# U.S. Small Cap Growth Strategy

**Representative Commentary — 3Q24**

| Performance | | | | | | |
|---|---|---|---|---|---|---|
| | | | Annualized | | | |
| | **3Q24** | **1YR** | **3YR** | **5YR** | **7YR** | **10YR** |
| U.S. Small Cap Growth Composite (Gross) | 6.50% | 21.59% | -0.13% | 9.59% | 9.60% | 10.43% |
| U.S. Small Cap Growth Composite (Net) | 6.24% | 20.41% | -1.12% | 8.51% | 8.52% | 9.34% |
| Russell 2000® Growth Index | 8.41% | 27.66% | -0.35% | 8.81% | 7.59% | 8.94% |

***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.***

The third quarter was even handed for global markets, with most equity or credit markets posting mid-to-high single digit returns. Measures of economic activity were stable, and energy prices receded, although heightened tensions in the Middle East began reversing that recently. Most central banks either began (U.S., U.K., Switzerland) or continued (EU) cutting their policy rates, with the notable exception of Japan—though rates there remain a rounding error away from zero.

Within equities, developed markets showered greater rewards on smaller or value-oriented stocks, while the reverse was true in emerging markets. After a weak first half in 2024, beta was one of the strongest factors in global equities this quarter.

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:

- As the U.S. Federal Reserve began to ease rates, companies gained greater certainty about the future costs of capital.
    - That seems particularly beneficial for **Information Technology**, as many corporations begin to set their IT budgets for 2025. AI remains a dominant trend with many companies seeing greater risks of underspending and being left behind rivals.
    - We do not see that happening widely yet for **Industrials**, where many companies also want to see the results of the presidential election before planning increased spending on capacity or automation. For instance, short-cycle industrial markets showed recent deterioration while longer-cycle markets linked to public infrastructure spending or various secular trends remained strong.
- The investment exodus from **China** continues, driven by economic or political considerations. We witness:
    - Companies and investors shift more of their focus to other Asian markets with better forecasted growth or stability.
    - Corporations move more production capacity closer to home.
    - China's domestic stimulus plans aiming to counteract some of that, though it is focused on internal activities.
- The stabilizing U.S. economy with rising home prices and wage growth and low unemployment claims, coupled with lower inflation, bolstered **Consumer spending**.
    - Although activity remains choppy and selective across sub-categories.

Amidst this environment, the portfolio underperformed the Russell 2000® Growth Index in the third quarter.

Our preferences in the Consumer-oriented sectors lean toward value-oriented or specialty retailers, franchise models, premium brands, or support services for other consumer companies. Kicking in a 30% gain was **Boot Barn**, a leader in a highly fragmented retail segment focused on western and work footwear, apparel, and accessories. Boot Barn's recent revenues and earnings not only exceeded expectations, but also showed the first sequential improvement in two years. All segments improved and management expects that momentum to continue, so it increased its guidance for 2025. Later in the quarter, management pre-announced better-than-expected in-stores and online sales, and we trimmed our position on the further price appreciation. Slipping back by -6% was the warehouse club operator **BJ's Wholesale Club**. Its recent revenues and earnings exceeded expectations, though management merely reaffirmed its previous guidance range for the balance of the fiscal year, noting that planned long-term investments might bring those projections to the lower end of that range. In our history with this position, we have seen BJ's benefit over the longer-term from these growth initiatives. Concerns about lower levels of customer traffic at two of our holdings led us to exit both. Additionally, each still had significant ownership from pre-IPO owners that remained a near-term overhang on their share prices. While we owned the stocks during the quarter, **Savers Value Village** (the largest for-profit thrift store operator in the U.S. and Canada, with over 300 stores) was down -22% and **European Wax Center** (the largest franchisor of out-of-home hair removal services) was down -49%. Also detracting from results was **Topgolf Callaway Brands**, which manufactures golf equipment and accessories, as well as operates entertainment venues. Although recent channel checks indicated that TopGolf activity trends were improving, that softened later in the quarter. Overall revenues and earnings were less than anticipated, which led management to lower its guidance for the rest of the year. The company's Callaway equipment and apparel business was more stable, though management also discussed a strategic review of the entertainment business. Subsequently, the company announced plans to spin off TopGolf in 2025. While we agreed with the rationale, the timing was at a point of weakness, and we exited the position that was down -31% during the quarter. New to the strategy was **Wyndham Hotels & Resorts**, one of the world's largest hotel franchising companies with a variety of midscale or economy brands and partners. Operating in secondary or tertiary markets, Wyndham focuses on leisure travelers in spots with sparse competition. Its franchise model limits the need for capital spending or significant debt.

