



Kayne Anderson Rudnick  
Investment Management

Small Cap Core Portfolio  
Managed Accounts  
Third Quarter 2018 Review

[kayne.com](http://kayne.com)

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# Firm Overview

As of September 30, 2018



Kayne Anderson Rudnick  
Investment Management

## Profile

- Originally established to manage founder capital
- Over three decades of experience
- A differentiated “business analyst” investment approach focusing on high-quality businesses
- A disciplined and repeatable investment process that produces high-conviction portfolios
- A wholly owned, independent subsidiary of Virtus Investment Partners

## At a Glance

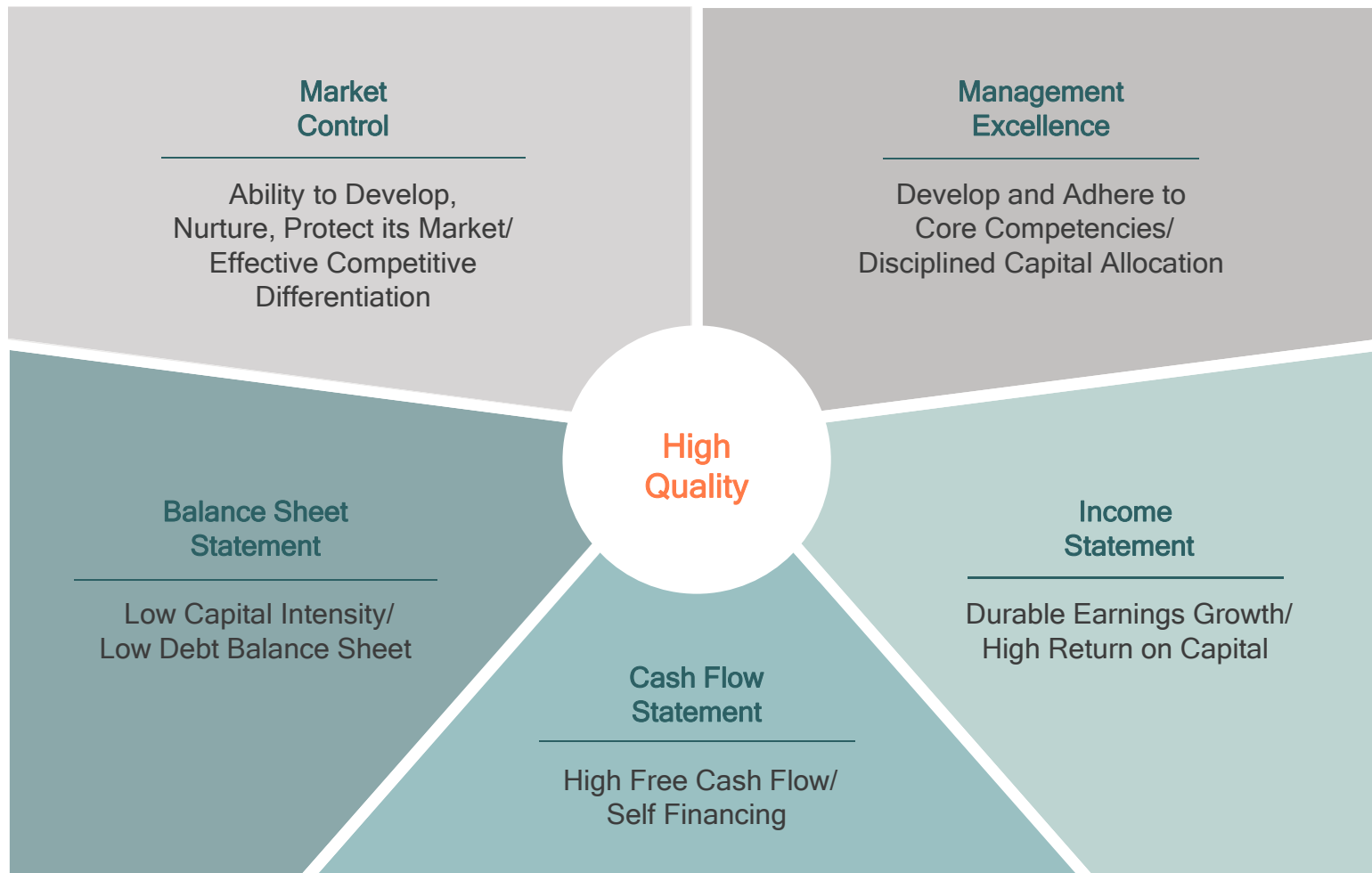
Year Founded	1984
Headquarters	Los Angeles, CA
AUM	\$26.8 billion
Number of Investment Professionals	17
Average Investment Experience	15 Years

### Investment Philosophy

We believe that purchasing high-quality businesses with competitive protections at attractive valuations will achieve excess returns over a complete market cycle

### Investment Objectives

- To achieve a return meaningfully above that of the Russell 2000® Index
- To achieve this return objective with a portfolio that exhibits lower overall risk characteristics



