Stephens
Investment Management Group®
The Power of Growth®

STEPHENS SMALL CAP GROWTH SEPARATE ACCOUNT

QUARTERLY COMMENTARY
THIRD QUARTER 2018

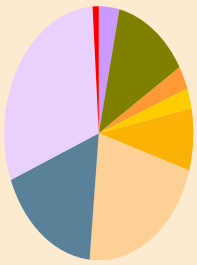
TOP 10 HOLDINGS[1]

COMPANY	% of PORTFOLIO
1.Ligand Pharmaceuticals Inc.	2.24%
2.ICON Plc	2.11%
3.Proto Labs, Inc.	1.85%
4.Ollie's Bargain Outlet	1.78%
5.Aspen Technology, Inc.	1.70%
6.Aaron's, Inc.	1.63%
7.Trex Company, Inc.	1.61%
8.Wingstop, Inc.	1.59%
9.Semtech Corporation	1.55%
10.HEICO Corporation	1.52%

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	3.50%
Consumer Discretionary	12.80%
Consumer Staples	2.96%
Energy	2.60%
Financials	7.88%
Health Care	21.81%
Industrials	17.46%
Information Technology	29.94%
Materials	1.05%



Stephens Investment Management Group, LLC

9 Greenway Plaza
Suite 1900
Houston TX 77046

CUSTOMER SERVICES,
SALES & MARKETING
(800) 458-6589

WEBSITE:
stephensimg.com

MARKET OVERVIEW

The third quarter of 2018 showed a continuation of the trends we saw in the prior quarter. Equity markets moved higher still, while interest rates inched up. The S&P 500® Index gained 7.71%, as large cap stocks made up some ground on their smaller counterparts. The Russell 2000® Index was up 3.58%.

The economy was apparently still firing on all cylinders. Corporate earnings showed even further improvement. Unemployment remained at multi-decade lows. The Federal Reserve raised the Fed Funds rate a quarter point again this quarter as they tried to normalize policy into a strong economic backdrop.

There was much talk about the impact from trade negotiations and increased tariffs with many of the US's trade partners. From a macro economic standpoint, the impact to GDP appeared to be minimal so far, but some companies are starting to feel a measurable impact.

Energy prices climbed toward the end of the quarter to hit 52-week highs. Inflation was still at the front of everyone's minds, although CPI, PPI, and PCE remained at levels which weren't causing alarm.

SMALL CAP GROWTH SEPARATE ACCOUNT COMPOSITE PERFORMANCE

In a bit of a reversal from last quarter, it was large cap stocks that had the strongest performance. Across all market caps, growth strategies fared better than value, and this had been consistent for most of the year so far.

Even with the robust absolute returns, our strong relative performance from the first half of the year continued into this quarter as well, for many of the same reasons as before. While the Russell 2000® Growth Index gained 5.52%, the Stephens Small Cap Growth Composite rose 11.17%(10.98% net).

Communication Services is a new sector code that incorporates some stocks that were previously in Technology, Telecom, or even Consumer Discretionary. For us, it represents about 3% of the portfolio, essentially inline with the benchmark weight. These stocks had the highest returns of any sector. From a relative performance standpoint, we did well in this new group, with strong performance from ANGI Homeservices, Inc. and Take-Two Interactive Software.

Consumer Discretionary was also another source of relative strength for us. Wingstop, Inc. excelled, as they have been well positioned for the e-commerce and delivery transition the restaurant industry is experiencing. As a result of that same transition, we reduced our exposure to Chuy's Holdings, Inc. On the retail side of things, Ollie's Bargain Outlet Holdings Inc. posted another great quarter, and was one of our top performers.

We made some changes to our Consumer Staples portfolio. We sold e.l.f. Beauty, Inc. as fundamentals weakened. We added a new position in Limoneira Company, a grower of various fruits.

We did well in Energy also, primarily because of a sharp rebound in the shares of RigNet Inc. The stock had been oversold in prior quarters and posted stronger revenue growth in the quarter.

We lagged a bit in Financials, although there wasn't any particular stock that caused this. We continued to add to positions here as the changing interest rate landscape and healthy economy are fueling new opportunities.

Healthcare stood out again this quarter. Our returns were significantly better than the benchmark's. Biotech was a big positive swing factor for us – it is a huge weight in the benchmark, where it lagged the broad market, but for us it was our best performing industry in the sector. Ligand Pharmaceuticals Incorporated is our largest biotech holding, and it was our single biggest contributor to return. However, it has also grown to be our largest holding. We sold some of our position into the strength it saw this quarter, and we expect to continue to reduce our exposure as its market cap has grown beyond our definition of small cap.

From a sector standpoint, Industrials contributed the most to our relative performance. All of our aerospace & defense holdings were particularly strong. Proto Labs, Inc. was the strategy's second biggest contributor to performance; we trimmed this one as well.

Since most of our performance was style- or factor-driven, it is no surprise that Technology was also a source of relative performance. Here the returns were more broad-based, with fewer individual stand out holdings. We benefitted from M&A activity as Integrated Device Technology Inc. was acquired by Renesas for a substantial premium.

[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 five new positions and eliminated four this quarter. Sector weights did shift around a bit, but mostly as a result of the restructuring of Communication Services. Technology, Healthcare, and Industrials remain our three largest at 29%, 21%, and 17% respectively. We are still overweight Technology, and underweight Healthcare (primarily because of Biotech), Real Estate, and Materials. Most other sectors are surprisingly close to the benchmark.

