TimesSquare Global Health Care Fund

To Our Investors,

Through the end of third quarter, the Fund's net performance was +2.16% QTD (+1.66% Net), +8.72% YTD (+7.40% Net), and +34.92% (+22.82% Net) cumulative since inception (April 1, 2020).

Global equity markets fell in the third quarter, though remained positive year to date. Value generally held up better than Growth, which was evident from the market indexes and the style factors. The strongest style factor in the U.S. market was Profitability, though its influence was far more muted worldwide. Enthusiasm for the new series of GLP-1 obesity treatments touched nearly all areas of Health Care, and part of the Consumer Discretionary sector. Aspects of that sentiment seem extreme to us, especially the way many medical technology stocks were punished. However, we believe those dislocations create interesting investment opportunities.

The Health Care sector outperformed the broader market with MSCI World Health Care returning -2.66% vs. -3.36% from MSCI World. Contrary to the broader market, small cap health care, where we tend to focus our attention, underperformed the broad small cap index. The MSCI World Health Care Small Cap Index posted a -12.81% return vs. the MSCI World Small Cap Index of -4.39%. Outside of Pharmaceuticals, which finished the quarter down -2.45%, the remaining subsectors of small cap Health Care had double-digit negative returns.

As a Fund, our approach and long-term view is unchanged. We continue to pursue investments in companies driving health care innovation and believe the greatest long-term alpha will be achieved by identifying these disruptive companies at an early stage.

3Q 2023 Commentary

Amid elevated market volatility, we continued tightening our net exposure; now 11% at the end of the quarter from 14% as of the end of June. We maintain our focus on high quality growth companies that are less economically sensitive.

As discussed in previous investor letters, we expected M&A activity to pick up in the growthier areas of health care with a particular focus on biotech. So far, 2023 has been supportive of increased biopharma dealmaking. We are encouraged to see large pharma companies deploying more capital. In the second quarter, we were fortunate to participate in two deals, with Iveric being acquired by Astellas Pharma and Merck announcing the acquisition of Prometheus. During the third quarter, this trend continued, as the Fund benefited from Biogen's decision to acquire Reata. With patent cliffs approaching, we expect large pharma companies to continue to restock their pipelines through M&As.

The potential impact of GLP-1 therapies on health care dominated the narrative in 3Q23. The announcement that Novo Nordisk's Select trial met its primary endpoint fueled a dogmatic view that GLP-1 agonists were a panacea for all illnesses. Impressively, the Select trial demonstrated, for the first time, in a non-diabetic population, that weight loss fueled by GLP-1 agonism significantly reduced cardiovascular events. Subsequently, we have seen selling across most health care subsectors as investors irrationally extrapolate the impact of this data. Our view is more balanced. While we do see some clear losers from broader GLP-1 use, many of the assumptions the market has made on the potential fallout would take a generation to prove true, if ever.

We have seen a steady increase in health care utilization as we moved further away from the pandemic. However, we are beginning to see normalization of demand trends in the industry. Quarterly earning calls saw more corporates highlighting a return to normal seasonality, particularly highlighting the reduced utilization in 3Q tied to summer vacations.

We are at an interesting time in US politics. While health care remains in the rhetorical political crosshairs, we do not expect any new major legislation that would materially impact the space. Assuming the split Congress, with a more conservative Speaker of the House, can agree to a government funding bill, we think the most likely scenario is a continuing resolution that includes PBM transparency. Drug pricing remains a hot button issue, but we think it is unlikely the Republican controlled House will participate in another pass at drug pricing reform. Currently, the focus is on the potential impact from the Inflation Reduction Act (IRA), which allows for direct price negotiation between Centers for Medicare & Medicaid Services (CMS) and manufacturers. We are monitoring the multiple court challenges to the IRA, filed by pharmaceutical manufacturers, which likely represents the best opportunity to reverse the IRA, outside of a republican sweep in 2024.

Our enthusiasm for investing in innovative health care is unchanged. We believe the recent volatility and risk-off sentiment has created attractive entry points, particularly into growth stocks that have been punished beyond what their fundamentals would justify. However, as the ripple effect from the March banking crisis continues to unfold, we remain cautious in earlier stage companies, as well as companies that have exposure to early-stage companies (such as CROs and CMOs). Our alpha short positions are primarily focused on companies burning cash that are unlikely to achieve breakeven without raising additional capital.

Fund Performance

The Fund's positive performance during the quarter was reflective of strong contributions from Biopharma positions on the long side, alpha generating shorts within Health Care Equipment and Services, as well as downside protection from other hedges.

Reata Pharmaceuticals (RETA) is the Fund's top contributor on the long side. In 2023, RETA received approval for Skyclarys, the first marketed therapy for Friedreich's Ataxia, an orphan neurodegenerative disease. Early demand has been robust. As mentioned above, RETA agreed to an acquisition offer from Biogen, Inc.

Another significant contributor was argenx SE (ARGX), a global immunology company focused on autoimmune diseases. Sales of Vyvgart in myasthenia gravis have been impressive. Shares were driven by the announcement that the company's pivotal CIDP trial met its primary endpoint. Our view is that CIDP more than doubles Vyvgart's market opportunity. Additional data readouts are expected in 4Q23.

Our top holding in Life Sciences Tools & Services, **Gerresheimer AG (GXI)**, is a German manufacturer of primary packaging products for drug packaging and drug delivery system. Enthusiasm for the new series of GLP-1 obesity treatments touched nearly all areas of Health Care, and we were looking for alternative ways to express the long GLP-1 trade outside of the obvious big pharma companies. We identified Gerresheimer as a potential candidate and after getting comfortable with the market opportunity and valuation, we were able to leverage the experience of our international investment team who had prior experience with the GXI CEO. We believe the company's position in the supply chain for other GLP-1 producers will lead to sustainable above market growth and a positive mix benefit to margins.

Conclusion

As bottom-up investors with a focus on business fundamentals, we look for competitively advantaged growth companies with pricing power, strong management teams, and excellent balance sheets. We continuously review the business models and management teams of current and potential holdings, and fine tune our own valuation models on an ongoing basis. While it will be hard to escape the macro drivers from the past year, we will remain focused on minimizing the factor exposure to reduce volatility.

While capital markets remain tight reducing funding opportunities for the sector, we are encouraged to see increasing M&A activity and are hopeful for continued acceleration for the balance of the year and into 2024, as large cap balance sheets remain healthy. Overall, despite some near-term headwinds, our long-term outlook for the health care sector remains bullish. Innovation in the sector and the structural themes we have been investing in are very much intact.

Our objective as a Fund is to deliver consistent positive returns in any market. We aim to achieve that goal by identifying health care innovation and building a diversified Fund through fundamental bottoms-up research.

We thank you for your continued confidence during these challenging market conditions. As always, we are available for any questions you might have as we endeavor to protect and grow the assets you have entrusted with us. Meanwhile, we hope that you, your family, and your colleagues remain in good health.

Best Regards,

David Ferreiro, Ph.D.
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Co-Portfolio Manager

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