International and Global Growth Equity Strategies

Q1 2018 COMMENTARY

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CHAUTAUQUA CAPITAL MANAGEMENT
A DIVISION OF BAIRD

INTRODUCTION

Headwinds and tailwinds can result in choppy waters. In his initial Congressional testimony, incoming Federal Reserve Chairman Jerome Powell spoke of headwinds becoming tailwinds and vice versa. We are not sure that we agree with his assessment of which is which, but we do see policy headwinds and technology-driven tailwinds. So while this is an extraordinary time for advantaged companies to produce wealth for shareholders, policy missteps, power grabs and the removal of monetary accommodation are a counter-weight. With this as a backdrop, while the first quarter was a bumpy ride, we were able to outperform.

In the first quarter of 2018, the Chautauqua Capital International Growth Equity composite appreciated 1.90%. This compared favorably to the MSCI ACWI ex-U.S. Index®, which declined 1.08%, and the MSCI EAFE Index®, which declined 1.41%. This quarterly outperformance continues the same trend from 2017. The Chautauqua Capital Global Growth Equity composite appreciated 1.34%. This compared favorably to the MSCI ACWI Index®, which declined 0.84%, and continues the trend of outperformance from 2017.*

MARKET UPDATE

For the MSCI ACWI ex-U.S. Index®, the growth style index outperformed the value style index except within emerging markets, where the value style index outperformed the growth style index. Large capitalization stocks underperformed small capitalization stocks.

For the MSCI ACWI Index®, the growth style index outperformed the value style index except within the emerging markets, where the value style index outperformed the growth style index. Large capitalization stocks underperformed small capitalization stocks of the world index.

For the MSCI EAFE Index®, the growth style index outperformed the value style index, but large capitalization stocks also underperformed small capitalization stocks.

Two markets where we are devoid of exposure, Brazil and Russia, continued to rally as their economies recover. For quality reasons, we have stayed on the sidelines. Russia's leadership continues to move away from market-friendly safeguards. Brazilian President Michel Temer has only a single-digit approval rating in the face of general elections, and the popular former President Lula has been sentenced to a prison term so we are concerned about political stability.

Sector performance was mostly negative with information technology, up 3.25%, and consumer discretionary, up 1.09%, being the exceptions.

MSCI Sector and Country Performances (QTD as of 03/31/2018)

Sector	Performance	Country	Performance	Country	Performance
Information Technology	3.25%	Brazil	12.5%	Singapore	2.8%
Consumer Staples	1.09%	Austria	2.3%	South Africa	-4.0%
Health Care	-0.80%	Canada	-7.2%	Switzerland	-3.9%
Financials	-0.91%	China	1.8%	Taiwan	5.6%
Utilities	-1.07%	Denmark	-1.1%	United Kingdom	-3.9%
Industrials	-1.47%	Germany	-3.5%	United States	-0.6%
Materials	-3.61%	India	-7.0%		
Energy	-3.62%	Ireland	-5.7%		
Consumer Staples	-4.77%	Japan	1.0%		
Telecomm	-5.28%	Korea	2.71%		
Real Estate	-5.40%	Netherlands	1.0%		

* Performance data represents past performance and does not guarantee future results. Current performance data may be lower or higher than the data quoted. For performance data to the most recent month end, contact Chautauqua directly at 303-541-1545 or www.chautauquacapital.com.

