Q2 2018 U.S. Large Cap Growth Commentary

Highlights

- *SGA's U.S. Large Cap Growth portfolio returned 6.5% (gross) and 6.3% (net) in Q2 2018 compared to 5.8% for its primary benchmark the Russell 1000 Growth Index, and 3.4% for the broad market S&P 500 Index*

- *Higher interest rates and significant repatriation of funds from overseas due to tax law changes pushed the U.S. dollar higher relative to other major currencies*

- *Market volatility, and the portfolio's relative performance, declined in May and early June before rebounding consistent with the pattern we would have expected; we anticipate further increases in volatility over the next few years as investors reprice risk*

- *Concerns over more aggressive U.S. interest rate hikes moderated as Q1 GDP growth was revised downward and strength in the dollar and continued trade tensions negatively impacted export driven sectors; concerns over regulatory oversight in the Technology sector also moderated*

- *Smaller-cap U.S. growth companies performed best, companies with lower betas outperformed later in the quarter; the return to business quality was mixed with high return on equity companies and those with low debt performing best, but those with no earnings also outperforming*

- *The Energy, Consumer Discretionary and Technology sectors performed best by a wide margin; all other sectors trailed the Index with Industrials and Financials providing the weakest returns as U.S. exporters came under pressure and expectations for rapid interest rate increases waned*

- *New positions in Estee Lauder and Microsoft were initiated and the remainder of the portfolio's position in Facebook was sold; while positions in J.B. Hunt, Ulta Beauty, Nike and others were reduced on strength and positions in Yum! Brands and Alliance Data Systems among others were added to on weakness*

Performance

SGA's U.S. Large Cap Growth portfolio returned 6.5% (gross) and 6.3% (net) in the second quarter of 2018 while its benchmark, the Russell 1000 Growth Index, returned 5.8%, and the S&P 500 Index returned 3.4%.

The portfolio outperformed in Q2 despite headwinds from three key factors:

1. A 50%+ decline in market volatility from April highs before rebounding later in June

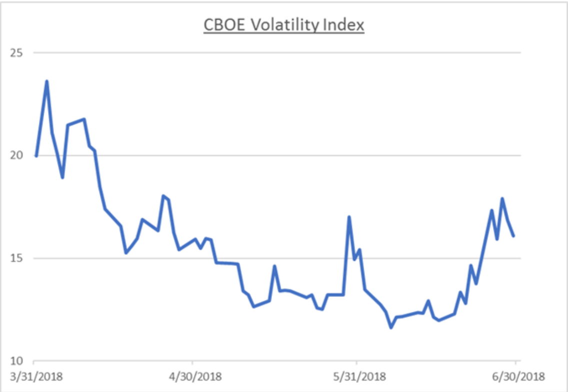
2. Strength in the U.S. dollar relative to developed and emerging market currencies

3. A continuation of narrow market leadership

Volatility Declined from Q1 Highs

Following an 81% rise in the CBOE Volatility (VIX) Index in the second half of Q1 which benefited the portfolio's relative returns, volatility declined by over 50% in Q2 before rebounding later in the quarter. Concerns over rising interest rates, more protectionist trade policies and the potential for a trade war with China stoked fears. With Q1 U.S. GDP growth being revised down to 2.0%, its weakest reading in a year, signs of more benign core inflation, expectations for a NAFTA agreement and an easing of trade tensions with China, market volatility eased during the quarter, leading the VIX to decline from 23.6 on April 2nd to 11.6 on June 6th before rising again to end the quarter at 16.1. However, with the G-7 Summit ending in disarray, expectations for a NAFTA agreement declining and the application of $50 billion of tariffs on Chinese products, and the threat of $200 billion more, investors became more wary later in the quarter.

While broad market earnings improved nicely in Q2, and according to Factset were expected to jump 18%, the most since Q1 2011, the market reaction to such growth was relatively muted with companies that reported stronger than expected earnings and lower than expected earnings both experiencing smaller subsequent price moves than historically seen.