# Small Cap Core Team

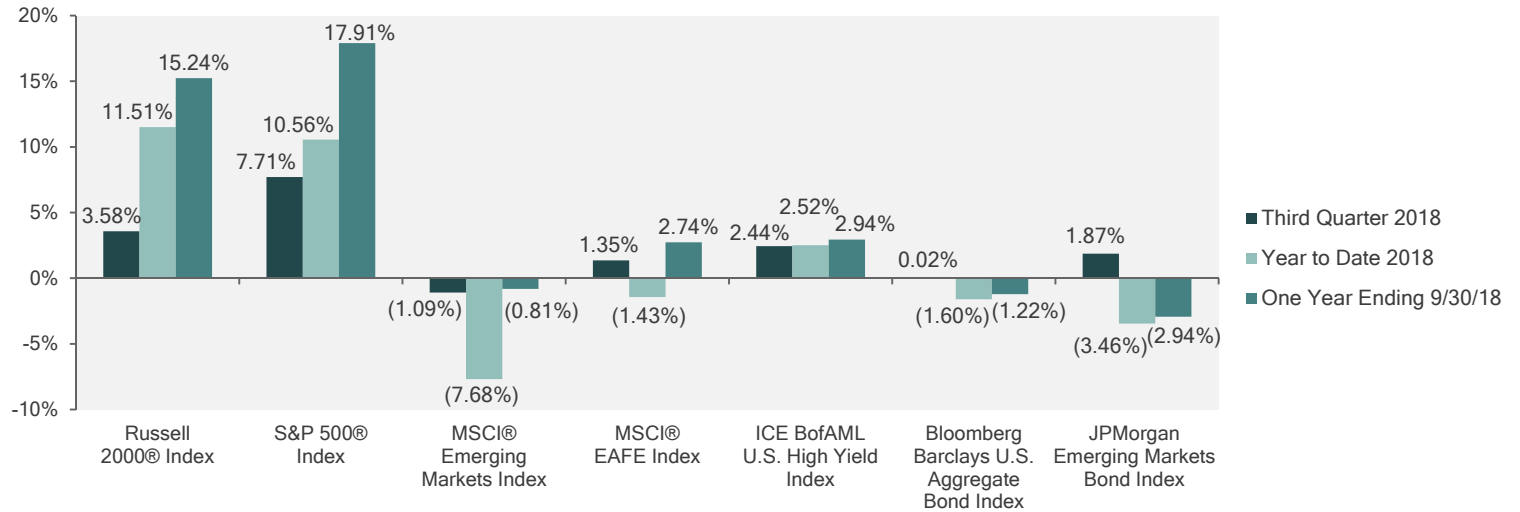


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Portfolio Manager/Analysts	Responsibility	Research Experience	Years with KAR
Douglas S. Foreman, CFA	Chief Investment Officer	32 Years	7 Years
Todd Bailey, CFA	Portfolio Manager & Senior Research Analyst Sector Coverage: Energy and Consumer Discretionary	19 Years	16 Years
Jon Christensen, CFA	Portfolio Manager & Senior Research Analyst Sector Coverage: Health Care	23 Years	17 Years
Julie Biel, CFA	Senior Research Analyst Sector Coverage: Technology	10 Years	5 Years
Julie Kutasov	Senior Research Analyst Sector Coverage: Materials and Processing	17 Years	17 Years
Craig Stone	Senior Research Analyst Sector Coverage: Producer Durables	29 Years	18 Years
Chris Wright, CFA	Senior Research Analyst Sector Coverage: Financials	8 Years	6 Years
Sean Dixon	Research Analyst Sector Coverage: Consumer Discretionary and Producer Durables	9 Years	<1 Years
Adam Xiao, CFA	Research Analyst Sector Coverage: Consumer Staples, Financials and Producer Durables	3 Years	<1 Years
Jordan Greenhouse	Portfolio Specialist	21 Years <sup>†</sup>	2 Years

<sup>†</sup>Represents years of industry experience.

