Stephens Investment Management Group®

The Power of Growth®

STEPHENS SMALL CAP GROWTH SEPARATE ACCOUNT

QUARTERLY COMMENTARY

FOURTH QUARTER 2017

MARKET OVERVIEW

I suppose it was a fitting end to 2017. We cut and pasted some of our comments from Q2 to Q3, and we could have done it again this quarter. Equity markets rose again throughout Q4. The S&P 500® gained 6.64%. Volatility remained near record low levels, which was reflected by the fact that domestic equity markets posted gains in every single month of 2017.

While much of the story was the same, some important dynamics changed this quarter. Interest rates moved higher, especially at the short end of the curve. Commodity prices generally rose, and inflation expectations picked up toward the end of the period. Some of this could be attributed to the "Tax Cuts and Jobs Act" that was signed into law in late December.

Even though we are almost nine years into this bull market, the economy finally seems to be heating up and delivering the kind of growth one would expect coming out of a cyclical bottom.

SMALL CAP GROWTH SEPARATE ACCOUNT COMPOSITE PERFORMANCE

Across the broad market, large cap companies fared better than small, and growth strategies beat value, similar to Q2 and Q3.

The Russell 2000® Growth Index rose 4.59%, while the Stephens Small Cap Growth Composite gained 4.63%, gross of fees (4.45% net).

Consumer Discretionary stocks rebounded in Q4 from some softness in the prior quarter. Our underweight position worked against us, but we fared better in terms of security selection. Boot Barn Holdings, Inc. was a standout again this quarter; it was our top contributor as sales accelerated.

Although it is a small part of the portfolio, Consumer Staples did very well. MGP Ingredients, Inc. posted another strong quarter and is benefitting from increased demand for premium alcohol. Calavo Growers, Inc. was another top contributor, seeing success in their avocado business and fresh cut produce for grocers.

Our recently reduced position in Energy didn't affect the portfolio too much this quarter, although the direction was negative.

Financials gained slightly more than the overall market. We did well in this sector, particularly with our new additions of EZCORP, Inc. and Green Dot Corporation. EZCORP is an operator of pawn shops, and Green Dot is primarily known for pre-paid debit cards, but is also the bank behind Apple Pay's new service.

For once, Biotech wasn't the driving force behind our relative performance in Healthcare. The sector lagged the broad market. Acadia Healthcare was our largest detractor; Q3 earnings were hurt by seemingly one-time issues: hurricanes and labor issues in the U.K.

Industrials stood out in both absolute and relative terms. We had many winners in this sector. Trex Company, Inc. continued its run from last quarter. Proto Labs, Inc., one of our larger holdings, is back to hitting on all cylinders after a challenging 2016. Many Industrials are benefitting from the anticipation of an economic acceleration as a result of the recent tax reform bill.

Technology stocks were up in absolute terms, but lagged market returns. Software companies and those associated with our automation theme were the best performers, while semiconductor companies and internet-related firms generally underperformed.

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[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.

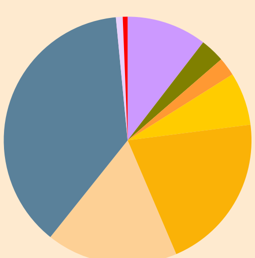
TOP 10 HOLDINGS[1]

COMPANY	% of PORTFOLIO
1.ICON Plc	2.02%
2.Proto Labs, Inc.	1.87%
3.Calavo Growers, Inc.	1.74%
4.CoStar Group, Inc.	1.71%
5.Ligand Pharmaceuticals Incorporated	1.59%
6.WageWorks, Inc.	1.57%
7.Take-Two Interactive Software, Inc.	1.56%
8.Proofpoint, Inc.	1.51%
9.Neogen Corporation	1.49%
10. Trex Company, Inc.	1.46%

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	10.44%
Consumer Staples	3.19%
Energy	2.42%
Financials	6.92%
Health Care	20.61%
Industrials	17.14%
Information Technology	37.76%
Materials	0.89%
Telecommunication Services	0.63%



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PORTFOLIO CHARACTERISTICS

We added seven new positions and eliminated four this quarter. Sector weights didn't change much at all, however. Technology, Healthcare, and Industrials are our three biggest, at 37%, 20%, and 17% respectively. We remain overweight Technology, and underweight Materials, Real Estate, Healthcare, and Consumer Discretionary.

As prices advanced, so did earnings expectations, so valuation metrics didn't change much. Our weighted harmonic average P/E ratio on the next twelve months earnings is still 28.8, and the same stat for the Russell 2000® Growth inched up to 21.2. Our median company is expected to grow earnings at 20% and revenues at 12.3% over the next year. In the most recent quarter, our median holding grew earnings at 14.4% and revenues at 14.0% versus the benchmark's 8.9% and 9.0%.

While there wasn't much of a shift with respect to sectors, there was a noticeable shift toward *earnings catalyst* companies. Catalyst now represents 53.6% of the portfolio, and core growth is the remaining 46.4%.

