

U.S. Small/Mid Cap Growth Strategy

Representative Commentary — 4Q21

| Performance | Annualized | | | | | |
|--|------------|-------|--------|--------|--------|--------|
| | 4Q21 | 1YR | 3YR | 5YR | 7YR | 10YR |
| U.S. SMID Cap Growth Composite (Gross) | 1.76% | 5.28% | 26.80% | 17.36% | 12.68% | 15.37% |
| U.S. SMID Cap Growth Composite (Net) | 1.51% | 4.24% | 25.57% | 16.21% | 11.57% | 14.24% |
| Russell 2500™ Growth Index | 0.20% | 5.04% | 25.06% | 17.64% | 13.77% | 15.74% |

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.

2021 began with the expectation that vaccinations would reduce COVID-19's grip on the economy and our collective psyche. For a time, we progressed along that course and looked forward to a return to normal by the summer. However, varying levels of vaccinations, changing mandates, and the late-year emergence of new COVID variants, created a sense of "déjà vu all over again" by the close of the year. More consistent in 2021 was the steady increase of global inflation for consumers and producers, typically coupled with ongoing supply chain woes. Despite that, global equity markets posted double-digit gains for the year, led by the U.S. with 26% followed by developed non-U.S. at 11%, though emerging markets dipped by -3% (however, small cap emerging markets *increased* by 19%).

In the final quarter of 2021, the focus was on COVID-19's Omicron variant that was identified in November. The equity markets briefly retreated that month, though gains in October and December more than offset that in most geographies. As with the year, in the fourth quarter U.S. equities led with a 9% return compared to a 3% rise for developed non-U.S. and a -1% slip for emerging markets (though again, small cap emerging markets showed gains). Market volatilities briefly spiked in late November, though soon ebbed to levels near their 12-month lows. Similarly, commodity prices momentarily fell mid-quarter, before reapproaching their highs.

In the U.S., the pace of economic activity slackened though remained well in the expansionary range. Meanwhile, monetary policy tightened—the Federal Reserve

announced plans to taper its \$120 billion monthly purchases of bonds and later increased the pace of those reductions, which could end completely as soon as March 2022. In the quarter, there were better returns for larger stocks than smaller capitalizations and value outperformed growth, except for the megacap dominance with the usual FANG+¹ suspects (the same was true for the full year). Among small-to-mid capitalization growth stocks, those preferences were evident with the superior performance from the Utilities, Real Estate, and Industrials sectors; higher quality stocks; those with lower valuations; or moderate growth expectations. Notable laggards included stocks with negative earnings or those in the Health Care or Communication Services sectors.

Amidst this environment, the portfolio outperformed the Russell 2500™ Growth Index in the fourth quarter, bringing it in line with the benchmark for the full year. There was relative weakness in the Communication Services and Consumer Discretionary sectors that was more than offset by strength from our positions in the Consumer Staples, Information Technology, Industrials, Financials, and Health Care sectors.

Within the Communication Services sector, **Zynga Inc.** develops, markets, and operates social games as live services on mobile platforms. Its gaming portfolio includes *CSR Racing, Empires & Puzzles, FarmVille, Merge*

¹ Commonly consisting of Facebook (Meta), Apple, Netflix, Google (Alphabet), along with Amazon and Microsoft. All except Google are considered 100% growth by FTSE Russell.

Dragons!, *Words With Friends*, *Mafia Wars*, *Zynga Poker*, and *Treasure Isle*. In the face of the negative impact from Apple's privacy changes on the mobile gaming and digital advertising industry, Zynga succeeded by reporting advertising bookings and profits that were ahead of expectations. Its 2022 guidance was unchanged and will hinge on several new game launches. Despite those positive points, Zynga's shares traded down by -15% (though as of this writing, Zynga announced plans to be acquired by Take-Two Software).