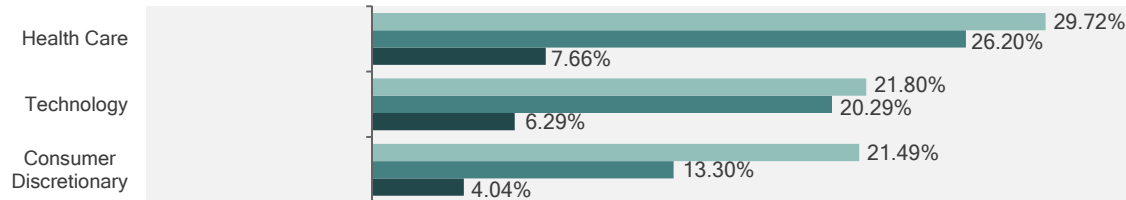
## Index Performance



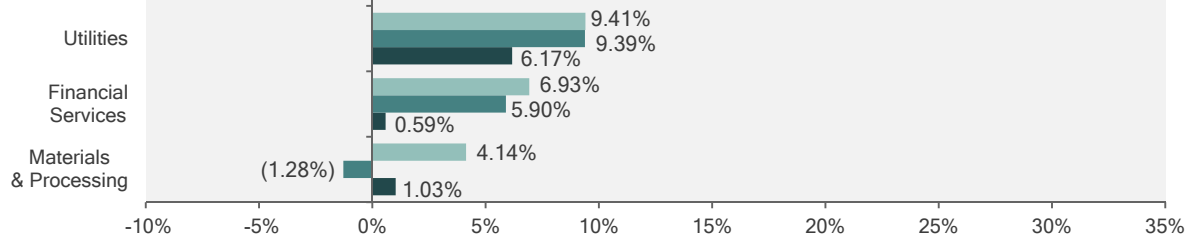
## Sector Performance

### Russell 2000® Index

#### Top Performers



#### Bottom Performers



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# Market Review

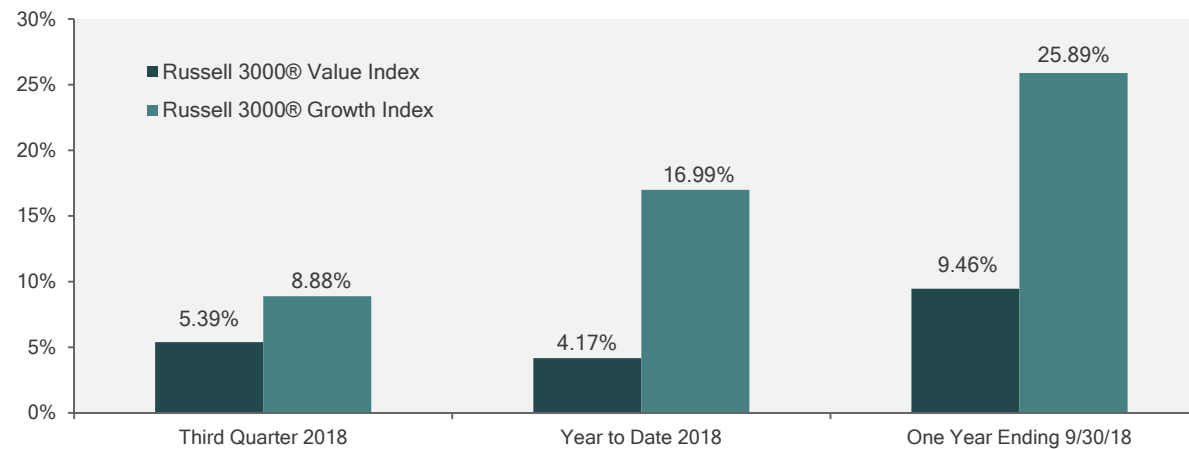
## Performance by Style and Quality



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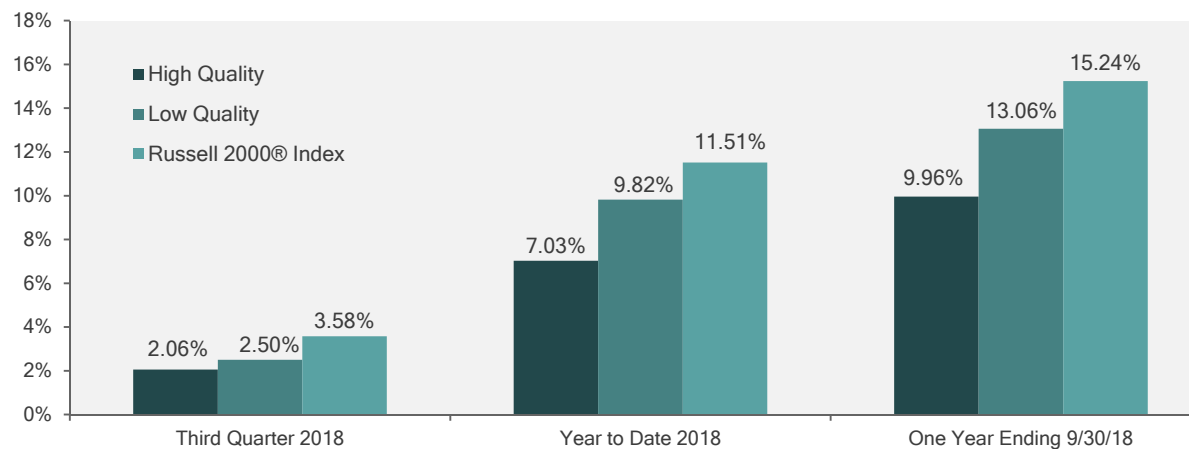
### Performance by Style

Russell 3000® Value Index vs. Russell 3000® Growth Index



### Performance by Quality

Russell 2000® Index



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*High Quality is defined as all stocks with an S&P Quality Ranking of B+ and above. Low Quality is defined as all stocks with an S&P Quality Ranking of B and below.*

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# Quarterly Performance Overview

## Small Cap Core Portfolio

Periods Ending September 30, 2018



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### Monthly, Quarterly and Year to Date Performance

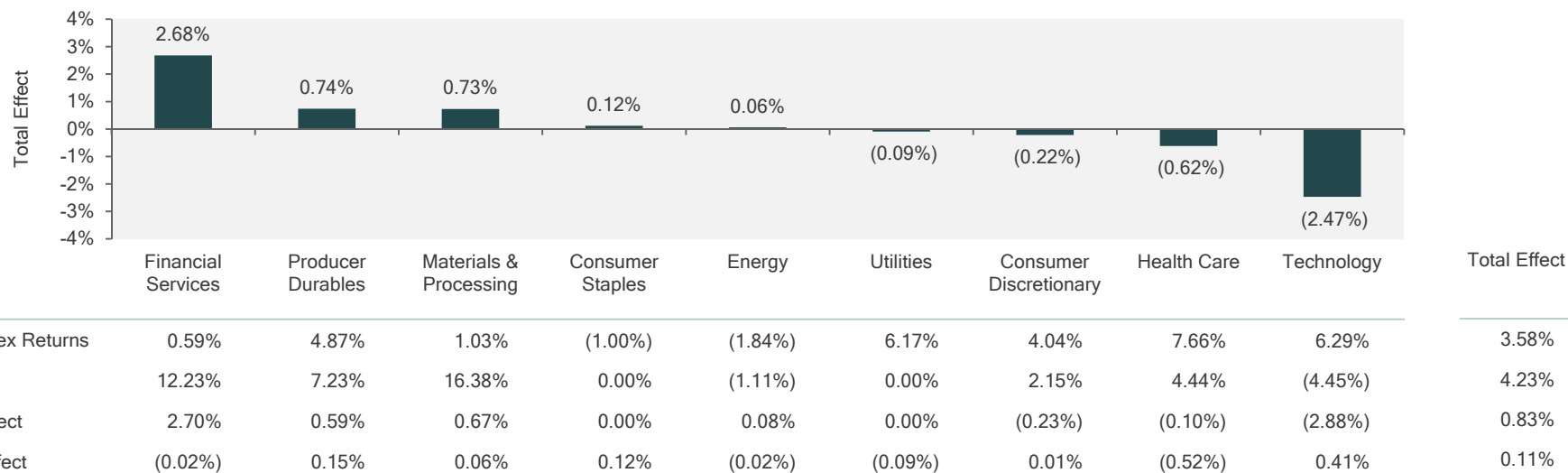
	Gross (%)	Net (%)	Index (%)	Excess Returns (bps)
July	3.23	2.98	1.74	149
August	3.38	3.13	4.31	(93)
September	(2.33)	(2.58)	(2.41)	8
Third Quarter	4.23	3.48	3.58	66
Year to Date	15.69	13.23	11.51	418

### Contributors

Highest	Contribution
Teledyne Technologies	+1.34%
Primerica	+1.13%
Aspen Technology	+1.08%
Lowest	Contribution
Autohome	(2.26%)
Rightmove	(0.73%)
Copart	(0.53%)

### Attribution by Sector

Quarter Ending September 30, 2018



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# Annual Performance Overview

## Small Cap Core Portfolio

### Periods Ending September 30, 2018



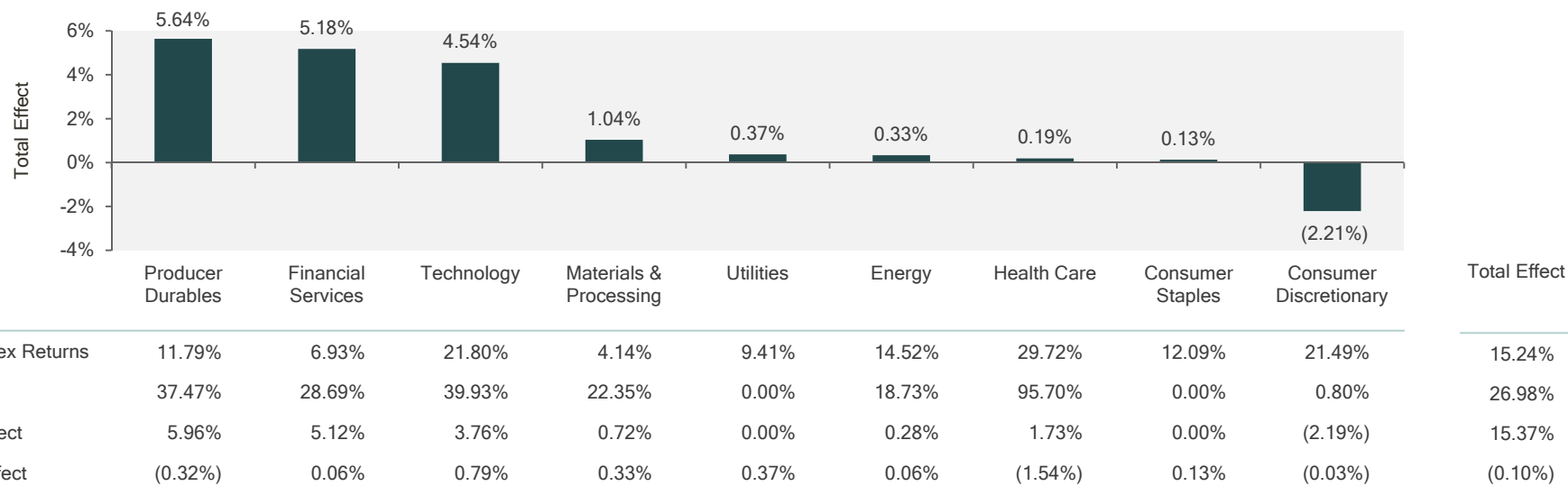
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#### Quarterly and Annual Performance