INVESTMENT TEAM

- Generalists with Specialized skills
- Averaging 23 Years investment experience

BRIAN BEITNER, CFA
MBA, University of Southern California

DANIEL BOSTON
MBA, Yale University

JESSE FLORES
MBA, Stanford University

HAICHENG LI, CFA
MBA, Stanford University
MMSc, Harvard Medical School
MS, Harvard University

DAVID LUBCHENCO
MBA, University of Denver

MICHAEL T. MOW, CFA
MBA, University of Southern California
MS, University of Iowa

ORGANIZED FOR INVESTMENT SUCCESS

- Autonomous institutional boutique
- Employee owners
- We invest alongside our clients
- Self-imposed limit on growth

The quarter began with a widespread and significant rally. Then, in February, markets experienced a broad sell-off. In March, the markets became more volatile and trended broadly lower with a preference for more defensive stocks. The so called “FANG” stocks made the headlines over security and other issues. We wish to point out that while we have maintained a significant exposure to information technology, the two “FANG” names held, Amazon and Google, have a combined portfolio exposure of approximately 2%.*

During the first quarter, Jerome Powell succeeded Janet Yellen as Chair of the U.S. Federal Reserve and the Fed has stayed on message as it voted to raise the benchmark rate by 25 basis points. Also during the quarter, the White House spooked markets with talks of trade restriction and instability among personnel.

Other central banks talk of pivoting away from bond buying (Quantitative Easing) and potentially raising rates, but at this stage, it’s just talk. Across the political landscape, it was a mix of power grabs and fragility. Chancellor Angela Merkel was able to form a coalition government in Germany, but conceded a lot of power in the process. This will hamper Germany’s ability to bring about necessary reform in the European Union (E.U.). Negotiations between the E.U. and the United Kingdom (U.K.) have made little progress as the U.K. Prime Minister has little support and her constituencies are not of one mind as to how to proceed. The equation was further complicated by Italy’s general election where no party gained enough votes to drive a coalition but, of those parties (which are diametrically opposed in many ways) that garnered the most support, the thing they agree on is that Italy should exit the euro. Italy, excluding the U.K., is the third largest economy in the currency block. Years ago, when tiny Greece was at risk of leaving the euro, there was tremendous market angst. The risk of Italy leaving and the challenges for the European Central Bank (ECB) attributable to Italy’s ailing banks bear careful monitoring.

Shinzo Abe, Japan’s Prime Minister, is embroiled in a scandal that may compromise his ability to bring further reform to Japan. Meanwhile, President Trump is dogged by election-related issues. While some are on shaky ground, others have consolidated power. By eliminating term limits, Czar Vladimir Putin won a large majority in a low turnout Russian Presidential election. In China, the People’s Congress affirmed the Xi Dynasty by making its leader their “President for life”. Turkish President Recep Tayyip Erdoğan also did away with term limits, eliminated opponents and views himself as the Sultan of the new Ottoman Empire. It’s no wonder that volatility is back.

PERFORMANCE ATTRIBUTION

In the international portfolios, superior selection effect, in five of the seven sectors, drove the outperformance in the first quarter. This was especially true about holdings in the information technology and health care sectors where the portfolio held overweight positions relative to the benchmark. Selections in the energy sector, where we held an overweight position, were a drag on performance. Security selection was also additive when considered from a regional exposure. The portfolios were negatively impacted by a lack of exposure to the Brazilian market.

In the global portfolios, superior selection effect, in four of the seven sectors, contributed to outperformance in the first quarter. This was especially true about holdings in the consumer discretionary and financials sectors where the portfolio held similar weightings to the benchmark. The strategy benefited from an underweight to consumer staples and an overweight to information technology. In addition, security selection was additive when considered from a regional exposure. The portfolios were negatively impacted by a lack of exposure to the Brazilian market.

COMPOSITE PERFORMANCE FOR THE PERIODS ENDING MARCH 31, 2018* (%)

International

	Q1 2018	1 Year	3 Year	5 Year	10 Year	Since Inception (01/01/2006)	Cumulative Since Inception (01/01/2006)
International Growth Equity – Gross	**1.90**	**26.07**	**12.08**	**10.06**	**6.49**	**8.69**	**177.40**
International Growth Equity – Net	**1.84**	**25.73**	**11.67**	**9.66**	**6.21**	**8.45**	**170.11**
MSCI ACWI ex-U.S. Index® - GD	-1.08	17.05	6.68	6.37	3.17	5.15	85.07
MSCI EAFE Index® - GD	-1.41	15.32	6.05	6.98	3.23	4.79	77.37

*These are preliminary figures from our portfolio accounting system that have yet to be verified by Ashland Partners.

