for the quarter, where the index's average sector return was 2%. For example, up 47% was **Paylocity Holding Corp.**, a provider of cloud-based payroll and human capital management software for medium-sized organizations. The company reported robust fiscal fourth quarter results and provided strong fiscal 2022 guidance. Management noted client retention remained above 92%, where sales momentum has returned along with a higher headcount among its customers. We trimmed our position into strength toward the end of the quarter. Turning to the digital payment platform **PayPal Holdings** delivered mixed second quarter results. There was a slight miss on revenues due to a meaningful decline in the take rate from **eBay**, a global eCommerce company, as they are transitioning away from PayPal's platform faster than expected. While the near-term outlook has been damped by the eBay transition, trends in the rest of the business remain solid as digital payments continue to surge. In September, PayPal announced the purchase of Paidy, a buy-now-pay-later (BNPL) provider in Japan for \$2.7B. We believe the acquisition makes sense since the BNPL segment of the payments market is significant and growing, along with immediate growth exposure in Japan. Shares were down -11% for the quarter, where we added on price weakness. Next up is **Microsoft Corp.**, a global technology company, where shares were up 4% during the quarter. The company released strong quarterly results across all three operating segments, beating consensus estimates on both the top and bottom lines. Management also issued a healthy outlook for fiscal first quarter 2022 revenue growth, calling out steady growth for Azure, their cloud computing segment. The company's sustainable growth profile remains intact as it continues to benefit from the shift of on-premises workloads to the cloud and as a consolidator of corporate IT spending. **Twilio Inc.** provides a cloud communication platform that enables developers to build, scale, and operate customer

engagement within software applications. The company reported solid second quarter results as revenues beat analyst estimates. However, gross margins fell slightly below estimates during the quarter, mostly due to application-to-peers (A2P) carrier fees from AT&T and T-Mobile. While A2P carrier fees need to be monitored in the near term, management guided for higher third quarter revenues. Shares were down -19%, where we added on price weakness towards the end of the quarter. **CS DISCO, Inc.** provides artificial intelligence-powered software for e-discovery, legal document review and case management to corporate legal departments and law firms. During the quarter we participated in the company's Initial Public Offering, as we view the company as an innovative technology solution for the e-discovery market, as legal disputes have provided a constant source of opportunity over any business cycle. Despite our enthusiasm for the company, we exited the position with a 37% gain, as shares exceeded our price target.

Our Industrials sector holdings also contributed to relative outperformance, where the index's average sector return was -5%. **Rexnord Corporation** specializes in water management (WM) and process and motion control (PMC) products for end markets including industrial, energy, food and beverage, aerospace, and construction. Rexnord's revenues and earnings exceeded expectations in the second quarter. More importantly, the WM operations drove that strength while the PMC business was as expected. Earlier in the year, the company announced it would divest the PMC operations to Regal Beloit, which would narrow Rexnord's focus on the higher growth WM segment. This led to a 29% gain for its shares. Shortly after quarter end the transaction occurred, and the WM business of Rexnord was renamed **Zurn Water Solutions** while the PMC business became the newly christened Regal Rexnord. Turning to the manufacturer of wood-alternative decking, railing, trim, and molding, **AZEK** produced higher-than-anticipated fiscal quarterly revenues and earnings, and its stock climbed initially. However, rising raw materials and logistic costs added to margin pressure and eventually led the stock down -14% for the quarter.

Turning to our only name in the Consumer Staples sector is **Sysco Corporation**. The company distributes food products to over 650,000 locations, including restaurants, healthcare, and educational facilities, lodging establishments, and other foodservice customers. The company beat analyst estimates on revenue and earnings-per-share (EPS). Management raised fiscal 2022 earnings guidance on strong market share gains, faster than expected industry recovery, and effective management of labor cost pressures. Shares were up 2%, outperforming the index's average sector return of 0% during the quarter.

There were mixed results within Financials, which had an index average return of 6%. **LendingTree, Inc.** is an online marketplace for third-party consumer financial products, such as loans, credit cards, and insurance. With consumers having increasing worries regarding the future, and household balance sheets generally in better shape from prior reductions in spending, there was a market view that consumer loan growth would have a

slower-than-expected recovery. That led LendingTree's shares to retreat by -26%, making it our worst detractor for the quarter. New to the portfolio is **Signature Bank**, a provider of commercial banking products and services, including cryptocurrency related deposits. Second quarter results beat sell-side estimates on higher revenue growth as well as a lower loan loss provision and the stock gained 3% since its purchase.

Within the Health Care sector, **Royalty Pharma Plc** funds biopharma development by purchasing future royalties for a variety of treatments. Despite reporting in line results for their latest quarter, shares were lower on the potential for royalty erosion from its Vertex Pharmaceutical's Cystic Fibrosis franchise in view of the potential entry of Vertex's next-generation triple combination therapy, which is in development. The new therapy is at least a few years away from entering the market and it remains to be seen if that treatment will pass muster for "meaningful improvement" over the current therapy. We exited the position with a -5% share decline and deployed funds into higher conviction names. Up 6% was **Phreesia, Inc.**, the cloud-based platform for practice management and electronic health

records. The company announced a new module designed to reschedule automatically and fill appointment slots created by cancellations from other patients. In addition to benefiting the client's practice, this increases payment processing fees for Phreesia and may make its offering more appealing for hospitals that need assistance balancing the loads of their physicians.

Turning toward the end of the year, despite this quarter's setback, global equities in most areas have posted meaningful gains thus far in 2021. Yet all the usual suspects lie in wait: new COVID variants, higher-than-typical inflation, tighter monetary policies, and a slowly recovering global supply chain. Countering that is a high degree of stifled producer and consumer demands, along with improving consumer outlooks. Each effect can create or amplify both risks and opportunities for companies, which we continue to review and assess for your investments. As always, we are available for any questions you might have as we endeavor to enhance 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 3000® Growth – a market capitalization-weighted index that measures the performance of those Russell 3000® companies with higher price-to-book ratios and higher forecasted growth rates. All indexes, including the Russell 3000® 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 above \$2.0 billion at time of purchase. Portfolios will hold approximately 35 securities. The process is fundamental research driven. The investment style is growth. Historical turnover has averaged 99% per year. Composite inclusion threshold \$200,000. Fee basis is 75 basis points. Composite creation date is January 2, 2008.*

*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.*

*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 0.75% 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. To illustrate performance net of fees, assume \$20,000,000 is placed under management for ten years and sustains 10% annual gross return for each year during this period. If an advisory fee of 0.75% of average assets under management is charged per year, for each year of the ten-year period, the resulting annual net return would be 9.25%. The ending dollar value of the account would be \$48,444,497, as compared to \$51,874,849 if the advisory fees had not been deducted.*