Healthcare Opportunities

NICHOLAS INVESTMENT PARTNERS

Key Takeaways

- Healthcare stocks locked in a solid Q3 and outpaced the broader market on a solid Q2 earnings and sales growth.
- Security selection was the key driver of Healthcare Opportunities absolute returns, as strong company fundamentals were rewarded.
- Innovation-driven companies in biotech and healthcare equipment portfolio holdings were particularly strong performers.

Composite Performance as of September 30, 2018

COMPOSITE PERFORMANCE (%)	HEALTHCARE OPPS (GROSS)	HEALTHCARE OPPS (NET)	S&P 500	R3000 HEALTHCARE*
MTD	1.45	1.22	0.57	2.10
QTD	11.35	9.85	7.71	13.61
YTD	33.62	28.67	10.56	18.33
1 YEAR	39.42	33.37	17.91	20.21
ITD**	43.14	36.60	18.58	23.99

**Russell 3000 Healthcare Index. **Composite inception date: 1/1/2017. Returns over one year are annualized. Performance for individual accounts may vary. See performance disclosure for additional information. Past performance is no guarantee of future results.*

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MARKETS DYNAMICS

It was a strong quarter for equities. Stocks scaled a wall of worry in Q3, driven by a mix of renewed synchronized global economic growth, robust Q2 earnings growth and strong Q3 forecasts. Companies found innovative ways to compete and excel.

- The S&P 500 Total Return Index rose 7.7%—its best quarterly performance since Q4 2013.
- Stocks were strong in most regions worldwide, with only emerging markets generating a negative return.
- All US cap sizes posted gains and large caps outpaced mid and small caps.
- Growth significantly outperformed value in all cap sizes.

Healthcare Landscape. Healthcare stocks posted an impressive quarter on solid Q2 earnings and sales growth strength. Medtech companies, in particular, benefited from revenue acceleration and pipeline optionality that lead to a rotation into the space. We expect EPS revisions over the next 12 months to be broadly positive. Valuation of small-cap growth companies in the healthcare segment are also expected to reaccelerate. We also believe the healthcare market structure remains favorable with strong M&A activity and a robust IPO pipeline with 62 IPOs year-to-date.

LOOKING AHEAD

Equities are attractive—but not without risk. While we see further upside driven by company fundamentals, the US economic expansion and upward revisions of earnings and revenue estimates, we're also aware that the expansion cycle is in its later stages—meaning that growth and valuations are more vulnerable to changing investor sentiment or potential external shocks.

As we write in early October, stocks have already taken a hit from jitters about rising yields across the curve, China and the potential for a US-China trade war to hamper US earnings growth. We wouldn't be surprised by additional choppiness in Q4 (particularly in the runup to and aftermath of the November US midterm elections), but expect markets to weather the storm and enter 2019 with fundamentals in good shape given the ongoing strength in secular growth.

WHERE WE STAND NOW

Emphasis on innovation. With rising volatility putting a premium on effective stock selection, we continue to focus on innovation-driven companies.

Growth style to remain strong. The factors we've cited—innovation, the supportive economic environment, positive earnings and revenue estimates, particularly in small cap—should keep growth stocks strong heading into 2019. If growth slows due to an external shock, investors would likely prize growing companies with high earnings transparency.

Small caps remain in an uptrend. In addition to the upward revisions in small cap earnings and revenues, we expect small caps to benefit from earnings growth that we noted earlier.

Stock selection is critical in healthcare. Volatility within and among healthcare sectors means that stock selection should be the key to performance. We continue to focus on innovation-driven companies and are finding new opportunities in healthcare's robust IPO pipeline.

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PERFORMANCE ATTRIBUTION

Healthcare Opportunities delivered solid performance in Q3 and outperformed the broader equity market, extending the strategy's lead year-to-date. Positive contribution to absolute returns was broad-based across sector groups, except for pharmaceutical holdings. Strength in biotech, medtech and healthcare technology holdings lifted portfolio performance the most in Q3.

