

## U.S. Mid Cap Growth Strategy

Representative Commentary — 3Q23

Performance	Annualized					
	3Q23	1YR	3YR	5YR	7YR	10YR
U.S. Mid Cap Growth Composite (Gross)	-3.91%	15.67%	6.35%	10.05%	12.55%	11.54%
U.S. Mid Cap Growth Composite (Net)	-4.11%	14.77%	5.51%	9.18%	11.66%	10.66%
Russell Midcap® Growth Index	-5.22%	17.47%	2.61%	6.97%	10.39%	9.94%

*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.*

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.

As our investment team meets with companies, reviews recent earnings reports, and surveys the global landscape, they note several investment dynamics that inform our positioning:

- Labor pools continue to shrink and get more costly. Some companies adjusted to wage inflation and are in stronger positions to offset those costs and maintain margins thanks to their pricing power. Others either outsource certain operations to specialized providers or increase their use of productivity enhancement tools or software.
- While adoption of cloud-based processes is still in the nascent stages, earlier this year many businesses slowed their pace of spending as part of broader cost-cutting measures. Now in better financial positions, companies are beginning to reengage with their cloud initiatives and those green shoots were noted by some of our holdings.
- 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, that may create investment opportunities.
- Consumers have traded down with their spending habits or tightened the hold on their wallets. That was partly a response to higher expenses from rising credit costs and energy prices, which makes us more cautious about some consumer-oriented companies.
- One area benefiting from increased spending has been Industrial infrastructure. Companies have been reassessing their supply chains in the face of geopolitical pressures and the greater costs or risks with long-distance shipments. At the same time, many of the larger economies provided new government support programs for infrastructure investments. That causes growing shifts of production capacity to local regions and leads to significant project backlogs for some of our holdings, especially those capable of improving industrial efficiency.

Among small-to-mid cap growth stocks this quarter, the better performing stocks had lower betas or higher returns on equity. Those with excessive valuations (defined by price/earnings) or lacking near-term earnings were out of favor. Amidst this environment, the portfolio outperformed the Russell Midcap® Growth Index in the third quarter.

For the Communications Services sector, we generally prefer to invest in media and services companies that are either well placed from an advertising perspective with a target audience or provide differentiated services. **IAC Inc.** is engaged in the media and Internet business. Its two core business segments are Dotdash Meredith and ANGI Homeservices. Dotdash Meredith provides digital and print publishing services. ANGI Homeservices offers a gateway to repair, remodeling, cleaning, and other services. While Dotdash Meredith results were in line, ANGI fell short of expectations as they are shifting their focus to high-quality customers to generate more profitability. Shares of IAC fell -20% on this report and we added to the position on weakness. Slightly better were the results of **Pinterest Inc.**, an image-based social media company. The second quarter included a slight revenue acceleration and profit margin improvement. Forward guidance calls for further revenue expansion amid signs of recovery in the advertising market. Management's comments on the Amazon advertising partnership were also encouraging. While Pinterest slid by -1%, that exceeded the index sector average return of -9%.

In Consumer-oriented sectors, we lean towards value-oriented or specialty retailers, franchise models, as well as premium brands. We have seen challenges this quarter stemming from falling consumer confidence and sentiment measures. **Five Below Inc.** is a discount retailer focused on teens and pre-teens with most goods priced less than \$5. The company's fiscal quarterly revenues and earnings were in line with expectations, aided by growth in transactions from ongoing store conversions to the "Five Beyond" (over \$5 price point) format. Its shares tumbled -18% on a lower earnings outlook stemming from an increase in provisions for theft or shoplifting. This has become an increasing headwind for retailers across the spectrum. Hard surface flooring and accessories company **Floor & Decor Holdings Inc.** pulled back by -13%. While we recognize that higher mortgage rates are having an impact on project activity, Floor & Decor enjoys a strong position in a fragmented market. Gross margins are improving along with lower supply chain costs. Therefore, we added to the position on weakness. Conversely, we decided to exit our position in **Marriott Vacations Worldwide Corp.**, a timeshare resort property management company. The combination of weak second-quarter results and lower forward guidance caused the stock to drop by -9% during the time it was held in the quarter. Faring better was **Ross Stores Inc.** and its 1% markup. They operate off-price retail stores featuring apparel and home fashion. Their second quarter results outpaced estimates on better customer traffic and higher gross margin due to lower freight costs. Management raised its full-year sales comparisons and earnings guidance. Another benefit came from **Aptiv plc**, a supplier of electronic automotive technology for safety and entertainment systems. Second quarter revenues, operating margins, and earnings topped consensus estimates. Its -3% return outpaced the index sector average of -6%. Membership warehouse club operator **BJ Wholesale Club Holdings Inc.** reported second quarter results that beat expectations on profits and earnings with better operating margins. Customer membership has continued to climb and that led to a 13% rally.

