CHAUTAUQUA CAPITAL MANAGEMENT
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From Chautauqua Capital Management
A Division of Robert W. Baird

International and Global Growth Equity Strategies

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Introduction

Immediately after the U.K. referendum, nearly all equity markets worldwide experienced significant downside volatility. However, markets recovered sharply in the next month given an absence of calamitous effects of Brexit and continued to grind higher in the quarter, propped by central bank action in the U.K. and reassurances from the euro-zone and Japan on the future availability of easing.

In this environment, the Chautauqua Capital International Growth Equity composite increased 6.45%, underperforming the MSCI ACWI ex-U.S. Index®, which increased by 7.00%, and slightly underperforming the MSCI EAFE Index®, which increased 6.50%. The Chautauqua Capital Global Growth Equity composite increased 11.26%, outperforming the MSCI ACWI Index®, which increased 5.43%.

Review

For the MSCI ACWI ex-U.S. Index®, value style outperformed growth style. Within emerging markets, growth style outperformed value style. Small capitalization stocks outperformed large capitalization stocks in all but the emerging market indices. For the MSCI EAFE Index®, the value style outperformed the growth style, and small capitalization stocks outperformed large capitalization stocks.

For the MSCI ACWI Index®, the value style outperformed the growth style, and small capitalization stocks outperformed large capitalization stocks. Within emerging markets, the growth style outperformed the value style, and large capitalization stocks outperformed small capitalization stocks.

Performance by country, in which the portfolios were invested and as measured by MSCI, is as follows: Brazil 11.37%, Canada 5.04%, China 13.96%, Denmark -6.17%, France 6.43%, Germany 10.02%, Hong Kong 11.92%, Ireland 7.50%, Italy 2.34%, Japan 8.76%, Korea 10.97%, Netherlands 9.23%, South Africa 6.39%, Spain 9.45%, Switzerland 2.66%, Taiwan 12.35% and U.K. 3.99%.

Sector performance was similarly dispersed, though mostly positive. The best performing sectors were information technology 13.62%, materials 9.81% and financials 7.44%. The worst performing sectors were utilities -2.99%, telecom -1.50% and consumer staples -0.32%.

Theresa May, the former Home Secretary in David Cameron’s administration, became the new U.K. Prime Minister. Although she was a supporter of the “Remain” campaign, Prime Minister May appointed Boris Johnson, a leader in the “Leave” campaign and former Mayor of London, as the new Foreign Secretary.

Meanwhile, initial economic data in the U.K. triggered worries of recession post-Brexit, which just as quickly abated when data later in the quarter sharply improved. Purchasing Managers’ Index (PMI) data in July showed a swift decline, the largest on record, moving the indicator to its lowest point in the U.K.

since early 2009 and signaling a strong risk of recession. In response, the Bank of England announced in its August meeting a broad package of monetary stimulus to counteract the material drop in demand following the referendum. Policy actions included cutting interest rates in half to 0.25% and expanding bond purchases, both sovereign and corporate, by 70 billion pounds over the next six months. Bank of England Governor Mark Carney also announced downward revisions to the U.K. Gross Domestic Product (GDP) forecast, now anticipating second half 2016 GDP growth of 0.5% and 2017 GDP growth of 0.8% (down from 2.3% growth previously). Curiously, and surprisingly, U.K. PMI data showed a sharp increase in August, the second largest on record, relieving recession fears, at least in the immediate term.

In Europe, second quarter GDP growth was 1.2%, which slowed from 2.1% in the first quarter. More significantly, downward revisions to the European Central Bank's (ECB) growth and inflation projections following the U.K. referendum were surprisingly small. The ECB actually raised their 2016 euro-zone GDP growth forecast slightly to 1.7% (from 1.6%), and only lowered 2017 and 2018 by ten basis points to 1.6%. Marginal changes to the forecast convey a more constructive outlook than perhaps anticipated, given the economic uncertainty created by Brexit, but ECB President Mario Draghi did acknowledge that the forecast risk skewed to the downside.