The five largest contributors to absolute returns included Viking Therapeutics (clinical-stage therapies for heart and liver diseases as well as bone/hip fractures), Novocure (disruptive cancer cell treatments), Teladoc Health (remote and mobile tele-healthcare services), Invuity (surgical and imaging devices) and Exact Sciences (colon cancer screening). Shares of Viking Therapeutics rallied on the release of phase II data supporting strong efficacy and tolerability profile for its VK2809 treatment to significantly reduce liver fat in patients with hypercholesteralmia (fatty liver disease). Novocure rallied on stronger-than-expected Q2 revenue growth and positive mesothelioma data released in the quarter. Teladoc continued to benefit from strong revenue growth supported by higher membership and utilization trends and reported better-than-expected revenue growth in Q2. Shares of Invuity advanced in response to the company's earlier-than-expected new imaging product launch and announcement of being acquired at a premium by Stryker (surgical instruments and equipment). Positive reaction to Exact Sciences distribution partnership with Pfizer drove its share price higher and is viewed as a key catalyst to drive sales growth and market share gains.

The five largest detractors from absolute returns were OptiNose (drug treatment for chronic sinusitis), Portola Pharmaceuticals (therapeutics for thrombosis, hematologic disorders, and inflammation.), AxoGen (surgical solutions for nerve damage repair), Collegium Pharmaceutical (alternative pain medication less prone to opioid abuse) and CRISPR Therapeutics (cancer and blood disorder therapies). OptiNose delivered on their first post-approval sales report for their newly approved chronic sinusitis drug, but the whisper number was much higher. Our due diligence review confirms prescriptions are tracking well and we continue to hold the position. Axogen declined on lower-than-expected Q2 results. We sold the position. Subsequently, the stock was the target of a short thesis of rising competition in the nerve repair space and weaker demand than management projected. The stock has continued to underperform as of this report. We also sold Collegium Pharmaceuticals and Portola Pharmaceuticals on slower growth trends. In terms of the other holdings that detracted, we believe their pullbacks during Q3 were short term in nature, resulting from rotational selling pressure on small-cap and high multiple stocks in September. Their underlying growth catalysts and fundamentals remain intact, so we continue to hold these positions.

Contribution to Portfolio Absolute Return – 3Q 2018

BY INDUSTRY (%)	
Biotechnology	4.01
Health Care Equipment & Supplies	3.69
Health Care Providers & Services	1.67
Health Care Technology	2.24
Life Sciences Tools & Services	1.83
Pharmaceuticals	-1.97
Other	0.01

BY MARKET CAP (%)	
>$15B	2.35
$7.5B–$15B	2.67
$4.5B–$7.5B	2.18
$1.5B–$4.5B	0.25
$750M–$1.5B	-0.98
$400M–$750M	3.89
<$400M	1.12
Other	0.01

BY AVERAGE PORFOLIO WEIGHT (%)	
>3%	5.23
2-3%	6.20
1-2%	0.93
<1%	-0.89
Other	0.01

Source: FactSet, Nicholas Investment Partners. Based on a representative portfolio. Specific securities identified do not represent all securities purchased, sold or recommended to advisory clients. It should not be assumed investments in these securities were or will be profitable. Past performance is no guarantee of future results.

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POSITIONING

Near-term we expect increased volatility ahead of key industry conferences in late November/early December and a choppier trading environment as investors may be quick to take profits amid broader macro concerns (i.e. rising rates, bifurcation of global growth, global trade wars). As the focus shifts back to earnings, we believe the fundamental backdrop for healthcare subsectors, biotech and medical equipment stocks in particular, remains positive with expectations of continued sales growth strength longer term.

As of September 30, 2018, Healthcare Opportunities remains fully invested with 2.37% cash, reflecting a positive outlook on the fundamental strength in the underlying stock-specific holdings and industry trends. The portfolio is positioned with a tilt toward small-to-mid cap companies. Nearly 85% of the portfolio is invested in companies with market capitalizations below $30 billion, with ~64% of the portfolio exposed to companies below $7.5 billion in market cap. The ten largest positions, those we believe have the strongest potential for accelerated growth, accounted for 35.8% of the portfolio.