In the Consumer Discretionary sector, we thought the market showed some shortsightedness. One example was the -15% decline for **National Vision**. Revenues and earnings were higher than anticipated for this value-oriented optical retail chain providing eye exams, eyeglasses, and contact lenses. However, guidance for the balance of the fiscal year was increased by a smaller margin because of higher costs expected in the first half of 2022. To us, that appeared to be a timing issue, as management was constructive regarding expectations for the full year of 2022, so we added to our position. We also had a different perspective than the market with **PowerSchool Holdings**, a cloud-based platform and collaboration software for K-12 educational settings. The company bested expectations for revenues and earnings as it continued to broaden its suite of offerings. However, later in the quarter, there was a pessimistic sellside research report that pressured the share price. In our view, the combination of a recently public company—PowerSchool had its IPO last July—and a newly assigned sellside analyst led to fundamental misunderstandings of PowerSchool and its -33% price weakness. It was a different story for **2U, Inc.**, which provides not-for-profit schools the technology platform and marketing services to build online, interactive graduate degree programs. The company closed its acquisition of edX this quarter, which is the massive open online course (MOOC) provider created by Harvard and MIT. At the time of the announcement, we saw that as a positive strategic move, though had concerns about increased leverage levels. We trimmed the position early in the quarter as competition increased from new entrants, though 2U later reported better-than-expected earnings with an improved outlook. However, later in the quarter two significant clients of 2U were reportedly considering alternative online platforms, and we exited the position that had declined -34% while held in the quarter. Stronger results were turned in by **Leslie's Inc.**, a provider of direct-to-consumer pool care products and services. Rebounding from recent weakness, Leslie's gained 15% with a more bullish than usual report. Revenues, earnings, and the new fiscal year's guidance each were above expectations, and the company announced its first share repurchase program. A significant backlog of new pool orders should provide long-term demand for Leslie's.

In the Consumer Staples sector, **BJ's Wholesale Club** rang up a 22% gain. Revenues and earnings were much better than expected for this warehouse club operator focused on smaller package sizes for clients that tend to live in cities or smaller homes. There had been concerns in the market that inventory disruptions could weigh on BJ's margins, though the company showed it had adapted since last year to the new environment with an upgraded product assortment, fewer suppliers with tighter relationships, and the ability to increase membership fees successfully.

There were highs and lows from the Information Technology sector, which in aggregate contributed to performance this quarter. That included this quarter's greatest contributor, **Synaptics Incorporated**. A developer of human interface technologies for a variety of devices, Synaptics bested expectations for revenues and earnings. There was growth across all segments: mobile devices, computers, and internet of things (IoT) connectivity. Forward guidance was also pleasing, with revenue growth expected to be led by high demand for IoT—a segment with positive long-term secular trends. In the near term, Synaptics shares climbed by 61% and we trimmed the position. At the other extreme was the strategy's greatest detractor, the -20% pullback from **Bentley Systems**, which develops an infrastructure engineering software, used for the design, construction, and operations of a variety of transportation, public utility, and industrial purposes. The company's revenues and earnings were as expected, with recent wins of new business increasing its growth of annual recurring revenues. Management noted that its results were tracking ahead of expectations, though maintained its stance of refraining from updating guidance intra-year. That appeared to disappoint some investors—despite Bentley being well-positioned to benefit from the recent federal infrastructure spending program. Another negative price reaction that we thought was disconnected from the underlying fundamentals was the -26% return for **Avalara Inc.** An outsourced provider of end-to-end tax compliance services for small to mid-sized businesses, Avalara reported better-than-expected revenues, earnings, and forward guidance. Growth in billings and revenues were in the 29%--30% range, though a few percentage points lower than the prior quarter's unusually high levels. We view Avalara as a long-term stable growth business, though this quarter the market had no patience for any imperfections. Returning to the positive, there was a 53% gain from **New Relic**, which develops Application Performance Monitoring systems that optimize software across different platforms and environments. With the short-term disruptive effects of its transition to simpler pricing tiers now in the past, New Relic surpassed expectations for its revenues and earnings. Its results showed meaningful gains of new customers, lower amounts of contract churn, and higher productivity among its global sales teams.

