Stephens Investment Management Group®

STEPHENS SMALL-MID CAP CORE GROWTH SEPARATE ACCOUNT

QUARTERLY COMMENTARY

SECOND QUARTER 2017

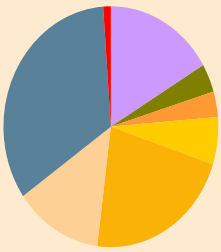
TOP 10 HOLDINGS[1]

Company	% of Portfolio
1. IDEXX Laboratories, Inc.	2.64%
2. ICON Plc	2.47%
3. MercadoLibre, Inc.	2.43%
4. CoStar Group, Inc.	2.41%
5. Ross Stores, Inc.	2.11%
6. Euronet Worldwide, Inc.	2.08%
7. Netflix, Inc.	2.03%
8. MarketAxess Holdings Inc.	1.99%
9. ResMed Inc.	1.94%
10. Microchip Technology Incorporated	1.92%

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]

Consumer Discretionary	16.46
Consumer Staples	3.82
Energy	3.42
Financials	6.35
Health Care	21.98
Industrials	13.20
Information Technology	33.63
Materials	1.14



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MARKET OVERVIEW

The second longest bull market since World War II continued its march into record territory. The Dow Jones Industrial® Average, the S&P 500® Index, and the Russell 2000® Index each hit all-time highs this quarter.

Interest rates trended lower for most of the quarter, but bounced back to finish virtually unchanged. The Federal Reserve raised the Fed Funds rate again this quarter, but it came as no surprise, and ultimately had very little impact on the market. However, the yield curve continued to flatten.

Volatility remained at very low levels – perhaps driven by the money that continued to flow into ETFs. Approximately $180B of new money entered equity ETFs year to date.

Economic data was generally in-line with expectations. Unemployment remains low, but the labor force participation rate hasn't risen as much as economists would like. It's not exactly a "Goldilocks" environment, but it's good enough that it hasn't slowed the market.

SMALL-MID CAP CORE GROWTH SEPARATE ACCOUNT COMPOSITE PERFORMANCE

Similar to last quarter, growth strategies beat value-oriented strategies by a wide margin, but there wasn't much dispersion across market cap ranges.

The Russell 2500® Growth Index rose 4.13%. The Stephens Small-Mid Cap Core Growth Composite gained 2.03% gross of fees (1.82% net).

Stylistically, this quarter presented a more favorable environment for us. However, the reason for our underperformance was mostly due to idiosyncratic, stock-specific issues.

Coincidentally, most of those issues were in Consumer Discretionary. Our cinema-related investments both suffered during the quarter. In last quarter's commentary, we mentioned that we had trimmed our position in National Cinemedia Inc. While those sells were timely, we were still hurt by the underperformance in Q2. We continue to hold a position, albeit much smaller than it has been in the past. IMAX Corporation was another underperformer for us. Box office receipts have been weak, but not outside of normal variability with the movie calendar. Consumer stocks in general were weak, many of them because of fears about the continued intrusion of Amazon. We remain underweight the sector.

Although Consumer Staples stocks were in negative territory for the benchmark, our holdings fared much better. Monster Beverage Corporation and Brown-Forman Corporation both did well this period.

Our overweight position in Energy worked against us. North American markets seemed poised to over-produce in the short run. And we worry about the long term prospects for oil demand as electric vehicles begin to enter the market at a brisk pace in the coming years. We are still positive on natural gas however.

Healthcare stocks were the best performers in absolute terms. Biotech stocks were strong this quarter, and while our underweight position hurt us, we made up for it with strong returns in some of our other holdings. ICON Plc., a provider of contract clinical research, was a top contributor; it moved higher in sympathy with one of its peers, which was acquired for significant premium.

Industrials trailed the broad market, and our holdings with basically in-line with the benchmark's. Proto Labs, Inc. was another top contributor, after posting a quarter with accelerating organic growth. Even industrial distribution companies were hit with concerns about competition from Amazon. Our positions in MSC Industrial Direct and Fastenal Company were both negatively impacted as a result.

Technology continued to shine. Our overweight position here helped relative returns. MercadoLibre, Inc. was a top performer again this quarter after having the top spot in Q1. They continued to post excellent financial results. We also had success with CoStar Group, Inc. and National Instruments Corporation.

PORTFOLIO CHARACTERISTICS[1]

We added four new positions and eliminated as many. Technology remained our largest sector at about 32%. Healthcare's strong performance led to a slight increase. It now stands at 21%. Consumer Discretionary and Industrials are at 16% and 13%, respectively. After the annual rebalancing of our benchmark, our relative weights shifted slightly. We are still overweight Technology and Healthcare. We are underweight Industrials, Materials, and Real Estate.

Valuation ticked up again. Our weighted harmonic average P/E ratio of next twelve months earnings is nearly 27. For the Russell 2500® Growth Index, that figure stands at 21. Growth expectations expanded as well, however. Our median company is expected to grow earnings at 14.2% and revenue at 9.0%. Actual earnings growth for our median company came in at 14.3%.

