TIMESSQUARE
CAPITAL MANAGEMENT, LLC

Global Small Cap Strategy

Representative Commentary — 2Q22

Performance				
			Annualized	
	2Q22	1YR	3YR	Since Inception (1/1/2018)
Global Small Cap Composite (Gross)	-18.91%	-26.57%	0.08%	0.93%
Global Small Cap Composite (Net)	-19.10%	-27.25%	-0.82%	0.03%
MSCI World Small Cap (Net) Index	-17.18%	-21.97%	4.19%	2.75%

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.

In the second quarter, the "I"s had it: Interest rates and Inflation commanded the attention of the global markets. Central banks accelerated the pace of their quantitative tightening measures, though inflation stubbornly refused to slacken. The heighted levels of interest rates and inflation punished the equity markets with double-digit negative returns for the quarter, with the U.S. hit the hardest at -17%, developed non-U.S. at -15%, and emerging markets "only" down -11%.

The U.S. Federal Reserve increased rates twice during the quarter, including the largest single increase (75 basis points) since 1994. The subsequent statement indicated that the current range of 1.50% to 1.75% may be double that by the year's end. The European Central Bank noted it will raise rates from 0% by 25 basis points at its July meeting and again in September—its first increase since 2011. The Bank of England raised its rates for the fifth consecutive time, albeit at a slower pace of 25 basis points, though indicated that its tempo may increase. Many other banks followed suit including even the Swiss National Bank, though its first increase since 2007 lifted rates from -0.75% to -0.25%. Japan was the lone holdout among the major money centers to maintain its accommodative monetary policies though markets punished that stance with a sharp depreciation in the yen which broke 20-year lows.

While commodity and energy prices eased late in the quarter, they remained at elevated levels compared with earlier in the year. Global supply chains remained stretched, demand was subdued, and business optimism waned so that were it not for a rebound in China after recent COVID lockdowns were eased, growth in global business activities would have slowed for a third straight month.

The mixture of high inflation and rising interest rates fueled concerns for a coming recession. In addition to weighing on business optimism, that combination—though especially inflation—pushed down consumer sentiment. One result was the continued relative outperformance of value stocks over growth and relatively better returns when moving up the size continuum from microcaps to mega caps. All sectors suffered from negative performance, though Utilities, Consumer Staples, and Energy held up relatively better.

Amid this environment, the portfolio underperformed the MSCI World Small Cap Index for the quarter. Our holdings in Asia/Pacific ex Japan and Middle East contributed while other regions lagged.

Regional Performance: Europe

The portfolio's European holdings slightly underperformed benchmark regional performance. France and Finland helped while United Kingdom and Germany hurt.

In recognition of rising cost inflation and supply chain woes, we trimmed our exposure to UK-based **Rotork**, a manufacturer of mission-critical flow control and instrumentation solutions for oil and gas, water, and other flow control markets. Revenues declined year-over-year due to continued semiconductor component challenges and reduced deliveries from the company's facility in Shanghai. Supply chain disruptions prevented Rotork from capitalizing on improving demand conditions in the oil and gas end markets. As a result, shares declined -31% for the quarter. Over in Germany, also negative was leading forklift manufacturer **KION Group**. Shares declined -37% on the deterioration of the business environment due to supply chain disruptions and another rise of raw material and component prices. We added on that share price

weakness. The situation was better for Spain-based automotive components manufacturer **CIE Automotive** with its 7% gain**.** The company posted better-than-expected first quarter results and reiterated its long-term guidance. They continued to gain market share against smaller players, managed cost inflation, and generated cash even in very uncertain times for the Consumer Discretionary sector. Moving in a similar trajectory was **Huhtamaki**, a Finland-based company focused on packaging solutions for the food industry with clients including Starbucks, McDonald's, Nestle, Unilever and Mondelez. Huhtamaki is shifting towards sustainable packaging solutions for their clients. The company's strong quarterly earnings beat demonstrated its pricing power and ability to offset cost inflation via price hikes, mix improvement, and operating efficiencies. We added to the name and its shares ascended 14%.

Multiple compression in a rising rate environment hurt select holdings in the Communication Services sector. In addition, recessionary concerns, and tightening consumer belts further hobbled sentiment for consumer-facing companies. Sweden based **Viaplay** (formerly Nordic Entertainment) is the region's leading entertainment provider. When global streaming peer Netflix reported weak quarterly results, shares in Viaplay declined -50% in sympathy. In contrast to Netflix, Viaplay continues to benefit from healthy subscriber growth. Further, we appreciate the strong visibility of its pipeline and expansion into other countries. Also weaker with a -39% pullback was UK-based **Future plc,** a specialty content publisher transitioning from a print-to-online-platform. After a temporary decline in audience numbers for the first quarter, the group started to see audience growth in April. Future reconfirmed it is on track to achieve full-year guidance. We continue to witness momentum across its portfolio; the average site user is affluent, which should translate into more resiliency than the average consumer.

Amidst the multiple market dislocations, industrial buyers were opportunistically seeking price inefficiencies in quality assets. This was the case for UK based **HomeServe,** which offers a range of home emergencies via subscription-based Membership services. A top detractor in 2021, the tide turned as Canada-based Brookfield Asset Management offered to purchase HomeServe in a £4bn transaction and shares appreciated 28% for the quarter. Finally, other holdings benefited from their exposure to the energy and the structural shortages in that market. Delivering strong performance in France was **GTT,** which develops membrane containment systems for liquefied natural gas vessels. Shares jumped 12% on continued high visibility and new project wins.