Often the Energy sector moves in lockstep with the underlying commodity prices. Here we aim to find companies that either are low-cost exploration and production companies with high yielding fields, or specialized service providers. Gaining 14% was **Cactus, Inc**., a provider of onshore wellhead and pressure control equipment for oil drilling. Initially, Cactus benefited from the perception that the outcome of the U.S. Presidential election might bolster drilling activity. In addition, we expect stronger fundamentals in the near-term--Cactus's non-U.S. operations were growing to become a larger portion of overall revenues—though we trimmed the position on its rise. That was partly offset by the -17% showing from **Matador Resources**, an oil and natural gas exploration and production company with acreage in major Texas fields and the neighboring states. Although Matador reported strong quarterly growth and completed a debt offering for a recent acquisition, concerns about falling oil prices and possible oversupply weighed on its share price.

Our preferences among Health Care stocks are those companies providing novel therapies for unmet needs that deserve premium pricing, or specialized service providers. Here we benefited from the 14% return from **Addus HomeCare,** a comprehensive provider of non-clinical home and community-based care services. Its revenues and earnings edged ahead of expectations following strong revenues from its personal care and home health operations, which offset lower hospice activities. Pulling back by -15% was **Certara, Inc**., which develops biosimulation technology that facilitates development and regulatory approvals for new medicines. Certara's revenues and earnings each fell shy of expectations because some of Certara's large biopharma clients had been cautious with recent spending. While Certara's management reaffirmed its guidance for the remainder of the year—implying that spending may catch up in the next quarter, we grew increasingly concerned that biopharma spending could deteriorate. Hence, we trimmed the position. We added two new biotechnology companies to the strategy this quarter: **Vaxcyte, Inc**. (developer of vaccines) and **Insmed Incorporated** (developer of treatments for various pulmonary diseases). Vaxcyte's lead pneumococcal vaccine candidate recently reported positive clinical data across a wider range of pneumonia types than current treatments. That created significant potential for Vaxcyte to take share within a multi-billion-dollar market, and we began to build a position. Insmed has one commercially approved treatment for lung infections that is under review for expanded use. Recently another treatment reported positive clinical data that paves the way for a commercial launch in 2025. The latter, Brensocatib, will be the first approved to treat directly chronic bronchial issues that currently only have symptom mitigation methods.

Many of our Industrials positions provide necessary business-to-business operational services, highly technical components, equipment enabling automation & efficiency improvements, or essential infrastructure services. Providing a 40% lift was **Loar Holdings Inc**., a diversified manufacturer and supplier of niche aerospace and defense components. We first added Loar to the strategy on its IPO in April and continued building the position early this quarter. Later, Loar reported higher-than-anticipated revenues and earnings, then boosted its guidance for the rest of the year. Loar forecasted increased growth for all three of its end-markets: aerospace original equipment, aftermarket, and defense. There was a -25% price retrenchment from **MYR Group Inc**., a leading specialty contractor serving the electric utility infrastructure, commercial, and industrial construction markets. Its fiscal quarterly revenues and earnings were lower than anticipated, driven by a handful of delayed utility transmission & distribution projects. Those hiccups largely were caused by the end clients and its problematic projects are expected to be completed by year-end. Looking past its problem projects, MYR's backlog increased at a healthy pace, and we added to our position on its weakness. Leaving the strategy this quarter was **EMCOR Group**, which provides construction and operational services for mechanical and electrical systems to a broad range of commercial, industrial, utility, and institutional customers. It had been one of the steadiest gainers and contributors this year, though the stock's market capitalization grew past the upper limit for the strategy.