We often see the ebb and flow of the Energy sector tied to underlying commodity prices. In this area, we seek low-cost exploration & production companies with high-yielding acreage or specialized service providers. **Pioneer Natural Resources Co.** is an independent exploration and production company with operations in West Texas. The combination of strong second quarter results and well productivity boosted the share price by 12%. Capital expenditure projections were lowered, and oil production estimates increased. We added to our position on increased conviction. **Cheniere Energy Inc.** operates liquefied natural gas terminals in Louisiana and Texas. The company reported a solid quarter and raised forward guidance. During the quarter, Cheniere bought back stock and paid down debt. Although these amounts did not meet Street expectations, management is building cash to fund projects and plans to accelerate share repurchases in the back half of the year. Its 9% return fell short of the index sector average of 15%.

In Financials, we prefer well-placed insurance companies and niche businesses while tending to avoid banks which face credit deterioration and rising deposit costs. **RenaissanceRe Holdings Ltd.**, a provider of reinsurance and insurance products, surged ahead by 6%. Its second quarter numbers were solid across underwriting, property catastrophe premiums, investment income, and fee income. While there was an impact from severe storms during the quarter, RenRe's losses were modest. **Interactive Brokers Group Inc.** operates as an automated electronic broker worldwide. Their company's second quarter net interest income came in better than expected while revenues were slightly ahead. Earnings, however, fell short of sell-side projections due to a one-time legal reserve. The market looked past this blemish as its stock price gained 4%. Partially countering these positives was **Nasdaq Inc.**, which is engaged in trading, clearing, exchange technology, regulatory, securities listing, and company services. Its shares pulled back by -2% despite reporting an upside to consensus projections, driven by stronger trends in their solutions business.

Our preference within Health Care is for novel therapies to address unmet medical needs, specialized providers, and innovators. **argenx SE** is a global immunology company focused on autoimmune diseases. Their share price advanced 28% after outpacing estimates and aided by sales of Vyvgart for treating myasthenia gravis. Management also gave an encouraging update on clinical readouts and their expanding pipeline. **Repligen Corp.** is a global sciences company engaged in providing bioprocessing technologies and solutions used to manufacture biologic drugs. They reported mixed second quarter results and lowered forward guidance. Management did however highlight an improving mid and late-stage pipeline as well as expectation for improved orders in the fourth quarter. Investors appear to have looked past the short-term challenges as the stock climbed 13%. Moving in the other direction was **IDEXX Laboratories Inc.** This company develops, manufactures, and distributes products and services for the animal veterinary, livestock, poultry, dairy, and water testing markets. Their second quarter results were solid and forward guidance was raised. Its core pet diagnostics business has returned to double-digit growth. Despite these positives, its shares sold off by -13% and we added to the position on this weakness. We have also been confounded by the -13% share price weakness associated with **Royalty Pharma plc**, which operates as a buyer of drug therapy royalty streams and a funder of innovation for the biopharmaceutical industry. The stock has not been given credit for its differentiated business model and additions to its royalty stream. We decided to sell out of the position and potentially revisit Royalty Pharma in the future. New to the portfolio this quarter is **DexCom Inc.**, a producer of glucose monitoring systems for people with diabetes. While GLP-1 drugs can help with weight loss, individuals with type 1 diabetes would remain insulin dependent. We used share price weakness as an opportunity to initiate the position. We also added **Shockwave Medical Inc.**, a medical devices company that uses intravascular lithotripsy technology for treating calcified plaque in patients suffering from coronary diseases. The company is well positioned and continues to expand their product offerings. It appears the stock has been caught up in the market's medical technology unwind.

