Flexible Equity

QUARTERLY STRATEGY UPDATE

Brown ADVISORY
Thoughtful Investing.

Second Quarter 2018

COMPOSITE PERFORMANCE (%)

	COMPOSITE GROSS OF FEES	COMPOSITE NET OF FEES	S&P® 500 INDEX
3 MOS.	5.53	5.43	3.43
YTD	6.09	5.89	2.65
1 YR.	19.87	19.41	14.37
3 YR.	12.60	12.17	11.93
5 YR.	13.75	13.31	13.42
10 YR.	12.38	11.84	10.17
25 YR.	11.52	10.82	9.60
ITD (12/31/1984)	13.57	12.82	11.26

The composite performance shown above reflects the Brown Advisory Institutional Flexible Equity 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

	FLEXIBLE EQUITY REP. ACCT.	S&P 500 INDEX
Wtd. Avg. Market Cap.	$233.4 B	$217.3 B
Weighted Median Market Cap.	$100.0 B	$104.8 B
P/E Ratio (FY2 Est.)	16.9x	15.6x
Price/Book Value	3.1x	3.2x
Earnings Growth (3-5 Yr. Est.)	16.0%	13.5%
Return on Equity (ROE)	23.4%	19.6%
Portfolio Turnover (3-Yr. Average)	12.1%	--
Active Share	72.7%	

REP. ACCOUNT TOP 10 PORTFOLIO HOLDINGS

SECURITY	% PORTFOLIO
Visa, Inc.	5.8
Alphabet. Inc. (Class A & C)*	4.9
Mastercard, Inc.	4.7
Berkshire Hathaway, Inc. Cl B	4.6
Microsoft Corp.	3.5
CarMax, Inc.	3.5
Wells Fargo & Co.	3.5
Apple, Inc.	3.4
Charles Schwab Corp.	3.3
Lowe's Companies, Inc.	3.2
TOTAL	**40.4**

*Alphabet Inc. represents a 2.1% holding position in class A and 2.8% in class C shares of the stock.

R. HUTCHINGS VERNON, CFA
Portfolio Manager

MANEESH BAJAJ, CFA
Portfolio Manager

Review & Outlook

The U.S. stock market rose in the second quarter, and the S&P 500® Index, the strategy's benchmark, returned 3.4%. Flexible Equity portfolios rose as well and generally outpaced the market's results. Positive and negative headlines of events in the world and company developments created ups and downs in the day-to-day share prices, yet the averages finished higher than where they started.

Finishing higher than they started should be the usual expectation for investors in U.S. equities, especially as time periods stretch from quarters to years and beyond. But many investors seem built to worry. When investors are making money, they worry that winning may turn to losing or that they are not making as much as the next person. When they are losing money, investors may worry that their losses will not stop. When investors are just holding steady, they may worry about finding another more exciting game to play. All this worry makes it hard to enjoy the ride in productive businesses when, in fact, that is exactly what most investors should be doing over long periods of time.

At the most recent **Berkshire Hathaway** shareholders meeting, Warren Buffett shared a great example of enjoying the ride, with a story about his first stock purchase in March 1942 and how U.S. stocks have done since. Buffett shared headlines from the New York Times that showed how badly World War II was going for the U.S. This was just three months after the attack on Pearl Harbor. Buffett, who was 11 years old and was aware of the stock market because his father was a stockbroker, decided to put his life savings into three shares of Cities Service preferred stock at a price of $38.25 per share. The stock had traded as high as $84 during the previous year, but by the end of the day was $37 and later sunk to $27. Having seen Cities Service fall to $27, Buffett sold it as soon as it recovered to $41, only to see it go up to $200 in later years. In 1942, Buffett had not yet discovered Benjamin Graham's teachings about the market existing to serve the intelligent investor rather than to guide him.

Buffett took a step back from that personal experience and asked the audience to imagine what would have happened if they had put $10,000 into U.S. stocks in March 1942 into the then-equivalent of an S&P 500 Index. How much would that money be worth today? After a pause, he revealed the answer is $51 million, the result of $10,000 compounding at 11.9% annually over 76 years. As he explained, you did not have to understand accounting, finance, the Federal Reserve or watch the stock market every day, all you had to do was believe in America and that it would rise above its challenges. That compounding is the power of putting your money into the productive assets of businesses within the American system. He noted that the key question for equity investors in the general market is how American business will do over an investment lifetime.

In contrast, Buffett cited gold as the asset people often turn to when they are worried about the future, but he noted that gold is an unproductive asset. It just sits there doing nothing. Gold does not pay dividends or earn interest, and it doesn't adapt and change to new developments and opportunities. If you put $10,000 into gold in 1941, you would have purchased 300 ounces of it. That 300 ounces today would be worth about $400,000, for a compounding rate of 5.0%.