Top 5 International Holdings* (as of 03/31/2018)

Security	Avg. Weight	Contribution
ASML Holding NV ADR	5.47	0.68
DBS Group Holdings Ltd	5.18	0.61
HDFC Bank Limited	5.07	-0.15
Novo Nordisk A/S	4.97	-0.28
Toronto-Dominion Bank	4.80	-0.10

Bottom 5 International Holdings* (as of 03/31/2018)

Security	Avg. Weight	Contribution
Fanuc Corporation	0.83	0.02
Sinopharm Group Co., Ltd. Class H	1.23	0.19
Ctrip.com International	1.37	0.07
Alibaba Group Holding Ltd.	1.62	0.10
Eni S.p.A.	1.89	0.05

Top 5 Global Holdings* (as of 03/31/2018)

Security	Avg. Weight	Contribution
Temenos Group AG	4.23	-0.41
Recruit Holdings Co., Ltd.	3.97	0.01
Pioneer Natural Resources	3.72	0.00
TJX Companies Inc	3.69	0.26
Charles Schwab Corporation	3.67	0.08

Bottom 5 Global Holdings* (as of 03/31/2018)

Security	Avg. Weight	Contribution
Fanuc Corporation	0.39	0.01
Lululemon Athletica Inc	0.52	0.00
Roche Holding Ltd.	0.88	-0.05
Eni S.p.A.	0.90	0.03
BYD Company Limited	0.91	-0.09

*the holdings identified do not represent all of the securities purchased, sold, or recommended for advisory clients; and
*past performance does not guarantee future results.

* As of 03/31/2018, Amazon had a 1.12% weighting and Alphabet (Google) had a 0.93% weighting in the Global Portfolio

Global							
	Q1 2018	1 Year	3 Year	5 Year	10 Year	Since Inception (01/01/2007)	Cumulative Since Inception (01/01/2007)
Global Growth Equity – Gross	**1.34**	**26.95**	**15.18**	**14.37**	**10.14**	**9.76**	**184.89**
Global Growth Equity – Net	**1.17**	**25.73**	**14.37**	**13.65**	**9.71**	**9.38**	**173.97**
MSCI ACWI Index® - GD	-0.84	15.44	8.71	9.79	6.15	5.62	85.05
MSCI World Index® - GD	-2.11	14.20	8.58	10.32	6.51	5.74	87.38

*These are preliminary figures from our portfolio accounting system that have yet to be verified by Ashland Partners.

PORTFOLIO HIGHLIGHTS | BUYS AND SELLS

In the International strategy, we exited our positions in ENI and Lululemon, both as a result of governance concerns, and initiated a position in Fanuc, the world leader in robotics and industrial automation.

In the global strategy, we exited our positions in Antero, due to concerns about natural gas prices, and ENI and Lululemon due to concerns about corporate governance.* We initiated a position in Fanuc, the world leader in robotics and industrial automation.

We continued to make changes to weightings to reflect our concerns regarding market fragility and elevated valuations for equities. Being nimble enough to exploit current market volatility has been additive to returns.

For the Chautauqua International Growth composite, 82% of companies that reported earnings during the quarter exceeded consensus expectations.

For the Chautauqua Global Growth composite, 86% of companies that reported earnings during the quarter exceeded consensus expectations.

