

MARKETS AND PERFORMANCE

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.

Credit markets faced challenges. US Treasury yields rose across the curve, reflecting increases in potential growth and additional rate hikes based on the Fed's telegraphed intention to maintain its interest-rate and balance-sheet normalization process. US corporate bond performance was mixed as the yield curve flattened.

- The 10-year Treasury yield closed at 3.05%, up 20 basis points, and continued to breach its five-year high heading into October.
- The Bloomberg Barclays US Aggregate Bond Index fell 0.16%, versus a 1.03% gain for the Bloomberg Barclays US Corporate High-Yield Bond Index.

Convertibles continued to rally. Strength in their underlying equities and tight corporate credit spreads helped convertibles deliver modest gains, led by healthcare and tech issues. The primary convertible market remained strong.

- The Thomson Reuters All Cap Focus Convertible Index locked in a 2.01% return.
- New convertible issuance maintained a healthy pace, with 27 issues raising \$11.6 billion—enough to push YTD totals above the full-year levels for 2017 (i.e., 122 issues and \$46.3 billion).

Our strategies outperformed for the quarter (see page 3). All of our strategy composites generated positive returns for Q3 2018. Most meaningfully outperformed their benchmarks.

News & Investment Insights

www.nicpartners.com/news-insights/

October 2018

DC Finance's Annual East Coast Family Office Conference, Oct 25, New York*

Lisa Wheatley, Portfolio Manager and healthcare specialist, will be a featured speaker on healthcare innovation and its resulting investment opportunities.

September 2018

Catherine Nicholas featured on Asset TV's Masterclass: Small Caps*

On September 12, CIO and Portfolio Manager Catherine Nicholas joined host Gillian Kemmerer along with three other small-cap managers to discuss some of the current and prospective drivers of small-cap stock performance.



*Appearances sponsored by Nicholas Investment Partners.

Giving Back

www.nicpartners.com/giving-back/

October 2018

Team NIC Rolls Up Its Sleeves at Local Beach Clean Up

Saturday, October 6, Nicholas Partners team members lent a hand to a local beach clean up near Oceanside Pier, just north of our Rancho Santa Fe, CA offices. Spearheaded by the firm's Giving Back Committee, the team collected 26.5 pounds of trash!



LOOKING AHEAD: THE BIG PICTURE

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.

The US economy: solidly supportive. A variety of US economic indicators suggest that corporate profit growth may have more room to run:

- No signs of a recession are in sight.
- The unemployment rate—currently at 3.7%, its lowest level since 1969—continues to fall as nonfarm payrolls and real wages rise.
- Consensus forecasts for quarter-on-quarter Q3 GDP growth are above 3%, with projections of 2.9% for 2018 as a whole.
- Multiple metrics are bullish for consumer spending: the strengthening US dollar, high consumer confidence, rising household net worth, improving wage growth and new income benefits for middle- and low-income earners from the late-2017 tax law.
- Capital spending, while close to historical highs, is mostly focused on meeting replacement demand instead of funding new projects. Translation: Capex can comfortably rise further without becoming overextended.
- Inflation—whose resurgence is investors' biggest fear—remains modest despite the robust economy. The Fed, for its part, is less likely to aggressively tighten rates as long as inflation stays under control.

Earnings and revenues: cap divergence. The Q2 earnings environment exceeded our expectations. With the US economy and global growth both projected to remain buoyant going forward, we expect moderate-to-strong earnings and revenue growth to persist into 2019, albeit with a divergence between large and small caps.

2018 consensus earnings forecasts for large (i.e., the S&P 500) and small are both vibrant: 20.3% and 26.9%, respectively. But in 2019, small cap earnings should grow 18.5%, according to Jefferies research, nearly double the 9.5% consensus for large caps. 2019 revenue growth, by contrast, favors large caps, (i.e., 5.3% versus 4.8% for small caps)—suggesting that small companies will be more cost-efficient.

