TimesSquare Capital Management, LLC

International Small Cap Strategy

Representative Commentary — 2Q22

Performance

			Annualized			
	2Q22	**1YR**	**3YR**	**5YR**	**7YR**	**10YR**
International Small Cap Composite (Gross)	-18.03%	-31.76%	-3.34%	-1.52%	2.82%	7.31%
International Small Cap Composite (Net)	-18.25%	-32.45%	-4.30%	-2.49%	1.81%	6.26%
MSCI EAFE® Small Cap (Net) Index	-17.69%	-23.98%	1.12%	1.72%	3.73%	7.18%

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. The safer havens were in the Utilities, Energy, and Consumer Staple sectors whereas the Information Technology, Real Estate, and Communication Services were shunned.

Portfolio Performance Attribution

Amidst this environment, the International Small Cap Portfolio slightly underperformed the MSCI EAFE Small Cap benchmark primarily driven by stock selection. Holdings in Japan detracted the most from performance while relative weakness was also seen in the Emerging Markets. Europe and Asia/Pacific Ex Japan were areas of strength. From a sector perspective, there was weakness in the Communication Services, Health Care, and Industrial sectors; that was somewhat offset by strength in Materials, Information Technology, and Energy.

Regional Performance: Europe

Selection in Europe generally contributed to performance. Our holdings in France, Finland, and Denmark helped while Italy detracted.

In recognition of continuing rising cost inflation and supply chain strains, 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. The situation was better for **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. Its shares ascended 13%.

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 its 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 confirmed it is on track to achieve full-year guidance. We continue to witness momentum across its portfolio; the average site user is affluent and we believe their customers should be more resilient than the average consumer. However, in considering the rising rate environment and tightening consumer belts, we downsized our position in both names.

In light of the market turbulence, our holdings related to the capital markets also experienced share price contraction. **St. James's Place** engages in the wealth management business primarily in the UK. Despite experiencing a -28% share price decline, they experienced a strong quarter with better-than-expected net new business of £2.9bn. This provides evidence of the strength and resilience of its business model. Delivering relatively better share price performance in the financial sector was **Topdanmark**, Denmark's second largest non-life insurance company. Its premium-driven business remained defensive and the company continues to execute well, with improving combined ratio and profit forecasts. Its shares only declined -8%, better than the Financial sector's -16% drop.

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 defense sectors as well as the structural shortages in those markets. 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; we added to the name. Within aerospace and defense, we purchased **Saab**, a Swedish aerospace and defense company. The military and defense markets have enormous barriers to entry; hence the industry is relatively consolidated with only a handful of players. The structural increase in defense spending will be beneficial for Saab and its shares climbed 15% since we purchased the name.

Regional Performance: Japan

Japan was our weakest region 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. Giving back some gains earlier in the year was **Kadokawa**, a comprehensive entertainment publisher that monetizes its significant anime library across an increasing array of e-books, mobile games, and movie titles. We added to the name last quarter but started trimming in April to lock in some profits on back of the company's successful Elden Ring game launch. They reported strong quarterly results, but guidance was generally conservative and shares retreated -19%. In considering its consumer facing end markets, we further pared back the holding.

In the real estate sector, home renovation company **Katitas** experienced selling pressure with shares dropping -23%. Despite healthy company fundamentals, the market remained apprehensive on home builders exposed to higher input costs and waning consumer purchasing ability. In reality, Katitas has much lower exposure to inflationary inputs than new home builders but negative sentiment on the sector warranted a smaller position and we trimmed our exposure.

More positive was **Nippon Gas** with its 15% share price increase. 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 is able to pass on the rise in input prices into its LPG (liquified

petroleum gas) rates, so we see relatively little risk to operating profits.

New to the portfolio and positive was **Shoei,** the world's largest manufacturer of premium motorcycle helmets that has top share in virtually all markets for premium helmets. With the number of motorcycle licenses issued trending upward in Japan and Europe, we believe the company is well positioned. The company reported better than expected operating results and shares climbed 5% since it was purchased.

Regional Performance: Asia Pacific Ex-Japan, Middle East, and Americas

The portfolio's Asia Pacific Ex-Japan holdings outperformed while Middle East detracted from performance. Leading the gains was the region's largest insurance broker network, **Steadfast Group.** Premium rates continued to rise and operating conditions remain supportive. Shares were resilient and retreated -4%, better than the region's -20% correction. The rising premium rate cycle, acquisitions, and technology efficiencies provide tailwinds for the company.

Experiencing a speed bump was Israeli-based **RADA Electronics**, an Israeli defense company focused on radars and defense electronics. The company operates in the niche market of small radars that serve areas such as Active Protection System (APS) and critical infrastructure protection. RADA's unique position as an Israeli company with a prominent U.S. subsidiary provides access into the U.S. defense market and exports globally. Earnings missed due to delays in congressional resolutions passed and shares corrected -44% as a result.

Regional Performance: Emerging Markets

Within the Emerging Markets, Asia was an area of strength while Latin America lagged. 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 opportunity for its Techfin division.

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 macroeconomic 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:

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 MSCI EAFE® Small Cap (Net) Index. MSCI EAFE® Small Cap (Net) Index is a trade or service mark of MSCI Inc. The MSCI EAFE® Small Cap (Net) Index is an unmanaged, market-weighted index of small companies in developed markets, excluding the U.S. and Canada. Its returns include net reinvested dividends but, unlike the Composite returns shown, do not reflect the payment of sales commissions or other expenses incurred in the purchase or sale of the securities included in the Index. All indexes, including the MSCI EAFE Small Cap (Net) Index, are based on gross-of-fee returns, including net reinvested dividends.

This composite generally invests in MSCI EAFE® stocks with market capitalizations below $5.0 billion at time of purchase. Portfolios will hold approximately 70-75 securities. The process is fundamental research driven. Historical turnover has averaged 41% per year. Composite inclusion threshold $500,000. Fee basis is 100 points. The composite creation date is April 1, 2012.

This composite had a significant cash flow policy from April 1, 2015 to December 31, 2016. 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.