MARKETS AND PERFORMANCE

Investor worries overwhelmed fundamentals. A combination of worrisome factors—any one or two of which would normally be sufficient—drove stocks downward during the fourth quarter.

- The US trade war with China persisted.
- Global economic growth decelerated, particularly in China, sparking fears of corporate earnings declines, supply chain disruption and, potentially, a US recession.
- The Fed raised interest rates in December for the fourth time in 2018 and indicated that it would keep hiking, leading many investors to question whether the Fed fully grasped the potential implications of both its rate-tightening and balance-sheet reductions on the US economy.
- Oil prices fell, reflecting concern about softening global economic activity.
- Political turmoil rocked the US and culminated in a partial federal government shutdown, while Europe dealt with Brexit-related uncertainty and tension over Italy's proposed spending and debt levels.
- Technical factors such as trading by algorithm-based investors and exchange-traded funds, as well as tax-loss trading, exacerbated selling momentum in the last weeks of the year.

For stocks, the worst performance in a decade. Stocks retreated as sentiment shifted from tempered optimism to anxiety that earnings growth would evaporate.

- On a total return basis, the S&P 500 returned -13.5% in Q4 and -4.4% in 2018, its worst such performances since Q4 2008 and 2008, respectively.
- The Q4 decline was large enough that 2018 was the first year in which the S&P 500 posted an annual loss after rising in the first three quarters.
- Large caps outperformed mid caps and small caps for the quarter and year.
- As measured by the Russell 2000 Total Return Index, small caps registered their biggest respective quarterly and annual losses (-20.2% and -11.0%) since Q3 2011 and 2008.

Bonds benefited from flight to quality. Even as the Fed raised benchmark interest rates and reiterated its intention to keep doing so, investors sought safe-haven Treasuries. The 10-year Treasury yield closed at 2.68%, down 37 basis points during the quarter.

- The high-quality Bloomberg Barclays US Aggregate Bond Index gained 1.6% and 0.01% in the quarter and year. The Bloomberg Barclays US Corporate High-Yield Bond Index lost 4.5% and 2.1%, respectively.

Convertibles lost ground. Not surprisingly, convertibles fared better than stocks due to their bond-like characteristics but worse than bonds because of weakness in their underlying equities. The Thompson Reuters All Cap Focus Convertible Index returned -7.5% in the quarter and -0.1% in the year.

News & Investment Insights

www.nicpartners.com/news-insights/

January 2019

Launch of Nicholas Partners Small Cap Growth Mutual Fund

On January 16, Nicholas Investment Partners announced the launch of its first no load mutual fund, the Nicholas Partners Small Cap Growth Fund (NPSGX, NPSYX), with $40 million in partner assets, based on its institutional US Small Cap strategy. (www.nicfunds.com)

January 2019

Compelling US Small Cap Outlook for 2019

The Russell 2000 fell -27% in 4Q 2018 with more than 2 out of 3 stocks falling over 20%. We believe that the better relative valuations and earnings for small cap stocks creates opportunity in 2019, especially as growth becomes more scarce and commands a premium.

—Catherine Nicholas, CIO and John Wylie, Portfolio Manager

December 2018

Is the Leveraged Loan Market a Signal?

The leveraged loan market has grown in significance as issuance has increased over the last few years—and their prices have fallen dramatically since mid-November. We believe that quality matters in this environment, so investors should be wary of highly leveraged companies whose stocks tend to perform poorly in periods of widening credit spreads and tend to receive lower multiples, generally, over time.

—John Wylie, Portfolio Manager

November 2018

Uncertainty Leads to Volatility

What's driving the current volatility? Rather than one or two factors, investors are feeling uncertain about a number of things whose aggregate potential impact on stocks could be highly unfavorable. The bottom line: We remain confident in the stocks we own and seek to take advantage of more attractive valuations to position the portfolio for future gains.

—Catherine Nicholas, CIO and John Wylie, Portfolio Manager

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Our strategies generally underperformed (see page 4). Although we had adjusted our portfolios to weather a downturn, all of our strategy composites generated negative quarterly returns, and most did so for the year as a whole. Healthcare Opportunities and Convertible Arbitrage achieved annual returns that were both positive and significantly higher than those of their respective benchmarks.