The Industrials sectors also contributed to relative performance this quarter. At the lead was a 27% return

from **AZEK Company**, a manufacturer of wood-alternative decking, railing, trim, and moulding. The company reported revenues and earnings above expectations, noting that its end markets were robust with support from repairs and remodeling activities. Elsewhere, **Hexcel Corporation's** shares retreated by -13% this quarter and we added to our position. A manufacturer of composite materials for aerospace, commercial and industrial uses worldwide, Hexcel reported sequentially improving revenues as customers restarted ordering as their inventories depleted. However, as the latest variant of COVID-19 led to weakness across the aerospace industry, Hexcel's shares faltered—temporarily in our view. There were better returns from our newish position in **Regal Rexnord**. Formed at the start of the quarter when our prior holding Rexnord Corporation divested its process and motion control operations to Regal Beloit, the new company did not miss a beat and reported revenues and earnings that were higher than anticipated. Management also released preliminary 2022 guidance that was higher than expected, citing high levels of orders and demand. That lifted Regal Rexnord's shares by 22%.

Within the Financial Services sector, there were several credits to the portfolio. That included **Signature Bank**, a commercial bank serving businesses and private clients, predominantly in the New York metropolitan area. The pace of the bank's loan and deposit growth was impressive with a quarterly record of \$4 billion of new loans and total assets now over \$100 billion. At the end of the quarter, Signature's stock received another lift with the announcement it would be added to the S&P 500. The price climbed by 19% and we trimmed our position. During the quarter we sold our holdings in **LendingTree, Inc.** Shares had been weak in the prior quarter for this online marketplace for third-party consumer financial products, such as loans, credit cards, and insurance. Consumer loan growth had a slower-than-expected recovery, with some investors waiting for a return to pre-pandemic levels while we observed that its consumer business was recovering. That was the case this quarter, however, LendingTree's automotive insurance revenues weakened. As a result, management reduced its forward guidance and we exited our position, which was down -21% while we held it during the quarter. Reinsurance provider **RenaissanceRe Holdings** reported higher-than-expected levels of net premiums written,

followed by sizable stock purchases by five senior executives. We also added to our position and the stock posted a 22% gain for the quarter.

A final bastion of strength this quarter was the Health Care sector. That included the 40% gain from **Intra-Cellular Therapies**, a biopharma developer of small molecule treatments for neurological disorders. Intra-Cellular reported healthy volumes of prescriptions for its Caplyta treatment for schizophrenia. In addition, the FDA approved Caplyta's supplemental new drug application for bipolar depression later in the quarter and we trimmed the position on the subsequent gains. Weighing on our performance in this sector was a -13% showing from **Encompass Health Corporation**, one of the largest U.S. providers of post-acute services, such as rehabilitation, home health, and hospice services. Revenues and earnings each fell shy of projections, despite the company telegraphing the impact of labor pressures on its margins. Encompass also announced that its year-long strategic review will result in the partial or full separation of its home health and hospice business into an independent public company via a carve-out or a spin-off. A better reception was provided to the medical device developer of insulin pumps for diabetes patients, **Tandem Diabetes Care**. Sales growth reaccelerated, which allowed Tandem to exceed expectations for revenues and earnings, as well as increase its forward guidance by a larger measure. That lifted its shares by 26%.

Looking forward in 2022, this year brings another set of opportunities and risks. Globally, the current wave of COVID-19 cases should ebb though the possibility of future variants may change its status from pandemic to endemic. In addition, the world will grapple with higher inflation—both from materials and labor costs—and a fragile global supply chain may also become an enduring feature of the economic landscape. Expectations for further monetary tightening may create headwinds for the equity markets, especially if new fiscal stimulus measures fail to take shape. However, the investment terrain always shifts, which is why ongoing reevaluations of bottom-up opportunities is critical and where we focus our energies. 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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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.