	Gross (%)	Net (%)	Index (%)	Excess Returns (bps)
Fourth Quarter 2017	9.76	8.96	3.34	642
First Quarter 2018	5.45	4.70	(0.08)	553
Second Quarter 2018	5.26	4.51	7.75	(250)
Third Quarter 2018	4.23	3.48	3.58	66
1 Year Ending 9/30/18	26.98	23.38	15.24	1175

#### Attribution by Sector

One Year Ending September 30, 2018



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# Highest Contributors

Small Cap Core Portfolio

One Year Ending September 30, 2018



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Security	Contribution	Comments
Autohome	+3.49%	Autohome's shares rose after management exited the unprofitable direct-sales segment. The company's core subscription and advertising businesses continued to prosper.
Aspen Technology	+2.95%	It has been over a year since Aspen released its latest solution, the Asset Performance Monitoring suite. Demand for this software has been robust, helping to accelerate annual contract value growth. Additionally, with greater stability now in the oil markets, the company believes it has finally seen a bottom in revenue associated with engineering and construction clients. Longer term, Aspen should continue to benefit from solid demand in its client base and derive very high levels of profitability as a result.
Teledyne Technologies	+2.90%	Through the past 12 months, Teledyne saw organic growth outpace management's guidance, supported by strong demand throughout the company's product categories. We view the company's success as a result of its differentiated offerings facing end markets with positive tailwinds.

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*A complete list of portfolio holdings and specific securities transactions for the preceding 12 months is available upon request. Holdings are subject to change. All information is provided for informational purposes only and should not be deemed as a recommendation to purchase the securities mentioned. Kayne Anderson Rudnick has chosen to review the securities in this document based upon objective criteria. It should not be assumed that securities recommended in the future will be profitable. Data is obtained from FactSet Research Systems and is assumed to be reliable. Past performance is no guarantee of future results.*

# Lowest Contributors

## Small Cap Core Portfolio

One Year Ending September 30, 2018



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Security	Contribution	Comments
WABCO Holdings	(1.10%)	WABCO shares declined due to inflation in raw-material costs and the impact on margins, as well as the uncertainty surrounding the implications of tariffs and their influence on heavy-duty truck demand. We have no special insight regarding inflation and tariffs, so we remain focused on assessing the strength of the company's competitive position, which remains intact. Also, tailwinds remain for WABCO to continue to outgrow global commercial truck production by increasing its content per vehicle.
Fox Factory Holding	(0.82%)	Fox shares experienced weakness through the end of 2017 and into 2018 as the company indicated growth was likely to decelerate in 2018 to a level more consistent with the company's annual long-term target ranges. Additionally, Fox illustrated that while its long-term EBITDA target margin goal remained, the pace of margin improvement would be lower in 2018 than in 2017. We exited the position in the first half of 2018.
PriceSmart	(0.25%)	PriceSmart owns and operates 41 retail membership warehouse clubs in Latin America, the Caribbean, and the U.S. PriceSmart's results have been negatively impacted by the political turmoil in Nicaragua.

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# Purchases and Sales

Small Cap Core Portfolio

Quarter Ending September 30, 2018

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- There were no purchases or sales during the 3<sup>rd</sup> Quarter.

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# Portfolio Characteristics

Small Cap Core Portfolio – As of September 30, 2018



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	KAR Small Cap Core	Russell 2000® Index
<b>Quality</b>		
Return on Equity—Past 5 Years	27.1%	9.9%
Total Debt/EBITDA	1.1 x	5.5 x
Earnings Variability—Past 10 Years	29.5%	80.6%
<b>Growth</b>		
Earnings Per Share Growth—Past 10 Years	14.1%	7.5%
Dividend Per Share Growth—Past 10 Years	14.0%	5.3%
Capital Generation—{ROE x (1-Payout)}	20.1%	7.6%
<b>Value</b>		
P/E Ratio—Trailing 12 Months	28.7 x	37.2 x
Dividend Yield	0.8%	1.2%
Free Cash Flow Yield†	3.2%	1.6%
<b>Market Characteristics</b>		
\$ Weighted Average Market Cap—3-Year Average	\$5.1 B	\$2.1 B
Largest Market Cap—3-Year Average	\$9.7 B	\$8.6 B
Annualized Standard Deviation—Since Inception*	15.4%	19.1%

\*April 1, 1992

†Free cash flow data is as of June 30, 2018. Prices are as of September 30, 2018. Excludes financials.

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*Data is obtained from FactSet Research Systems and BNY Mellon and is assumed to be reliable. Other principal consultant firms may use different algorithms to calculate selected statistics.*

*Estimates are based on certain assumptions and historical information. Past performance is no guarantee of future results.*