LOOKING AHEAD: THE BIG PICTURE

Mixed picture portends a challenging year. The factors that sent investors to the exits in the fourth quarter remain the primary market risks as 2019 begins. Concerns about global growth rose after Apple reduced its Q4 revenue forecast in early January due to slowing iPhone sales in China—exacerbating fears that the Chinese economy is slowing down.

That said, we also see significant positives that could support a stronger market environment:

- While fundamentals aren't as favorable as in 2018, they're hardly disastrous.
- Credit markets aren't signaling recession: While high-yield spreads have widened, they aren't close to historical peaks.
- According to FactSet, consensus forecasts for S&P 500 earnings and revenue growth in 2019 are 6.9% and 5.5%, respectively. To be sure, these numbers are meaningfully lower than those in 2018 and 2017, but they're also much higher than those in 2012–2016—when the S&P 500 posted solid gains in all but one year (2015).
- Valuations are more reasonable. The S&P 500's 12-month forward P/E ratio is around 15x (per FactSet), down from 16.8x at the start of the fourth quarter.
- The drop in bond yields makes stocks look more attractive by comparison: At a 15x forward P/E, the S&P 500 earnings yield is 6.7%, almost triple the 10-year Treasury yield of around 2.6%.
- A strong December US jobs report—312,000 jobs were added, nearly double what economists had predicted—suggests that the US economy hasn't lost steam.

Giving Back

www.nicpartners.com/giving-back/

November 2018

Team NIC Laced up for *Race for the Cure*

Sunday, November 4, Nicholas Partners employees and friends walked in support of Breast Cancer Research in Balboa Park, just south of our Rancho Santa Fe, CA offices. Spearheaded by the firm's Giving Back Committee*, the team had a great time completing the picturesque 5K!*

It's all about trade, rates and confidence. We believe that the economy's directional movement ultimately will be driven by what happens with regard to three factors: trade, interest rates and investor confidence.

- **Trade.** As we write, the US and China have entered a 90-day window to negotiate a resolution of their tariff war. Investors would welcome an agreement that ends tariffs or at least provides for greater certainty, and likely reject anything less.
- **Rates.** The question here is whether the Fed remains on autopilot and will continue to reflexively tighten, or takes a more flexible data-driven approach. In recent remarks, Chairman Powell emphasized that the Fed's monetary stance would be "patient" going forward. Markets would react enthusiastically if the Fed's actions align with these comments.
- **Confidence.** The December Conference Board Consumer Confidence Index® results reflected a cacophony of crosswinds in which respondents felt good about the present but concerned about the future. Business confidence surveys were incrementally more pessimistic. Investors would like to see these sentiments reverse course.

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Bifurcated outcome. We expect market activity in 2019 to follow either of two most probable scenarios, and are hopeful that conditions will become clearer as companies report fourth-quarter earnings over the next few weeks.

- In the negative scenario, the earnings outlook deteriorates if the trade situation doesn't show meaningful progress; the Chinese economy continues to decelerate; the Fed keeps hiking; and confidence doesn't recover. Large caps would likely outperform in this case.
- The positive scenario is the opposite: The earnings outlook improves if there's greater clarity on trade; the Chinese economy picks up; the Fed adopts a more accommodative approach both to rates and its balance sheet; and confidence recovers. Small caps would likely fare best in the positive scenario.

Volatility will likely remain elevated as these issues continue to weigh on investors, in our view. Given positive policy resolution and our belief that stocks are reasonably valued, risk assets could provide attractive upside. Lack of positive resolution, on the other hand, would likely expose risk assets to further downside.

WHERE WE STAND NOW

Rigorous stock selection. As always, we focus on innovation-driven, disruptive companies with strong management teams and bright futures. Our research shows that these businesses tend to generate earnings growth that not only outpaces most other companies, but also accelerates while doing so.

