

U.S. Mid Cap Growth Strategy

Representative Commentary — 3Q21

Performance	Annualized					
	3Q21	1YR	3YR	5YR	7YR	10YR
U.S. Mid Cap Growth Composite (Gross)	1.34%	31.39%	20.80%	20.09%	16.06%	18.52%
U.S. Mid Cap Growth Composite (Net)	1.14%	30.37%	19.85%	19.15%	15.15%	17.59%
Russell Midcap® Growth Index	-0.76%	30.45%	19.12%	19.25%	15.37%	17.53%

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. Among small-to-mid capitalization stocks, those with higher quality or lower risk emerged from the quarter with fewer bruises. Across the economic sectors, there were better returns from the more bond-like ones, such as Utilities, Real Estate, and Financials. Greater laggards included the Communication Services, Consumer Staples, and Materials sectors.

Amidst this environment, the portfolio outperformed the Russell Midcap Growth Index in the third quarter. Weakness in the Communication Services, Financials, and Consumer Staples sectors was offset by strength across the Consumer Discretionary, Health Care, Industrials, and Information Technology sectors.

The largest detractors for the strategy this quarter were found in the Communication Services sector. **Zynga Inc.**, a social game developer for mobile devices, dropped by -29%. Although the company's fiscal quarterly results were as expected, they experienced unexpected levels of customer turnover in recent months with users having less time available for mobile games as businesses reopen. That and the challenges posed by Apple's new privacy framework led management to reduced full year's bookings guidance. 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 -35%. **Vimeo Inc.** is an online video creation and distribution platform for businesses. Second quarter results were in line with prior projections; however, a lower growth outlook caused a -40% selloff. Nevertheless, management remains confident in the market opportunity ahead, with average revenue per user continuing to benefit from a mix shift toward Enterprise customers.

Within Financials, **RenaissanceRe Holdings Ltd.** offers reinsurance and insurance services. Their second quarter earnings outpaced Street estimates on better-than-anticipated catastrophe losses and reserve releases. Its shares were down by -6% due to the potential insured losses associated with Hurricane Ida. RenRe's sophisticated modeling capabilities are a major competitive advantage and differentiator in underwriting catastrophe risk. **Progressive Corp.** provides insurance coverage in areas including autos, residential, and specialty property-casualty. We exited the position in view of decelerating fundamentals after a strong run, which included a pandemic-aided 2020. The stock dropped by -4% for the time it was held in the quarter. Turning to credits, consumer finance company **Discover Financial Services** edged forward by 4% after reporting an earnings beat. That was driven by a sizable gain associated with the company's ownership in Marqeta (which went public in the second quarter) and a reserve release associated with last year's high provision for loan losses. Setting these unusual items aside, revenues still outpaced expectations. Another new buy was **Signature Bank**, a provider of commercial banking products and services. Second quarter results beat sell-side estimates on higher revenue growth as well as a lower loan loss provision and the stock gained 20% since its purchase.

In Consumer Staples, **Lamb Weston Holdings Inc.** produces and distributes frozen potato products. Fiscal fourth quarter results were solid, stemming from an upside to revenue estimates and a more favorable sales mix. While the revenue outlook was in line with Street projections, management did not offer profit guidance due to near-term inflationary trends in both labor and transportation. The absence of this data resulted in a -24% tumble. Later in the quarter there were concerns on the yields from the current potato crops, which combined with higher costs further dampened Lamb's outlook, and we began scaling out of the position.

Within the Consumer Discretionary sector, aftermarket automotive parts retailer **O'Reilly Automotive Inc.** reported second quarter earnings that outpaced the consensus and were driven by higher-than-expected same store sales. Management also increased sales growth projections, which pushed the stock price higher by 8%. **Lululemon Athletica Inc.**, a designer and retailer of athletic apparel for women and men, jumped 11%. Second quarter earnings were well ahead of consensus projections, driven by solid sales momentum from both their stores and online. **Brunswick Corp.** manufactures recreation marine

products. Their boat segment includes Sea Ray, Bayliner, and Boston Whaler and engines are under the Mercury brand. Second quarter results came in better than expected, with retail demand continuing to be strong. Supply chain challenges remain the biggest potential obstacle for further upside and that pulled the stock back by -4%. **Burlington Stores Inc.** is a retailer of apparel, footwear, toys, coats, baby, and home products. While second quarter results were ahead of Street projections, elevated freight costs slowed margin improvements and that caused its shares to slide by -12%.

