Strategy Update | 3Q 2018

US Growth Equity

NICHOLAS INVESTMENT PARTNERS

Key Takeaways

- US mid-cap stocks posted positive returns but lagged large caps as a rotation to more defensive positioning ensued during September amid a period of rising interest rates and higher volatility due to escalating trade tensions. The Russell Midcap Growth rose 7.57% versus 9.17% for the Russell 1000 Growth.
- Security selection was the key driver of US Growth Equity absolute and relative performance, as strong company fundamentals were rewarded.
- Innovation-driven companies in technology and healthcare and were particularly strong performers.

Composite Performance as of September 30, 2018

COMPOSITE PERFORMANCE (%)	US GROWTH EQUITY (GROSS)	US GROWTH EQUITY (NET)	RMIDCAP GROWTH*
MTD	-0.42	-0.49	-0.43
QTD	7.85	7.63	7.57
YTD	17.33	16.62	13.38
1 YEAR	24.61	23.62	21.10
3 YEAR	16.01	15.07	16.63
5 YEAR	12.09	11.16	12.99
7 YEAR	16.60	15.63	16.85
10 YEAR	13.70	12.75	13.45
ITD**	10.60	9.68	9.30

**Russell Midcap Growth Index. **Composite inception date: 7/1/2007. 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.*

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.

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Mid Cap Growth Landscape.
Mid-cap growth stocks rose on Q2 earnings and sales growth strength, racking up 35.6% EPS growth and 8.7% sales growth. Technology, healthcare and industrial stocks rallied in Q3. Telecomm and materials stocks lagged. Other characteristics of strong performing mid-cap growth stocks, based on the Russell Midcap Growth Index, included those with the fastest sales growth, highest P/E and lowest foreign sales exposure. The set up for Q3 and Q4 earnings looks good on strong US economic growth, particularly consumer spending metrics.

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 smaller 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.

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PERFORMANCE ATTRIBUTION

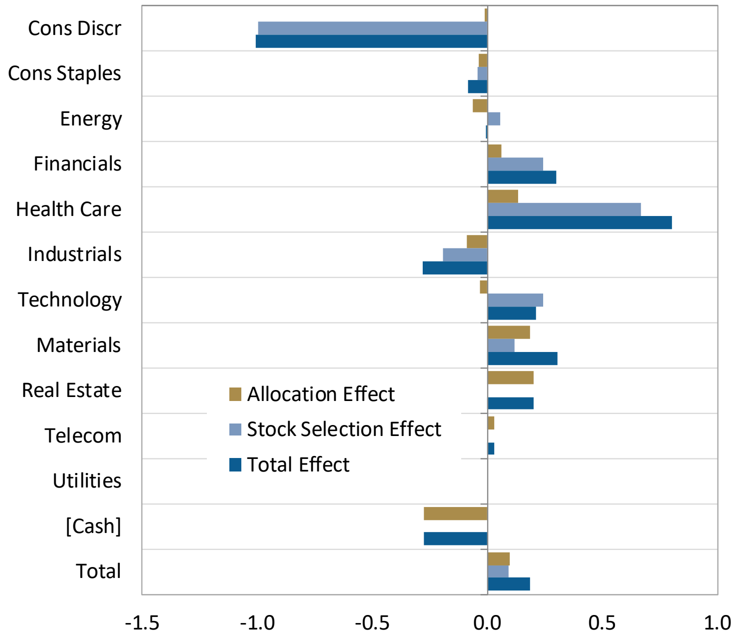
US Growth Equity closed Q3 in positive territory and modestly beat the Russell Midcap Growth Index–pushing it ahead of the benchmark year-to-date by ~3.95% (before fees). Positive contribution to absolute returns was broad-based across sector groups, except for consumer discretionary holdings. Auto component and media stocks, specifically, were weak. Materials holdings were also flat. Strength in technology, healthcare and industrial holdings lifted portfolio performance the most in Q3, particularly IT services, biotechnology and machinery positions.