# Market Outlook

## U.S. Economy

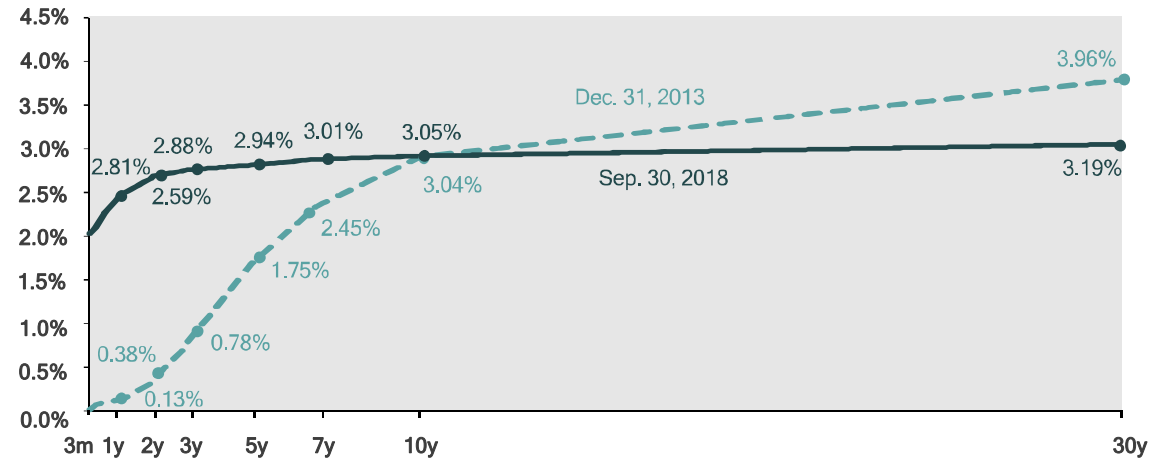


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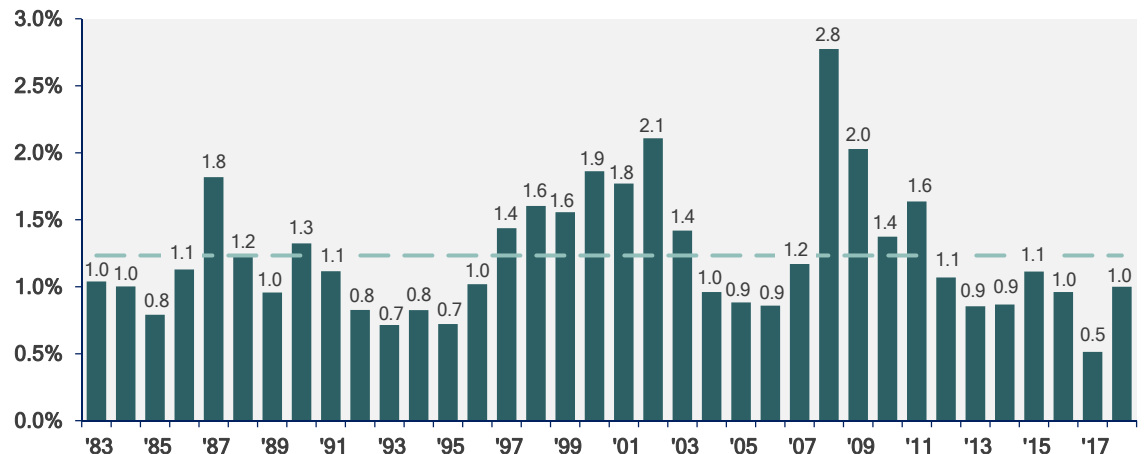
### The U.S. economy should accelerate modestly. International economies have decelerated, possibly due to trade concerns.

- The economy has accelerated over the last couple of quarters to above 3% GDP growth. 2018 growth should stabilize in the 2.5% to 3.5% GDP range.
- The Fed has raised short-term interest rates. However, the yield curve flattening will make future increases harder to attain for the Federal Reserve.
- Mid-term elections may create some short-term volatility in markets, but usually there is no meaningful long-term impact.
- Energy, materials and industrials are out of a recession and should continue to improve in 2018. Trade war threats are threatening to slow this recovery.
- Tax reform is undoubtedly a positive for corporate America, but the impact may be more uneven by industry/company than many analysts are assuming. Merger and acquisition activity has been picking up since the announced changes.
- Volatility is rising from extremely low levels and was the catalyst for a correction in equities back in February.
- Innovation and disruption is continuing at a breathtaking pace in the U.S. in a variety of industries, creating clear winners and losers in many industries. Stock picking is key.

**Yield Curve**  
U.S. Treasury Yield Curve



**Volatility Reverting Back to the Long-term Mean**  
S&P 500® Average Daily Trading Range



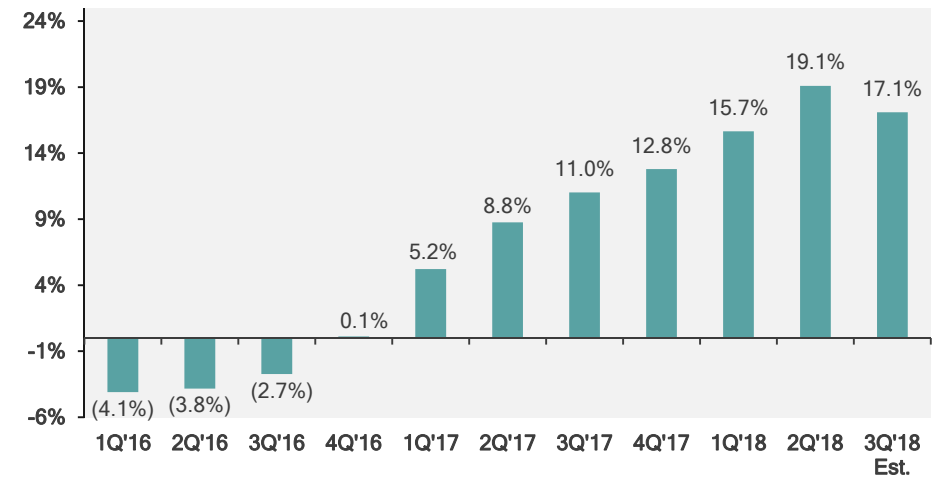
Data as of September 30, 2018.

Data is obtained from FactSet Research Systems, Federal Reserve, J.P. Morgan Asset Management and Strategas and is assumed to be reliable. Past performance is no guarantee of future results.

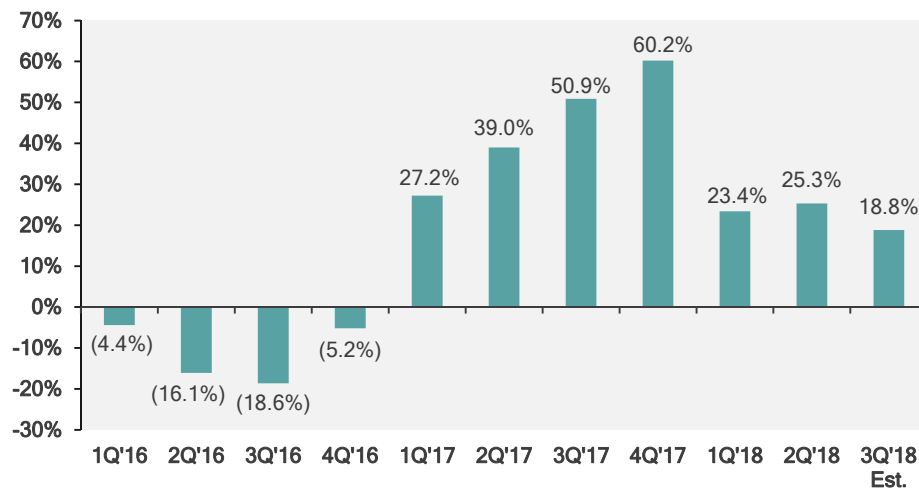
Global growth prospects have not improved as much as expected this year primarily due to trade conflicts.

- Global earnings growth has been steadily improving since last fall for the first time since the great recession. However, Europe and Emerging Markets economies have not picked up materially this year.
- Trade concerns have grown globally but we believe they will ultimately be favorably resolved. Emerging markets and international stocks have been hit hard by trade concerns.
- Global inflation expectations are still very benign, but is picking up somewhat. Global competition, oil prices and modest wage growth are the key drivers behind this longer-term.

