

TIMESSQUARE
CAPITAL MANAGEMENT, LLC

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TSCM: Inside the Investment Room

TSCM: Inside the Investment Room is a bulletin offering the Firm's perspectives on current market developments.

Beyond Market Rotation: AI Financing, Earnings Resilience, and Emerging Growth Opportunities

In this edition of *Inside the Investment Room*, we examine how AI financing concerns, shifting investor positioning, and persistent input-cost pressures are influencing market leadership and investment opportunities across small and mid cap equities.

From the expanding role of advanced semiconductor technologies and biosimilars to resilient regional banks and selective industrial opportunities, the team remains focused on identifying businesses whose underlying fundamentals may be stronger than recent share-price performance suggests.

Executive Summary

Market volatility continues to create opportunities as investor positioning and macroeconomic uncertainty drive sector divergence. While AI financing concerns and rising input costs challenge near-term expectations, underlying fundamentals remain supportive across select semiconductor, healthcare, and financial businesses. The team continues to emphasize valuation discipline, company-specific earnings catalysts, and fundamental research to identify durable growth opportunities amid shifting market conditions.

22
AVERAGE YEARS OF EXPERIENCE

17
INVESTMENT PROFESSIONALS

Sector Perspectives — Takeaways

Technology

AI infrastructure remains a compelling structural growth theme, although financing concerns, slowing growth indicators, and elevated expectations are driving greater differentiation across the technology ecosystem.

- **AI financing under scrutiny:** Capital availability, data-center valuations, and potential deceleration in frontier-model growth are raising questions about the pace of future infrastructure investment.
- **Semiconductor fundamentals resilient:** Committed fab construction, advanced packaging, and process-control demand support equipment suppliers, while resetting expectations may create selective opportunities.
- **Optical networking opportunities:** Adoption of $1.6T networking and the prospective transition to co-packaged optics could benefit select suppliers, although the timing of broader deployment remains uncertain.

Financials

Regional banks and capital-markets businesses have demonstrated resilience, while insurance pricing and margin trends remain mixed.

- **Regional banks remain constructive:** Net interest income modestly exceeded expectations, aided by loan repricing and manageable deposit costs; the team discussed potential additional exposure.
- **Capital-markets activity holds up:** Strong trading results and relatively healthy investment banking pipelines remain supportive despite moderation from earlier highs.
- **Insurance trends mixed:** Soft-cycle conditions and margin concerns reinforce a selective approach to brokers and underwriting businesses.

Energy

Oil prices remain highly sensitive to geopolitical developments, creating a wide range of potential outcomes for energy-related equities.

- **Oil outlook remains uncertain:** Developments in the Middle East could meaningfully alter crude prices and sector performance.
- **International activity offers potential:** Select service providers could benefit from a recovery in Middle East activity, although timing remains uncertain.
- **2027 outlook in focus:** Upcoming earnings commentary should clarify the outlook for regional activity and future growth.

Industrials & Infrastructure

Industrial demand remains generally constructive, but rising costs and reduced investor positioning are creating valuation dispersion.

- **Demand remains relatively solid:** Management commentary has been more resilient than share-price performance, despite fuel, freight, and materials cost pressure.
- **Positioning may create opportunities:** Sector underperformance and reduced investor exposure could support a rebound if earnings and demand stabilize.
- **Pricing power remains essential:** The ability to offset cost inflation and preserve margins remains central to company selection.

Consumer

Recent gains in staples and retail appear driven more by positioning than by a broad improvement in fundamentals.

- **Rotation outpaces fundamentals:** Recent share-price strength requires confirmation from upcoming earnings and demand trends.
- **Input costs challenge profitability:** Elevated freight, materials, and tariff-related costs may prompt further pricing actions.
- **Unit growth under pressure:** Higher financing and build-out costs could constrain expansion economics into 2027; AI-enabled travel distribution is also emerging as a longer-term theme.

Health Care

Healthcare performance remains influenced by subsector rotation, with opportunities requiring careful assessment of valuation and company-specific catalysts.

- **Medtech valuations attractive:** Select businesses appear inexpensive, although the timing of sustained multiple expansion is uncertain.
- **Biosimilar opportunity develops:** Upcoming patent expirations may benefit pharmaceutical packaging and distribution businesses as manufacturers become more multisourced.
- **Biotech selectivity critical:** Mixed market reactions to clinical news underscore the value of differentiated precision-oncology and longer-acting immunology programs.

Key Macro Trends

- **Market Rotation & Positioning:** Recent sector leadership shifts appear driven in part by investor flows rather than broad fundamental improvement.
- **AI Financing & Infrastructure:** Funding uncertainty is weighing on some data-center operators, while committed fab investment and optical networking demand remain supportive.
- **Earnings Season as a Catalyst:** Upcoming results will help establish whether resilient demand can offset cost pressure and support valuations.
- **Persistent Cost Pressures:** Fuel, freight, tariffs, and raw materials continue to challenge margins across multiple industries.
- **Geopolitical & Commodity Uncertainty:** Middle East developments create a wide range of possible oil-price and energy-equity outcomes.

The Bottom Line

The investment landscape remains characterized by divergence between market sentiment and underlying business fundamentals. Although AI financing concerns, geopolitical uncertainty, and input-cost pressures create near-term challenges, select opportunities in semiconductor infrastructure, healthcare, regional banks, and industrials merit continued attention. The team remains focused on valuation discipline, earnings execution, and company-specific catalysts to identify high-quality small and mid cap businesses with durable growth potential.

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Read the prospectus or summary prospectus carefully before investing.

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