The ECB held policy steady in their most recent meeting in September. However, President Draghi focused the attention to their forward guidance, which stated that quantitative easing would continue until the expiration of the current program in March 2017 or longer, if needed to meet the 2% inflation target. He did not make explicit what the future policy moves would look like. The base case remains that the ECB will extend quantitative easing in its current form, purchases of 80 billion euros per month, once the program expires.

Similarly, the Bank of Japan (BOJ) avoided substantial easing measures, instead reconfiguring their policy framework to spur inflation. First, the BOJ committed itself to continue expanding the monetary base until the inflation rate exceeded their 2% target. Second, and as a matter of new tactics, the BOJ will begin targeting the yield, initially at zero percent, on 10-year Japanese government bonds. In other words, the BOJ will shift its quantitative easing program from specifying the quantity of assets to purchase, but letting the market determine the price, to setting a price target on assets and then purchasing as much or as little quantity required to reach the target. Thus, future monetary easing can employ either short-term rate cuts or cuts to long-term yields on Japanese government bonds. Earlier in the quarter, the Japanese government also approved fiscal stimulus worth 4.6 trillion yen (approximately 60 billion dollars) to be included in this year's supplementary budget, suggesting a more balanced approach to stimulus, on the margin.

In the U.S., the Federal Open Market Committee (FOMC) kept policy rates unchanged, although the decision appears to have been a close call. The case for an increase in the federal funds rate has strengthened as the U.S. labor market has strengthened, and growth has picked up from the modest pace seen in the first half of the year. In the post-meeting statement, the FOMC described risks to the U.S. economic outlook as being "roughly balanced", a departure from a more worried tone at the end of the second quarter.

China's economy grew 6.7% in the second quarter, the same as in the first quarter, which is a healthier pace than many investors expected. Investment in infrastructure surged and personal consumption has been strong.

Members of the Organization of Petroleum Exporting Countries (OPEC) agreed to limit output. No quotas were formally set, and the agreement would still need to be ratified in OPEC's next official meeting in November. Notwithstanding, the OPEC agreement is the first since the oil bear market began in 2014, and, as such, will likely provide support to oil prices at least in the short term.

Portfolio Highlights

A stronger than expected monetary stimulus in the U.K. in July, followed by reassurances by the major central banks that more stimulus would be available in the future, helps explain market movements during the quarter. The major world indices advanced strongly in July, traded slightly higher in August and continued to advance in September.

Performance Attribution

In a volatile quarter, the International Growth Equity portfolio generated positive returns, in-line with the benchmark. Strong stock selection, along with an overweight to the information technology sector, contributed to performance despite leadership from value and small caps during the quarter, which is a typical headwind for our high quality growth approach. Further, our opportunistic approach to select investments in emerging markets contributed to returns with strong stock selection, notably in the Asia & Pacific Basin.

The Global Growth Equity portfolio generated positive returns, in excess of the benchmark. Stock selection accounted for 95% of the outperformance vs. the MSCI ACWI index during the quarter. On a regional basis, North America accounted for 70% of the stock selection, with strong contributions from Europe and Asia. From a sector standpoint, strong stock selection and an overweight to information technology contributed to performance, as did strong stock selection in health care, which made up for the negative allocation affect from an overweight in the underperforming healthcare sector. Of note, the leadership rotation away from consumer staples, utilities and telecommunication services aided performance, given our underweights to these sectors. While we have select investments in these sectors, we find it difficult to find high-quality growth companies that meet our rigorous growth and valuation requirements.