[1]The information is shown as supplemental only and complements the full disclosure presentation located on the back, The Russell 2500® Growth Index measures the performance of those Russell 2000® 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. You cannot invest directly in an index. 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.

Outlook – a side note

Malcolm Gladwell's book, *Blink*, makes a case for the power of "'thin-slicing" – that is, for the well-trained, intuition can often arrive at correct conclusions with very limited data. In thinking about the market lately, I couldn't help but be reminded of the first chapter of *Blink*.

Mr. Gladwell tells the story of the Getty kouros, a rare marble statue dating back to the sixth century B.C. It was offered to the J. Paul Getty Museum for $10mm. The museum went to great lengths to confirm that the statue was authentic. Geologists studied the marble, and lawyers investigated a history of ownership and payments. Everything checked out. But when some very experienced art experts saw it, their first intuition was that it was a fake.

> *When [they] looked at the kouros and felt an "intuitive repulsion", they were absolutely right. In the first two seconds of looking – in a single glance – they were able to understand more about the essence of the statue than the team at the Getty was able to understand after fourteen months.*

The book goes on to say that oftentimes these experts struggle to express exactly why their intuition tells them something. It just knows. And sometimes the cognitive dissonance of trying and struggling to explain their intuitive conclusion makes them change their minds. Gladwell advises: if you're an expert, trust your intuition.

Why is this relevant? When I look at the market today, I have a little bit of that "intuitive repulsion". It's a little like the fake statue. It appears real, everything seems to check out, but there's something not quite right about it.

Those of you that know me and my passion for behavioral economics would be quick to point out that the whole point of behavioral economics is to not trust your intuition. In some sense, Gladwell's conclusions in *Blink* run counter to the lessons of behavioral economics. So, maybe this is nothing more than an unfounded feeling, but I thought it was worth passing along.

Outlook – part 2

I remember in the late 1990s investors often spoke of the resurgence of the "nifty fifty". I was still a boy when the original nifty fifty were in fashion in the '70s. In the '90s, the idea was that all you needed to own were the 50 largest companies – most of them tech. Nothing else really mattered. In fact, the line of reasoning progressed to the point where some people came to the conclusion that all you needed to do was own one stock – AOL.

Does this sound familiar? It's hard to come up with a reason that the so-called FANG stocks of today (Facebook, Amazon, Netflix, and Google) will lose their stranglehold on their respective markets and on the mindshare of most investors. All you need to own is F.A.N.G., right? Guess what, there's even an ETF for that, the ticker is FNG (FANG was taken by Diamondback Energy, a Permian Basin E&P company).

As dominant as Facebook, Netflix, and Google are, Amazon has stepped it up a notch. Any mention of the idea that Amazon might be competition for a specific company, and it sends investors running for the hills. Amazon's acquisition of Whole Foods Markets sent some shock waves through the grocery and food retailing industry. Amazon is now selling auto parts, private label electronics, and private label clothing. They're rumored to be partnering with Nike, in a move that could be devastating for footwear retailers everywhere. It seems as though nothing is safe. Nothing is safe, because so much has changed.

The iPhone was launched merely ten years ago. It's hard to imagine life just ten years ago - you probably had a Motorola RAZR phone and a Blackberry, and you felt you were at the bleeding edge of technology, basking in the marvels of its convenience and productivity improvements. You'd be at a serious disadvantage in today's world with only those tools.

Today, Apple, Google, Microsoft, Amazon, and Facebook comprise the five largest US companies. Ten years ago the list was Exxon, GE, Microsoft, AT&T, and Citigroup. Facebook has only been public for five years.

As we note that we live in a world of incredible change, we should also acknowledge that the rate of change is changing. The next ten years almost certainly hold more change for our world than the last did. And that change will lead to further disruption. Surely some of the winners today will hold on to that power, and further solidify their leadership position. But there will be new winners too. And losers.

Herein lies the opportunity. We love finding disruption, new winners. Underdog, smaller companies toppling the bigger, established ones. Change is disruption, and disruption is opportunity.

As money pours into passive strategies, buying the broad market and everything in it, it suppresses volatility, and increases correlations. All this coincident with the fastest changing and most disruptive economic environment the world has ever known.

My point with all of this is to say that our outlook today is: change. Lots of it. And that doesn't fit with what looks like a complacent, record low volatility market.

OUTLOOK

Outlook – part 3

If you haven't read *Thinking, Fast and Slow* by Daniel Kahneman, I highly recommend it. It's a little dry and academic, but it's a treasure trove of information on behavioral economic concepts.

If it's too much for you, then take a look at Michael Lewis' new book, *The Undoing Project*. In typical Lewis fashion, it's very readable. It is the story of Daniel Kahneman and Amos Tversky (Nobel Prize winners in 2002).