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OUTLOOK

Headwinds and tailwinds will likely continue to produce choppy waters. From our vantage point, we cannot recall a better time for advantaged businesses. The reduction in the cost of compute, storage and the ease with which information can be moved around is creating extraordinary opportunities for the best-in-breed leaders to exploit these changes. Jen-Hsun "Jensen" Huang, CEO of Nvdia, likes to say, "The more you spend (buying their graphics processors) the more you save". For scale operators who can afford to adopt cutting edge technology, it is true. If a business is not, it will be massively disrupted. Asset light, platform-oriented businesses are rapidly changing the way business is being done and are offering a much better business proposition for their customers. Our studies show that the top quartile growers are growing exponentially faster than the average company.** Likewise, the most profitable companies are becoming increasingly more profitable than the average company. This is a trend that has been a centerpiece to our investing approach for more than a decade. A book that we have all read, which does an excellent job of explaining this, is called "Machine, Platform, Crowd: Harnessing Our Digital Future" by Andrew McAfee and Erik Brynjolfsson of the Sloan School of Business at MIT. The opportunities for the types of companies we invest in are very exciting. This is the big tailwind for global quality growth investors like us.

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The headwinds are more numerous. The most powerful and necessary is the reversal of monetary accommodation by central banks. In an effort to support an economic recovery in the absence of fiscal stimulus, interest rates have been held to artificially low levels for the past 9 years. This was done by first setting the rates at which banks can borrow or deposit with the central bank at very low levels (to encourage the banks to lend), and second by the central banks purchase of newly issued government bonds and subsequently other types of bonds (in some cases equity securities) which altered the supply and demand dynamics in the markets. This form of "life support" was necessary early on, but now that the world economy has closed its output gap and is running at full capacity, this stimulus is no longer necessary. The major central banks are at various stages of pivot but the tonic for the 9-year bull market rally for all financial assets is being reversed.

When an economy is running at full capacity and unemployment rates fall to friction levels absent an infusion of new workers, wage pressures start to build. In order to pay higher wages, businesses need to either become more productive or raise prices (or both) to maintain their margins. Inflation

*Antero had a 1.36% weighting in the Global portfolio as of 12/31/2017
**Data as of 02/09/2018. Source: Bloomberg MSCI ACWI ex US ETF

measures all have their faults and the statistics can be volatile. In the first quarter, numerous countries got an inflation scare and subsequent reassurance as inflation subsided at the next observation. We remain concerned, however, because the calculus implies inflation is looming. Accordingly, the reflation trend is a part of our current posturing. Rising inflation and rising interest rates are generally bad for all financial assets. Often time, value-oriented styles outperform growth as rates rise. Given our belief that the best-in-breed high growers that enjoy pricing power have an outsized opportunity, we should not give up on our time-tested approach. But we must be extra careful to ensure that when we are paying premium valuations, the companies indeed grow fast enough to more than justify the premium.

We are also concerned about political brinkmanship. As competitions play out in trade – be it U.S. tariff threats, NAFTA re-negotiations, BREXIT terms or China's "One Belt One Road" debt inducements in Africa – there is a big potential for damage. For many years, America's trade deficit was attributable to imported oil. As a result of the shale boom, this is no longer the case; but the trade deficit persists. As a nation with a low household savings rate and a widening government deficit, we consume more than we produce. When that happens, the gap is filled by imports. High imports without offsetting exports results in a trade deficit. Moreover, as our trade partners take dollars for their goods and services, we have a widening capital account deficit. This is not all bad since those who sell us their goods and have a trade surplus get paid in dollars that find their way back into U.S. dollar-denominated debt instruments. This effectively reduces interest rates for Americans as dollar-denominated borrowers. It's a subsidy for consuming more than we produce.

The point of weakness in the equation is that the trade deficit will cause an adjustment in the relative value of the currency. The bigger the trade and capital account deficit, the worse it is for the dollar. This augurs for a sizeable non-U.S. equity exposure. While we believe International stocks generally are more reasonably priced, gains from their currencies may be additive too. Tariffs will create winners and losers within the U.S. as there are steel sellers and steel buyers in the same economy. What is more, tariffs trigger retaliations. In the aftermath of a trade war, the benefits of comparative advantage are diminished for all concerned. Ironically, the source of the problem is not cheap steel made abroad but a widening Federal deficit. The markets understand this – it's too bad that policy makers don't.