We continue to favor innovation-driven companies with differentiated secular growth themes, more domestically-oriented revenue exposure, and those with strong financials and the ability to finance growth internally. At quarter end, the portfolio's largest industry exposures were in biotechnology (50.8%) and healthcare equipment stocks (17.2%). Innovation in oncology and gene therapy remain strong and the portfolio reflects a particular focus in those innovative areas.

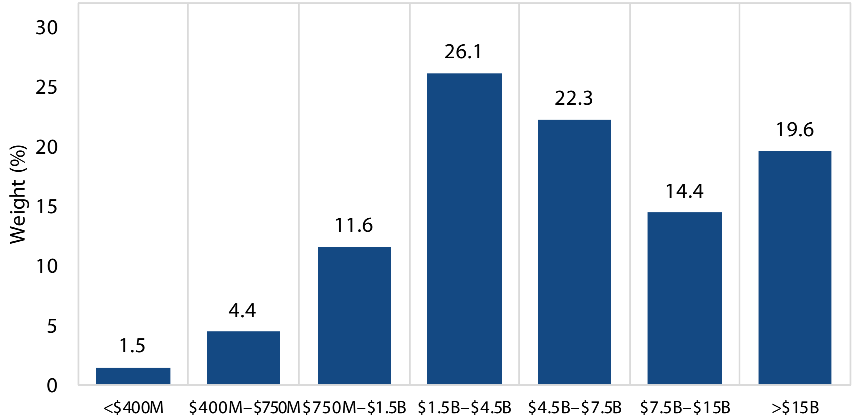
We remain vigilant in selecting those companies that have secular growth drivers and high-quality management teams able to execute through a changing business climate, and where we have high visibility and confidence in future growth. We believe that the combination of equity and credit research we do provides differentiated insights that benefit our portfolios.

CHARACTERISTICS

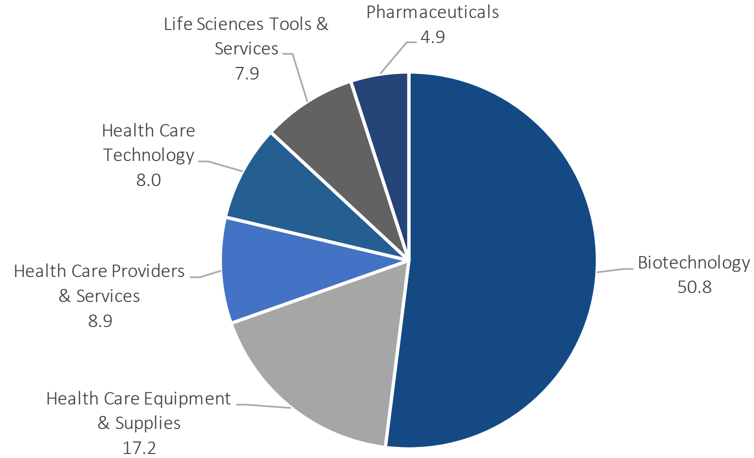
Number of Holdings	44
Top 10 Positions	35.7%
Long Exposure	100.0%
Short Exposure	0.0%
Cash Position	2.4%
Turnover (TTM)	127%
EPS Growth *(FY1/FY2 wtd. avg.)*	13.8%
EPS Growth *(3–5 year wtd. avg.)*	20.9%
Price to Earnings *(FY2)**	23.5 x
Price to Sales*	2.8 x
Price to Book*	7.0 x
Market Cap *(wtd. avg.)*	$11.6 B
Market Cap *(median)*	$3.7 B

*Weighted harmonic average.