$51 million versus $400,000 is the difference in choosing productive assets over unproductive ones, or perhaps in not letting worry over short-term possibilities overcome a likely long-term favorable result. 1942 is a long time ago. Is a similar result still possible today? Yes, the U.S. system continues to work well over time despite periodic challenges. Compounding at nearly 12% would seem a stretch for reasons we have discussed in earlier commentaries, but the long-term outcome should nevertheless reward the persistent investor. We share other observations from Buffett and his business partner Charlie Munger in our notes on the Berkshire Hathaway annual meeting, which we look forward to publishing later this quarter.

The Flexible Equity team searches for investment bargains among long-term attractive businesses with shareholder-oriented managers—those with productive assets and productive managers. These businesses should have or develop competitive advantages that result in good business economics, managers who allocate capital well, capacity to adjust to changes in the world and an ability to grow business value over time. Bargains in these types of stocks can arise for various reasons but are often due to short-term investor perceptions, temporary business challenges that will improve, company or industry changes for the better, or as-yet-unrecognized potential for long-term growth and development. Despite the occasional investment that will go awry and stretches when the general stock market is unrewarding, we are optimistic about the long-term outlook for equities of good businesses purchased at reasonable prices and our ability to find them.

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

Sector Diversification

- We base our investment approach on individual company selection and incorporate a reasonable balance of sector exposures as part of risk management. Companies in the same economic sectors can vary as greatly in their business economics and profiles as companies in completely different sectors.
- The consumer discretionary weighting increased, as it was the second best contributor to the portfolio's return. We trimmed **Chipotle Mexican Grill** based on its price.
- All three energy holdings increased in share price.
- Our financials weighting decreased as a result of the sector's negative return. We added to **Ameriprise** in the quarter.
- In health care, we trimmed **Aetna** and added to **Anthem and UnitedHealth Group**. The health care weighting increased with the strong return of these holdings.
- Information technology stocks rose in the quarter. We trimmed **Mastercard**, **Visa** and **PayPal Holdings** following their price appreciation.
- In real estate, we added to **SBA Communications Corp**.
- In the coming quarter, Standard & Poor's will change its sector composition and move several companies with a communications element in their business from the consumer discretionary and information technology sectors to the communication services sector. This will have no effect on how we select portfolio holdings, but it will affect how these stocks are classified.

SECTOR	FLEXIBLE EQUITY REP. ACCOUNT (%)	S&P 500 INDEX (%)	DIFFERENCE (%)	FLEXIBLE EQUITY REP. ACCOUNT (%)	
	Q2 '18	Q2 '18	Q2 '18	Q1 '18	Q2 '17
Consumer Discretionary	14.23	12.86	1.37	13.82	18.32
Consumer Staples	3.93	6.96	-3.03	3.86	1.37
Energy	5.36	6.34	-0.98	4.65	4.01
Financials	25.65	13.84	11.81	27.49	27.22
Health Care	9.13	14.07	-4.95	8.61	10.18
Industrials	6.46	9.51	-3.05	7.15	6.50
Information Technology	32.81	26.02	6.79	32.13	30.55
Materials	--	2.60	-2.60	--	--
Real Estate	2.44	2.86	-0.42	2.29	1.84
Telecommunication Services	--	1.99	-1.99	--	--
Utilities	--	2.95	-2.95	--	--

Quarterly Attribution Detail by Sector

- Attribution is a tool that calculates the effect of sector allocation and stock selection relative to market and sector benchmarks of performance. This tool does not reflect how we manage investments, and we believe it has significant limitations, but it is frequently requested, so we share it for that reason.
- The portfolio return exceeded the return of the S&P 500 Index.
- Information technology was the strongest contributor due to both our higher-sector weighting and its higher return. The consumer staples sector was the second highest contributor, as the sector in the portfolio had a lower weighting and a positive return relative to the decline of the sector in the Index.
- The financials sector was the biggest detractor to results due to its decline and its higher weighting than the S&P 500 Index.