Valuations: fair for now. Stocks currently appear fairly valued at a consensus multiple of 16.7 times forward 12-month earnings. We believe caution is appropriate, as multiples already include the upbeat forecasts we've described—meaning that earnings surprises may be more likely on the downside than upside at this point.

Macro risks: external shocks loom large. There are several potential shocks that temper our optimism, any of which could reverse the market's direction. These include the US elections in November, a Chinese economic slowdown, trade wars, geopolitical developments (notably in the Middle East) and the spread of economic problems in emerging markets to the developed world (particularly Europe).

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—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.

More upside for convertibles. We remain optimistic about convertibles, which benefit from strength in underlying stocks, healthy new issuance and relatively favorable monetary conditions. The asset class continues to offer attractive risk-controlled equity exposure, income and a lower duration than bonds at a time when equity valuations are at the higher end of their range and rates are rising.

EQUITY STRATEGIES
US SMALL CAP
Inception Date: 7/1/2007

	Annualized Returns						
	QTR	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception
Gross Return	6.9	21.0	28.7	17.0	11.1	15.1	10.0
Net Return	6.7	20.1	27.4	15.8	10.0	14.0	8.9
Russell 2000 Growth	5.5	15.8	21.1	18.0	12.1	12.6	9.3

US SMID CAP GROWTH
Inception Date: 1/1/2017

Gross Return	9.0	22.1	28.7	--	--	--	26.0
Net Return	8.7	21.2	27.5	--	--	--	24.8
Russell 2500 Growth	7.2	15.8	23.1	--	--	--	23.2

US GROWTH EQUITY
Inception Date: 7/1/2007

Gross Return	7.8	17.3	24.6	16.0	12.1	13.7	10.6
Net Return	7.6	16.6	23.6	15.1	11.2	12.7	9.7
Russell Midcap Growth	7.6	13.4	21.1	16.6	13.0	13.5	9.3

OPPORTUNISTIC STRATEGIES
US EQUITY OPPORTUNITIES
Inception Date: 7/1/2014

	Annualized Returns						
	QTR	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception
Gross Return	5.7	17.6	27.7	18.8	--	--	13.5
Net Return	5.5	16.9	26.6	17.8	--	--	12.6
S&P 500	7.7	10.6	17.9	17.3	--	--	12.0

HEALTHCARE OPPORTUNITIES
Inception Date: 1/1/2017

Gross Return	11.3	33.6	39.4	--	--	--	43.1
Net Return	9.9	28.7	33.4	--	--	--	36.6
S&P 500	7.7	10.6	17.9	--	--	--	18.6

CONVERTIBLE STRATEGIES
CONVERTIBLES
Inception Date: 1/1/2009

	Annualized Returns						
	QTR	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception
Gross Return	3.6	9.7	9.7	7.8	5.7	--	12.3
Net Return	3.4	9.0	8.9	7.0	4.9	--	11.4
TR US All Cap Focus (Cvts)	2.0	8.0	9.7	8.2	6.4	--	9.4
BofA ML All US Convertible	3.9	10.4	12.2	11.8	9.3	--	13.7

CONVERTIBLES PLUS
(LEVERED)
Inception Date: 1/1/2009

Gross Return	6.6	17.9	17.8	13.3	8.0	--	24.5
Net Return	6.3	16.8	16.4	11.9	6.6	--	23.0
TR US All Cap Focus (Cvts)	2.0	8.0	9.7	8.2	6.4	--	9.4
BofA ML All US Convertible	3.9	10.4	12.2	11.8	9.3	--	13.7

CONVERTIBLE ARBITRAGE
(HEDGED, UNLEVERED)
Inception Date: 11/1/2002

Gross Return	1.3	3.2	3.8	4.0	2.5	6.0	5.2
Net Return	1.1	2.4	2.8	3.0	1.4	4.9	4.1
BofA/ML 3-Month T-Bill	0.5	1.3	1.6	0.8	0.5	0.3	1.3

As of September 30, 2018. Source: Nicholas Investment Partners. The indices shown above are for illustrative purposes only and not to be considered as representative benchmarks. Performance results are based on total returns, including the reinvestment of dividends, income and realized gains. Information is reported in US dollars. Nicholas Investment Partners does not guarantee the success of any investment product. There are risks associated with all investments and returns will vary over time due to many factors such as changing market conditions, liquidity, economic and other factors. Investing in any strategy involves the risk of loss. Please see the additional disclosures including the GIPS performance presentation at www.nicpartners.com. Past performance is no guarantee of future results.

