

## U.S. Small Cap Growth Strategy

### Representative Commentary — 1Q22

Performance	Annualized					
	1Q22	1YR	3YR	5YR	7YR	10YR
U.S. Small Cap Growth Composite (Gross)	-13.17%	-7.63%	11.16%	13.53%	10.69%	13.05%
U.S. Small Cap Growth Composite (Net)	-13.40%	-8.55%	10.07%	12.41%	9.60%	11.94%
Russell 2000® Growth Index	-12.63%	-14.33%	9.87%	10.32%	8.52%	11.20%

*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.*

Russia's invasion of the Ukraine at the end of the first quarter shook the world. In addition to the grave human toll, the ongoing assault sent oil prices surging toward 15-year highs, with similar spikes in other commodities. That led to cascading inflationary pressures in a global environment that remained beset by supply chain frailties. The current watchword was "tightening," whether referring to the belts on consumers with their spending, corporate balance sheets, or central bank quantitative monetary policies. On the last point, the Federal Reserve embarked on its well-telegraphed plan to increase the federal funds rate—though only by 25 basis points in March—and reducing the \$9 trillion asset portfolio it amassed—soon at the steady rate of -\$95 billion per month. That paralleled similar actions by the Bank of England, which increased rates for the third consecutive time, and the European Central Bank, who announced plans to end its bond buying sooner than expected. Among the major economies, only the Bank of Japan remained staunchly in the dovish camp. Nonetheless, global inflation continued to rise.

Economic activity began to climb in February, though the war in Eastern Europe quickly reversed that for manufacturing and service activities. However, while equity markets stumbled badly in January with one of the worst calendar year starts in some time, they began clawing their way up by March. For the quarter, U.S. equities fell -5%, somewhat better than developed non-U.S. markets at -6% and emerging markets at -7%. Generally, the regional small capitalization indexes fared worse, except for emerging markets where small caps bested large caps.

Across U.S. equities in the first quarter, there were pronounced preferences for larger size and value. Returns steadily increased moving up the market capitalization range, from -8% for microcaps to -5% for megacaps. In each size segment, value bested growth by nearly 10 percentage points or more. That was also evident among small-to-mid growth stocks, where lower valuations were better rewarded (and stocks without earnings or near-term growth prospects were especially punished). Also notable was the preference for lower risk. Among economic sectors, Energy and Consumer Staples had better performance—with Energy being the only sector with positive returns, while the Consumer Discretionary and Health Care sectors were common laggards.

Amidst this environment, the strategy slightly underperformed the Russell 2000® Growth Index for the quarter. Strength in the Consumer Discretionary and Health Care sectors was offset by weakness in Communication Services, Energy, and Information Technology.

Within Consumer Discretionary, **Visteon Corp.** is an automotive electronics supplier. Fourth quarter results were above consensus expectations for revenues and earnings as the company continues to reach higher profitability levels despite a constraint on sales from the ongoing supply chain challenges. While its stock price slipped by -2%, that outpaced the average index sector return of -19% and we added to the position on weakness. Of note, one-third of its new business wins were for electric vehicles. The **RealReal Inc.** operates an online marketplace for

consigned luxury goods. Its shares tumbled by -37 after reporting mixed fourth quarter results with revenues above consensus estimates, though gross margin and profits missed due to an unfavorable sales mix. The company's new Chief Financial Officer is very focused on controlling costs moving forward and on a path to profitability.

In the Health Care sector, **Inspire Medical Systems Inc.** offers minimally invasive solutions for patients with obstructive sleep apnea. Fourth quarter results were well ahead of sell-side expectations and that sent its shares up by 11%. **Blueprint Medicines Corp.** is a precision therapy company focused on developing medicines to improve the lives of patients with genomically defined cancers and rare diseases. Fourth quarter results were in line with projections. However, management's outlook disappointed investors sending the stock down -41%. Their Ayvakit drug therapy is used to treat advanced systemic mastocytosis, a rare disorder which causes too many mast cells to build up in one's body and that can impair organ function. As such, the market opportunity for Ayvakit is smaller than we originally forecasted. Blueprint Medicines also made a less than compelling acquisition of a private oncology biopharmaceutical business. That gave further impetus in our decision to start exiting the position.

Withing the Industrials sector, **Hexcel Corp.** develops and manufactures lightweight structural materials used in the aerospace and industrial applications. The company reported inline fourth quarter sales while earnings exceeded sell-side expectations. They are seeing growth in all three commercial aircraft verticals (business jet, wide, and narrow body). Hexcel's shares were lifted 15% and we trimmed back the position on this strength. **Casella Waste Systems Inc.** is a vertically integrated solid waste services company operating in the northeast region of the U.S. Their client base includes residential, commercial, municipal, institutional, and industrial customers. Its stock edged forward 2% after revenues, profits and earnings topped the Street's estimates for the fourth quarter. Solid waste pricing and volumes continue to accelerate. **Sterling Check Corp.**, a supplier of technology-enabled background and identity verification services, climbed 30%. Fourth quarter results were strong and the company provided robust/first time guidance for 2022. Sterling has a dominant U.S. market share plus a growing international presence. We added to the position before its price climbed late in the quarter. **AZEK Company Inc.** designs and manufactures wood-alternative building products for residential, commercial, and industrial markets. Despite reporting in line fiscal first quarter results, its shares were punished by -46% as profit margin guidance was lower than expected due to the inclusion of its StruXure acquisition, a manufacturer of aluminum pergolas and cabanas. In this environment, businesses that possess any blemishes are getting punished. New to the portfolio this quarter is **Columbus McKinnon Corp.**, a producer of intelligent motion solutions that ergonomically move, lift,

