

Second Quarter 2018



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Portfolio Manager

COMPOSITE PERFORMANCE (%)

	COMPOSITE GROSS OF FEES	COMPOSITE NET OF FEES	S&P 500® INDEX
3 MOS.	2.90	2.76	3.43
YTD	-0.17	-0.45	2.65
1 YR.	10.49	9.88	14.37
3 YR.	8.92	8.30	11.93
5 YR.	9.95	9.33	13.42
ITD (09/30/2010)	12.37	11.73	14.22

The composite performance shown above reflects the Brown Advisory Equity Income Composite, managed by Brown Advisory Institutional. Brown Advisory Institutional is a division of Brown Advisory LLC, and Brown Advisory Institutional is a GIPS compliant firm. Please see the end of this for a GIPS compliant presentation.

REP. ACCOUNT CHARACTERISTICS

	EQUITY INCOME REP. ACCT.	S&P 500 INDEX
Weighted Avg. Market Cap.	\$187.2 B	\$217.3 B
P/E Ratio (FY2 Est.)	15.8x	15.6x
Active Share	77.4%	
Dividend Yield	2.7%	1.9%
Return on Equity (ROE)	20.9%	19.6%
Portfolio Turnover (3-Yr.Avg.)	12.1%	--

REP ACCOUNT. TOP 10 PORTFOLIO HOLDINGS

SECURITY	% PORTFOLIO
Cash & Equivalents	5.7
Microsoft Corp.	5.1
Apple, Inc.	4.2
Cisco Systems, Inc.	3.9
Altria Group, Inc.	3.8
Merck & Co, Inc.	3.3
McDonald's Corp.	3.2
JPMorgan Chase & Co.	3.2
Automatic Data Processing, Inc.	3.1
United Technologies Corp.	2.8
TOTAL	38.4

Review & Outlook

After declining during the first quarter, U.S. stocks rose in the second quarter amid a period that featured a subdued level of day-to-day price volatility. The Equity Income Strategy rose during the quarter but trailed its benchmark, the S&P 500® Index.

As in the first quarter, the consumer discretionary and information technology sectors performed well during the second quarter. Energy joined them on the leaderboard as the top gainer on a sector basis for the period due to a rise in oil prices. The strategy's energy holdings meaningfully outperformed the benchmark. In fact, all of the strategy's holdings in energy, consumer discretionary and information technology rose in price during the quarter.

Consumer staples was one of the weakest sectors during the quarter, and the strategy's holdings fared worse than the benchmark. The main culprit was **Philip Morris International**, which reported a slowdown in sales of its innovative iQOS heated tobacco product in Japan. The iQOS product has been a major success for Philip Morris International in the initial markets where it has been introduced, such as Japan. But sales unexpectedly slowed in the first quarter of this year, raising concerns that the new product's growth might have already reached a plateau. Altria, which has an agreement with Philip Morris International to sell the iQOS product in the U.S. upon approval from the FDA, fell in sympathy.

There were no additions to the portfolio during the quarter and two deletions. We eliminated chipmaker **Qualcomm** based on a reduced outlook for earnings and dividend growth over the next few years, whether or not its long-planned purchase of fellow chipmaker NXP Semiconductors is eventually completed. We sold reinsurance broker and professional services firm **Willis Towers Watson** after the stock reached its estimated fair value. After a successful multiyear merger integration and cost-cutting program, Willis is on a strong financial footing to grow its business. As a result, management's capital allocation focus is shifting away from growing the dividend in favor of share repurchases and potential acquisitions.

The Equity Income Strategy favors investments with attractive dividend growth opportunities over those offering high absolute dividend yields but inferior growth potential. This positioning has largely helped performance over the past two years as compared to other income-focused investment strategies. During this span, long-term U.S. interest rates have risen, and faster-growing stocks have generally outperformed slower-growing ones.

This year's corporate tax reform in the U.S. has already boosted available cash with which companies can pay dividends. Thus, several of the strategy's holdings accelerated their dividend growth rates. In the first half of this year, 12 portfolio companies announced dividend increases of 10% or more. We expect several more sizable dividend increases from other holdings in the second half of the year as well.

We believe that focusing on industry leaders with durable business models and emphasizing sustainable dividend growth over absolute dividend yield is currently a prudent portfolio strategy for an income-oriented investor. The strategy has kept a consistent eye toward downside protection since its inception and seeks to use periods of market volatility as opportunities to make new, profitable long-term investments. As always, the objective is to construct the best possible portfolio of investments that offer above-average yields with a strong potential for future growth at reasonable valuations. [B](#)

Please see disclosure statements at the end of this presentation for additional information and for a complete list of terms and definitions.