In the Industrials sector we gravitate towards business service companies, those focused on automation & efficiency improvements, and essential infrastructure services. **Equifax Inc.** is a credit bureau offering data analytics and information services. Its stock lost -22% due to second quarter revenues falling short of estimates and lower 2023 guidance. Lowered expectations were almost entirely attributable to a worse outlook for second-half mortgage origination volumes. **GFL Environmental Inc.** provides non-hazardous solid waste management and environmental services in the U.S. and Canada. Their shares dropped -18% on mixed second quarter results. While earnings outpaced estimates, revenues came up short on lower solid waste volumes. Of note, these appear to be linked to the purposeful shedding of lower margin, non-core businesses inherited from acquisitions. We added to the position on this weakness. **CoStar Group Inc.** provides information, analytics, and online marketplace services to the commercial real estate industry. Second quarter revenues were in line with Street estimates while profits and earnings were above. Updated company guidance included a slight downtick in revenues, but an increase in profits. The company also increased its earnings guidance. However, the company plans to continue investing in the Homes.com initiative, which is seeing increased customer traffic and is taking market share. The specter of continued investments resulted in its shares trading down by -14%. **Verisk Analytics Inc.**, a supplier of data analytic solutions for the insurance market, rose 5%. Second quarter revenues were above Street projections, driven by broad-based revenue upside across Underwritings & Ratings as well as Claims. Management increased full year guidance. **A. O. Smith Corp.** manufactures heat pumps, water heaters, boilers, tanks, and water treatment products. The company reported solid second quarter results with margin expansion from North America and improved operating performance from the rest of the world, despite currency and economic headwinds in China. We decided to exit the position and redeploy the proceeds into other areas with more favorable growth prospects. A.O. Smith lost -8% for the time it was held during the quarter. **Rockwell Automation Inc.** is a new addition this quarter. They provide industrial automation and digital transformation solutions. There is secular growth stemming from a rapid push towards automated and connected manufacturing; as well as offering an offset to rising labor costs.

Across the Information Technology universe, we seek companies possessing differentiated capabilities, products, and services. **NICE Ltd.** provides enterprise software solutions and services. Its second quarter results were roughly in line with expectations, however, cloud revenues decelerated. NICE continued to demonstrate success moving upmarket with its artificial intelligence offerings. Management raised forward guidance for revenues and earnings. The stock sold off by -18% on concerns about the company's cloud revenue growth trajectory. **Keysight Technologies Inc.** supplies electronic design and test solutions to many industries including commercial communications, networking, aerospace, defense, energy, and semiconductors. They reported a solid fiscal third

quarter, with in line revenues and a modest beat to earnings. However, the fourth quarter outlook fell short of sell-side expectations and that resulted in a -21% retreat. **Palo Alto Networks Inc.** supplies network and cloud-based security solutions to enterprises, service providers, and government entities. The latest quarter was mixed with the company falling shy versus the Street on billings, in line for revenues, and outpacing earnings. Palo Alto's updated guidance was materially ahead of lowered Street expectations. Nevertheless, its shares pulled back by -8%. Turning to positives, **Elastic NV** is a data analytics company, engaged in open-source search and analytics engine services. Its shares jumped 27% on strong fiscal first quarter results with beats across billings, revenues, and earnings. Management noted they are benefiting from the trend of vendor consolidation. **Aspen Technology Inc.** develops software applications for optimizing asset performance and management monitoring. Their share price was lifted 22% by steady fiscal fourth quarter results and better-than-expected guidance. While demand has been lackluster in the chemical space, other end markets have been strong; including the business they acquired from Emerson. Management also announced the termination of an agreement to acquire Micromine due to difficulty in obtaining regulatory approval. **Synopsys Inc.**, a supplier of electronic design automation software for use in designing and testing integrated circuits, edged forward 5%. The company reported a solid fiscal fourth quarter and raised forward guidance. Despite macroeconomic concerns, their customers remain focused on developing next generation semiconductors with their electric design automation tools. We trimmed the position as it approached our price target. A new buy this quarter was **HashiCorp Inc.**, which offers multi-cloud infrastructure automation solutions worldwide. The company is well positioned to benefit long-term from a myriad of secular tailwinds and architectural shifts in software. These include increasing adoption of infrastructure automation tools, sustained growth in the pace of applications development, and ongoing shifts of workloads to the cloud. We used share price weakness as an opportunity to initiate the position.