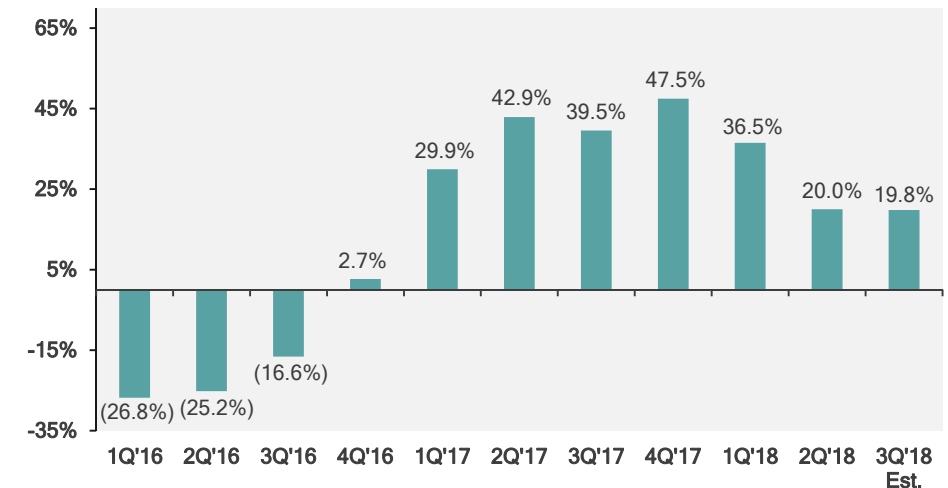
S&P 500® Trailing 12-Month Earnings Growth (Year Over Year)



Nikkei 225 Trailing 12-Month Earnings Growth (Year Over Year)



STOXX 600 Trailing 12-Month Earnings Growth (Year Over Year)



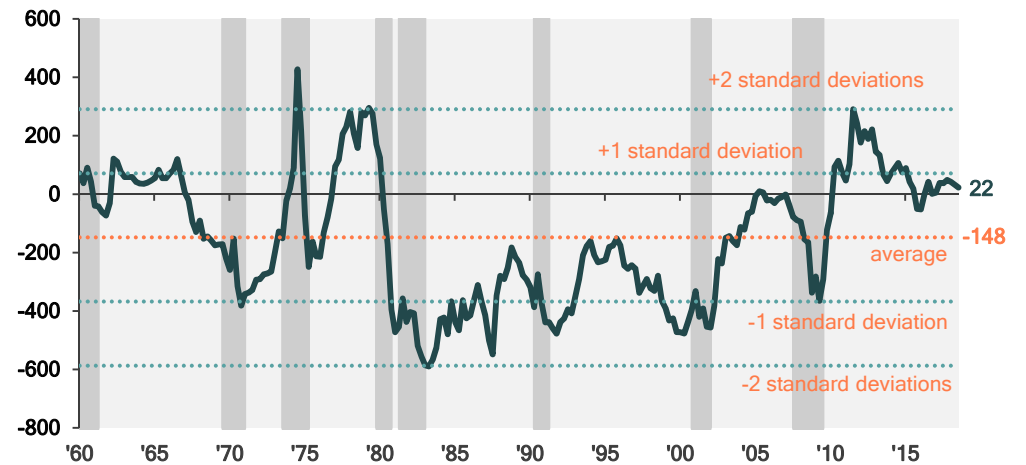
Data as of September 30, 2018.

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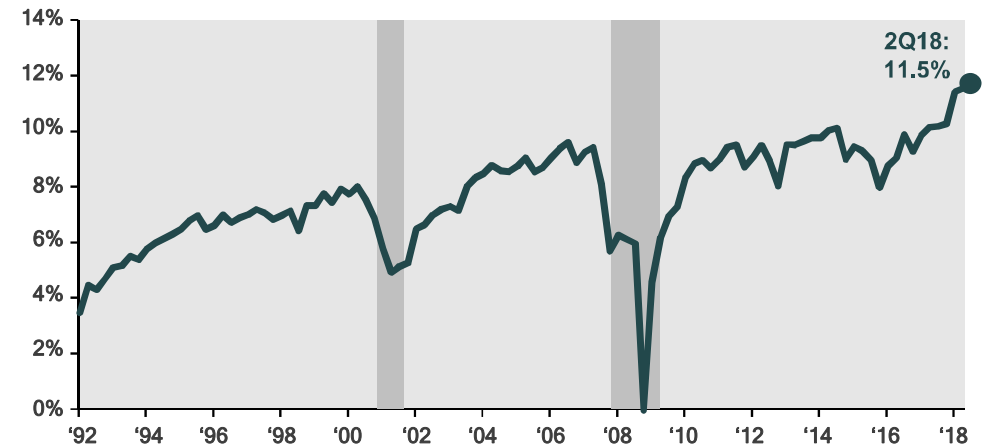
We continue to believe that the risk/reward ratio for equities over the long term is favorable on an absolute basis and particularly relative to fixed income.

- There is potential for P/E ratios to improve slightly from current levels. Retail investors still are not fully engaged in the equity market.
- Equity valuations remain reasonable by historic measures, both on absolute levels but particularly relative to interest rates.
- Foreign markets are finally supporting U.S. EPS growth rates, particularly for large multinationals, but trade concerns are starting to threaten this.
- With favorable corporate cash flow, investors are being rewarded with increased share buybacks, dividends and acquisitions.
- Corporate profit margins are still being maintained at very high historical levels, despite a much tighter labor market.
- Due to tax reform, we believe high-quality businesses with protected markets are a better place to invest than lower quality companies operating in more competitive markets which will pass on these savings to their customers eventually.
- Investors should expect more modest equity returns going forward (6% to 8% range over time) based on the maturity of this economy and business cycle. Volatility will likely pick up, but we believe the longer term outlook is still favorable.

**S&P 500® Equity Risk Premium**  
Earnings Yield Less Baa Corporate Bond Yield (bps)



**S&P 500® Profit Margins**  
Quarterly Operating Earnings Per Share/Sales Per Share



Data as of September 30, 2018.

