Stephens Investment Management Group®

The Power of Growth®

STEPHENS MID CAP GROWTH COMPOSITE

QUARTERLY COMMENTARY

THIRD QUARTER 2020

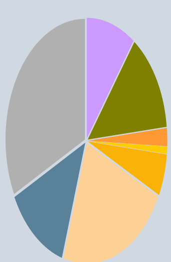
TOP 10 HOLDINGS[1]

COMPANY	% of PORTFOLIO
1. Cadence Design Systems, Inc.	2.28%
2. IDEXX Laboratories, Inc.	2.26%
3. DexCom, Inc.	2.23%
4. MercadoLibre, Inc.	2.07%
5. Spotify Technology	2.04%
6. MarketAxess Holdings Inc.	2.02%
7. DocuSign, Inc.	1.95%
8. Verisk Analytics Inc	1.95%
9. Shopify, Inc.	1.84%
10.Copart, Inc.	1.79%

Excludes Money Market Fund Holdings. Portfolio holdings and asset allocations are subject to change and are not recommendations to buy or sell a security. Current and future portfolio holdings are subject to risk.

SECTOR WEIGHTINGS[1]

Communication Services	10.00%
Consumer Discretionary	13.31%
Consumer Staples	2.42%
Energy	0.99%
Financials	5.60%
Health Care	22.44%
Industrials	12.77%
Information Technology	32.46%
Materials	0.00%



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MARKET OVERVIEW

The V-shaped recovery in equity markets extended into Q3 of 2020, with several broad market indices hitting all-time highs. The S&P 500® Index was up 8.93%. Growth strategies extended their streak of outperformance, and larger companies fared better than small. Interest rates fell a little but ended the quarter about where they started. Gold and Bitcoin rallied significantly, or perhaps it's more correct to say that the U.S. Dollar fell.

Covid-19 cases continue to spread across the globe, although some states and some countries fared better than others. Mortality rates have steadily dropped as treatment protocol has been refined and new drugs are being approved for emergency use. The race for a vaccine is on, and some early (and optimistic) reports are that there may be one available by year's end.

Economic data was generally better than what most had feared. Despite some industries being particularly hurt by the coronavirus, many companies have benefitted or strengthened their leadership positon. The Federal Reserve Board indicated a change in policy with respect to inflation: they will now target an *average* of 2%, meaning that in the short run it would be acceptable to have inflation exceed 2% in order to make up for prior shortfalls. This change, along with the Fed Funds rate near zero and continued balance sheet expansion, was at least a contributing factor in equity market performance.

Surprisingly, the uncertainty surrounding the upcoming presidential election did not seem to have much impact on equity markets this quarter. Similar to last quarter, the best I can tell is that the mantra is "don't fight the Fed" or "there is no alternative" – it was back to being *risk-on*.

MID CAP GROWTH COMPOSITE PERFORMANCE

This quarter was quite different from the prior two. In Q1 and Q2, as investors dealt with the implications of Covid-19 and the policy responses, they reassessed business models in light of new information. This caused a great deal of dispersion, as there were clear winners and clear losers – the easy way of saying this is "fundamentals mattered."

In Q3, investors seem to have settled into a Covid-19 reality, and the process shifted from processing news to speculation. Every few days the mood would shift on macro issues like more stimulus spending, or the election, or re-opening a locked-down economy. As a result, beta, sector exposure, and other factors seemed to drive stock performance much more than idiosyncratic matters.

While Q1 and Q2 were ripe environments for stock picking, Q3 was less so. The Stephens Mid Cap Growth Composite rose 6.63% gross of fees (6.50% net), but trailed the 9.37% return of the Russell Mid Cap® Growth Index. Growth strategies beat value, but interestingly, our core growth holdings dramatically outperformed our catalyst stocks.

The Communication Services sector was the benchmark's best performing. We lagged those returns a little, but our overweight positioned helped our relative returns. We had continued success with video game maker, Take Two Interactive. Our relatively new position in Roku, Inc. helped our returns, as it was our second largest contributor to performance. Roku's home entertainment streaming platform continues to gain traction.