The strong returns this quarter resulted in slightly higher valuations. Our weighted harmonic average P/E on next twelve months earnings ticked up to 29.4 from 28.5, while that same statistic for the benchmark edged up to 20.1 from 19.3. Expected earnings growth is still strong at 22% for us and 19% for the benchmark, but actual earnings growth ticked up even from very high levels we saw last quarter. Our median company posted actual earnings growth at over 35%. Revenue growth metrics are also healthy, with our median company growing at 16.2% versus 12.0% for the benchmark.

The balance between *core growth* and *earnings catalyst* shifted slightly in favor of *core* since last quarter. Catalyst represents 52.2% of the portfolio, while core stands at 47.8%.

I'd like to note that our recent performance has generated an unintended side effect: our market capitalization statistics have moved higher. I want to be explicit about this – we have not changed our process or our focus on style purity. As a result, we have been systematically reducing and eliminating positions that have grown beyond the definition of small cap.

OUTLOOK

If you've heard me give a presentation on behavioral finance, you may have heard this joke before.

> Three men are stranded on an island with nothing to eat but a small stash of canned food. The problem is that they have no way of opening the cans.
>
> The first man is a mechanical engineer. He says, "I have an idea! If we can secure the cans in between some rocks, we can use another rock to strike the can at the proper angle to ensure opening the can and minimizing spillage."
>
> The second man is a chemist. He says, "That might work. But I recognize some of the plants on this island and some have a sap that it is acidic. If we harvest enough, perhaps we can make an acid that will eat at the seal on the cans, and we can open them that way."
>
> They both turn to the third man, an economist, and ask for his input.
>
> The economist scratches his head for a moment and then replies, "Assume we have a can opener…"

Right now you're probably judging my sense of humor based on how many economics classes you had. If you had none, you might not see any humor at all. However, if you spent enough time listening to economics lectures and arguments, you know that they all begin with a set of assumptions. The world is a complex place, and if we make assumptions to simplify certain aspects or hold others constant, it becomes easier to create an economic model – a model that might only be valid under those initial set of assumptions.

If you spent more of your time in finance and investment classes than economics classes, you probably were taught that value strategies outperform growth strategies. The data confirm this. Since the industry has kept track of such things, it is true that value has beaten growth more often than not.

Academics have embraced this idea, and at almost any institution of higher education it is taught. I don't pretend to think that I can summarize all the arguments behind this case, but in my personal experience, it has been explained thusly: Growth investors tend to overpay for what they perceive as growth, while value investors are careful about paying too much, and tend to buy stocks that are out of favor and win via mean reversion.

Every time I hear the case for the long term outperformance of value over growth, it seems as if it's implied that value investors are smarter, or that it's somehow inherently more prudent to be a value investor. Could that be true?

It's an interesting time in the market. Since the great recession, growth strategies have beaten value, bucking a 60+ year trend. Few saw this coming. Few thought it would last this long. And lately, **the flavor-of-the-month investment idea has been that "surely, we will see some mean reversion and value will once again rule the day".**

Remember the can opener? What if the assumption that value beats growth over time is a can opener? Couldn't it be just as reasonable to start with the assumption that what we oversimplify as "growth" and "value" will do relatively well or worse as the market and the economy go through various cycles, and that over the VERY long term, the net spread between them ought to balance out to zero?

If that's the case, then everyone making the mean reversion argument should recalculate – growth could still be in the early innings of what might be a multi-decade run.

Now I don't want to waste all my time this quarter on growth vs. value alone, but since this is an issue that many of our clients are wrestling with, I thought I'd add a few more thoughts.

Over time, some of the characteristics that tend to be associated with growth or value have surprisingly changed. Our friends at Cornerstone Macro have uncovered some interesting data: in 2000, the highest P/E stocks had the highest beta, and the cheapest stocks, the lowest. Today that has flipped. The lowest P/E stocks now have the highest beta!

OUTLOOK

Given all of our work on the tidal wave of passive investing, we feel pretty certain that the impact has been to narrow the spreads between high quality and low quality companies. The combination of very accommodative monetary policy and an explosion in passive investing has led to the perpetuation of many so-called zombie companies, those that would have failed otherwise. Here's a hint: they aren't growth stocks! Is now the time to shift assets into a subset of stocks full of zombie companies?

In my experience mean reversion needs a catalyst. Trends will persist until something changes. What are today's changes? Higher interest rates. Quantitative tightening. Possibly higher inflation. The approaching anniversary of easy growth comparisons from tax reform. Slowing EM growth. Possible fallout from trade wars and tariffs. Rising energy prices.

These things don't sound bullish, but they do add noise and complexity to the situation. Frankly, it's only been the last year or so that we've had volatility reemerge. I mentioned in our commentaries earlier this year about a market regime change, and this is it. It took nine years to get ourselves in this situation. I don't think it will unwind in nine months.

I won't belabor this with the cliché that it's different this time. **It's different every time.** There is no precedent for this interest rate and economic environment.

Now, I don't want to go too far out on a limb making the case that growth will continue to beat value, especially in the short run. Given how much money shifts around based on top-down, factor-based investing, and that value's return to glory is the flavor of the month, I know better than to fight the tide of dollars in the short run. It's an easy, seemingly low risk decision to shift money away from growth and into value right now. I think it will be important to untangle the speculative rebalancing from changes to underlying fundamentals.

From a fundamental standpoint, and as an active manager with a focus on high quality, secular growth companies, I really like where we sit today. There's so much noise, so much uncertainty, so much change, this continues to be a target rich environment – *not despite the volatility, but because of it*. Buckle up and enjoy!

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 June 30, 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 June 30, 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.