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- Portfolio Data
- Disclosure

# Sector Weights

## Small Cap Core Portfolio

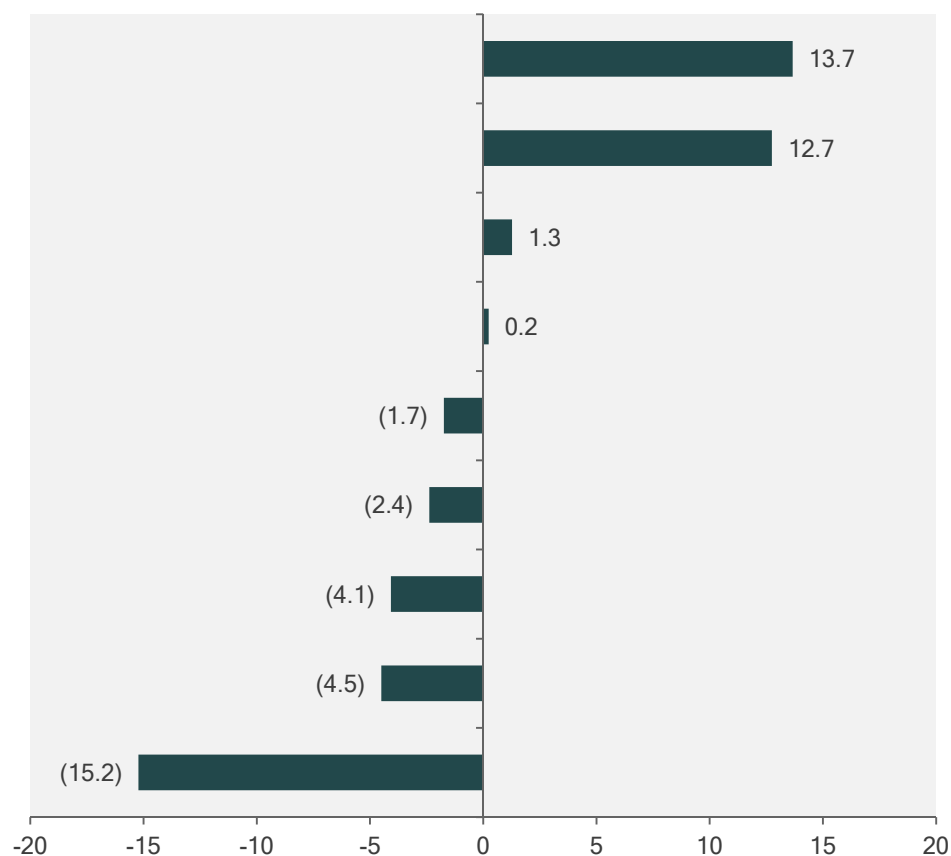
### As of September 30, 2018



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Sectors	KAR Small Cap Core (%)	Russell 2000® Index (%)
Producer Durables	27.2	13.5
Technology	25.6	12.8
Financial Services	25.7	24.5
Energy	5.0	4.7
Materials & Processing	5.0	6.8
Consumer Staples	—	2.4
Utilities	—	4.1
Consumer Discretionary	10.6	15.1
Health Care	0.9	16.2

### Underweight/Overweight (%)



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# Conviction-Driven Investing Provides Opportunities for Excess Return

Small Cap Core Portfolio  
As of September 30, 2018



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Top 10 Holdings	Russell Sector	% of Portfolio
Autohome	Technology	7.4
Teledyne Technologies	Producer Durables	7.0
Primerica	Financial Services	6.4
Copart	Producer Durables	6.0
CDW	Technology	5.9
Old Dominion Freight Line	Producer Durables	5.8
Aspen Technology	Technology	5.7
Rightmove	Technology	5.2
WABCO Holdings	Consumer Discretionary	4.5
POOLCORP	Consumer Discretionary	4.2
<b>Total</b>		<b>58.1</b>

Research confidence leads to large active weights

	KAR Small Cap Core	Russell 2000® Index
# of Holdings	27	2,040
Average Position Size (%)	3.7	0.05
Weight of Top Ten Holdings (%)	58.1	2.6
Active Share (%)	99.0	—

The strategy benefits from diversification while still taking significant active positions

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# Strong Risk-Adjusted Returns

## Small Cap Core Portfolio

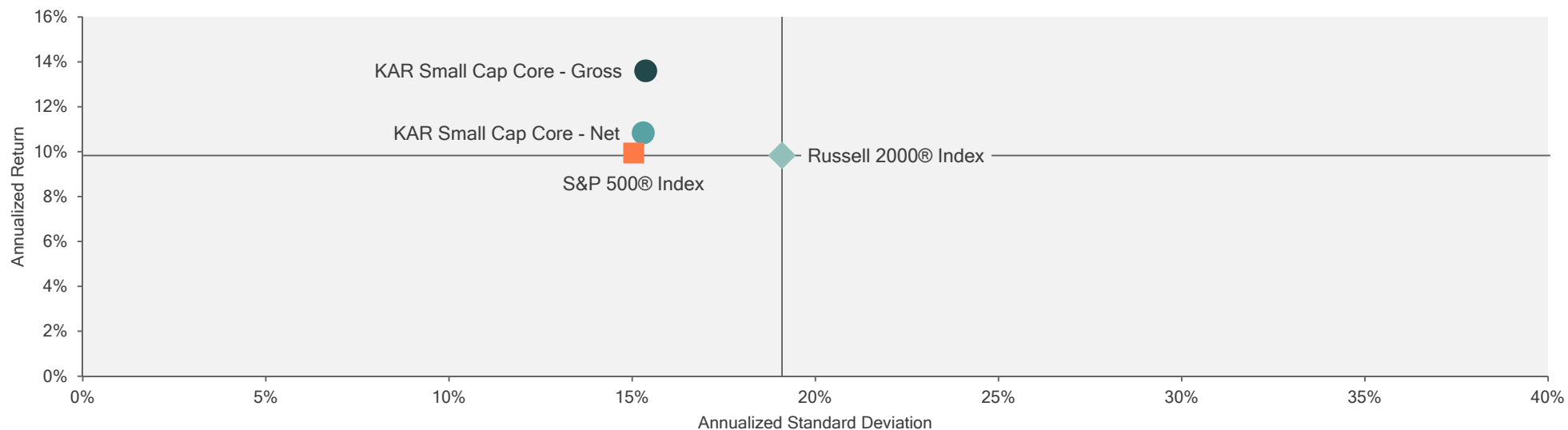
Inception\* to September 30, 2018



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### Meaningful Excess Return with Lower Volatility

Annualized Since Inception\*



### Strong Risk-Adjusted Performance Metrics

Annualized Since Inception\*

	Alpha	Sharpe Ratio	Standard Deviation	Semi-Standard Deviation	Beta	Tracking Error
KAR Small Cap Core	5.35	0.72	15.37	11.54	0.72	8.62
Russell 2000® Index	0.00	0.38	19.09	14.25	1.00	0.00

\*April 1, 1992

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*Returns for the Kayne Anderson Rudnick composite are preliminary and are gross of fees unless otherwise specified. For further details on the composite, please see the disclosure statement in this presentation. Data is obtained from FactSet Research Systems and is assumed to be reliable. Past performance is no guarantee of future results.*