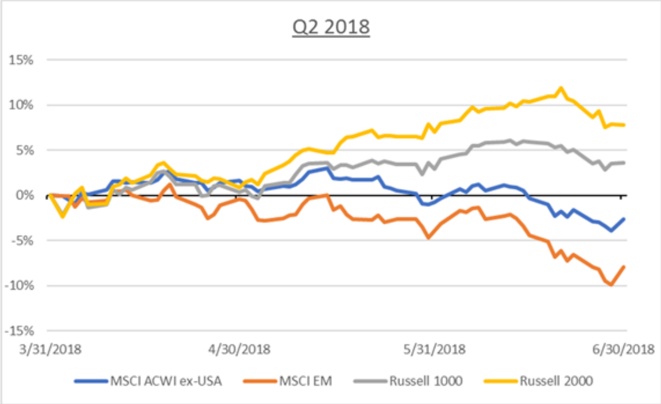
Source: FactSet.

Strength in the U.S. Dollar Favored Domestically Focused Small Caps

The U.S. dollar appreciated back to levels last seen in 2017. U.S. markets outperformed non-U.S. (developed and emerging) markets on expectations for continued improving economic growth. Rising interest rates, the stronger dollar and increased concern about trade tensions and weaker global growth led investors to seek the perceived safety of smaller cap U.S. domiciled businesses with less international sales and foreign currency exposure. This continued a trend seen in Q1. According to Factset, Russell 1000 companies generate about 37% of their income overseas while those in the Russell 2000 Small-Cap Index generate only 21% from markets outside the U.S. For the year, the Russell 2000 Index has returned 7.7% while the Russell 1000 Index has returned 2.9%.

Source: FactSet.

While the dollar depreciated relative to other major currencies in Q4 2017 and appeared to bottom in Q1 2018 on expectations of improving non-U.S. economic growth, in Q2 it reversed course and made up much of the decline. With U.S. interest rates rising and growth in Europe, China and some key emerging markets showing weakness or signs of sluggishness, the outlook for a stronger dollar gained ground with investors and negatively impacted areas of the U.S. market heavily tied to exports such as industrials and consumer staples. Stocks such as Boeing and other multinational manufacturers came under pressure but Technology shares, which generally have high exposure to overseas markets, continued to experience strength. Interestingly, Technology companies in the S&P 500 broad market index actually have the highest non-U.S. exposure of the Index's 11 sectors, with about 59% of their revenues coming from outside the U.S.

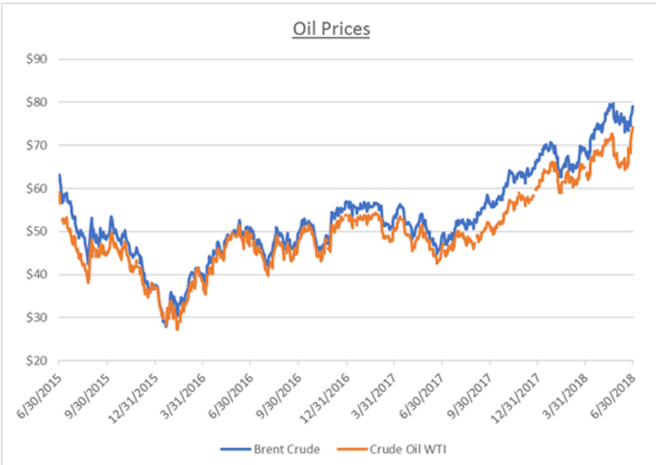


Source: FactSet, MSCI, Russell.

As a result of investors' desire to reduce exposure to currency risks, domestically focused U.S. small cap stocks outperformed large caps and non-U.S. stocks by a wide margin as seen above with the Russell 2000 Index outperforming the Russell 1000 Index handily.