Among the wide variety of Information Technology companies, we prefer critical system providers, specialized component designers, systems that improve productivity or efficiency for their clients, and others that are growing their shares of corporate IT budgets. We trimmed our position in **Clearwater Analytics** as its shares climbed by 35%. A cloud-based investment accounting and analytics provider to insurers, asset managers, and corporate treasury departments, Clearwater's revenues and earnings exceeded expectations. Margins and levels of annual recurring revenue each improved as Clearwater saw high levels of cross selling of its expanded product line to existing clients. That led management to lift guidance for the rest of 2024. Nearly all stocks in the semiconductor sphere retreated this month, which affected **FormFactor, Inc.**, a manufacturer of consumable interfaces between semiconductors and testing equipment. The company's management indicated that there might be some end market absorption of current inventory in high memory bandwidth chips, though expected overall demand to remain stable. That weakened its share price by -24%. Another detractor was **JFrog Ltd**., which provides systems to manage and speed the release of software updates from developers to users. Although results were in line with earlier projections, JFrog's management reduced guidance for the rest of 2024. The caution arose from longer sales cycles among clients, who grew more concerned about the macroeconomic environment. After speaking with the company's management, we were encouraged that the underlying business trends remained strong. While there were delays in signing new contracts, those were not cancellations. Still, JFrog's shares retreated by -23% and we trimmed our position. Moving in the other direction was the 37% gain from our new position in **OneStream, Inc**., a software developer of cloud-based enterprise systems that streamlines corporate financial reporting and forecasting. Added to the strategy on its IPO and later purchases, its subscription business has retention rates of nearly 100% as it continues to displace legacy providers—often in situations where OneStream singularly took the place of several incumbent systems. Other current clients, such as Walmart, have expanded their OneStream use with its newer machine learning modules.

Heading into the last quarter of 2024, with most central banks easing the lending rates the next questions are "how far?" and "how fast?". Equally front of mind is the outcome of November's U.S. presidential election, which will reverberate across domestic and non-U.S. economies. With that dynamic economic backdrop, our focus remains on projecting growth potential for our investments relative to their valuations and finding where those meaningfully differ from market expectations while managing risks. As always, we are available for any questions you might have.

***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.*

*The opinions and information expressed and provided are for general information only and are not intended to provide specific advice or recommendations but rather, a basis from which strategies can be built, taking into account the specific objectives of each portfolio, in terms of return, time horizon, and risk constraints, as well as diverging investment perspectives and assumptions. All material has been obtained from sources believed to be reliable, but its accuracy and completeness are not guaranteed.*

*This document, which is being provided on a confidential basis, shall not constitute an offer to sell or the solicitation of any offer to buy which may only be made at the time a qualified offeree receives a confidential private offering memorandum ("CPOM"), which contains important information (including investment objective, policies, risk factors, fees, tax implications and relevant qualifications), and only in those jurisdictions where permitted by law. In the case of any inconsistency between the descriptions or terms in this document and the CPOM, the CPOM shall control. These securities shall not be offered or sold in any jurisdiction in which such offer, solicitation or sale would be unlawful until the requirements of the laws of such jurisdiction have been satisfied. This document is not intended for public use or distribution. While all the information prepared in this document is believed to be accurate, TimesSquare Capital Management, LLC, makes no express warranty as to the completeness or accuracy, nor can it accept responsibility for errors, appearing in the document.*

*TimesSquare Capital Management, LLC claims compliance with the Global Investment Performance Standards (GIPS®).*

***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. From October 1, 2000 to November 18, 2004, the performance is that of the TimesSquare Inc. small cap composite. From November 19, 2004, the performance is that of the TimesSquare small cap composite which consists of all small cap accounts managed by the team at TimesSquare and TimesSquare Inc. There has been no change in the investment management responsibility or strategy from the prior firm.*

*This composite invests in stocks with market capitalizations at time of purchase generally within the range of capitalizations of stocks in the Russell 2000 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 90-120 stocks. Historical turnover has averaged 54% per year. Composite inclusion threshold $5mm. Fee basis is 100 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 small cap market as represented by the Russell 2000® 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 June 2012, TimesSquare had modified its purchase capitalization range to match the changes in the small cap market as represented by the Russell 2000® Growth Index at that time, with a change from $50 million to $1.5 billion at time of purchase to $50 million to $2 billion.*

*The opinions and information expressed and provided are for general information only and are not intended to provide specific advice or recommendations but rather, a basis from which strategies can be built, taking into account the specific objectives of each* *portfolio, in terms of return, time horizon, and risk constraints, as well as diverging investment perspectives and assumptions. All material has been obtained from sources believed to be reliable, but its accuracy and completeness are not guaranteed.*

*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 2000® Growth – a market capitalization-weighted index that measures the performance of those Russell 2000® companies with higher price-to-book ratios and higher forecasted growth rates. All indexes, including the Russell 2000® 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 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.*

*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. 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@tscmllc.com.*



TIMESSQUARE CAPITAL MANAGEMENT, LLC

75 Rockefeller Plaza, 30th Floor New York, NY 10019