The five largest contributors to absolute returns included Illumina (gene sequencing), Wellcare Health Plans (government sponsors managed care services), Veeva Systems (cloud-based enterprise CRM and content management solutions), Square (mobile payment processing solutions) and Exact Sciences (colon cancer screening). Wellcare Health, specifically, beat Q2 consensus estimates on margin expansion and raised guidance on strong medicare performance expectations and meaningful revenue growth resulting from the Meridian acquisition. Veeva Systems rose on Q2 revenue and margin strength–beating consensus estimates. Momentum in early adoption of new Nitro and Vault EDC products, in our view, are also expected to accelerate their growth. Square and Ilumina also beat Q2 estimates.

The five largest detractors from absolute returns were Visteon Corporation (cockpit electronics for automotives), LogMeIn (remote connectivity services), PVH Corp (apparel), New York Times (media/publishing) and Aptiv (auto components). Visteon pulled back on lower-than-expected Q2 revenue and volume growth. We continue to hold the position and believe this is a short-term issue with a stronger long-term growth set up as new business wins accelerated–building significant order backlog. PVH Corp. reported Q2 growth in line to slightly higher-than-expectations, but lowered 3Q guidance on concerns of strong US dollar as ~40% of the company's revenues are outside the US. We sold the position to realize profits and purchase a more attractive investment candidate with stronger growth catalysts. We sold LogMeIn, which disappointed on Q2 results. We also exited out of New York Times, which lowered Q3 guidance on expectations of higher operating expenses. The assets were redeployed in a stronger investment candidate. In terms of Aptiv, we continue to hold the position and believe the pullback during Q3 was short term in nature. The underlying growth catalysts and fundamentals remain intact.

Relative to the Russell Midcap Growth benchmark, stock selection in healthcare, materials and financials drove outperformance during the quarter, particularly medical devices and insurance holdings. An underweight to real estate and materials also boosted active returns. The portfolio's consumer discretionary and industrials positions were negative outliers versus the benchmark.

Performance Attribution vs. RMC Growth 3Q 2018



5 Largest Absolute Contributors/Detractors 3Q 2018

TOP 5	AVG WEIGHT (%)	CONTRIB TO RETURN*
Illumina, Inc.	2.26	0.63
WellCare Health Plans, Inc.	2.04	0.56
Veeva Systems Inc	1.49	0.53
Square, Inc.	0.88	0.43
Exact Sciences Corporation	1.17	0.34

BOTTOM 5	AVG WEIGHT (%)	CONTRIB TO RETURN*
Visteon Corporation	1.26	-0.39
LogMeIn, Inc.	0.21	-0.17
PVH Corp.	1.48	-0.16
New York Times Company	0.72	-0.15
Aptiv PLC	1.67	-0.12

Contribution to portfolio absolute return.

POSITIONING

Reflecting our focus on innovation-driven dynamic growth companies, the US Growth Equity portfolio has a 16.2% EPS Growth (FY1/FY2 wtd. avg.) and trades at 20.3x P/E (FY2 wtd. harmonic avg.). We believe the growth estimates for many of our holdings are understated. This compares to Russell Midcap Growth Index's earnings growth of 14.2% with 19.2x P/E. Indicative of our fully invested, active approach the portfolio's cash level was 3.2% at quarter end. The ten largest positions accounted for 21.2% of the portfolio, not materially different from the prior quarter.

As of September 30, 2018, the US Growth Equity portfolio's largest sector exposures remained in technology, consumer discretionary and healthcare, although we selectively trimmed and/or sold positions to take profits in stocks where the price fully reflected their growth catalysts and, in our view, were trading above their historical averages. We sold the position in PVH Corp (apparel) and New York Times (media/publishing), reducing the consumer discretionary weight. Exposure to financials decreased with the sale of Synovus Financials, as shares came under pressure on the announcement of the company's plans to acquire FCB Financial Holdings. In our opinion, the deal metrics were at a premium with no accretive synergies. We took profits and redeployed the assets into a more attractive investment candidate. The portfolio's weight to consumer staples increased in Q3 with the addition of Archer-Daniels (oilseeds/corn, oats and wheat products) which we expected to realize accelerated growth through 2019 from improved execution, acquisition growth, and a favorable soybean meal backdrop.