Continued Narrow Market Leadership

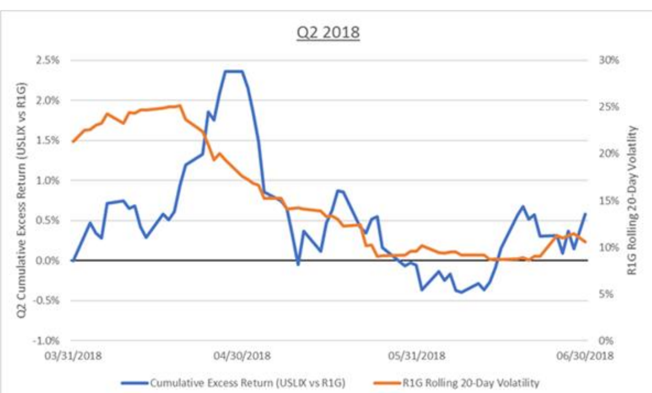
The continued strong performance of the FAANG stocks in the Technology and Consumer Discretionary sectors, presented a headwind for our process (as in Q4 and Q1) due to our adherence to our valuation discipline and resulting decisions to reallocate capital to more attractively valued growth opportunities. Facebook rebounded strongly as concerns over regulatory issues waned while Netflix, Apple, Alphabet and Amazon all handily beat the market as well. In addition, Energy stocks rebounded strongly with the Energy sector returning +9.6% for the quarter as oil prices climbed on continued strong demand and supply constraints. With OPEC and Russia agreeing to limit output and Iranian oil to be sanctioned again, doubts arose over the ability of North American shale oil to meet the demand. This is consistent with our thesis for Schlumberger and Core Labs, and we expect increasing investments in oil related capex, particularly overseas in the coming years.



Source: FactSet.

Key Performance Drivers

After the portfolio's strong finish to Q1 continued in April, its relative returns weakened in May when market volatility declined. This also led to a resurgence in the momentum trade. Portfolio relative performance rebounded in late June consistent with expectations as trade tensions between the U.S. and China again escalated and volatility increased. For the overall quarter, the portfolio outperformed despite this fluctuation in market volatility levels and its heavier exposure to larger sized companies with greater international sales which investors generally shied away from. The chart below illustrates the relationship over the quarter between the portfolio's relative performance and the market's varying volatility.



Source: FactSet, Russell. USLIX is the Institutional share class of the John Hancock U.S. Global Leaders Growth Fund for which SGA serves as sole sub-advisor.

Within the Russell 1000 Growth Index, the Energy, Consumer Discretionary and Technology sectors performed best during the quarter while the Industrials and Financials sectors generated the weakest absolute returns. While we build our portfolios from the bottom up, business by business, the portfolio's relative return during the quarter benefited from its underweights in the weakly performing Industrials and Financials sectors and its overweight in the strongly performing Consumer Discretionary sector. Stock selection detracted from relative returns due primarily to selection within the Consumer Discretionary sector due to lower returns generated by Starbucks and Yum! Brands. The reward to business quality in Q2 was mixed, with lower beta companies performing well late in the quarter and companies with high ROE's and low debt being rewarded, along with those with no earnings.

Top Contributors

Nike's shares surged to a record high after the company reported sales which exceeded most analysts' estimates and noted a return of growth (albeit modest at this point) in the U.S. market which had slowed in recent quarters due to difficult conditions for many retailers and excess inventories which needed to be worked off. Strong international sales, particularly in China, as well as attractive digital sales and successful new product launches boosted results. The company's new strategy of selling more directly to consumers (and thereby improving gross margins) and use of online wholesale partners such as Zalando, Asos, Tencent and Amazon benefited results as did their greater focus on women's footwear and apparel. We continue to see attractive opportunities for Nike as it continues to build its direct to consumer sales and capitalize on the trend toward more athletic-leisurewear in developing markets. We trimmed the position on strength during the quarter and held an average weight position at quarter end.