Composite performance for the periods ending September 30, 2016*

International

	Q3 2016	1 Year	3 Year	5 Year	Since Inception 1/1/06	Cumulative Since Inception 1/1/06
International Growth Equity - Gross	**6.45%**	**20.20%**	**4.03%**	**9.15%**	**7.24%**	**111.98%**
International Growth Equity - Net	**6.38%**	**19.82%**	**3.67%**	**8.72%**	**7.03%**	**107.57%**
MSCI ACWI ex-U.S. Index® -GD	7.00%	9.80%	0.64%	6.52%	3.73%	48.20%
MSCI EAFE Index® - GD	6.50%	7.06%	0.93%	7.88%	3.46%	44.20%

Global

	Q3 2016	1 Year	3 Year	5 Year	Since Inception 1/1/07	Cumulative Since Inception 1/1/07
Global Growth Equity - Gross	**11.26%**	**22.93%**	**9.64%**	**13.83%**	**8.13%**	**114.24%**
Global Growth Equity - Net	**11.21%**	**22.36%**	**9.09%**	**13.28%**	**7.85%**	**108.93%**
MSCI ACWI Index® -GD	5.43%	12.60%	5.74%	11.23%	4.09%	47.82%
MSCI World Index® - GD	4.99%	12.02%	6.44%	12.27%	4.32%	51.04%

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

Outlook

In response to the great financial crisis, numerous central banks of developed economies have deployed quantitative easing. By purchasing large quantities of sovereign bonds, they attempted to shift the supply and, thereby, lower long-term interest rates. While the policy aim is laudable, quantitative easing also created some unintended negative consequences. These negative consequences have most significantly affected the business models of commercial banks, which have been hampered as massive purchases of government bonds pushed long-term yields to very low levels and, in some cases, into negative territory. With low interest rates, banks are challenged to make a reasonable spread between their borrowing and lending rates. Moreover, some central banks, in an effort to encourage lending, charge banks for depositing funds at the central bank. Despite the size and duration of these quantitative easing programs, and while they have proven to be beneficial to the financial markets, they have not benefited the broader economy. The U.S. and U.K. central banks tapered their buying beginning in 2014. The U.S. Federal Reserve is currently contemplating rate hikes.

The Bank of Japan (BOJ) and the European Central Bank (ECB), while commencing their programs later, have been notable for their volume and pace. The BOJ acquired nearly $790 billion of government debt, corporate bonds and equities via exchange traded funds. Consequently and early in the third quarter, yields on the 10-year Japanese government bond reached -0.3%, which was only marginally higher than the yield on 3-month Japanese bills and has resulted in a flattening of the yield curve. The economy stunting effect of a flattened yield curve seems to have marked the end of quantitative easing. Prime Minister Shinzo Abe is now emphasizing fiscal measures to stimulate the Japanese economy. While not in recession, deflation has been persistent. Private consumption remains weak, and demographics present a structural challenge.

Europe also faces headwinds. A combination of the European Central Bank's negative interest rate policy and quantitative easing has also caused a flattening of the euro-zone's yield curve. For the first time in history, Germany sold 10-year government bonds offering a negative yield. This interest rate environment creates the same structural problems for the banking and economic system of Europe as it does for Japan. Furthermore, idiosyncratic issues at the Italian banks and at Deutsche Bank potentially create immediate concern.

The final outcome of U.K. and European Union relations post-Brexit, as well as their economic consequences, remains another swing factor. Forecasts for economic growth are already being revised down. The Bank of England significantly downgraded its projections for U.K. GDP growth in the second half of this year and in 2017, but their base case still avoids recession. Meanwhile, the European Central Bank downgraded their projection for euro-zone growth for 2017. Bank of England (BOE) Governor Mark Carney already warned that the slowdown in the U.K. economy could be even more pronounced than the downgraded forecasts reflect, as he has endorsed adding more monetary stimulus to buoy demand. Ultimately, the true impact of the U.K. referendum on economic growth remains to be seen. The BOE will meet next in November. For now, the consensus view is that the Brexit vote will manifest as a regional economic event, rather than a global one. The U.K. accounts for less than 4% of world GDP and, accordingly, its economy is not big enough to influence the trajectory of global growth.

Given the lack of economic growth attributable to quantitative easing, the ECB is also expected to tapper its bond buying. This widespread reduction in monetary accommodation should lead to higher interest rates and increased financial price volatility in the developed markets. It spells good news in many of the developing economies as it creates an opportunity for central bankers to cut rates. In places like China, India, Brazil, Indonesia and Russia, real rates (the interest rate premium over inflation) are relatively high. Rate reductions create a favorable tail wind for most financial assets. Accordingly, we continue to opportunistically evaluate quality investments in the emerging markets.