We believe that we do not have material exposure to any of the industries that are identified for trade restriction but we do understand that even talk of trade wars is not healthy for equity markets.

We believe that the significant presence of value agnostic participants in the global equity markets make these markets more fragile. Additionally, after a 9-year bull market, valuations are relatively high. High valuations do not necessarily induce a sell-off but mean that prices can fall that much further in a sell-off before value-conscious buying stabilizes the markets. Accordingly, we continue to do things that do not cost very much to help us preserve capital while continuing to participate in profits growth from advantaged businesses.

The first quarter was choppy and we should not expect the rest of the year to be any easier. Especially with the cast of policy makers the markets have to deal with. As a focused and nimble investment team, we welcome increased volatility.

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BUSINESS UPDATE

There have been no changes to the investment staff at Chautauqua Capital Management nor have there been any changes to the ownership structure of our parent company Baird.

Respectfully submitted,

The Partners of Chautauqua Capital Management – a Division of Baird

CHAUTAUQUA CAPITAL MANAGEMENT
A DIVISION OF BAIRD

Investment Professional	Educational Background	Years of Experience	Prior Affiliation
Brian Beitner, CFA *Managing Partner*	MBA, University of Southern California BS, University of Southern California	38	TCW Group Scudder Stevens & Clark Bear Stearns Security Pacific
Daniel Boston *Partner*	MBA, Yale University BS, Brigham Young University	13	Ensign Peak Advisors Wasatch Advisors
Jesse Flores *Partner*	MBA, Stanford University BS, Cornell University	12	Roth Capital Partners Blavin & Company Lehman Bros.
Haicheng Li, CFA *Partner*	MBA, Stanford University MMSc, Harvard Medical School MS, Harvard University BA, Rutgers University	17	TCW Group
David Lubchenco *Partner*	MBA, University of Denver BA, The Colorado College	26	Marsico Capital Management Transamerica Investment Management Janus Capital
Michael Mow, CFA *Partner*	MBA, University of Southern California MS, University of Iowa BA, California State University, Northridge	31	American Century TCW Group Farmers Insurance

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The MSCI ACWI Index® is a free float-adjusted market capitalization weighted index that is designed to measure the equity performance of developed and emerging markets. The MSCI ACWI Index® consists of 44 country indices, including the United States, comprising 23 developed and 21 emerging market country indices.

The MSCI ACWI ex-U.S. Index® is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets excluding the United States.

The MSCI EAFE Index® is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets, excluding the United States and Canada. The MSCI EAFE Index® consists of 21 developed market country indices.

The MSCI World Index® is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets. The MSCI World Index® consists of 23 developed market country indices.

Performance results will vary among client accounts. The actual return and value of an account will fluctuate and at any point in time could be worth more or less than the amount invested. The performance results displayed herein represent the investment performance records for the Chautauqua composites that include fully discretionary fee paying client accounts. The composites' returns are total, time weighted returns expressed in U.S. dollars. Composite returns reflect the reinvestment of dividends and other earnings. The net performance reflects the deduction of investment advisory fees and transactions costs and the gross performance is net of transaction costs, but gross of advisory fees. The cumulative performance information shown is the aggregate amount that the composites have gained since inception through March 31, 2018.

The Chautauqua Capital Management Strategies are available to institutions and persons with a minimum account asset value of $50,000,000, which is negotiable in certain instances.

For additional important information about the fees, expenses, risks and terms of investment advisory accounts at Baird, please review Baird's Form ADV Brochure, which can be obtained from your financial advisor and should be read carefully before opening an investment advisory account.

Robert W. Baird & Co. 777 East Wisconsin Avenue, Milwaukee, Wisconsin 53202
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