Amazon reported an impressive first quarter with AWS revenue growth accelerating to 49% and revenues from advertising growing 75% on a normalized basis. In response to questions about the United States Postal Service, the company highlighted its progress with Amazon Logistics, which in some countries account for as much as 50% of fulfillment. Our research continues to indicate a strong growth opportunity for the company, however we remain cognizant of recent stock price appreciation and an above-average cash-flow based valuation. Hence, we trimmed the position during the quarter.

Off-price retailer **TJX Companies** reported Q1 sales that beat the highest analyst estimates as well as our own. Comparable store sales guidance was in line with expectations, while margins remained steady at about 29%. The company continues to benefit from attractive inventory situations from vendors who have overproduced due to excessive optimism, as well as the proliferation of e-commerce brands who often misgauge demand creating additional inventory for TJX. The company also continues to take advantage of real estate opportunities resulting from the weakness of traditional retailers, adding attractive new locations as they come up. Increased wage costs in Canada and some U.S. states, and higher freight costs pose headwinds, but the company continues to work toward improving its efficiency, including moving its IT from legacy to outsourced and cloud solutions to offset cost headwinds. TJX has also been investing in capex to improve its supply chain and distribution system for HomeGoods. We expect these short-term expenses to enhance the company's competitive position over the long-term and contribute to future growth. We continued to maintain an average weight position.

The fourth and fifth largest contributors to portfolio performance were **UnitedHealth** and **Salesforce.com**.

Largest Detractors

Starbucks was the largest detractor from performance during the quarter after it announced a reduction in its sales guidance for 2018 with lower comparable stores sales, and raised its target for cash to be returned to shareholders to $25 billion via increased share buybacks and a 20% dividend increase. The stock declined over 10% on the announcement as investors' discounted slowing growth for the company due to continued slow afternoon traffic and a higher degree of uncertainty over the likely trajectory of their growth in China moving forward. The company also announced plans to take steps to optimize its store footprint domestically, closing more underperforming stores while also taking steps to enhance its operating efficiency.

Given the significant weakness in the stock, we conducted a "Man Overboard Drill" to determine whether the company thesis still merited a space on our Qualified Company List and whether we would purchase the stock today given the new information. After significant analysis and discussion, we determined that we would add the stock to the List today, albeit at a higher risk category given the greater maturity of its business, higher execution risk under this management team and the business' increased dependence on growth in China. We raised the equity risk premium in our valuation system, but still see 20% EPS growth possible with improved visibility for comparable store sales over the next two years as underperforming stores are closed, benefits from the price increase they recently implemented are felt, digital sales initiatives progress, new products add value, and benefits from the increased share repurchase kick in. After meeting with company management in China, we have high regard for the team's insight and capabilities, and continue to see attractive growth opportunities given significant potential to open stores in many lower tier cities not yet served. We remain cognizant of the risk to sales in China should trade tensions escalate further, however over our 3-5 year time horizon we see this as a temporary issue. Given the higher risk associated with the position, we reduced the position to a lower than average weight at quarter end and will continue to look for better execution in the U.S. and more visibility (i.e. growing comparable store sales) regarding success in China.

Yum! Brands detracted from performance during the quarter after it posted weaker than expected Q1 results due to slower comparable store sales at KFC UK after a supplier was unable to meet their demand for chicken (the supplier has since been replaced), and Pizza Hut International where a couple new product introductions in China failed to meet expectations. These detractors offset in-line results at Taco Bell, which were actually quite good versus a difficult year-over-year comparison, and better than expected results at Pizza Hut U.S. Total company sales grew about 4%, while store growth continued at a modest, but steadily accelerating pace driven by new franchise agreements. While the weaker than expected results in Pizza Hut China and select other international markets should not be ignored, they represent less than 20% of profits combined and we are confident that management will effectively address these issues over time. In addition, the company's performance in the quarter highlights the value of its franchise model which insulates profitability against deleverage that can occur when sales growth disappoints. Given strong overall results and the short-term issues affecting the quarterly report, we purchased additional shares on the weakness.