Active measures. Beginning in last year's third quarter, we fine-tuned our portfolios to reduce downside risk and raise potential upside exposure. Key actions included:

- Cutting the number of holdings to concentrate on our highest-conviction positions;
- Exiting companies whose valuations surpassed their historical averages;
- Reducing exposure to companies with significant non-US revenues; and
- Trimming or selling positions in companies with high leverage.

As a result, our portfolios are well-positioned for an environment in which growth is scarce.

Opportunities. We're reinvesting in securities we previously sold when their valuations exceeded our price targets and are now appealing after selling off.

Favoring tech, health care, consumer and industrial companies. These sectors have compelling upside potential based on a combination of attractive valuations, strong demand and—for selected industrials—domestic orientation and high-quality balance sheets.

Healthcare: oversold. We've reviewed our healthcare portfolios for vulnerability to a possible decline in access to capital. Our companies are in good shape and sufficiently funded for at least the next 18 months. In addition, we see the sector—which has a high percentage of non-earnings generators that investors shun when they derisk—as oversold. Upcoming conferences and clinical trial readouts could catalyze support for companies that beat expectations.

Convertibles: portfolio repositioning. We've repositioned our convertibles portfolios much as we did with our equities, by reducing exposure to certain sectors with extended valuations as well as to companies with highly leveraged balance sheets and/or greater equity sensitivity. Convertibles could benefit from a potential rebound in smaller-cap companies (which dominate convertibles issuance).

EQUITY STRATEGIES

Strategy		QTR	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception
				Annualized Returns				
US SMALL CAP *Inception Date: 7/1/2007*	**Gross Return**	**-25.3**	**-9.6**	**-9.6**	**6.0**	**3.3**	**15.5**	**7.0**
	Net Return	**-25.5**	**-10.5**	**-10.5**	**5.0**	**2.3**	**14.3**	**5.9**
	Russell 2000 Growth	-21.7	-9.3	-9.3	7.2	5.1	13.5	6.8
US SMID CAP GROWTH *Inception Date: 1/1/2017*	**Gross Return**	**-23.7**	**-6.9**	**-6.9**	--	--	--	**6.9**
	Net Return	**-23.9**	**-7.8**	**-7.8**	--	--	--	**5.9**
	Russell 2500 Growth	-20.1	-7.5	-7.5	--	--	--	7.3
US GROWTH EQUITY *Inception Date: 7/1/2007*	**Gross Return**	**-19.6**	**-5.7**	**-5.7**	**7.1**	**5.5**	**15.1**	**8.3**
	Net Return	**-19.7**	**-6.4**	**-6.4**	**6.2**	**4.6**	**14.1**	**7.4**
	Russell Midcap Growth	-16.0	-4.8	-4.8	8.6	7.4	15.1	7.4

OPPORTUNISTIC STRATEGIES

Strategy		QTR	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception
				Annualized Returns				
US EQUITY OPPORTUNITIES *Inception Date: 7/1/2014*	**Gross Return**	**-22.5**	**-8.8**	**-8.8**	**7.6**	--	--	**6.5**
	Net Return	**-22.6**	**-9.6**	**-9.6**	**6.7**	--	--	**5.6**
	S&P 500	-13.5	-4.4	-4.4	9.2	--	--	7.8
HEALTHCARE OPPORTUNITIES *Inception Date: 1/1/2017*	**Gross Return**	**-25.0**	**0.2**	**0.2**	--	--	--	**18.5**
	Net Return	**-23.2**	**-0.8**	**-0.8**	--	--	--	**15.5**
	S&P 500	-13.5	-4.4	-4.4	--	--	--	7.9

