U.S. Equity Growth Fund

2018 Year in Review

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For the calendar year 2018, the Brown Advisory U.S. Equity Growth Fund[1] returned 4.84% versus the -1.89% return for the Russell 1000 Growth Net Index.

The closing chapters of 2018 turned out to be quite the page turners as market volatility took a pronounced step higher. There were 17 days during the fourth quarter in which the Russell 1000 Growth Index, the Fund's benchmark, was up or down 2% or more for the day, compared to just 10 days for the rest of the year and none in the entirety of 2017. The benchmark dropped nearly 16% in the fourth quarter, erasing all the gains from the prior three quarters and ending the year down. The narrative has not changed dramatically, yet the market has seemingly developed an increased sensitivity to the news flow as of late. Concerns of the Federal Reserve missing the target on interest rates juxtaposed with inflationary pressures and the prospect of a cooling global economy continue to dominate the financial headlines. The U.S. Equity Growth Fund held up better than the benchmark in the fourth quarter, like it did in the previous periods of volatility that we experienced earlier in the year. In fact, the portfolio outperformed in all four months the benchmark return was negative in 2018.

Stock selection in health care was a standout contributor in 2018. A combination of several names that we purchased in recent years, such as **DexCom, Inc.** (+108.7), **Zoetis, Inc.** (+19.5%) and **Edwards Lifesciences Corporation** (+35.9%), coupled with longtime holdings **Intuitive Surgical, Inc.** (+31.2%) and **Danaher Corporation** (+11.8%), both of which we have held for more than decade, all provided strong positive contributions in 2018. **DexCom**, which was the best performing stock in the portfolio, manufactures an industry-leading continuous glucose monitoring (CGM) device, used by diabetics to monitor their blood sugar levels in real time. A series of rapid succession approvals by the FDA and Medicare reimbursement approval for Dexcom, and several competitors, has validated the importance of CGM in the treatment and management of diabetes. This expanded awareness has created a massive market opportunity and DexCom is positioned well to capitalize on it. Another top contributor for the year was **Intuitive Surgical**, the robotic surgical device company which has continued to exceed expectations. This company is one of the longest held stocks in the portfolio due in large part to its innovative culture. They enjoy a nearly global monopoly on minimally invasive robotic surgical systems, yet they continually invest in the platform in order to further their competitive advantages which create a virtuous cycle driving future procedure growth.

After flipping from a modest detractor on a relative basis at the end of August, information technology became the second largest positive contributor for the full year. This was partially due to meaningful weakness in several stocks that we do not own, such as Apple, NVIDIA and IBM, which are meaningful weights in the benchmark. Software companies **Adobe, Inc.** (+29.1%) and **salesforce.com, inc.** (+34.0%) were two of our top contributors for the year. Businesses across the globe are transforming the way they operate. Everything from internal processes to the way they interact with customers is changing due to innovative digital technologies. Salesforce.com and Adobe are two software companies that are on the leading edge of this digital transformation wave, which is translating to impressive results. Both of these companies continue to take advantage of market opportunities and have been successful in prolonging their growth trajectories far longer than market expectations. **Amazon's** (+28.4%) e-commerce and public cloud businesses (Amazon Web Services) performed well in 2018 making it one of the top contributors for the year despite a pullback in the fourth quarter.

The recently reformed communications services sector was the biggest drag on the portfolio for the year. The most significant detractor was **Electronic Arts Inc.** (-24.9%), one of the world's leading video game publishers. The company experienced several setbacks during the year, some of which in our view, were self-inflicted. However, our investment thesis remains intact and management has demonstrated the ability to bounce back from these obstacles in the past which gives us confidence. The video game industry is experiencing secular growth as well as a structural profitability tailwind as consumers purchase a greater proportion of console video game services digitally. We also feel that ample opportunity remains to improve monetization of gamers' playing time, which is much lower than other forms of entertainment. Electronic Arts offers a stable portfolio of titles,

[1]Brown Advisory U.S. Equity Growth Fund B USD share class, net of fees.

anchored by their sports franchises and particularly FIFA which has global appeal.

Companies with emerging market exposure have been pressured as of late, exacerbated by expectations of a global trade war leading to an economic slowdown in some of the largest emerging economies such as China. **Alibaba Group** (-20.5%), the Chinese version of Amazon, is one of our stock holdings that has experienced weakness due to these fears. While some of the circumstances are different the situation with Alibaba is quite similar to that of our initial purchase of Amazon several years ago. Alibaba remains a relatively small position in the portfolio partly because of the elevated risk profile.

In keeping with our process of funding new positions by eliminating pre-existing names, Darwinian Capitalism as we refer to it, we sold a few companies over the year in order to invest or add to better ones. We sold our position in **Ecolab Inc.** as their growth rate has begun to slow and the proceeds were used to fund a new position in **Cintas Corporation**. As the largest provider of uniform rental and facility services in North America, we believe Cintas represents a much better growth opportunity going forward. They are the market leader in a fragmented industry with only a few large players, so their scale and management quality creates a wide competitive moat. We believe Cintas can grow faster than the industry average, as they gain market share and generate above-average margins. We also initiated a new position in the software company **Autodesk, Inc.** which provides leading architectural and manufacturing computer aided design software. Autodesk is early on in the transition to a subscription-based business model which many software companies such as another portfolio holding, Adobe, has already undertaken. We believe the upside in the stock is very compelling as the company moves forward with this transition and simultaneously takes advantage of several other opportunities such as construction and building management software. We funded this position by selling our position in **ANSYS, Inc.**, which was a fine investment for the Fund, however we believe Autodesk is a superior opportunity.

We are pleased with the performance of the portfolio over the course of the year, especially during periods of increased market volatility. Holding companies with strong fundamentals, core to our investment approach, are one of the weapons we have to combat market volatility. Business model, end-market diversification and time-tested sensitivity to excessive valuation are all components of our investment process geared toward protecting investors' capital in volatile markets. We appreciate the fact that we are not going to win the relative performance game every year, but maintaining a steadfast discipline with respect to our investment process in both favorable and difficult market conditions is crucial to adding value over the long term.

The S&P 500 Index represents the large-cap segment of the U.S. equity markets and consists of approximately 500 leading companies in leading industries of the U.S. economy. Criteria evaluated include market capitalization, financial viability, liquidity, public float, sector representation and corporate structure. An index constituent must also be considered a U.S. company. The Russell 1000® Growth Index measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000® Index companies with higher price-to-book ratios and higher forecasted growth values. The Russell 1000® Growth Index is constructed to provide a comprehensive and unbiased barometer for the large-cap growth segment. The Index is completely reconstituted annually to ensure that new and growing equities are included and that the represented companies continue to reflect growth characteristics. The Russell 1000® Growth Index is a trademark/service mark of the Frank Russell Company. An investor cannot invest directly into an index.