MARKET CAP DISTRIBUTION



INDUSTRY WEIGHTS (%)



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Performance contribution/attribution, characteristics and portfolio risk statistics information is from a representative account for the strategy composite. The representative account was chosen based on non-performance criteria such as account size, cash flows and the level of account restrictions. While Nicholas believes the information is representative of other accounts in the strategy, specific information for other accounts may differ from the representative account. Nicholas used third-party information in the preparation of the characteristics and/or market environment charts. While Nicholas believes the third-party information was obtained from reliable sources, we cannot guarantee the accuracy, adequacy or completeness of the information obtained from these sources.

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Gross and net returns, presented within were calculated in U.S. dollars on a time-weighted, total return basis, including reinvestment of all dividends, interest and income, realized and unrealized gains or losses and are net of brokerage commissions, execution costs, and any applicable foreign taxes. Accrual accounting was used for dividend income recognition. Securities transactions are accounted for on trade date. Cash and cash equivalents are included in the performance returns. The gross returns do not give effect to investment advisory fees which would reduce gross returns. The deduction of investment advisory fees will reduce gross returns and are subject to compounding. The composite results include all actual, fee paying fully discretionary accounts under management by Nicholas after one full calendar month that have substantially the same investment objectives, policies and restrictions. Unless otherwise noted the returns reflect the performance of the product composite. Performance and incentive based fees will have similar, yet often larger, impacts to performance and account values than standard management fees. Please see Nicholas' ADV Part 2A for a complete description of investment advisory fees.

The composite performance shown does not include the impact of private investments, although the strategy may invest in private, illiquid securities in the future. The strategy may invest up to 20% in private investments which may be illiquid. The strategy may also invest 20% of its assets in short sale positions. A short sale is a transaction in which an account sells a security it does not own in anticipation that the market price of that security may decline. Selling securities short involves unlimited risk as the security's price can theoretically continue to

Disclosure *(continued)*

appreciate indefinitely which may result in unlimited losses. In addition, short positions typically involve increased liquidity risk, transaction costs, and the risk that the third party to the short sale may fail to honor its contract terms. The account may have to pay a fee to borrow particular securities and is often obligated to pay over any accrued interest and dividends on such borrowed securities to the buyer. Any gain will be decreased, and any loss increased, by the transaction costs described above. The successful use of short selling may be adversely affected by imperfect correlation between movements in the price of the security sold short and the securities being hedged.

Net returns reflect the deduction of the highest investment management fee for the product, which is 1.00% and a 10% performance fee. The performance fee was accrued at the end of each month based on the total profits for the month. The performance fee is subject to a highwater mark with no hurdle. Any earned performance fee is paid after each calendar year. Actual fees charged may vary by portfolio due to various conditions such as account size, client relationship, complexity, etc. Client's accounts may also be subject to additional fees unrelated to Nicholas such as custodial and administration fees, among others.

During the product incubation period from January 1, 2017 through December 31, 2017, the benchmark presented as a general indicator of stock market performance was the Russell 3000 Healthcare Sector index. Beginning on January 1, 2018 the S&P 500 replaced the Russell 3000 Healthcare Index as a proxy for the general market performance. The change was made retroactively to inception. Although this strategy is focused on the healthcare sector, its performance objective is to exceed the general market performance, as measured by the S&P 500, over a full market cycle. This strategy is not intended to track the performance or resemble the construction of any specific benchmark and may deviate significantly from the index shown. The strategy holdings are expected to be highly concentrated in the healthcare sector which may create risks that will vary significantly from the S&P 500 index which is more diversified across multiple sectors.

The S&P 500 Index is a widely regarded gauge of the US equities market, that includes 500 leading large cap companies in leading industries of the US economy. Although the S&P 500 focuses on the large cap segment of the market, with approximately 80% coverage of available market capitalization, it is also typically used as a proxy for the total market. Index returns include the effect of dividends and income which are reinvested daily.

The Russell 3000 Healthcare Index consists of healthcare stock components of the Russell 3000® Index, a market-capitalization weighted equity index maintained by the Russell Investment Group that seeks to be a benchmark of the entire US stock market.

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