

## International Small Cap Strategy

Representative Commentary — 2Q24

Performance	Annualized					
	2Q24	1YR	3YR	5YR	7YR	10YR
International Small Cap Composite (Gross)	-1.45%	9.20%	-5.95%	1.93%	1.74%	4.68%
International Small Cap Composite (Net)	-1.70%	8.12%	-6.89%	0.92%	0.74%	3.65%
MSCI EAFE® Small Cap (Net) Index	-1.84%	7.78%	-3.35%	4.19%	3.74%	4.29%

*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.*

The second quarter was good for the equity markets—provided one only owned a handful of the largest, most growthy, U.S. stocks (i.e., the Magnificent Seven).

- While the S&P 500 climbed 4%, the equal-weighted version of the index declined by -3%. That lagged the flat 0% return for non-U.S. developed markets (MSCI EAFE) and a 5% gain from MSCI Emerging Markets.
- Momentum continued to be the dominant global market factor, though Profitability was positive this quarter after negative or neutral results in prior quarters.
- Distinctions between growth and value were overshadowed among large caps given the outperformance of the Magnificent Seven. Beyond that there was little differentiation by style among mid caps, small caps, or outside the U.S.
- Specific to the international small cap universe, Europe was the only positive region while Japan and the Middle East saw the large declines.

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:

- Upcoming **Interest Rates** decisions vary from region to region
  - **Europe:** The ECB faces challenges significantly lowering interest rates in 2024. Unfavorable demographics with stagnant productivity may keep wages rising faster than expected in a low-growth environment. Meanwhile, the ongoing shift away from China's reliance creates additional inflationary pressure.
  - **Japan:** The weak yen has boosted inflation, raising the likelihood of a rate hike by the BOJ. However, the BOJ remains cautious, fearing a rate hike could stifle economic growth.
- The narrative for **Technology** and related services continues with its GenAI headlines.
  - Though deeper in that story, we observe that enterprises remain in the early stages of determining what their GenAI uses might be, and how to implement them.
  - Corporate IT spending on software has been muted thus far in 2024 compared with the same period in 2023 (even allowing for the typical seasonality that sees spending increase late in the calendar year).
  - Data center capital expenditures remain strong, boosting semiconductors and related companies. Globally, capex spending in the cloud is projected to be nearly 40% higher in 2024 than 2023.
  - Demand recovery in the semiconductor industry is still in an early stage, with AI leading the way while consumer electronics and auto/industrial sectors play catch-up.
- Among **Industrials**, strength persisted for longer-cycle end markets such as electrification, aerospace and defense, and infrastructure. Reshoring trends continue to drive capital investment.

- Shifts in energy requirements continue to drive implicit **energy transitions** globally. These moves will necessitate significant investments across the value chain, from production to distribution. The recent election results in the U.K. and Europe are also supportive of continued investment in this area.

The International Small Cap Portfolio performed in line with the MSCI EAFE Small Cap benchmark during the second quarter of 2024.

### **Regional Performance: Europe**

The portfolio's holdings in Europe performed in line with the benchmark's regional return. Denmark and the UK outperformed, while Germany lagged. Our underweight position in Norway also hurt relative returns.

There were multiple M&A deals announced during the quarter including a strong showing from Leading insurance company **Topdanmark**. Increasing 28%, **Topdanmark** reported a strong quarter despite higher claims due to harsh winter weather. The company's use of technology continues to lower claims handling cost while improving retention rate. In June, Finnish Insurer Sampo agreed to buy Topdanmark in an offer that represented a significant premium per share to Topdanmark's then price. Another strong performer was **Keywords Studios (KWS)**, a UK-based provider of outsourced creative and technical services to the video game industry, whose stock surged 78%. Late in the quarter, KWS confirmed they were in advanced discussions with the private equity firm EQT regarding a possible cash offer.

In the lead-up to the snap parliamentary election, political uncertainty weighed French stocks, particularly those exposed to government spending. Losing -19% was France based **Sopra Steria Group**, which provides consulting, systems integration, software development, infrastructure management and business process services.

Worldwide military expenditures had been on a long-term decline; however, the current geopolitical situation has led to a structural need in defense spending, particularly in Europe. Last quarter, we added **RENK Group** to the portfolio on its IPO. The German company is a global leader in mission-critical drive technology for land and naval defense applications, with civilian products used in marine, industrial, and energy transition sectors. RENK's share price dropped -30% this quarter after its initial 134% gain.

Danish medical device company **Ambu**, a global leader in single-use endoscopes, reported strong second-quarter results and raised full-year guidance. They later released detailed results with updated growth forecasts for the endoscopy segment. We trimmed our position in Ambu as its share price rose 17% for the quarter. Similarly, U.K.'s online automotive platform **Auto Trader** reported strong annual results, with management indicating a 'robust' used car market continuing into fiscal year 2025. This positive outlook pushed the stock price 15% higher.