In a complete reversal from Q2, where Consumer Discretionary stocks were big relative winners, this quarter was much more challenging. Many struggling companies rebounded on hopes of a reopening. The biggest winners were casinos and slow growing restaurants, where we have no exposure. At the same time, the winners of the last two quarters sold off. Bright Horizons Family Solutions, Inc. rebounded nicely this quarter. We trimmed our prior quarter's big winner, Spotify Technology. Fundamentals are still very strong there, but we felt it made sense to reduce our exposure for style purity and risk control reasons.

Financials were mixed and a slight drag on relative returns. We did well with our one bank holding, SVB Financial Group, but our pawn-related investment didn't fare as well. Despite economic difficulties that would normally benefit the pawn industry, stimulus checks, unemployment benefits, and the PPP program have all crowded out some of the incremental need for pawn.

Healthcare stocks were generally inline with the broad market. Our disproportionate split towards core growth companies here helped our returns. IDEXX Laboratories, Inc. was the top contributor in the sector. Their focus on veterinary equipment and services has paid off particularly well in this work-from-home and isolated environment – the demand for pets has been unprecedented. We also benefited from M&A activity. Siemens agreed to acquire Varian Medical Systems, one of our long held positions.

We did a good job of keeping up with the benchmark in Industrials. Some of the more cyclical names in the sector rose for the same reasons as the lower quality Consumer Discretionary stocks – anticipation of a re-opening and cyclical recovery. Our defense-related holdings lagged a bit, as the market began to discount the likelihood of a Biden win. Copart Inc. continued its rebound from Q2. They reported stellar earnings results during the quarter, on continued improvements in their core business, but some Covid-related tailwinds as well.

Technology lagged the broad market. Software alone represents nearly 19% of the benchmark and is the primary reason why Tech is the largest sector. Our weight is similar in both Software, as an industry, and in Technology in general. DocuSign, Inc. was our top contributor across all stocks, the shift toward electronically signed documents has been massively accelerated with the Covid-related adjustments of working from home and almost non-existent business travel. We trimmed our position into the strength.

[1]The information is shown as supplemental only and complements the full disclosure presentation located on the back. The Russell Midcap® Growth Index measures the performance of those Russell Midcap® companies with higher price-to-book ratios and higher forecasted growth values. You cannot invest directly in an index. The S&P 500® Index is a broad-based unmanaged index of 500 stocks, which is widely recognized as representative of the equity market in general. *See additional information regarding S&P ratings at https://www.stephensimg.com/terms-and-conditions/ The Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 8% of the total market capitalization of the Russell 3000® Index. You cannot invest directly in an index.*

PORTFOLIO CHARACTERISTICS[1]

We added four new positions and eliminated only two. Technology remains our largest sector, and grew to about 32% of assets as we added to several positions here. Healthcare still represents about 22%. Consumer Discretionary and Industrials each represents about 13% of the portfolio. Relative to the benchmark, we have a similar sector breakdown, with the exception of a slight overweight in Communication Services (10% vs. 5.6%), and a lack of exposure to Materials and Real Estate (where the benchmark has a modest weight).

Valuations are still stretched, but slightly lower than last quarter (as earnings estimates trended higher). Our weighted harmonic average P/E ratio on the next twelve months' earnings is now 33, while the benchmark is virtually the same, at 32. Growth estimates for earnings have picked back up, as the economy is doing better. Our median company is expected to grow earnings by 15% over the next twelve months. Actual growth in the most recent quarter was still anemic and actually negative on a median basis.

The shift from *core growth* to *earnings catalyst* is very similar to last quarter. Catalyst is 41% and core is 59%.

OUTLOOK

Today's Environment

In 1972 a psychologist at Stanford University came up with the idea of the Marshmallow Test. In it, a child was offered a marshmallow, but if the child could resist eating the marshmallow for 15 minutes, then the child was given a second marshmallow. Essentially it was a test of delayed gratification. Some of the research that followed showed that children who could resist the urge, ended up being more successful in life.

In the last several years, we have noticed a peculiar phenomenon with individual stocks. There is increased volatility around earnings reports, and much of our relative performance is generated during earnings season. I have hypothesized that in periods of minimal or no news flow on a particular stock, its movement is at the whim of the market. Its price action is determined by non-fundamental factors such as ETF flows, beta, factor exposure, et alia. These factors can push a stock further away from its efficient price. However, when new fundamental information is released (like a quarterly earnings report), fundamental investors jump in the fray, and process the new information, and participate in the price discovery process, which brings the stock back to a much more efficient price level. Rinse and repeat.