Novo Nordisk reported better than expected organic results for Q1 with underlying sales and operating profit growth of about 5%, however its reported results were flat due to currency. Throughout the quarter, the company also reported that its pipeline drug oral semaglutide achieved positive results in various trials comparing it against other diabetes drugs. We believe the evidence is building that oral semaglutide will be positioned as the best oral diabetes drug on market. Already, Novo Nordisk has the best in class injectable diabetes drug portfolio between its insulins and GLP-1 drugs (Victoza, Ozempic), thus oral semaglutide will only add to its strength in the marketplace. Despite continued pricing pressures in the industry, we expect Novo Nordisk will continue to be a leader in addressing the rising prevalence of diabetes and expect global growth for many years to come. We maintained an average weight position in the stock.

The fourth and fifth largest detractors from portfolio performance during the quarter were **Red Hat** and **Microsoft**.

Portfolio Activity

Turnover in the portfolio was consistent with our long-term average, with the sale of social networking leader Facebook and the purchases of high end cosmetic company Estee Lauder and software technology leader Microsoft. In addition to these sales and purchases, several other positions were trimmed or added to during the quarter. Specifically, positions in Amazon, J.B. Hunt, Nike, Red Hat, Salesforce.com, and Ulta Beauty were trimmed on strength while shares in Alliance Data Systems (ADS), Equinix, Red Hat and Yum! Brands were purchased on weakness.

Sales

We sold the remainder of our position in social networking leader **Facebook** following a rebound in its share price from the weakness it experienced in Q1 due to the unauthorized use of its personal user data by Cambridge Analytica. While our channel checks did not point to any meaningful deterioration in user engagement due to the issue, we do see increased potential for more regulatory scrutiny of the company in the U.S. and Europe and believe this has the potential to negatively impact Facebook's ability to monetize its precision ad targeting capabilities to the extent we had expected. The ability to monetize this capability is a key growth driver in our thesis, and we have some concern that the potential for regulatory action here may be underappreciated. Accordingly, while we continue to view the company's prospects favorably and it continues to meet our key business quality criteria, we sold the remainder of our shares to reallocate the capital toward other higher confidence opportunities.

Purchases

Estee Lauder was added to the portfolio in May. The company is a global leader in prestige beauty, with a strong portfolio of 25+ brands across skin care, make up, fragrances and hair care. The company's products are sold in over 150 countries around the world across multiple channels that include department stores, travel retail, online and specialty stores. Its brands include Estee Lauder, Clinique, Smashbox, Aveda and others.

Global beauty sales are expected to grow at a 3-4% rate over the next several years, with prestige products growing at a higher rate of 4-5% versus the mass segment as consumers around the world continue to trade up in this category. Beauty products generate highly recurring revenues since they are consumed and replaced on a regular basis. Growth is particularly high in emerging markets where (growing) middle class consumers, particularly women, have increasing purchasing power. While there is significant competition in the industry, competition has been focused mainly on innovation and brand, and not necessarily on price. Estee Lauder has multiple strong brands which provide it with attractive pricing power as well as strong runways of growth in diverse markets around the world.

Among the primary risks associated with the thesis are the discretionary nature of consumer purchases in periods of economic weakness. Consumers typically trade down from more expensive brands and retailers trim inventories in periods of economic weakness, but the company's wide array of offerings and geographic diversity help mitigate this risk. Additionally, there is healthy competition in the industry particularly for new customer acquisition, but we believe Estee Lauder is well positioned to compete with its portfolio of multiple brands. We initiated a below-average position in the stock and expect to build it opportunistically moving forward.

