Stephens
Investment Management Group®
The Power of Growth®

STEPHENS SMALL CAP GROWTH SEPARATE ACCOUNT

QUARTERLY COMMENTARY

SECOND QUARTER 2018

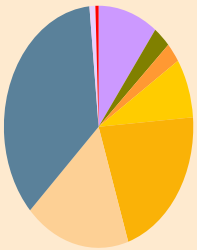
TOP 10 HOLDINGS[1]

COMPANY	% of PORTFOLIO
1.Ligand Pharmaceuticals Inc.	2.06%
2.ICON Plc	2.01%
3.Proofpoint, Inc.	1.68%
4.Neogen Corporation	1.66%
5.CoStar Group, Inc.	1.65%
6.ABIOMED, Inc.	1.65%
7.Calavo Growers, Inc.	1.62%
8.Aspen Technology, Inc.	1.58%
9.Proto Labs, Inc.	1.57%
10. Ollie's Bargain Outlet	1.49%

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	10.21%
Consumer Staples	2.95%
Energy	2.66%
Financials	7.93%
Health Care	21.18%
Industrials	17.95%
Information Technology	35.57%
Materials	1.01%
Telecommunication Services	0.54%



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MARKET OVERVIEW

Equity markets moved higher yet again in the second quarter of 2018. After the spike in volatility in February, markets regained some composure, and investors began to appreciate the significant acceleration in corporate earnings. The S&P 500® Index gained 3.43%. Small companies benefitted disproportionately from tax reform, and an easier regulatory environment. Additionally, with less international exposure, smaller companies are more isolated from the impact of potential trade wars. Consequently, smaller companies outperformed. The Russell 2000® Index was up 7.75%.

The economy showed continued signs of improvement. Unemployment remains at levels not seen since 2000. There are signs of inflation, but in aggregate, it is just now at the Fed's target of 2%. The Fed did raise rates in June as expected. Wage inflation has been modest, as the labor participation rate for prime-aged workers has ticked up. Economically speaking, there's a lot to feel good about.

It's not all rosy, however. The yield curve has flattened in the last three months - short terms rates have risen while long rates have been virtually unchanged. On top of that, oil prices continued to run up into the mid $70's per barrel. The impact of higher (or lower) energy prices is complicated now: it hurts disposable income and crowds out spending on other goods, but at the same time provides jobs and boost the economy in certain regions.

SMALL CAP GROWTH SEPARATE ACCOUNT COMPOSITE PERFORMANCE

While small cap strategies fared best, the split between growth and value was dependent on size. In the small cap arena, value slightly beat growth, but at the large cap end of the spectrum, growth strategies were clear winners.

After a great first quarter, our relative and absolute success continued into this quarter as well. From a factor standpoint, this was true as well – most of the same trends were still in place, higher growth, more stable, low debt companies were the best performers. While the Russell 2000® Growth Index was up 7.23%, the Stephens Small Cap Growth Composite gained 10.61% gross of fees (10.42% net of fees).

Consumer Discretionary stocks were particularly strong this quarter. All of our restaurant holdings were in positive territory. And we had great success with two newer companies, Chegg, Inc. and Canada Goose Holdings, Inc., but for very different reasons. Canada Goose reported a stellar quarter and announced plans to open more of its own stores. Chegg showed continued growth and continues to add online educational content both through internal development and acquisition.

As oil prices continued to climb, energy stocks went along for the ride. We have less exposure to Energy than we have had in the past, but we have remained overweight versus the benchmark. We added two new positions, Callon Petroleum Company, an operator in the Permian Basin, and Range Resources Corporation, a bigger company more focused on natural gas.

Financials lagged the broad market, and our returns were essentially in-line with our benchmark's. We continued to add to our positions in EZCORP, Inc. and PRA Group Inc.

Healthcare stood out this quarter, we had our best absolute and relative returns here. Biotech was a slight headwind, due to its massive weight in the index, but we mitigated that with far better performance. ABIOMED, Inc. was our single biggest contributor, after posting another big earnings surprise on the strength of their *Impella* heart pump. We trimmed our position into the strength, and expect to continue to pare back our holdings as it has grown beyond our market capitalization parameters.

Industrials couldn't keep up with the absolute returns in Healthcare, but our relative performance was just as good. Our Aerospace and Defense holdings lead the way: Axon Enterprise Inc. and AeroVironment, Inc. were our second and third largest contributors to returns. Axon (formerly known as Taser) had another fantastic quarter on the continued adoption of their body cameras for police. AeroVironment is benefitting from higher defense spending and their leadership position in drone technology. We trimmed our positions for both companies on the strength, largely for risk mitigation purposes.