Sector Diversification

- Our energy weighting increased because of an increase in stock prices. The strategy is currently underweight the sector.
- Our consumer staples weighting decreased because of a decrease in stock prices, most notably tobacco holdings Philip Morris International and **Altria Group**. The strategy is currently overweight the sector.
- Our financials sector weighting decreased during the quarter as we eliminated Willis Towers Watson from the portfolio. Despite the deletion, the strategy remains overweight the sector.
- We have no exposure to the telecommunication services and utilities sectors because of what we consider to be unattractive valuations and limited potential for dividend growth rates in the sectors.

SECTOR	EQUITY INCOME REP. ACCOUNT (%)	S&P 500 INDEX (%)	DIFFERENCE (%)	EQUITY INCOME REP. ACCOUNT (%)	
	Q2 '18	Q2 '18	Q2 '18	Q1 '18	Q2 '17
Consumer Discretionary	12.81	12.86	-0.04	12.23	9.88
Consumer Staples	11.90	6.96	4.94	13.33	15.63
Energy	5.78	6.34	-0.55	4.78	4.76
Financials	15.08	13.84	1.24	16.46	17.40
Health Care	12.83	14.07	-1.25	12.67	12.09
Industrials	8.49	9.51	-1.02	8.93	12.21
Information Technology	21.80	26.02	-4.22	21.50	19.52
Materials	3.73	2.60	1.12	2.96	1.75
Real Estate	7.58	2.86	4.72	7.14	6.77
Telecommunication Services	--	1.99	-1.99	--	--
Utilities	--	2.95	-2.95	--	--

Quarterly Attribution Detail by Sector

- The consumer staples sector was the biggest detractor from performance during the quarter because of unfavorable stock selection. Most notably, tobacco-related holdings Philip Morris International and Altria Group both declined in price during the period.
- The energy sector was the biggest contributor to relative performance during the quarter. All three of the strategy's holdings in the sector increased meaningfully in price during the period.
- The information technology sector also contributed to relative performance because of favorable stock selection. All six of the strategy's holdings in the sector increased in price during the period.

SECTOR	EQUITY INCOME REP. ACCOUNT		S&P 500 INDEX		ATTRIBUTION ANALYSIS		
	AVERAGE WEIGHT (%)	RETURN (%)	AVERAGE WEIGHT (%)	RETURN (%)	ALLOCATION EFFECT (%)	SELECTION AND INTERACTION EFFECT (%)	TOTAL EFFECT (%)
Consumer Discretionary	12.65	7.31	12.71	8.18	0.01	-0.10	-0.09
Consumer Staples	12.24	-6.61	6.90	-2.22	-0.37	-0.54	-0.91
Energy	5.47	23.05	6.16	13.44	-0.08	0.43	0.36
Financials	15.85	-2.88	14.45	-3.17	-0.07	0.02	-0.06
Health Care	12.85	1.13	14.00	3.47	--	-0.29	-0.29
Industrials	8.46	-3.60	9.93	-3.19	0.09	-0.07	0.02
Information Technology	21.61	8.37	25.63	7.17	-0.14	0.24	0.09
Materials	3.47	7.98	2.80	2.98	0.00	0.16	0.15
Real Estate	7.40	5.12	2.73	6.13	0.13	-0.08	0.05
Telecommunication Services	--	--	1.89	-1.01	0.08	--	0.08
Utilities	--	--	2.81	3.69	0.00	--	0.00
Total	100.00	2.87	100.00	3.45	-0.35	-0.23	-0.58

Quarterly Contribution to Return

- Payroll and business services provider **Automatic Data Processing** rose after reporting strong quarterly earnings and raising its guidance for bookings growth for the current year. The company also outlined its plans to increase margins at an analyst meeting and increased its dividend by 10%. We trimmed our position slightly during the quarter based on the stock's strong performance.
- Oil and gas producer **Occidental Petroleum** gained after reporting strong quarterly earnings that exceeded expectations. The company is benefiting this year from higher market prices for its oil production and increased activity in its core Permian Basin operations.
- **Apple Inc.** rose after reporting quarterly earnings that were ahead of expectations, led by solid iPhone and services-related sales. The company also raised its dividend by 16% during the quarter.
- Software maker **Microsoft** gained after reporting strong quarterly results across all of its various business segments. The company also announced the acquisition of GitHub for \$7.5 billion in stock to gain access to a broader array of software developers. We trimmed our Microsoft position slightly during the quarter, though the stock remains our largest holding.
- Pharmaceutical company **Merck & Co.** rose as its Keytruda cancer drug continued to show positive benefits in several trials and studies for treating various forms of cancer.
- Global cigarette producer Philip Morris International dropped sharply after reporting an unexpected slowdown in sales of its innovative iQOS heated tobacco device in Japan. The iQOS device garnered a significant market share among Japanese smokers over the past few years but is now growing more slowly as the product reaches beyond early adopters of the new technology. On the bright side, the company increased its dividend by 6% in the quarter.
- U.S. cigarette producer Altria Group fell in sympathy along with Philip Morris during the quarter. Altria is waiting for FDA approval to start selling the iQOS reduced-risk device in the U.S. under a licensing agreement with Philip Morris.
- Defense and aerospace company **General Dynamics** dropped after the company's CEO commented at an investor conference that margins at its Gulfstream business jet unit will decline over the next year as it shifts production to introduce new aircraft to the market. Customer demand for the new aircraft is strong, according to the company.
- Pharmaceutical company **Novartis** declined after reporting lower-than-forecasted sales of its psoriasis drug Cosentyx. Late in the quarter, Novartis announced it will spin off its Alcon eye care business to shareholders next year. The company's dividend and growth plans will not be impacted by the separation.
- Commercial insurer **Cincinnati Financial** fell after reporting quarterly results that were below expectations, due largely to winter-weather-related losses in several states. We expect the company's results to improve over the course of the year and added slightly to our position.