Within Materials, we seek well positioned companies that are less susceptible to swings in commodity prices. **RPM International Inc.** produces coatings, sealants, and building materials. Its fiscal fourth quarter earnings exceeded expectations, aided by better gross margins and cost containment initiatives. Going forward, management believes there will be moderating inflation and destocking trends, along with increased infrastructure spending. We trimmed the position on the strength of its 6% rise as its shares approached our price target. **Martin Marietta Materials Inc.**, a supplier of aggregates and other materials to the construction industry, dropped by -11%. Second quarter revenues were in line with expectations while profits were well ahead. Volumes were mixed and management lowered its aggregates volume outlook along with mid-year price increases. End market demand remains split with infrastructure and heavy commercial showing strength, while residential and light commercial markets have been weak.

As bottom-up investors, we seek underpinnings to near-term valuations in the form of expected earnings growth and other business fundamentals. 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, as we endeavor to protect the assets you have entrusted with us. As always, we are available for any questions you might have.

## **General Disclosure:**

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## **Firm and Composite Information**

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*This composite invests in stocks with market capitalizations at time of purchase generally within the range of capitalizations of stocks in the Russell Mid Cap Growth Index. The process is fundamental research driven. The investment style is growth. Primary selection criteria include quality management, distinct competitive advantage, and strong, sustainable growth. Portfolios will hold approximately 75 stocks. Historical turnover has averaged 51% per year. Composite inclusion threshold \$5mm. Fee basis is 80 basis points. The composite creation and inception date is October 1, 2000.*

*From 04/01/2015 until 12/31/16, accounts are removed from the composites 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 January 1, 2017 this composite does not have a significant cash flow policy.*

*In July 2014, TimesSquare modified its purchase capitalization range to match the changes in the mid cap market as represented by the Russell Midcap® 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 August 2007, TimesSquare had modified its purchase capitalization range to match the mid cap market as represented by the Russell Midcap® Growth Index at that time, with a change from \$1.5 billion to \$10 billion at time of purchase to \$2.5 billion to \$15 billion.*

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*TimesSquare's list of composites is available upon request. Past performance does not guarantee future results. The firm's list of limited distributed pooled funds are available upon request.*

## **Benchmark**

*Performance is measured against the Russell Midcap® Growth – a market capitalization-weighted index that measures the performance of those Russell Midcap® companies with higher price-to-book ratios and higher forecasted growth rates. All indexes,*

including the Russell Midcap® Growth Index, are based on gross-of-fee returns. FTSE Russell is the source and owner of the Russell Index data contained or reflected in this material and all trademarks and copyrights related thereto.

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

### **Performance Calculations**

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 fee level from the standard fee schedule listed for this strategy during the period presented. 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 and sustains 10% annual gross return for each year during this period. If an advisory fee of 0.80% of average assets under management is charged per year, for each year of the ten-year period, the resulting annual net return would be 9.2%. The ending dollar value of the account would be \$48,223,239, as compared to \$51,874,849 if the advisory fees had not been deducted.

Internal dispersion is calculated using the equal-weighted standard deviation of all accounts included in the composite on a gross basis for the entire year; it is not presented for periods less than one year or when there were five or fewer portfolios in the composite for the entire year.

The three-year annualized standard deviation measures the variability of the composite and the benchmark returns on a gross basis over the preceding 36-month period. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request.

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