I think the same is true on a larger scale. When there is a significant development in the economy, investors go to work, digesting the new information, recalibrating exposures, reevaluating business models, and so on. This process tightens up efficiency. This clearly happened from March through this early summer as Covid-related developments unfolded so rapidly. But when there is a lull in new information, it's not as if the market stops. Indeed, it moves along, but this time driven by *speculation and anticipation of the next newsworthy event*.

Q3 of 2020 was such a quarter. There wasn't much in the way of *new* news, but there was an overload of upcoming newsworthy events about which we can all speculate: the election itself, the policies of the election winner, Covid-19 developments, Covid-19 vaccines and therapeutics, stimulus bills, inflation, Fed policies, the political divide, and the list goes on and on.

As many investors consider these events and the impact they will have on the market, they typically paint with a broad brush - trading baskets of stocks based on their exposure to these issues. If you think the economy will reopen soon, buy a basket of beaten up retail stocks. If you think Biden wins, maybe you should sell all the defense-related stocks. If a stimulus bill passes, consumer goods will see some benefit. You get the point. The nuances of business models and the idiosyncratic matters of individual stocks are lost in the shuffle, until there is a reason to re-examine the individual company. The reckoning day, as I call it.

It's my theory that this cycle will continue to play out: fundamentals vs. factors, micro vs. macro, signal vs. noise, efficient vs. inefficient. As a stock picker, it can feel frustrating in the noisy/inefficient/factor/macro environment, but those are moments of opportunity. You just have to remember to be patient…and then you get the extra marshmallow.

Tomorrow's Environment

In a very similar vein to the marshmallow test, more recently psychologists and behavioral economists have examined the concept of hyperbolic discounting. The idea here is that people tend to discount things in the future significantly relative to things in the present. When I say "things," think costs and benefits. My favorite example is exercise. Let's say it's New Year's Day, and you're thinking to yourself, "I should get in better shape and start to exercise more!" You determine that you'd derive 10 units of utility from losing a little weight, being a little stronger, and looking a little better. You also determine that the cost of exercise is both the nominal cost of a gym membership or exercise equipment, but also the cost of doing the work – that is the time spent in the gym and the effort that goes into it. For the sake of this argument, let's say the cost of exercise is 8 units. Benefit is 10 units. Cost is 8 units. The benefit is greater than cost, so it's an easy decision to move forward with.

But that first day rolls around to go to the gym, and *suddenly the cost is now.* You have to spend the time to get dressed, get to the gym, do the work, shower, and so on. But you're well aware that the benefit is *not* now. You won't leave the gym looking any better, or being any stronger that day. The benefits of exercise only accrue over an extended period of time. Again, for the sake of argument, let's say that you discount all future costs and benefits at 50% versus costs and benefits in the present moment. So when both the cost and the benefit are in the future, you discount both. The 10 units of benefit become 5, and the 8 units of cost become 4. 5 is still greater than 4, so exercise makes sense.

When the cost moves into the present though, it's no longer discounted. It's an 8. But the benefit is still well into the future, and those 10 units of utility are only worth 5. The cost (8) is greater than the benefit (5), **so you decide to defer your workout until tomorrow or the next day when the costs and benefits are aligned in time.**

Does this bias sound familiar? It applies to anything where there is a mismatch in the timing of the cost and the benefit: changing that light bulb in the closet, preparing your taxes, flossing your teeth, drinking less alcohol.

I worry that this same behavior is prevalent in Congress with respect to profligate spending, and at the Federal Reserve, where no one wants a recession on their watch. When the benefit is now and the cost is later, it's very easy to keep making the same decision, even when the cost/benefit analysis indicates that it's a bad idea. Over the last decade, pundits and the market's conventional wisdom have moved the goal posts on many issues, presumably to rationalize the short-term benefits. People used to think that debt to GDP in excess of 100% was alarming. Today we're at 135%, with plans of massive spending from both parties. People used to think having interest rates of zero was dangerous. Today they're common place and go unnoticed.

Speaking of rates, it's worth mentioning that the Federal Reserve announced a change in inflation targeting. It comes as no surprise as this concept has been discussed in academic circles for a number of years. Rather than a 2% inflation target, the Fed is now targeting an average of 2%, meaning that extended periods below 2% could be balanced with extended periods above 2%. In other words, they're more willing to be accommodative and let the economy run hot.