In Health Care, outsourced manufacturing organization **Catalent Inc.** delivered a nice upside to fiscal fourth quarter estimates, driven by higher revenues in its Biologics and Softgel segments. Management noted an expansion of their cold storage facility in Singapore and plans to increase manufacturing capacity at their Italian plant. They also announced the acquisition of Bettera, a private CMO focused on gummy drug delivery for the OTC market. These developments served to boost the stock by 23%. Also surging by that same amount was **Ascendis Pharma**, a biopharmaceutical company focused on developing therapeutics for unmet medical needs. The company announced FDA approval of Skytrofa for pediatric growth hormone deficiencies. Ascendis has a number of other drug candidates in the pipeline at various stages of development. Turning to detractors, **Dentsply Sirona Inc.** manufactures and distributes dental products and technologies. While second quarter results beat the consensus with Technology & Equipment as the primary driver, forward guidance offered a more cautionary outlook for the balance of the year in terms of foreign exchange rates and that caused an -8% decline. **Royalty Pharma Plc** funds biopharma development by purchasing future royalties for a variety of treatments. Despite reporting in line results for their latest quarter, its shares traded down by -11% 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.

Within the Industrials sector, **Waste Connections Inc.** provides waste collection, transfer, disposal, and recycling services. Broad-based volume improvement and a modest pricing increase in the second quarter lifted the stock by 6%. Waste Connections has signed or closed 14 acquisitions thus far in 2021, including three that are expected to close later this year. **Nordson Corp.** offers systems to dispense, apply, and control adhesives, coatings, polymers, and sealants. A solid second quarter along with higher revenue guidance resulted in a 9% gain. Somewhat countering this strength was the -7% pullback in **Ametek Inc.**, a producer of electronic instruments and electromechanical devices. While the company experienced a strong rebound in both business segments,

management has maintained a conservative forward outlook given the challenging inflationary and supply chain environment. **Booz Allen Hamilton Holding** provides management and technology consulting services. Its shares fell -6% on mixed fiscal first quarter results that included a shortfall in revenues and an earnings beat. Management reaffirmed its guidance for the full year, with an expectation of organic revenue growth.

Information Technology was the home to several of our strongest contributors this quarter. **Paylocity Holding Corp.**, a provider of cloud-based payroll and human capital management software solutions, climbed 47%. Fiscal fourth quarter results were strong while client retention remained above 92%. Sales momentum has returned along with a higher headcount among its customers. **Gartner Inc.** offers independent and objective research and analysis on information technology, computer hardware, software, and communications. Its shares rose 25% as second quarter revenues and earnings beat Street projections due to improving average contract values and operational efficiencies. **Monolithic Power Systems Inc.** designs and develops integrated power semiconductor solutions and power delivery architectures. The stock rallied 30% after they reported an upside to consensus estimates as well as increasing forward guidance. Management noted they are gaining share and winning more designs. **HubSpot Inc.** offers a platform for cloud-based marketing, sales and client services. A strong beat and raise to forward guidance resulted in a 16% gain. There was noteworthy expansion of HubSpot's customer base during the quarter. **MKS Instruments Inc.** supplies instruments, systems, subsystems, and process control solutions for producing semiconductors. Despite reporting in line second quarter

results, forward guidance fell short of the Street's expectations due to the impact of supply constraints and that caused a -15% selloff. **Twilio Inc.** provides a cloud communication platform that enables developers to build, scale, and operate customer engagement within software applications. The stock price declined -19% on mixed second quarter results, which included higher revenues, but a lower sequential rate of customer additions. Gross margins were down slightly, impacted by higher A2P (application-to-person) message carrier fees at AT&T and T-Mobile. Guidance for the third quarter included higher-than-expected revenue growth, though with lower profitability. **Zendesk Inc.** is a software development company that supplies a system for tracking, prioritizing, and solving customer support tickets. Its shares dropped -19% as second quarter results fell short of the consensus. As the company moves up into the enterprise area, its bookings are increasingly becoming more back-end loaded for each quarter.

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.

The opinions and information expressed and provided are for general information only and are not intended to provide specific advice or recommendations but rather, a basis from which strategies can be built, taking into account the specific objectives of each portfolio, in terms of return, time horizon, and risk constraints, as well as diverging investment perspectives and assumptions. All material has been obtained from sources believed to be reliable, but its accuracy and completeness are not guaranteed.

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Composite & Performance Disclosure:

Performance is measured against the Russell Midcap® Growth – a market capitalization-weighted index that measures the performance of those Russell Midcap® companies with higher price-to-book ratios and higher forecasted growth rates. All indexes, including the Russell

Midcap® 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 \$2.2 and \$22 billion at time of purchase. The process is fundamental research driven. The investment style is growth. Portfolios will hold approximately 70-80 stocks. Historical turnover has averaged 45% per year. The minimum account size for inclusion into the mid cap composite is \$5 million. Fee basis is 80 basis points. Composite creation date is October 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 mid cap market as represented by the Russell Midcap® 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. Previously, in August 2007, TimesSquare had modified its purchase capitalization range to match the mid cap market as represented by the Russell Midcap® Growth Index at that time, with a change from \$1.5 billion to \$10 billion at time of purchase to \$2.5 billion to \$15 billion.

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 0.80% 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 and sustains 10% annual gross return for each year during this period. If an advisory fee of 0.80% of average assets under management is charged per year, for each year of the ten-year period, the resulting annual net return would be 9.2%. The ending dollar value of the account would be \$48,223,239, as compared to \$51,874,849 if the advisory fees had not been deducted.



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