Disclosures

Nicholas Investment Partners, L.P. (“Nicholas”) is an independent investment adviser registered with the SEC. Registration with the SEC does not imply a certain level of skill or training. The firm maintains a complete list and description of performance composites, which is available upon request. Policies for valuing portfolios, calculating performance, and preparing presentations are available upon request.

Past performance is no guarantee of future results. Current performance may be lower or higher than the performance presented. This information is intended for institutions, consultants and qualified investors only. No part of this material may be copied or duplicated, or distributed to any third party without written consent.

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Some information herein reflects general market commentary and the current opinions of the author which are subject to change without notice. It is provided for general informational purposes only and does not represent investment, legal, regulatory or tax advice and should not be construed as a recommendation of any security, strategy or investment product. There is no guarantee any opinion, forecast, or objective will be achieved in the future. The information, charts and reports contained herein are unaudited. Although some information contained herein was obtained from recognized and trusted sources believed to be reliable, its accuracy and completeness cannot be guaranteed. Unless otherwise noted, Nicholas is the source of illustrations. References to specific securities, issuers and market sectors are for illustrative purposes only. Nicholas does not undertake to keep the recipients of this report advised of future developments or of changes in any of the matters discussed in this report.

Market Capitalization 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.

Investors should consider comparing the performance of any potential investment to various benchmarks that are representative of their particular investment objectives, horizons and risk tolerances.

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.

Disclosures *(continued)*

Net returns reflect the deduction of the highest investment management fee for the product. Standard fees at the highest tier breakpoint are as follows: US Small Cap 1.00%, US SMID Growth 0.95%, US Growth Equity 0.85% inception through 2016 and 0.80% thereafter, US Equity Opportunities 0.85%, Healthcare Opportunities 1.00% with a 10% performance fee, Convertibles 0.75%, Convertible Plus 1.25% and Convertible Arbitrage 1.00%. 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.

Prior to January 1, 2018, US Equity Opportunities was named Concentrated US Equity. The investment strategy has remained consistent since the inception of July 1, 2014.

The Convertible Arbitrage strategy objective is to achieve a positive rate of return. The performance of the Convertible Arbitrage Composite noted above includes an account managed by the portfolio manager while employed at his previous firm, CapitalWorks Investment Partners, LLC which became a client of Nicholas Investment Partners on December 1, 2007. The portfolio manager was the primary portfolio manager responsible for the trading activity of this strategy. Performance data from November 1, 2002 (inception) through November 30, 2007 reflects performance at the previous investment adviser. Performance data from December 1, 2007 forward is reflective of performance of the strategy managed by the portfolio manager as an employee of Nicholas Investment Partners.

The Convertible Arbitrage strategy objective is to achieve a positive rate of return. Due to the lack of a specific market index that is directly comparable to the Convertible Arbitrage strategy based on asset class, risk profile and the absolute return objective of the strategy, we include the return and risk information for the Bank of America/Merrill Lynch US 3 Month T-Bill Index ("3 Month T-Bill Index") as the primary index comparison for informational purposes. The risk profile and return pattern of the Convertible Arbitrage strategy is significantly different from the risk profile and return pattern of the 3 Month T-Bill Index, which is generally considered a low risk investment represented by short-term government securities. The Convertible Arbitrage strategy invests in convertible bonds, convertible stock and common stock which are subject to various risks such as market, liquidity, credit, interest rate and conversion risk, among others. All investments are subject to some degree of market and investment specific risk, among others, and may limit the level of downside protection realized by the strategy.

