US SMID Cap Growth

NICHOLAS INVESTMENT PARTNERS

Key Takeaways

- US small- and mid-cap stocks posted positive returns but lagged large caps as a rotation to more defensive positioning ensued during September. It was characterized by rising interest rates and higher volatility due to escalating trade tensions. The Russell 2500 Growth Index rose 7.17% while the S&P 500 Index gained 7.71%.
- Security selection was the key driver of US SMID Cap Growth's absolute and relative performance, as strong company fundamentals were rewarded.
- Innovation-driven portfolio holdings in technology and healthcare were particularly strong performers.

Composite Performance as of September 30, 2018

COMPOSITE PERFORMANCE (%)	US SMID CAP GROWTH (GROSS)	US SMID CAP GROWTH (NET)	R2500 GROWTH*
MTD	-0.14%	-0.22%	-1.46%
QTD	9.00%	8.74%	7.17%
YTD	22.09%	21.23%	15.78%
1 YEAR	28.74%	27.52%	23.13%
ITD**	26.04%	24.85%	23.24%

*As of September 30, 2018. *Russell 2500 Growth 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.

Small to Mid Cap Growth Landscape

Small- and mid-cap growth stocks rose on Q2 earnings and sales growth strength, racking up 36.4% EPS growth and 14.8% sales growth for small-cap stocks while mid-cap stocks notched 35.6% EPS growth and 8.7% sales growth. Technology and healthcare stocks rallied in Q3. Energy stocks fell victim to rising oil prices concerns. Other characteristics of strong performing smid-cap growth stocks, based on the Russell 2500 Growth Index, included those with larger market caps and the fastest sales growth. 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

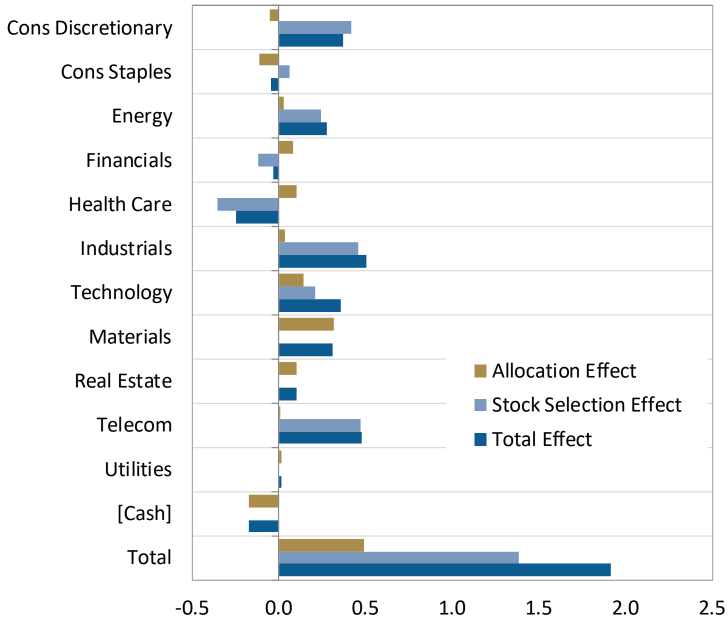
The US SMID Cap Growth portfolio closed Q3 in positive territory and beat the Russell 2500 Growth benchmark for the quarter. Positive contribution to absolute returns was broad-based across sector groups, with the exception of a modest pullback in financials and materials holdings. Strength in technology, healthcare and industrial holdings lifted portfolio performance the most in Q3, particularly software, medtech and machinery positions.

The five largest contributors to absolute returns included Callaway Golf (golf clubs, balls and accessories), Viking Therapeutics (clinical-stage therapies to treat metabolic and endocrine disorders), Teladoc Health (remote and mobile tele-healthcare services), Harsco Corp (metal fabrication) and Boingo Wireless (mobile internet services). Callaway Golf continues to execute on plan and is expected to realize strong top-line growth and market expansion on improving industry trends. Teladoc continued to benefit from strong revenue growth supported by higher membership and utilization trends, and reported better-than-expected revenue growth in Q2. In the case of Harsco, shares rose on higher-than-expected Q2 EPS growth as improving rail margins with new products lifted profitability. Boingo Wireless also reported strong Q2 results and raised CY 2018 guidance on strong organic revenue growth and its accretive acquisition on Elauwit Networks.

The five largest detractors from absolute returns were OptiNose (drug treatment for chronic sinusitis), Supernus Pharmaceutical (treatments for central nervous system disorders), Visteon Corporation (electronic automotive components), CRISPR Therapeutics (cancer and blood disorder therapies) and At Home (home décor). 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. In the case of Supernus, the stock traded off after reporting Q2 in line with expectations but did not beat. Subsequently a short story circulated suggesting competitive pressures from a new class of migraine drugs may dampen further upside to the stock. We sold the position to reduce risk in the portfolio given the lack of additional near-term catalysts. CRISPR Therapeutics was also sold from the portfolio as earnings and revenue visibility clouded. In terms of the other holdings that detracted, we believe their pullbacks during Q3 were short term in nature. Their underlying growth catalysts and fundamentals remain intact, we continue to hold these positions.