position, and secure materials worldwide. Through recent acquisitions, the company has diversified away from pure lifting assets with products focused on conveying, productivity, and automation. We believe there will be margin upside as the company modernizes and further integrates the acquisitions. While European sales momentum hasn't slowed, customers are nervous about the war in Ukraine and that appears to be the source of its -12% slide. **SAIA Inc.**, a transportation company that provides regional and interregional less-than-truckload services, dropped by -21%. Management has indicated they plan to open 10-15 new distribution terminals in 2022 and will relocate 10 others in order to drive volume expansion. This buildout has the potential to reduce margins over the near-term. Another consideration that factored in our decision to exit the position, is the ongoing labor challenges in the transportation industry and difficulty in hiring new truck drivers.

**Kennedy-Wilson Holdings Inc.** is our sole real estate holding, focused on multifamily and office properties located in the western U.S., the United Kingdom, Ireland, Spain, Italy, and Japan. Its multifamily business was the source of upside versus sell-side estimates in the fourth quarter. That was also a busy period of investment activity, with multifamily purchases in Nevada and office property in the United Kingdom. These developments served to boost the stock price by 3%.

An underweight to the Energy sector detracted from relative performance in this sector. During the quarter, we added **Matador Resources Co.** to the portfolio. It is an exploration and production company with operations in New Mexico and Texas. Their stock price surged ahead by 22% on higher production levels, profits and free cash flow in the latest quarter. Forward guidance offered upside to sell-side estimates for capital expenditures and production.

Within Information Technology, **New Relic Inc.** offers software solutions designed to help organizations collect, store, and analyze massive amounts of data. Fiscal third quarter results were highlighted by acceleration in revenues, billings, total customers, and net revenue retention. Despite these positive elements, some investors appear to have been dismayed by management's revenue growth projections and that caused a -39% pullback. **Synaptics Inc.** develops human interface semiconductor solutions for mobile computing, communications, entertainment, and other electronic devices. Sales and earnings outpaced estimates for the second fiscal quarter as growth of the Internet of Things (IoT) components offset declines in personal computers and mobile handsets. Supply chain constraints continue to hamper growth and that caused its shares to decline by -31%. **Smartsheet Inc.** provides a cloud-based enterprise platform to plan, capture, manage, automate, and report on projects for teams and organizations. Despite reporting solid fourth quarter results, management's guidance conservatively assumes

billings from new customers will decline. That appears to have been the focus of investor disappointment and caused its shares to fall by -29%. **Integral Ad Science Corp.** operates as a digital advertising verification company. Fourth quarter results were strong, led by its Context Control solution. Their acquisition of Context leverages artificial intelligence to provide image and video classification across social media platforms. Despite these positive factors, the shares of Integral Ad Science retreated by -38%, seemingly in sympathy with other industry peers. More positive was the 6% advance by **SailPoint Technologies Holdings Inc.**, a supplier of enterprise identity governance solutions. They reported a strong fourth quarter in which annualized recurring revenues and revenue growth exceeded projections due to strong demand for their products. **Paycor HCM Inc.** is engaged in the development of human capital management solutions for small and medium-sized businesses. Their share price gained 1% after reporting fiscal second quarter results that

were above Street projections due to better coverage of Tier 1 (larger employer) customers, a more favorable revenue mix, and cross-selling activity.

As events in Eastern Europe unfold, they create new risks with new global responses. At the same time, central banks launched a period of monetary tightening that may be anything but transitory. As long-time bottom-up investors, we understand the importance of having a steady hand on the tiller when navigating such waters, though recognize how the investment terrain constantly evolves. By combining those experiences and evaluations, we seek investments that may capitalize on new opportunities, may have become more attractive at lower valuations, or a blend of both. 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 2000® Growth – a market capitalization-weighted index that measures the performance of those Russell 2000® companies with higher price-to-book ratios and higher forecasted growth rates. All indexes, including the Russell 2000® 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 \$91 million and \$3.5 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 53% per year. Composite inclusion threshold \$5mm. Fee basis is 100 basis points. The 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 small cap market as represented by the Russell 2000® 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 June 2012, TimesSquare had modified its purchase capitalization range to match the changes in the small cap market as represented by the Russell 2000® Growth Index at that time, with a change from \$50 million to \$1.5 billion at time of purchase to \$50 million to \$2 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 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.*