### **Regional Performance: Japan**

Although Japan lagged other regions during the quarter, it was a positive relative contributor to the portfolio.

**Goldwin**, a leading sportswear retailer with exclusive rights in Japan and Korea to brands like The North Face and Helly Hansen, reported better-than-expected results but lowered guidance, causing its stock to drop -16%. **Nippon Gas**, one of Japan's largest LPG suppliers, saw its share price decline -12% after fiscal year results fell short of expectations due to warm weather decreasing gas usage. We trimmed our position in **Internet Initiative Japan (IIJ)**, the country's largest ISP after VMWare announced a significant price hike (3x-7x). While IIJ indicated they would pass on the cost increase, the potential lag in when the price increase takes effect concerned us. Shares of IIJ traded down -21% during the quarter.

Independent private equity firm **Integral Corporation**, benefiting from Japan's nascent PE industry, jumped 26% on the back of strong quarterly results. Edging forward by 7% was **Rohto Pharmaceutical**, a leading Japanese manufacturer of OTC healthcare products. Rohto boasts domestic market-leading eyedrops alongside its skincare lines and other health-related consumer products. The company guided conservatively, but we believe their recent acquisition of a Chinese pharmacy chain holds significant potential for future growth.

### **Regional Performance: Asia Pacific ex Japan, Middle East, and Emerging Markets**

The portfolio benefitted from holdings in the Middle East and Emerging Markets while holdings in Asia Pacific ex Japan detracted from performance.

Nova is a semiconductor equipment company based in Israel. The company is expected to benefit from the secular trend of chip proliferation, increasing chip complexity and increasing chip intensity. Shares of Nova rose 12% during the quarter. Hong Kong – based Samsonite, the world’s largest luggage maker, dropped -19% after the company announced plans for a dual listing in the U.S. to raise additional capital. We believe the continued travel trend will drive luggage demand, so we took advantage of this price weakness by adding to our position. Arcos Dorados, the world's largest McDonald's independent franchise in Latin America and the Caribbean, reported solid operating performance despite challenges in Argentina. However, non-cash FX charges and a higher royalty rate (due to strong sales) raised concerns about future royalties under a new franchise renegotiation in August. Shares of Arcos Dorados declined -19%. In a positive development, we initiated a position in HD Hyundai Marine Solution, the maintenance and repair unit of South Korea's biggest shipbuilding conglomerate. Shares of HD Hyundai Marine have surged 68% since we added them to the portfolio this quarter.

## **Conclusion**

At the midway point of 2024, as expected, fields of vision were occupied by central banks and election booths. Several European banks and the ECB began loosening their monetary policies. Global elections thus far saw some parties removed from power (England) or their majority standing curtailed (India). During the recent earnings reporting season, aside from pockets of technology or industrial infrastructure spending, companies were especially cautious about the near term, though many projected rebounds later in 2024. In our bottom-up evaluations, we look for those businesses where fundamentals either appear approaching positive inflection points, or ones with continued growth trajectories ahead. With that approach, we endeavor to protect the assets you have entrusted with us. As always, we are available for any questions you might have.

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### **Firm and Composite Information**

TimesSquare Capital Management, LLC (“TimesSquare”) is a registered investment adviser that is owned by the former equity management team of TimesSquare Capital Management, Inc. (“TimesSquare Inc.”) and Affiliated Managers Group, Inc. TimesSquare was formed to manage TimesSquare Inc.’s growth equity investment advisory business which was sold to TimesSquare in a transaction that closed on November 19, 2004.

This composite generally invests in non-US stocks with market capitalizations at time of purchase generally within the range of capitalizations of stocks in the MSCI EAFE Small Cap Net Index. Portfolios will hold approximately 70-75 securities. The process is fundamental research driven. Primary selection criteria include quality management, distinct competitive advantage, and strong, sustainable growth. Historical turnover has averaged 37% per year. Composite inclusion threshold \$500,000. Fee basis is 100 points. The composite creation and inception date is April 1, 2012.

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.

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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 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.

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. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size. TimesSquare’s fee schedule is available upon request and may also be found in Part 2A of our Form ADV.

Investment advisory fees generally charged by TimesSquare are described in Part 2A of its Form ADV. 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. Net of fee performance is available upon request.

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. The three-year annualized standard deviation calculation is not presented for the composite and/or benchmark for years when 36 monthly returns are not available. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request. To receive additional information regarding TimesSquare Capital Management, LLC, including a GIPS Composite Report for the strategy presented in this commentary, contact TimesSquare at [info@tscmlc.com](mailto:info@tscmlc.com).

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