China has been an area of emphasis for the portfolios. The transition of China's economy appears to be stabilizing and export and manufacturing growth has improved. Meanwhile, personal consumption and the services sector have been stronger than expected. We continue to invest in the businesses that benefit from domestic demand and we remain on the right side of government policy.

Now, seven years after the inflection point of the great recession, most of the world's economies are still laboring to de-leverage. The benefits derived through monetary stimulus are near the physical limits. Output gaps have persisted and many businesses have deferred spending to expand capacity or staffing. While this has been margin-enhancing, at some point, job growth will lead to tighter labor conditions and this will reverse. Favorable tailwinds including: monetary ease, productivity growth in the developing world, credit-driven increases in consumption, margin expansion due to low wage growth and, most importantly, the multi-decade decline in the cost of borrowing have largely run their course. As a result, it is much harder to earn high returns on investments. Moreover, in a slow growth world, the truly valuable wealth-generating businesses are increasingly rare. This actually augers for concentrated "best in class" portfolios, such as the ones we construct; nevertheless, the task has become harder. That said, we are up to the task and accept the challenge.

Business Update

During the third quarter, we further strengthened our investment team with the addition of a new Partner, Haicheng Li, CFA. Prior to joining Chautauqua Capital, Haicheng was a Senior Analyst and Portfolio Manager at TCW for the past 14 years, and she brings special expertise in the healthcare sector. Importantly, Brian actually hired Haicheng into TCW in 2002, and they overlapped for 7 years there. Needless to say, Haicheng is very familiar with Chautauqua Capital's long-term, concentrated and conviction-weighted investment strategy of owning advantaged businesses benefiting from secular growth trends.

It bears mentioning that the addition of Haicheng to our team has been made possible because of our relationship with Robert W. Baird. Baird has given us the financial security to retain key personnel and to attract high caliber talent, like Haicheng, and yet remain an autonomous, boutique investment firm. Additionally, Baird has expanded and enhanced our office space in Boulder, launched mutual fund vehicles for our strategies and enabled us to rehire David Lubchenco to the investment team in the previous quarter.

Respectfully submitted,

The Partners of Chautauqua Capital Management – a Division of Robert W. Baird

In April 2016, Baird launched the Chautauqua International Growth Fund (CCWIX, CCWSX) and the Chautauqua Global Growth Fund (CCGIX, CCGSX).

Investors should consider the investment objectives, risks, charges and expenses of the fund carefully before investing. This and other information can be found in the prospectus or summary prospectus. A prospectus or summary prospectus may be obtained from your financial advisor or the fund website and should be read carefully before investing.

The above commentary does not provide a complete analysis of every material fact regarding any market, industry, security or portfolio. Portfolio holdings information, opinions and other market or economic information and data provided are as of the date of the commentary, unless another date is expressly indicated, and may change without notice. The manager's assessment of a particular industry, security or investment is intended solely to provide insight into the manager's investment process and is not a recommendation to buy or sell any security, nor investment advice.

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 September 30, 2016.

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Chautauqua Capital Management Investment Team

- All investment team members have equity ownership
- Average years of experience: 20 years

Investment Professional	Degrees	Years of Experience	Prior Affiliation
Brian Beitner, CFA *Managing Partner*	MBA, University of Southern California BS, University of Southern California	36	TCW Group Scudder Stevens & Clark Bear Stearns Security Pacific
Daniel Boston *Partner*	MBA, Yale University BS, Brigham Young University	10	Ensign Peak Advisors Artisan Partners Wasatch Advisors
Jesse Flores *Partner*	MBA, Stanford University BS, Cornell University	8	Roth Capital Partners Blavin & Company Lehman Bros.
Haicheng Li, CFA *Partner*	MBA, Stanford University MMSc, Harvard Medical School MS, Harvard University BA, Rutgers University	15	TCW Group
David Lubchenco *Partner*	MBA, University of Denver BA, The Colorado College	24	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	29	American Century TCW Group Farmers Insurance