Relative to the Russell 2500 Growth benchmark, stock selection in industrials, telecommunication services and consumer discretionary drove outperformance during the quarter, particularly machinery, wireless communication and leisure product holdings. An underweight to construction materials and an overweight to software companies also boosted relative returns. Portfolio positions in healthcare stocks and consumer staples subtracted the most from active returns, particularly pharmaceutical holdings.

Performance Attribution vs. Russell 2500 Growth 3Q 2018



5 Largest Absolute Contributors/Detractors 3Q 2018

TOP 5	AVG WEIGHT (%)	CONTRIB TO RETURN*
Callaway Golf	3.13	0.83
Viking Therapeutics	1.15	0.77
Teladoc Health	1.54	0.65
Harsco Corporation	2.06	0.53
Boingo Wireless	0.98	0.52

BOTTOM 5	AVG WEIGHT (%)	CONTRIB TO RETURN*
OptiNose	0.79	-0.67
Supernus Pharmaceuticals	0.63	-0.44
Visteon Corporation	1.15	-0.36
CRISPR Therapeutics	1.01	-0.28
At Home Group	1.55	-0.26

**Contribution to portfolio absolute return.*

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 upcoming key industry conferences 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 innovation-driven subsectors remains positive with expectations of continued sales growth strength longer term.

Reflecting our focus on innovation-driven dynamically growth companies, the US SMID Cap Growth portfolio has a 17.8% EPS Growth (FY1/FY2 wtd. avg.) and trades at 20.8x P/E (FY2 wtd. harmonic avg.). We believe the growth estimates for many of our holdings are understated. This compares to the Russell 2500 Growth Index's earnings growth of 18.7% with 18.6x P/E. Indicative of our fully invested, active approach the portfolio's cash level was 0.5% at month end. The ten largest positions, those we believe have the strongest potential for earnings and revenue acceleration, accounted for 22.3% of the portfolio, not materially different from the prior quarter.

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 sector exposures were in technology (30.7%) and healthcare (26.3%). Innovation and strong secular growth trends in software-as-a-service, oncology and gene therapy remain strong and the portfolio reflects a particular focus to those markets. Relative to the Russell 2500 Growth benchmark, the portfolio was overweight consumer staples (+5.8%) and technology (+4.8%) stocks and underweight in industrials (-6.8%) and materials (-4.0%).

We remain vigilant in selecting 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.

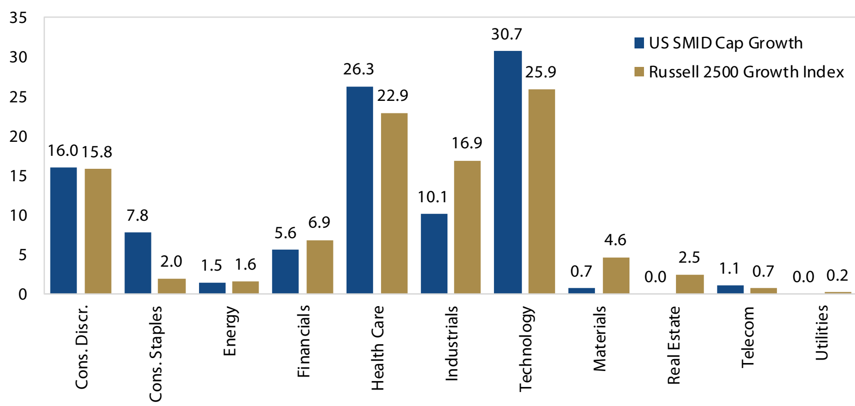
Portfolio Characteristics

SUMMARY	US SMID CAP GROWTH
Number of Holdings	85
% Active Share	88.9
% Off Benchmark Weight	25.5
% of Equity	99.5
% of Cash	0.5

CHARACTERISTICS	US SMID CAP GRWOTH	R2500 GROWTH
EPS Growth (FY1/FY2 wtd. avg.)	17.8%	18.7%
EPS Growth (3–5 year wtd. avg.)	18.3%	15.8%
P/E (FY2 wtd. harmonic avg.)	20.8 x	18.6 x
P/B (wtd. harmonic avg.)	4.9 x	4.6 x
Market Cap (wtd. avg.)	$7.0 B	$5.7 B
Market Cap (median)	$4.4 B	$1.3 B

TOP 5 HOLDINGS	SECTOR	WEIGHT (%)
Callaway Golf	Consumer Discretionary	3.1
Harsco Corporation	Industrials	2.3
Kemper Corporation	Financials	2.3
ABIOMED	Health Care	2.3
FLIR Systems	Information Technology	2.2

Sector Weights



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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 is 0.95%. 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 0.95%, Next $25M 0.85%, Next $50M 0.75%, Thereafter 0.65%.

The Russell 2500 Growth Index measures the performance of the small to mid-cap growth segment of the U.S. equity universe. It includes those Russell 2500 companies with higher growth earning potential as defined by Russell's leading style methodology. The Russell 2500 Growth Index is constructed to provide a comprehensive and unbiased barometer of the small to mid-cap growth market. The Index is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true small to mid-cap opportunity set and that the represented companies continue to reflect growth characteristics.

Nicholas Investment Partners, L.P. is an independent, employee-owned and majority women-owned investment boutique focused on investing in dynamic, less efficient markets such as US small- and mid-cap equities and convertible bonds. We believe that change creates opportunity. We invest in dynamic 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.

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