Technology leader **Microsoft** was added to the portfolio after we gained more confidence in the company's capital allocation discipline and the longer duration of its runways of future growth. While the stock has remained on our Qualified Company List for many years, and we have been convinced of its high repeat revenues and pricing power, we had historically viewed its future growth opportunities as being limited. Microsoft's success with its cloud computing service, Azure, propelled it to the second largest position in the quickly growing public cloud market, following Amazon Web Services (AWS). The company is effectively leveraging their traditional software based relationships with large enterprise customers while also embracing broader technologies such as Linux, a family of free and open-source software operating systems, to build a much larger public cloud business. The company's discipline in focusing on margin improvement in the meantime has added to our confidence.

Microsoft's recent acquisitions of LinkedIn and Github are positively strengthening the company's ecosystem. The company has changed the way in which it approaches decisions as seen with the recently announced strategic direction regarding its gaming business, and the decision to move toward streaming, which is likely to enhance the quality and duration of the segments growth opportunity.

While some of this change was visible a year ago, and we wish we had purchased the stock then (in retrospect), our confidence in the growth opportunity presented by the company relative to other candidates on our QCL was not sufficient for us to add the stock to the portfolio. Today, with more confidence in the durability of company's growth, particularly in Azure, its improved capital allocation discipline, and focus on margin structure, our research indicates that the stock continues to offer significant investment return potential over our 3-5 year time horizon. We initiated a below average position in the stock, and subsequently built the position to an average level.

Market Outlook

Volatility declined from Q1 levels despite higher interest rates, rising trade tensions, a stronger dollar and signs of slower economic growth outside the U.S. For much of the quarter, investors generally clung to hopes that the NAFTA negotiations would ultimately be successful and that trade wars with China and Europe would be avoided. Despite investors preferring smaller cap, domestically focused, high momentum growth stocks, the portfolio outperformed during the quarter. Looking forward, with interest rates rising and putting greater pressure on lesser quality businesses, signs that the monetary authorities are intent upon more aggressive increases over the next year, and a more cautious view of the likely outcome of current trade negotiations, we expect to see higher levels of uncertainty creep back into the market contributing to a rise in volatility and a greater differentiation between stocks. In such an environment, we expect the strong downside protection that our approach has historically provided to once again become more important as the "Goldilocks" landscape of the past decade transitions to something less accommodating. This backdrop combined with the superior business quality and attractive valuation of the businesses we own makes us excited for the opportunity present in the portfolio today. As we have seen time and again over the course of the portfolio's history, periods such as this have tended to be excellent opportunities for our strategy. Given our perspective over the years, we see every reason to be very optimistic.

Thank you for your continued confidence in our strategy and team. We look forward to speaking with you about the portfolio and the opportunity we see moving forward.

The opinions expressed herein reflect the opinions of Sustainable Growth Advisers, LP and are subject to change without notice. Past performance is no guarantee for future results. This information is supplemental and complements a full disclosure presentation that can be found with composite performance. The securities referenced in the article are not a solicitation or recommendation to buy, sell or hold securities. This commentary is provided only for qualified and sophisticated institutional investors.

Results are presented gross and net of management fees and include the reinvestment of all income. The Net Returns are calculated based upon the highest published fees. The net performance has been reduced by the amount of the highest published fee that may be charged to SGA clients, 0.75%, employing the U.S. Large Cap Growth equity strategy during the period under consideration. Actual fees charged to clients may vary depending on, among other things, the applicable fees schedule and portfolio size. SGA's fees are available upon request and also may be found in Part 2A of its Form ADV. The performance record presented for periods prior to July 1, 2003 occurred before to the inception of SGA and represents the portable performance record established by two of SGA's founders (and investment committee members) Gordon Marchand and George Fraise while affiliated with a prior firm. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request. Upon request, free of charge, SGA can provide a list of all portfolio holdings held in SGA's U.S. Large Cap Growth portfolio for the past year. SGA's earnings growth forecast data is based upon portfolio companies' non-GAAP operating earnings.