Inflation expectations ticked up. Gold rallied during the quarter as did Bitcoin. The breakeven inflation rate on TIPs spreads widened. However, CPI and PCE continue to disappoint, and remain in the sub 2% range.

Milton Freidman famously said, "Inflation is always and everywhere a monetary phenomenon in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output." It's safe to say that the Fed has been increasing the quantity of money more than output has grown. From the Fed's communications, the gating factor on money growth will be PCE at some level just north of 2%.

What if all that money growth isn't being transmitted to the baskets of goods that CPI and PCE track, at a time when deflationary forces of ecommerce and technological innovation are very powerful? What if that money is going into assets (via investment and saving) rather than goods (via consumption)? Are record-high equity valuations a sign of a different kind of inflation? What about collectible cars or art? Have you seen what has happened to the price of high-end watches lately? Commercial real estate has been negatively impacted by Covid, but have you seen residential real estate in prime locations?

This is just a working theory, but I'm starting to think that we may not see inflation in CPI or PCE for a very long time, and that the Fed will keep their foot on the gas, only to inflate asset prices. Is this why we are seeing record valuations across so many stocks?

OUTLOOK

Tomorrow's Environment – Part 2

This too shall pass. Right? Most investors are ready to assume that we eventually get a vaccine or achieve herd immunity or the coronavirus slowly mutates into a less dangerous strain, and the economy will revert back to something close to what we remember as normal. When this happens, there will be market volatility and rotation. The knee jerk reaction will be to unwind and reverse course – whatever got hit the hardest in the lock down will be up the most in the reopen.

Surely there are some things for which there is great pent-up demand, and despite them being missing in our lives for an extended period of time, we will jump right back into them. For me, it's live music. I was lucky enough to have seen The Eagles concert on March 6, but I haven't seen anything since. When it's safe to go to a concert, I'll be there and I intend to make up for the gap.

I haven't been to a movie theater in a long time either. But now that I think about it, I don't miss it that much. The big screen is great, but so is sitting on my own couch. I don't see myself going to the movies much, even when it's safe again.

Psychologist Phillippa Lally's work says it takes 66 days to form a new habit. We've been in Covid lockdown for over 7 months. Which behaviors, preferences, and attitudes will revert back to pre-Covid and which will have become habitual? The answer to this question has serious implications for many companies and industries. In terms of our outlook for the portfolio, it's something we are spending a lot of time considering.

Conclusion

I'd like to reiterate my conclusion from last quarter:

> As a final comment, I'd like to remind you of our core thesis: **because of human nature and behavioral biases, investors chronically underestimate the magnitude and duration of change**. We've been dealt a lot of change lately. And the instinct for most people is to assume that we will revert back to normal sooner rather than later. I'll take the other side of that bet. We've only yet begun to understand the long-term ramifications of these profound changes in our daily lives, the economy, and the market itself. While it has been challenging and even depressing dealing with all of this change on a personal level, it has been exciting and rewarding on a professional one. We remain disciplined and diligent in our efforts to take advantage of these unusual times.

When I was a child in 1983, Hurricane Alicia hit Houston. I distinctly remember the howling wind and pouring rain as the storm rolled in. But my most vivid memory was when the eye of the storm passed right over us. My family and I walked outside to a bizarre environment, so calm and so quiet, with the most unusual looking clouds in the distance. It only lasted a short while, and we retreated back inside as the winds and rain resumed.

Was Q3 the eye of the storm? Something tells me there's more change to come…

Earnings growth for a portfolio holding does not guarantee a corresponding increase in the market value of the holding or the portfolio. Earnings Growth is a measure of growth in a company's net income over a specific period, often one year. **Return on Equity** is the amount of net income returned as a percentage of shareholders equity and measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