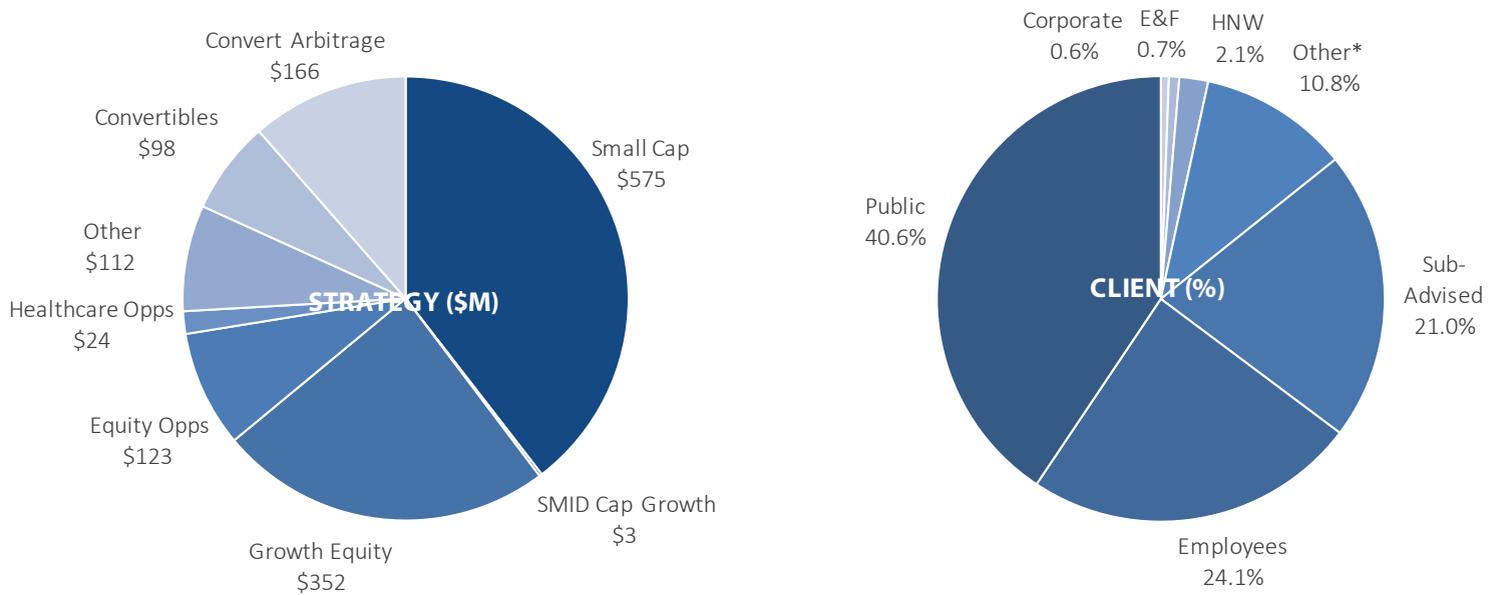
Please see additional information regarding product returns at <https://www.nicpartners.com/our-approach/>

About Us

Nicholas Investment Partners, L.P. is an independent, employee-owned and majority women-owned investment boutique focused on investing in dynamically growing small- and mid-cap companies, both their equities and convertible bonds. We believe that change creates opportunity. We invest in companies with accelerating revenue and/or earnings growth in which our research confirms the company's growth is sustainable and the company's stock is a timely investment. Our edge comes from combining fundamental equity and credit research with the objectivity and efficiency of quantitative analytics. We have a results-driven and client-centric culture centered on building lasting and value-added relationships with a select group of institutional and private wealth clients and consultants.

Assets Under Management

\$1.5 Billion



As of September 30, 2018. *Commingled pooled vehicles.

A Dedicated, Experienced Client Service Team



Meredith Genova
 Director of Sales & Marketing
 21 Years Experience



Laura DeMarco
 Partner/Director of Client Service
 34 Years Experience



Tammy Wiseman
 Partner/Client Service & Marketing Officer
 27 Years Experience



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