Regional Performance: Americas

The portfolio's holdings in the Americas underperformed the benchmark and housed some of the portfolio's top detractors. Within Industrials, **First Advantage** offers technology solutions to Human Resources departments for screening, verification, safety, and compliance. Though they reported a strong quarter and raised guidance slightly, their stock price corrected -37% on back of recession fears and tougher year-over-year comparisons for the balance of 2022.

Within Consumer Discretionary, **National Vision Holdings** is a specialty retailer of optical products operating under the America's Best and Eyeglass World brands. Its shares fell -37% after the company reported mixed first quarter results as earnings outpaced estimates while revenues fell short. A lack of available optometrists constrained vision exam capacity and forward guidance was cut due to recent trends. National Vision raised the price of its signature offering by 15% for an eye exam and two pairs of glasses, given the broader inflationary environment. We trimmed some exposure on the near-term headwinds. **Hilton Grand Vacations** is a timeshare company that sells vacation ownership intervals and manages resort properties. Their stock lost -31% despite reporting a beat-and-raise quarter amid a backdrop of increased travel demand. The Diamond Resorts acquisition appears to be integrating ahead of schedule, with cost synergies yet to be realized. The Board approved a $500 million share buyback program over the next two years.

Within Financials, **Silvergate Capital** offers banking and loans as well as ancillary services for users of cryptocurrencies. The stock felt the impact of cryptocurrency volatility with its shares tumbling by -65%. U.S. regulators want to bring crypto into the banking system and avoid the potential for systemic risk. Treasury Secretary Yellen has urged Congress to pass legislation for the regulation of stable coins. More resilient with only a -1% decline was reinsurance provider **RenaissanceRe Holdings.** RenRe's fiscal quarterly earnings were lower than anticipated, caused by higher losses tied to the Ukraine war and storm claims from Europe and Australia. However, the market credited RenRe with its progressively better investment income in the current rising interest rate environment.

Regional Performance: Japan

Japan was one of our weaker regions during the quarter due to stock selection. One of our top detractors was **MedPeer**, a first mover in Japan's online health care space. They operate a site that links doctors with pharmaceutical companies and recruiters. During its recent earnings release, second quarter profits declined year-over-year. The firm's ability to secure official contracts for services seems slower than expected and we also noted a shortfall of doctor participants at its webinars. We decided to exit our position which declined -54% for the period it was held.

More resilient and new to the portfolio was **Nippon Gas**; shares only declined -8% since its purchase. Nippon Gas enjoys a massive cost advantage versus its smaller, mom and pop competitors. It also bundles gas and electricity at slightly lower cost than peers and has a structural advantage in distribution by relying on third-party sales. We believe that a cash-strapped consumer is much more likely to seek out lower cost energy alternatives (away from the incumbent), to more nimble independents like Nippon Gas. This company has an ability to pass on the rise in input costs into its LPG (liquified petroleum gas) rates, so we see relatively little risk to operating profits.

Regional Performance: Asia Pacific ex-Japan and Middle East

The portfolio's Asia Pacific Ex-Japan holdings delivered positive relative performance. Relatively better results came from **IPH**, Australia's largest intellectual property management services provider. While rising costs and volatile currency swings have troubled some companies, IPH is able to pass on pricing, along with benefiting from a rising dollar since they remain unhedged. Moreover, industry filing volumes remain healthy despite the volatile macro backdrop. We added to the name while shares were down -7% during the quarter.

Experiencing share price disconnect relative to fundamentals was **CyberArk Software**, a global leader in Privileged Access Management (PAM) based in Israel. PAM controls access to critical enterprise applications and data on internal networks. They reported solid quarterly results and are firing on all cylinders with all key metrics (revenue, ARR/bookings, subscription mix, customer growth) trending positively. In a recession scenario, the company's demand is more durable given the criticality of identity security spend. That said, the market's recessionary and rising rate concerns weighed on share price which closed out the quarter with a -24% decline.

Regional Performance: Emerging Markets

Within the Emerging Markets and reversing its gains from the previous quarter was **TOTVS,** the largest software-as-a-service software provider in Brazil; shares declined -42% for this period. While the company posted strong quarterly results for its core business, the smaller divisions and new growth engines disappointed though they are expected to improve. In addition, they recently announced a joint venture with Itaú, the largest private bank in Brazil, and this will likely improve the business opportunities for its Techfin division. We added to the name.

Better was **Chinasoft,** China's largest IT services provider. It is a leading cloud-services provider that helps companies migrate to the cloud and accelerate their digital transformations. Recent partnership agreements with several local governments and Chinese conglomerate BYD indicate a solid business development trend. A recovering macro environment should further bolster its prospects, underpinned further by its active business development. Finally, the Chairman and CEO acquired 20mn shares in June, which we see as incrementally positive. Shares recovered 24% this quarter.

Conclusion

Looking into the summer and beyond, it remains to be seen if policy makers can engineer the proverbial "soft landing" that combats the global inflationary environment without triggering a recession. That may be possible, though its runway has been narrowing. Companies have been very tempered with their projections, though there have been few corresponding reductions to their consensus earnings estimates. So, while we see pockets of opportunities with lower prices, we recognize that further dips are possible. These concerns form some of the backdrop for our discussions with company management teams. That factors into our bottom-up evaluations as we seek a balance of positions that can weather oncoming waves along with those poised to gain when the winds change. 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:

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Benchmark returns are not covered by the report of independent verifiers.

This composite generally invests in MSCI World stocks with market capitalizations below $7.5 billion at time of purchase. Portfolios will hold approximately 110 securities. The process is fundamental research driven. Composite inclusion threshold $500,000. Fee basis is 90 points. The composite creation date is January 1, 2018.