Technology stocks were also an area of relative strength. Our e-commerce related holdings and software companies performed well. Stamps.com showed continued strength, and its solid results have finally forced most short-sellers to cover. Every industry within Technology showed strong absolute and relative strength except for Electronic Equipment, Instruments, & Components, where Cognex Corp and National Instruments saw some weakness this quarter. National Instruments had one of the very few disappointing earnings results we saw across the whole portfolio. At this point, it appears to be a one-time issue.

[1]The information is shown as supplemental only and complements the full disclosure presentation located on the back. The Russell 2000® Growth Index measures the performance of those Russell 2000® companies with higher price-to-book ratios and higher forecasted growth values. 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. 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

We added three new positions and eliminated five this quarter. Our sector weights didn't change much this quarter, but our relative weight did as the Russell rebalance occurred near the end of the period. Technology, Healthcare, and Industrials still represent our three largest at about 34%, 20% and 17% respectively. We are now more overweight Tech and more underweight Consumer than we were before. We are very cognizant of our relative sector and industry exposure, but are reluctant to change the portfolio simply because of the arbitrary timing of our benchmark's rebalancing process.

Valuations ticked back up this quarter. Our weighted harmonic average P/E ratio on next twelve months earnings now stands at 28.5 versus 27.5 last quarter. The benchmark remained about the same, at 19.3. Growth rates continued to improve. Our median company is expected to grow earnings at 24.5% over the next year, while the median benchmark holding is expected to grow at 21.8%. Actual growth has been even more robust. Our median company grew earnings per share at a whopping 33% this most recent quarter. One year ago, this same figure was only 16%! Much of this improvement has been the result of tax reform, but not all of it – revenue growth has accelerated as well. A year ago, our median company posted revenue growth of 11.5%, today that figure stands at 17.1%.

The balance between *core growth* and *earnings catalyst* essentially stayed the same since last quarter. Catalyst represents 53.5% of the portfolio, while core stands at 46.5%.

OUTLOOK

I got quite a bit of positive feedback on last quarter's *Outlook*. I suppose in the world of having to read the dry market analysis that so many of my peers (myself included sometimes!), it was a fun break. I don't know that I'll be able to top it this quarter. At least not in style…

With that being said, I want to focus on the two themes we've been talking about lately, plus one new one. First up is active vs. passive.

I don't normally write a lot of white papers. It's something I enjoy doing, but just don't have the time. Early 2017, I couldn't help myself. The situation was too compelling – something had to be said! I hope you had a chance to read what we wrote last year about active vs. passive. A year later, I think most of it is still relevant today, and in some cases, it was prophetic.

That's not to say I can see the future. I can't. But one of my specialties is applying everything I've learned about human psychology and behavioral economics to try to identify when other investors are affected by a cognitive bias, especially one that leads them to an irrational investment decision. Such has been the situation with passive investing, while it certainly has its place, the zeitgeist had gone a bit too far – people had forgotten just what active management can do. One of my points last year was the reminder (and data to back it up), that when active managers outperform, the margin of outperformance can be quite large, particularly for small and mid-cap growth managers.

We are happy to have delivered results that support this claim so far in 2018. The question I've been getting lately is: how long can this last?

I can't see the future here either. But as we postulated last quarter, the factors that contributed to the "everyone gets a trophy" environment were very powerful, multi-year forces. QE and ZIRP -> suppression of rates -> suppression of risk -> suppression of volatility = perfect environment for passive investing and risk-seeking.

The current unwind of quantitative easing is quantitative tightening ("QT"), and while long term rates haven't moved much, short term rates have been rising steadily. This is a very different economic regime than what we've had for the past ten years. And it should follow, that whatever market strategies worked in the prior environment, almost certainly won't work in this one.

I don't know how long this current economic or market regime will last. But I think we can pretty safely say that QT will take a long while to play out, and the Fed has explicitly mapped out their further project rate hikes. Mean reversion alone will take years to play out. My suspicion is that some unknown unknown will be the cause of the next market regime change.

Changing gears to the second theme, if you go back two quarters and re-read our *Outlook*, you'll see our enthusiasm about tax reform. So far, things have played out even more powerfully than we would have thought. The first order effects showed up in company guidance and Q1 earnings – lower tax rate instantly delivers more earnings. Today, we are seeing the impact of the second order effects. Those extra earnings are flowing through the economy, distributed to investors, used to fund higher wages, used to acquire other businesses, spent on capital expenditures, or passed along to customers via lower prices. All of these things are very stimulative to the economy. As we mentioned above in the *Portfolio Characteristics* section, we have seen a meaningful acceleration in revenue growth across our portfolios.