EQUITY INCOME REP. ACCOUNT TOP FIVE CONTRIBUTORS				
TICKER	NAME	AVG. WEIGHT (%)	RETURN (%)	CONTRIBUTION TO RETURN (%)
ADP	Automatic Data Processing, Inc.	3.30	18.81	0.58
OXY	Occidental Petroleum Corporation	2.25	29.98	0.57
AAPL	Apple Inc.	4.40	10.76	0.47
MSFT	Microsoft Corporation	5.51	8.51	0.45
MRK	Merck & Co., Inc.	3.36	12.31	0.39
EQUITY INCOME REP. ACCOUNT BOTTOM FIVE CONTRIBUTORS				
PM	Philip Morris International Inc.	2.82	-17.61	-0.59
MO	Altria Group Inc	4.09	-7.75	-0.34
GD	General Dynamics Corporation	1.73	-15.25	-0.29
NVS	Novartis AG Sponsored ADR	2.90	-6.57	-0.20
CINF	Cincinnati Financial Corporation	2.02	-9.27	-0.19

Portfolio Activity

- There were no new additions to the portfolio during the quarter.
- We eliminated chipmaker Qualcomm Inc. from the portfolio during the quarter. With its planned purchase of NXP Semiconductors, Qualcomm's focus is moving away from dividend growth in favor of acquisitions. Regardless of the outcome of the NXP deal, we see a weaker outlook for earnings and dividend growth for the company over the next several years.
- Insurance broker and professional services provider Willis Towers Watson was also eliminated from the portfolio. Willis has improved its earnings and competitive position within its industry over the past several years, and its stock price has performed well as a result. The stock reached our estimate of fair value during the quarter.

EQUITY INCOME REP. ACCOUNT PORTFOLIO ACTIVITY		
ADDITIONS		SECTOR
	None	
DELETIONS		SECTOR
QCOM	QUALCOMM Incorporated	Information Technology
WLTW	Willis Towers Watson Public Limited Company	Financials

Brown Advisory Equity Income Composite

Year	Composite Total Gross Returns (%)	Composite Total Net Returns (%)	Benchmark Returns (%)	Composite 3-Yr Annualized Standard Deviation (%)	Benchmark 3-Yr Annualized Standard Deviation (%)	Portfolios in Composite at End of Year	Composite Dispersion (%)	Composite Assets (\$USD Millions)	GIPS Firm Assets (\$USD Millions)
2017	21.5	20.8	21.8	8.7	9.9	49	0.3	289	33,155
2016	10.5	9.9	12.0	9.7	10.6	44	0.2	252	30,417
2015	-4.4	-5	1.4	10.1	10.5	53	0.2	331	43,746
2014	11.3	10.7	13.7	8.3	9	72	0.3	446	44,772
2013	29.2	28.5	32.4	8.6	11.9	84	0.3	450	40,739
2012	12.8	12.0	16.0	NA	NA	67	0.2	350	26,794
2011	11.6	11.0	2.1	NA	NA	43	0.2	120	19,962
2010*	6.5	6.5	10.8	NA	NA	8	N/A	22	16,859

*Return is for period October 1, 2010 through December 31, 2010.

Brown Advisory Institutional claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Brown Advisory Institutional has been independently verified for the periods from January 1, 1993 through December 31, 2017. The Verification reports are available upon request. 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. Verification does not ensure the accuracy of any specific composite presentation. GIPS® is a registered trademark owned by CFA Institute.