OUTLOOK

Here's a puzzle: We are almost nine years into this bull market. A simple analysis of history would lead us to believe that we are much closer to the end of this cycle than the beginning. At the same time, the economy is acting like it is in the early stages of a recovery. So where are we? At the beginning of the cycle or near the end?

I think it's fair to say that the tone of our commentaries the last few quarters has been somewhat cautionary. We've noted trends in risk-seeking, abnormally low volatility, expanded valuations, and the implications of the shift to ETFs and passive investing. At the same time, we haven't lost sight of what could go right.

The first is tax reform. We've been excited about the prospect of tax reform for a very long time. The first order effect is straightforward: with lower tax rates, companies will be more profitable. Ceteris paribus, greater earnings will lead to higher share prices. We could argue about whether or not the market has priced in the first order benefits of tax reform. I can't say definitively, but I would apply our firm thesis: d*ue to behavioral biases, investors tend to underestimate the magnitude and duration of change*. I don't think the market fully appreciates even the simple math of lower tax rates on corporate America. We have not yet seen the earnings estimate revisions that would reflect this. Perhaps valuations have expanded enough to anticipate these coming revisions. Perhaps not.

If it's possible that the first order effects aren't appropriately reflected in today's share prices, then I'm fairly certain that the second order effects aren't priced in much at all. What happens to those newfound profits as a result of lower taxes? They can be distributed to shareholders in the form of dividends or can be used to buy back shares. They can be used to attract or retain labor in the form of higher wages. They can be used to reinvest in the business in terms of new capital equipment or facilities. Or, finally, the profits could be essentially passed on to customers via lower prices. When it's all said and done, it will be some combination of all of the above.

The obvious and important conclusion is that any and all of those options are very stimulative to the economy. Within the first twenty-four hours of the tax bill being signed, several large companies had already announced wage increases and bonuses to employees. The trickle-down naysayers may be proven wrong very quickly.

Possibly as a result of tax reform, the second thing that could go right seems to be happening too, and that is higher interest rates. Not that higher rates are always better, but that coming off of a period of unprecedented monetary policy and even negative interest rates in some cases, and getting away from the zero bound and back into "normal" interest rate territory is an important thing. We have long argued that QE and ZIRP have contributed to, if not caused, some of the anomalous behavior we've seen in the market (risk seeking, explosion in passive investing, excess capacity in commodities, "zombie" companies, and arguably low inflation itself via neo-Fisherian channels, etc.).

The yield on the 10-year Treasury rose only ten basis points in Q4, but seems poised to keep climbing. Short term rates have increased much more. 1-month LIBOR rates climbed from 1.23% to 1.56% in the last three months of the year, up from just 0.77% a year ago.

Inflation expectations are climbing as well. With a healthy global economy and an uptick in inflation, we might get something we haven't seen in a long time: higher levels of *nominal* GDP growth. While economists usually focus on *real* growth as opposed to *nominal*, investors shouldn't dismiss the importance of the distinction between the two.

OUTLOOK

When inflation was much higher in the 1970s, economists recognized the money illusion – the tendency for consumers to feel good about their personal finances if there was meaningful nominal growth, even if in real terms their purchasing power was being eroded away by inflation. You can make a strong case that in the last nine years we've had the reverse situation. Since inflation has been so low, nominal growth has been too. In real terms, consumers have done ok, but without the nominal growth, it just doesn't feel as good.

An uptick in nominal growth might further enhance the animal spirits that we've already seen rebound of late. More importantly for our purposes, we should remember that companies report revenues and earnings in nominal terms, not real. And although inflation may be picking up, it will be exciting to see nominal growth rise to levels we haven't seen in a decade.

Without getting into the politics of the day, we think there is another interesting bias in the market. I don't think it's a stretch to say that President Trump is a controversial figure, and that many people have very strong negative feelings toward him. The Gallup poll at year end showed a 55% disapproval rating. I won't dare try to tackle whether those opinions are justified or not. Instead, with my behavioral economist hat on, I would point out that people try very hard to find data to reinforce their opinions, and go to great lengths to ignore any data that would refute them.

It's hard for me to prove this, but I think it's very possible that many of those 55% are underestimating the potential impact of these tax changes on the economy because they don't like Trump. It's easier said than done, but what investors should consider are the merits of the policy, not the character of the man who signed the bill.

So, while our tone now reflects a more bullish view of the market, we still worry about what could go wrong. At some point, rising rates will be a bad thing, as will inflation. The risks that we've identified in the past still loom. But for now, we are seeing optimism, excitement, and growth that we haven't seen in a long time.

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
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%
2007	391	353	10	192	8	15.66%	14.92%	7.05%	0.05%	13.36%	14.23%

*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 conditions, 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 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 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, 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 Cap Growth Separate Account Composite has been examined for the periods October 7, 2004 through June 30, 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 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.

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