We haven't seen growth rates like these in a long time. It has certainly been fun, and it may be the key reason for the strong returns we've experienced so far this year. This is where prudence takes over and we yet again remind ourselves "this too shall pass".

Which brings us to our new theme. Labor markets are very tight. There are more job openings than there are unemployed workers. I think nearly all economists would agree that we are at "full employment". Fortunately, the labor force participation rate for prime aged workers ticked up recently – it's great that people are re-entering the work force.

When we talk to company management teams, the messages we hear over and over is about how hard it is to find workers with the right skill sets and how wages are going up. From an aggregate economic sense, wage growth doesn't appear troubling, but that might be masked by demographic shifts.

On top of that, energy price have moved higher.

These trends are very inflationary.

OUTLOOK

Again however, the aggregate economic data doesn't show any sign for real concern. Inflation has been running right around 2%, which is the target rate for the Federal Reserve.

On one hand we have some powerful inflationary forces: very tight labor markets and rising energy prices. On the other hand, we are still in the midst of some powerful disinflationary forces: e-commerce, internet driven price transparency, technological advancement, global trade (although this is a little more at risk with trade war saber rattling).

Here's the problem: economists define inflation as a rise in the price-level. That's not what's happening today; it is not a uniform distribution of rising prices. Depending on your business, you might be suffering from rapidly rising wages and higher energy and transportation costs, to the extent that it materially affects profitability and company strategy. Or your business might be immune from those pressures, and instead reaping the rewards of lower costs due to technological improvements, robotics, A.I., and benefitting from other disinflationary forces.

This asymmetrical distribution of inflation and disinflation is creating great disparity among businesses today. And I love it! Yet another reminder of why and how active managers can beat an index.

And finally…I'm not saying I'm bearish, but if I'm doing my job right, there's always that healthy dose of skepticism and contrarianism. Here's some food for thought: for the last several years, whenever I've talked to the best and brightest economists and market strategists, they all say don't be concerned that we are on a near decade-long run, because bull markets don't die of old age. And that comment is followed by the explanation that it is usually higher interest rates or higher energy costs that cause the end. In any case, we are back to having a real market, with complicated and confounding issues, a divergence of opinions, and complex factors creating higher dispersion across the investable universe. In my white paper last year, I theorized that on the other side of the perfect storm for passive might be a golden age for active management. Is this it?

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 2000® Growth	Composite Dispersion	Composite Gross	Russell 2000® Growth
2017	4,446	1,820	18	1,242	17	20.24%	19.41%	22.17%	0.08%	13.06%	14.59%
2016	3,658	1,781	23	1,174	21	11.41%	10.62%	11.32%	0.10%	15.46%	16.67%
2015	2,903	1,610	26	1,095	25	-3.61%	-4.26%	-1.38%	0.06%	14.64%	14.94%
2014	3,436	2,198	29	1,501	28	-2.31%	-2.91%	5.60%	0.08%	13.59%	13.82%
2013	3,076	2,359	29	1,630	28	44.65%	43.74%	43.30%	0.14%	15.30%	17.27%
2012	1,222	1,096	20	888	19	16.99%	16.21%	14.59%	0.07%	18.00%	20.72%
2011	933	859	20	761	19	3.43%	2.74%	-2.91%	0.08%	20.96%	24.31%
2010	919	878	18	779	16	27.82%	26.98%	29.09%	0.05%	25.69%	27.70%
2009	554	521	15	459	14	38.41%	37.53%	34.47%	0.25%	23.61%	24.85%
2008	387	362	15	320	12	-39.92%	-40.33%	-38.54%	0.08%	20.87%	21.26%

*Strategy Assets are shown as supplemental information as these assets include mutual fund assets which are managed within the Small Cap Growth Strategy.

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.

Small Cap Growth Separate Account Composite *contains fully discretionary accounts invested primarily in small cap growth common stock of U.S. companies. Under normal market conditions, most of the securities purchased for this composite have market capitalizations equal to or less than the largest company contained within the Russell 2000® Growth Index at the time the security was initially purchased by accounts in the composite and are securities of companies 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 2000® 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 March 31, 2018. 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 Cap Growth Separate Account Composite has been examined for the periods October 7, 2004 through March 31, 2018. 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 management fees and performance fees incurred. Prior to June 2, 2005, accounts in the composite were charged a bundled fee based on a percentage of assets under management. The bundled fee covered investment management, trading and other account expenses. Gross returns for this period 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. Policies for valuating portfolios, calculating performance, and preparing compliant presentations are available upon request.

The management fee schedule begins at 1.25% of assets under management. Actual investment advisory fees incurred by clients may vary.

The Small Cap 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.