CONVERTIBLE STRATEGIES

Strategy		QTR	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception
				Annualized Returns				
CONVERTIBLES *Inception Date: 1/1/2009*	**Gross Return**	**-9.2**	**-0.4**	**-0.4**	**4.7**	**3.2**	**10.9**	**10.9**
	Net Return	**-9.4**	**-1.2**	**-1.2**	**3.9**	**2.4**	**10.0**	**10.0**
	TR US All Cap Focus (Cvts)	-7.5	-0.1	-0.1	4.5	4.0	8.3	8.3
	BofA ML All US Convertible	-9.3	0.2	0.2	7.9	6.0	12.2	12.3
CONVERTIBLES PLUS ***(LEVERED)*** *Inception Date: 1/1/2009*	**Gross Return**	**-18.8**	**-4.3**	**-4.3**	**6.6**	**2.8**	**21.2**	**21.2**
	Net Return	**-19.1**	**-5.5**	**-5.5**	**5.3**	**1.6**	**19.8**	**19.8**
	TR US All Cap Focus (Cvts)	-7.5	-0.1	-0.1	4.5	4.0	8.3	8.3
	BofA ML All US Convertible	-9.3	0.2	0.2	7.9	6.0	12.2	12.2
CONVERTIBLE ARBITRAGE ***(HEDGED, UNLEVERED)*** *Inception Date: 11/1/2002*	**Gross Return**	**-1.6**	**1.6**	**1.6**	**4.1**	**2.2**	**6.5**	**5.0**
	Net Return	**-1.8**	**0.6**	**0.6**	**3.1**	**1.2**	**5.5**	**3.9**
	BofA/ML 3-Month T-Bill	0.6	1.9	1.9	1.0	0.6	0.4	1.3

As of December 31, 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.

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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.

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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/

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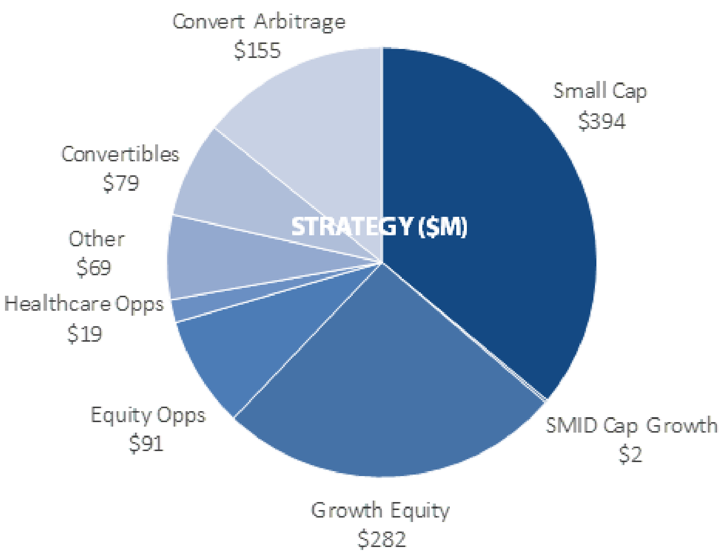
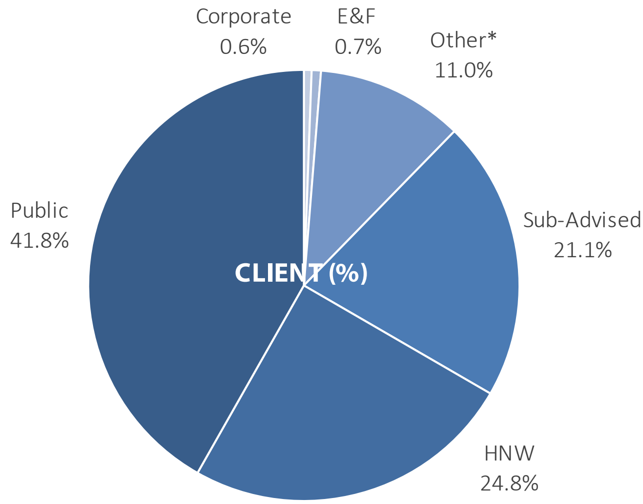
About Us

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

$1.1 Billion





*As of December 31, 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

Chauntelle Zwonitzer
Client Service & Marketing Associate
29 Years Experience

Meredith Genova
858-381-8176 (direct)
646-573-9248 (cell)

Laura DeMarco
858-381-8181 (direct)
858-692-5194 (cell)

Tammy Wiseman
858-381-8183 (direct)
619-857-1195 (cell)

P.O. Box 9267 | Rancho Santo Fe, CA 92067 | (858) 759-4545 | www.nicpartners.com

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