IMPORTANT LEGAL DISCLOSURES

Year	Total Firm Assets (millions)	Strategy Assets*		Composite Assets		Annual Performance Results				3 Yr Annualized Standard Deviation	
		USD (millions)	Number of Accounts	USD (millions)	Number of Accounts	Composite Gross	Composite Net	Russell Midcap® Growth	Composite Dispersion	Composite Gross	Russell Midcap® Growth
2019	5,416	654	17	263	13	33.57%	32.85%	35.47%	0.29%	14.79%	13.88%
2018	4,301	342	13	216	11	3.22%	2.68%	-4.75%	0.12%	14.13%	12.82%
2017	4,442	338	12	240	11	29.68%	29.01%	25.27%	0.20%	11.72%	10.88%
2016	3,644	287	13	201	9	7.98%	7.24%	7.33%	0.09%	13.13%	12.17%
2015	2,897	152	12	38	10	-0.27%	-1.01%	-0.20%	N.A.	12.01%	11.29%
2014	3,430	165	6	31	4	4.19%	3.40%	11.90%	N.A.	11.71%	10.87%
2013	3,054	155	6	35	4	34.63%	33.60%	35.74%	N.A.	13.54%	14.62%
2012	1,222	85	6	7	2	16.74%	15.78%	15.81%	N.A.	16.44%	17.91%
2011	933	40	3	1	1	3.26%	2.44%	-1.65%	N.A.	18.13%	20.82%
2010	919	25	2	1	1	30.65%	29.63%	26.38%	N.A.	24.46%	26.37%

*Strategy Assets are shown as supplemental information as these assets include mutual fund assets which are managed within the Mid Cap Growth Strategy
* Strategy Assets are shown as supplemental information as these assets include UMA assets managed within the Mid Cap Growth Strategy
N.A. - Composite Dispersion information is not statistically meaningful due to an insufficient number of portfolios in the composite for the entire year.

The investment objectives, risks, charges and expenses should be carefully considered before investing. SIMG nor their representatives provide legal or tax advice. Please consult your tax advisor before making any decisions.

There are additional risks associated with investments in smaller and/or newer companies because their shares tend to be less liquid than securities of larger companies. Further, shares of small and new companies are generally more sensitive to purchase and sales transactions involving the company's stock and to changes in the company's financial condition or prospects, and, therefore, the prices of such stocks may be more volatile than those of larger company stocks. Clients' investment results and principal value will fluctuate.

__Mid Cap Growth Composite__ contains fully discretionary accounts and pooled investment vehicles invested primarily in mid cap common stock of U.S. companies. Under normal conditions, securities purchased for this composite have market capitalizations between $1 billion and the market capitalization of the largest company in the Russell Midcap® Growth Index at the time of initial purchase, which appear to have clear indicators of future earnings growth or that appear to demonstrate other potential for growth of capital. In addition to common stock the composite may also purchase convertible and preferred stock as well as certain Exchange Traded Funds. This composite is actively managed and securities in the composite are frequently purchased and sold by the manager. For comparison purposes the composite is measured against the Russell Midcap® Growth Index.

Stephens Investment Management Group, LLC claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Stephens Investment Management Group has been independently verified for the periods December 1, 2005 through June 30, 2020. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The Mid Cap Growth Composite has been examined for the periods June 2, 2006 through June 30, 2020. The verification and performance examination reports are available upon request.

Stephens Investment Management Group, LLC is a registered investment advisor specializing in equity investment management, specifically small and mid-capitalization growth companies. The firm maintains a complete list and description of composites, which is available upon request.

Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Past performance is not indicative of future results.

The U.S. Dollar is the currency used to express performance. Returns are presented gross and net of fees and include the reinvestment of all income. Net of fee performance is calculated using actual fees incurred. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request. The management fee schedule begins at 1.00% of assets under management. Actual investment advisory fees incurred by clients may vary. The Mid Cap Growth Composite was created June 2, 2006.

Prior to September 1, 2011, composite policy required the temporary removal of any account from the composite which incurred a client initiated significant cash inflow or outflow of 10% or more of the value of the net assets of the account in any 30 day period. The temporary removal of such an account occurred at the beginning of the month in which the significant cash flow occurred and the account re-entered the composite at the beginning of the month after the cash flow. This policy was deleted effective September 1, 2011. Additional information regarding the treatment of significant cash flows is available upon request.

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The annual composite dispersion is an asset-weighted standard deviation calculated for the accounts in the composite the entire year.

Certain accounts in this composite direct trading to broker-dealers that execute trades for no commission. Assets in these accounts are 6.27% of total composite assets as of December 31, 2019.

This composite was redefined January 1, 2020 to include pooled investment vehicles following SIMG's Mid Cap Growth Strategy.

Prior to January 1, 2020, this composite was known as the Mid Cap Growth Separate Account Composite.

Firm AUM does not include accrued dividends.