SECTOR	FLEXIBLE EQUITY REP. ACCOUNT		S&P 500 INDEX		ATTRIBUTION ANALYSIS		
	AVERAGE WEIGHT (%)	RETURN (%)	AVERAGE WEIGHT (%)	RETURN (%)	ALLOCATION EFFECT (%)	SELECTION AND INTERACTION EFFECT (%)	TOTAL EFFECT (%)
Consumer Discretionary	13.87	10.17	12.71	8.18	0.06	0.24	0.31
Consumer Staples	3.81	7.29	6.90	-2.22	0.21	0.36	0.57
Energy	5.10	22.03	6.16	13.44	-0.09	0.37	0.28
Financials	26.81	-2.43	14.45	-3.17	-0.81	0.23	-0.59
Health Care	8.78	9.14	14.00	3.47	0.02	0.47	0.48
Industrials	6.81	-4.97	9.93	-3.19	0.21	-0.13	0.08
Information Technology	32.65	9.56	25.63	7.17	0.29	0.71	1.00
Materials	--	--	2.80	2.98	0.01	--	0.01
Real Estate	2.17	-2.02	2.73	6.13	-0.01	-0.17	-0.18
Telecommunication Services	--	--	1.89	-1.01	0.09	--	0.09
Utilities	--	--	2.81	3.69	0.01	--	0.01
Total	**100.00**	**5.51**	**100.00**	**3.45**	**-0.01**	**2.06**	**2.06**

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Quarterly Contribution to Return

- Visa and Mastercard, top holdings in the portfolio, posted strong quarterly results and increased financial guidance. Both companies continue to invest in new initiatives to support and enhance future growth.
- **Facebook's** shares recovered as headline news regarding user privacy concerns abated.
- **CarMax** reported attractive earnings results that were better than investors' expectations. CarMax's stock is often volatile and is based on quarter-to-quarter earnings fluctuations.
- **Occidental Petroleum's** stock increased with the rise in the price of crude oil.
- Financial stocks were generally lower in the quarter. Berkshire Hathaway, Ameriprise Financial and **JPMorgan** declined modestly.
- **General Dynamics** reported strong earnings results overall, but investors were disappointed in the Gulfstream aerospace business. The better results from the company's defense businesses offset lower revenue in aerospace, which management attributed to the timing of deliveries.
- **United Rentals'** stock declined as investors became more concerned about the potential impact of tariffs on economic growth.

FLEXIBLE EQUITY REP. ACCOUNT TOP FIVE CONTRIBUTORS				
TICKER	NAME	AVG. WEIGHT (%)	RETURN (%)	CONTRIBUTION TO RETURN (%)
V	Visa Inc. Class A	6.03	10.90	0.66
MA	Mastercard Incorporated Class A	4.93	12.36	0.61
FB	Facebook, Inc. Class A	2.86	21.61	0.57
KMX	CarMax, Inc.	3.31	17.65	0.53
OXY	Occidental Petroleum Corporation	1.61	29.98	0.43
FLEXIBLE EQUITY REP. ACCOUNT BOTTOM FIVE CONTRIBUTORS				
BRK.B	Berkshire Hathaway Inc. Class B	5.00	-6.43	-0.32
GD	General Dynamics Corporation	1.38	-15.25	-0.23
URI	United Rentals, Inc.	1.01	-14.54	-0.15
AMP	Ameriprise Financial, Inc.	2.54	-4.82	-0.15
JPM	JPMorgan Chase & Co.	3.29	-4.77	-0.14

Portfolio Activity

- We eliminated **Qualcomm** in favor of starting a new position in **Broadcom**. Broadcom was blocked in its attempt to acquire Qualcomm, but Qualcomm's resistance to Broadcom's offer highlighted a lack of shareholder orientation at Qualcomm. Broadcom, on the other hand, seems interested in generating returns for shareholders. It announced a large share repurchase once the possibility of acquiring Qualcomm was foreclosed. Broadcom has built an attractive business that we believe will continue to grow organically and through mergers, all while expanding margins through increased scale and cost reduction.

FLEXIBLE EQUITY REP. ACCOUNT PORTFOLIO ACTIVITY		
ADDITIONS		SECTOR
AVGO	Broadcom Inc.	Information Technology
DELETIONS		SECTOR
QCOM	QUALCOMM Incorporated	Information Technology

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Brown Advisory Institutional Flexible Equity 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	25.1	24.6	21.8	11.4	9.9	50	0.3	2,912	33,155
2016	9.9	9.5	12.0	12.1	10.6	52	0.2	2,883	30,417
2015	-2.0	-2.4	1.4	11.1	10.5	56	0.2	2,686	43,746
2014	14.0	13.5	13.7	9.2	9.0	49	0.2	3,195	44,772
2013	37.5	36.9	32.4	11.9	11.9	44	0.4	2,247	40,739
2012	19.9	19.5	16.0	14.6	15.1	40	0.3	1,818	26,794
2011	5.8	5.4	2.1	18.5	18.7	43	1.1	1,714	19,962
2010	11.1	10.3	15.1	22.7	21.9	45	0.7	1,811	16,859
2009	37.1	36.0	26.5	21.3	19.6	48	3.4	1,905	11,058
2008	-36.5	-37.0	-37.0	16.6	15.1	51	1.9	1,541	8,547