In thinking about change, and predicting change, I was particularly drawn to a passage in the book that is taken from a speech Tversky gave. Here it is:

> *All too often, we find ourselves unable to predict what will happen; yet after the fact explain what did happen with a great deal of confidence. This "ability" to explain that which we cannot predict, even in the absence of any additional information, represents an important, though subtle, flaw in our reasoning. It leads us to believe that there is a less uncertain world than there actually is, and that we are less bright than we actually might be. For if we can explain tomorrow what we cannot predict today, without any added information except the knowledge of the actual outcome, then this outcome must have been determined in advance and we should have been able to predict it. The fact that we couldn't is taken as an indication of our limited intelligence rather than of the uncertainty that is in the world. All too often, we feel like kicking ourselves for failing to foresee that which later appears inevitable. For all we know, the handwriting might have been on the wall all along. The question is: was the ink visible?*

Tversky also said, "He who sees the past as surprise-free is bound to have a future full of surprises."

What surprises are next, that we will later (and falsely) assume were inevitable and that we knew it all along?

To tie all this together, perhaps the investing world has been lulled into a sense of complacency because our biased hindsight tells us we knew about these changes all along. The reality is that the world is much more unpredictable than our subtly flawed minds can appreciate, and that is only getting worse.

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	Wrap Fees Assets	Composite		Russell 2500® Growth	Composite Dispersion	Composite Gross	Russell 2500® Growth
							Pure Gross[1]	Net				
2016	3,658	54	13	32	10	45.60%	6.72%	5.82%	9.73%	0.05%	12.43%	14.67%
2015	2,903	51	13	27	10	51.11%	0.45%	-0.40%	-0.19%	0.39%	11.44%	13.29%
2014	3,436	52	14	27	10	51.36%	1.78%	0.90%	7.05%	0.10%	10.94%	12.54%
2013	3,076	51	13	27	10	51.46%	35.31%	34.07%	40.65%	0.12%	12.05%	16.48%
2012	1,222	29	12	11	9	100%	16.63%	15.44%	16.13%	0.14%	15.01%	19.82%
2011	933	22	11	9	9	100%	3.50%	2.35%	-1.57%	0.07%	17.67%	22.91%
2010	919	23	18	14	16	100%	25.69%	23.93%	28.86%	0.23%	23.55%	27.20%
2009	554	19	22	16	21	100%	36.59%	34.72%	41.65%	0.39%	21.99%	24.53%
2008	387	12	21	12	21	100%	-39.76%	-40.70%	-41.50%	0.28%	19.60%	20.93%
2007	391	17	20	16	19	100%	25.28%	23.59%	9.69%	0.11%	N.A.	N.A.

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 decision.

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 price of such stocks may be more volatile than those of larger company stocks. Clients' investment results and principal value will fluctuate.

*Strategy Assets are shown as supplemental information as these assets include UMA assets managed within the Small and Mid Cap Core Growth Separate Account Strategy.
N.A. - Composite Dispersion is not statistically meaningful due to an insufficient number of portfolios in the composite for the entire year. Information for the 3-Yr Annualized Standard Deviation is not presented because there is less than 36 months of performance data.

Small and Mid Cap Core Growth Separate Account Composite *contains fully discretionary accounts invested primarily in small cap and mid-cap common stock of U.S. companies. Under normal conditions, securities purchased for this composite have market capitalizations equal to or less than the largest company contained within the Russell 2500® 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. Securities purchased for this composite are predominantly those categorized by SIMG as core growth securities which are securities SIMG perceives to be high quality, well managed businesses that have the potential for consistent, predictable revenue and earnings growth. 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 2500® Growth Index. Prior to September 1, 2011, this composite was known as the Small/Mid Cap Growth Separate Account Composite.*

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 March 31, 2017. 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 Small and Mid Cap Core Growth Separate Account Composite has been examined for the periods February 1, 2005 through March 31, 2017. 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 management fees and include the reinvestment of all income. Net of fee performance is calculated using actual fees incurred. [1]Pure Gross returns are shown as supplemental information and are stated gross of all fees and transaction costs; net returns are reduced by all fees and transaction costs incurred. In addition to a management fee, the accounts pay an all-inclusive fee based on a percentage of assets under management. Other than brokerage commissions, this fee includes advisory, custody, execution and other services provided in connection with the program. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

The bundled fee schedule begins at 2.75% of assets under management. Actual investment advisory fees incurred by clients may vary.

The Small-Mid Cap Core Growth Separate Account Composite was created December 1, 2005. Performance for the period prior to December 1, 2005 occurred while the Portfolio Management Team provided services on behalf of the prior firm, Stephens Inc., and the Portfolio Management Team members were the only individuals responsible for selecting the securities to buy and sell.

Beginning September 30, 2007, composite policy requires the temporary removal of any account from the composite which incurs 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 occurs at the beginning of the month in which the significant cash flow occurs and the account re-enters the composite at the beginning of the month after the cash flow. Additional information regarding the treatment of significant cash flows is available upon request.

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