1. *For the purpose of complying with the GIPS standards, the firm is defined as Brown Advisory Institutional, the Institutional and Balanced Institutional asset management divisions of Brown Advisory. As of July 1, 2016, the firm was redefined to exclude the Brown Advisory Private Client division, due to an evolution of the three distinct business lines.
2. The Equity Income Composite includes all discretionary portfolios invested in the equity income strategy. The strategy invests primarily in U.S. equities that exhibit above-average dividend yields, dividend growth and return on equity. The minimum account market value required for composite inclusion is \$1.5 million.
3. This composite was created in 2010.
4. The benchmark is the S&P 500® Index. The S&P 500 Index is a capitalization-weighted index of 500 stocks that is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. Index returns assume reinvestment of dividends and do not reflect any fees or expenses. An investor cannot invest directly into an index. Benchmark returns are not covered by the report of the independent verifiers. Standard & Poor's, S&P®, and S&P 500® are registered trademarks of Standard & Poor's Financial Services LLC ("S&P"), a subsidiary of S&P Global Inc..
5. The dispersion of annual returns is measured by the equal weighted standard deviation of portfolio returns. The composite dispersion is not applicable (N/A) for periods where there were five or fewer accounts in the composite for the entire period.
6. Gross-of-fees performance returns are presented before management fees but after all trading commissions. Net-of-fee performance returns reflect the deduction of actual management fees and all trading commissions. Other expenses can reduce returns to investors. The standard management fee schedule is as follows: 0.80% on the first \$10 million; 0.65% on the next \$15 million; 0.50% on the next \$25 million; and 0.40% on the balance over \$50 million. Further information regarding investment advisory fees is described in Part II A of the firm's form ADV. Actual fees paid by accounts in the composite may differ from the current fee schedule.
7. The three-year annualized ex-post standard deviation measures the variability of the composite (using gross returns) and the benchmark for the 36-month period ended on December 31. The three-year annualized standard deviation is not presented as of December 31, 2010, 2011 and 2012 because 36 month returns for the composite were not available (N/A).
8. Valuations and performance returns are computed and stated in U.S. dollars. All returns reflect the reinvestment of income and other earnings.
9. A complete list of composite descriptions, policies for valuing portfolios, calculating performance and preparing compliant presentations is available upon request.
10. Past performance does not indicate future results.
11. This piece is provided for informational purposes only and should not be construed as a research report, a recommendation or suggestion to engage in or refrain from a particular course of action or to make or hold a particular investment or pursue a particular investment strategy, including whether or not to buy, sell or hold any of the securities mentioned, including any mutual fund managed by Brown Advisory.

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Composite performance is based on the Brown Advisory Equity Income Composite and was obtained through FactSet®. All information and returns shown are as of 06/30/2018 for each period. Returns greater than one year are annualized. Past performance is not indicative of future results. Representative account characteristics and top 10 holdings were obtained through FactSet. This information is based on a representative Equity Income account and is provided as supplemental information. Account characteristics exclude cash and cash equivalents; top 10 holdings list includes cash and cash equivalents. FactSet® is a registered trademark of FactSet Research Systems, Inc.

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Terms and Definitions For Representative Account Calculations

All financial statistics and ratios are calculated using information from FactSet as of the report date unless otherwise noted. FactSet® is a registered trademark of FactSet Research Systems, Inc. The **Market Capitalization** refers to the aggregate value of a company's publicly-traded stock. **Weighted Average Market Capitalization** of a portfolio equals the average of each holding's market cap, weighted by its relative position size in the portfolio (in such a weighting scheme, larger positions have a greater influence on the calculation). **Price-Earnings Ratio (P/E Ratio)** is the ratio of the share of a company's stock compared to its per-share earnings. P/E calculations presented use FY2 earnings estimates; FY1 estimates refer to the next unreported fiscal year, and FY2 estimates refer to the fiscal year following FY1. **Active Share** measures the percentage of holdings in a manager's portfolio that differ from those in the benchmark index. An active share of 0% means that the portfolio is identical to the benchmark, while an active share of 100% means that the portfolio has no common holdings with the benchmark. **Dividend Yield** is the ratio of a stock's projected annual dividend payment per share for the fiscal year currently in progress, divided by the stock's price. **Return on equity (ROE)** is equal to a company's net income for a full fiscal year, divided by total shareholder equity. The **Average Weight** of a position or sector refers to the daily average for the period covered in this report of a stock's value as a percentage of the portfolio. The **Total Return** of an equity security is the sum of the return from price movement and the return due to dividend payments or other sources of income. The portfolio and benchmark returns provided reflect the sum of the returns of the equity holdings in the portfolio and the benchmark, respectively. The returns exclude cash. **Allocation Effect** measures the impact of the decision to allocate assets differently than those in the benchmark. **Selection and Interaction Effect** reflects the combination of selection effect and interaction effect. Selection effect measures the effect of choosing securities that may or may not outperform those of the benchmark. Interaction effect measures the effect of allocation and selection decisions (i.e., did we overweight the sectors in which we underperformed). **Total Effect** reflects the combination of Allocation, Selection and Interaction effects. Totals may not equal due to rounding. **Contribution To Return** is calculated by multiplying a security's beginning weight as a percentage of a portfolio by that security's return for the period covered in the report.