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, 2016. 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 Institutional Flexible Equity Composite includes all actual, discretionary, institutional accounts with a flexible value equity objective of 100%. The strategy seeks bargains in "value" as well as "growth" stocks and invests primarily in the common stock of domestic companies with market capitalizations greater than $2 billion at the time of purchase. As of January 1, 2013, the minimum account market value required for composite inclusion is $1.5 million. Prior to August 2013 the name of this composite was Institutional Flexible Value. The strategy remains the same.
3. This composite was created in 1985.
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. From January 2007, through December 2008, dispersion is calculated using the asset-weighted standard deviation of the annual gross returns of those accounts included in the composite for the full year.
6. Between October 2006 and December 2008, a significant cash flow policy was adopted for this composite. A significant cash flow is defined as a single flow of cash or securities of more than 25% of the portfolio's market value at prior month end. Accounts with significant cash flows are excluded from the composite for a grace period, defined as the month during which the flow occurred. Additional information regarding significant cash flow policies are available upon request.
7. Gross-of-fees performance returns are presented before management fees but after all trading commissions, and gross of foreign withholding taxes (if applicable). Net-of-fee performance returns reflect the deduction of actual management fees and all trading commissions. Other expenses can reduce returns to investors. Prior to 2011, net performance is based on a model fee using the highest fee in effect, 0.75% applied quarterly. The Actual fees may vary, depending on, among other things, the applicable fee schedule and portfolio size. The fee schedule is as follows: 0.60% on the first $25 million; 0.50% on the next $25 million; 0.45% on the next $50 million; and 0.40% on the balance over $100 million. For periods after 2011 actual fees are used to calculate net returns. Actual fees paid by accounts in the composite may differ from the current fee schedule.
8. 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.
9. Valuations and performance returns are computed and stated in U.S. Dollars. All returns reflect the reinvestment of income and other earnings.
10. A complete list of composite descriptions, policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.
11. Past performance does not indicate future results.
12. 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 Institutional Flexible Equity Composite and was obtained through FactSet®. All information and returns shown are as of 3/31/2018 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 Institutional Flexible Equity 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.

Sector diversification, attribution, top and bottom five contributors and portfolio additions and deletions source: FactSet. Total portfolio return figures provided reflect the sum of the returns of the equity holdings in the representative account portfolio due to price movements and dividend payments or other sources of income, and exclude cash. Performance figures may vary from actual portfolio performance, as calculations are based on end-of-day security prices and do not incorporate the actual cost basis or sale price of individual securities. #Contribution to return is calculated by multiplying a security's beginning weight in the portfolio by the security's return on a daily basis, and geometrically linking the return for the reporting period. The portfolio information provided is based on a representative Institutional Flexible Equity account and is provided as supplemental information. References to specific securities are for illustrative purposes only and do not represent all of the securities purchased, sold or recommended for advisory clients. The security returns listed represent the period of when the security was held during the quarter. Top five and bottom five contributors exclude cash and cash equivalents. Sector diversification and attribution excludes cash and cash equivalents. Sectors are based on the Global Industry Classification Standard (GICS) classification system. GICS® is a registered trademark of MSCI and Standard & Poor's Financial Services LLC. The individual amounts shown for top ten holdings, sector diversification and quarterly attribution may not sum to the total amount shown due to rounding. Please see composite disclosure statements above for additional information.

Terms and Definitions for Representative Account Calculations

Weighted Median: the value at which half the portfolio's market capitalization weight falls above and half falls below**. 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. **Price to Book Value** is a valuation ratio expressing the price of a security compared to its hard, or tangible, book value as reported in the company's balance sheet. The tangible book value number is equal to the company's total book value less the value of any intangible assets. Intangible assets can be such items as patents, intellectual property, goodwill etc. **Earnings Growth 3-5 Year Estimate** is the average predicted annual earnings growth over the next three to five years based on estimates provided to FactSet by various outside brokers, calculated according to each broker's methodology. All of the above ratios for a portfolio are expressed as a weighted average of the relevant ratios of each portfolio holding, EXCEPT for P/E ratios, which are expressed as a weighted harmonic average. **ROE, or Return on Equity**, is equal to a company's net income for a full fiscal year, divided by total shareholder equity. **Portfolio Turnover (3 yr. avg.)** is the ratio of the lesser of the portfolio's aggregate purchases or sales during a given period, divided by the average value of the portfolio during that period, calculated on a monthly basis. **Active share** is calculated by taking the sum of the absolute value of the differences of the weight of each holding in the manager's portfolio versus the weight of each holding in the benchmark index and dividing by two. 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. Standard benchmark-, sector- and portfolio-level returns are the sums of the weights of each security multiplied by its return, summed and calculated daily and summed over the period covered by the report or by an otherwise-noted period. **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.