The portfolio remained overweight in technology (+2.6%) and healthcare (+2.5%) relative to the benchmark. Electronic equipment, IT services and biotech stocks, in particular, accounted for the portfolio's largest overweights. IT services companies, specifically, trade on price-to-sales, as opposed to earnings growth. The portfolio remained underweight industrials (-5.2%) and real estate (-2.0%) versus the Russell Midcap Growth benchmark.

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. Within technology specifically, we believe high-tech capex spending is gaining momentum, providing a sustainable growth catalyst that may help drive earnings and/or revenue growth acceleration for these companies.

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 earnings.

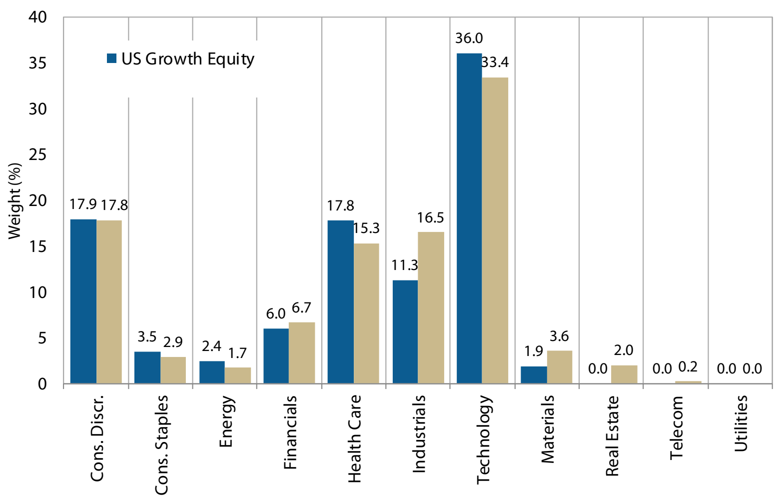
Portfolio Characteristics

SUMMARY	US GROWTH EQUITY
Number of Holdings	78
% Active Share	79.5
% Off Benchmark Weight	22.7
% of Equity	96.8
% of Cash	3.2

CHARACTERISTICS	US GROWTH EQUITY	RMIDCAP GROWTH
EPS Growth (FY1/FY2 wtd. avg.)	16.2%	14.2%
EPS Growth (3–5 year wtd. avg.)	16.5%	15.0%
P/E (FY2 wtd. harmonic avg.)	20.3 x	19.2 x
P/B (wtd. harmonic avg.)	5.0 x	5.7 x
Market Cap (wtd. avg.)	$15.7 B	$16.9 B
Market Cap (median)	$11.7 B	$9.0 B

TOP 5 HOLDINGS	SECTOR	WEIGHT (%)
Burlington Stores, Inc.	Consumer Discretionary	2.52
Illumina, Inc.	Health Care	2.45
ABIOMED, Inc.	Health Care	2.30
WellCare Health Plans	Health Care	2.25
Westinghouse Air Brake	Industrials	2.03

Sector Weights



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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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.

Disclosure *(continued)*

Net returns reflect the deduction of the highest investment management fee for the product, which was 0.85% from inception through December 31, 2016 and 0.80% thereafter. 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. Standard Management fee schedule: First $25M 0.80%, Next $25M 0.75%, Next $50M 0.65%, Thereafter 0.55%.

The Russell Midcap Growth Index measures the performance of the mid-cap growth segment of the US equity universe. It includes those Russell Midcap Index companies with higher price-to-book ratios and higher forecasted growth values. The Russell Midcap Growth Index is constructed to provide a comprehensive and unbiased barometer of the mid-cap growth market. The Index is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true mid-cap growth market. Index returns include the effect of dividends and income which are reinvested daily.

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

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