# 5-Year Rolling Returns

## Small Cap Core Portfolio

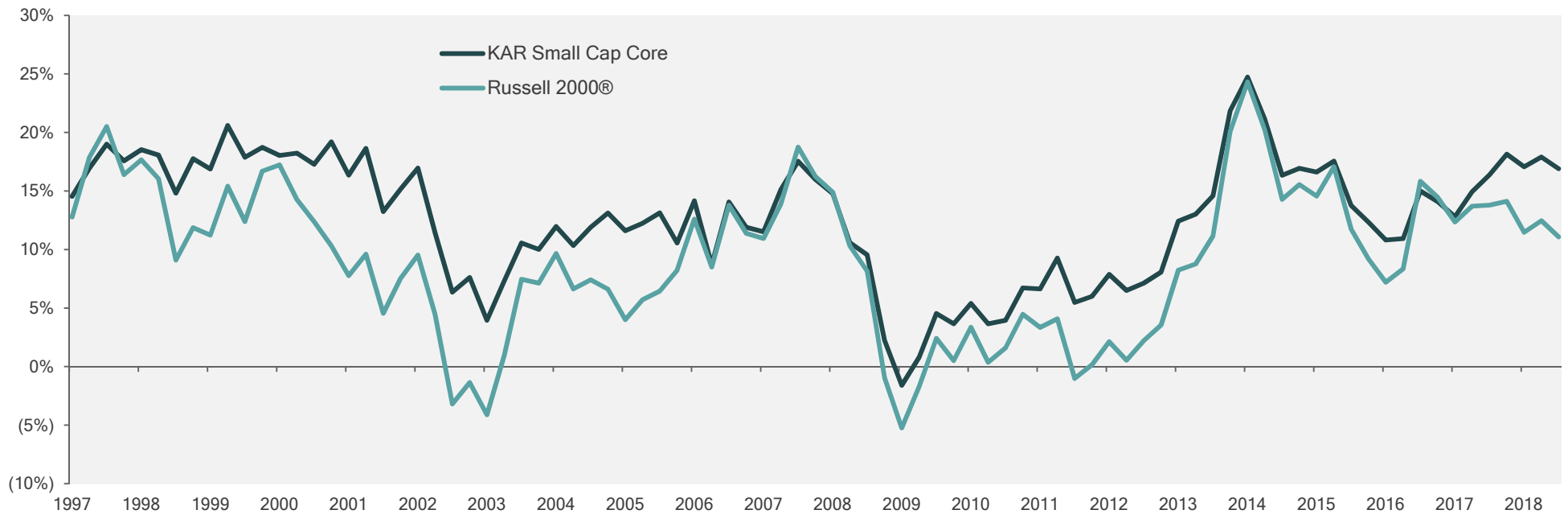
Inception\* to September 30, 2018



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### Performance Statistics

#### 5-Year Rolling Returns



\*April 1, 1992

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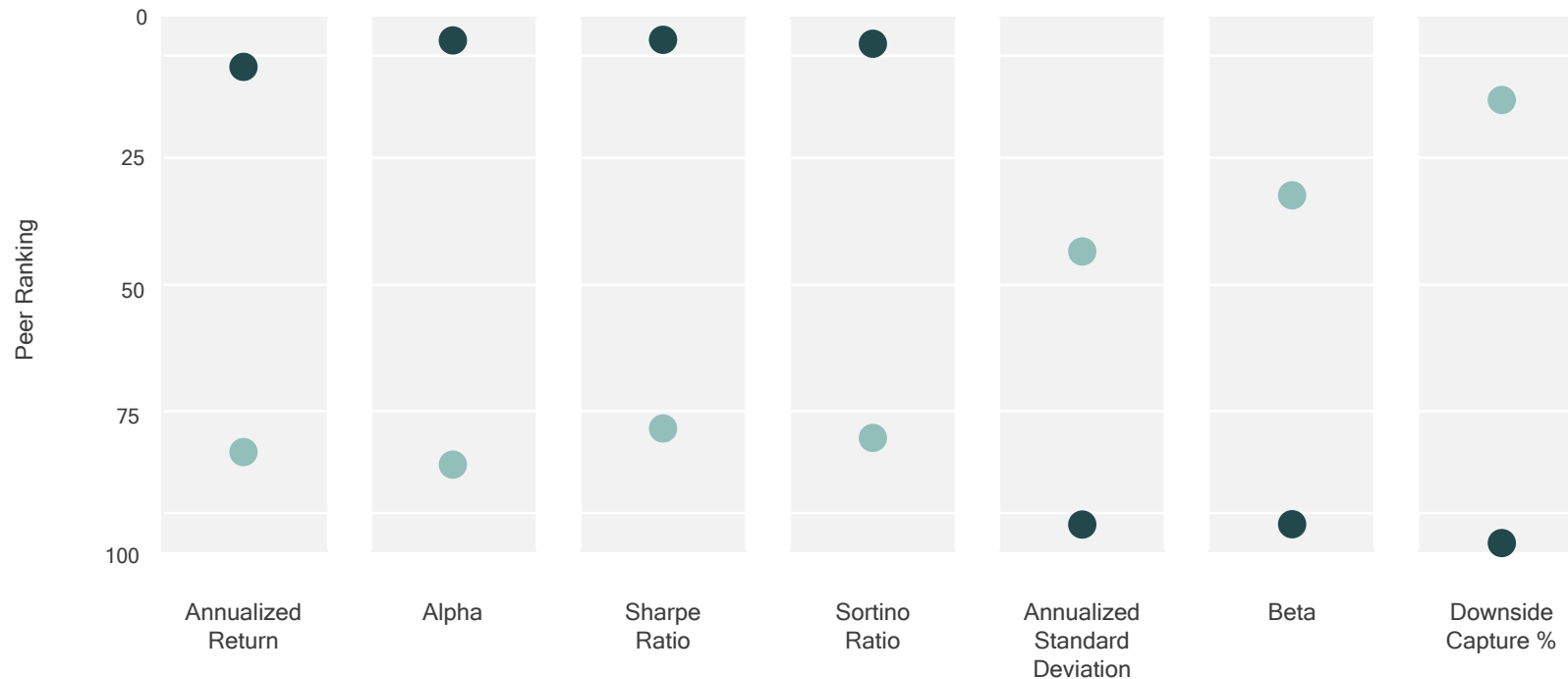
# Peer Comparison

## Small Cap Core Portfolio

### Ten Years Ending September 30, 2018



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● KAR Small Cap Core      ● Russell 2000® Index      ■ Small Cap Core Universe

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*The Small Cap Core Universe includes all managers categorized in the small cap core asset class by eVestment.*

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# Returns

## Small Cap Core Portfolio



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### Annualized Performance

Periods Ending 9/30/18	Gross (%)	Net (%)	Index (%)	Excess Return (bps)
Third Quarter	4.23	3.48	3.58	66
Year to Date	15.69	13.23	11.51	418
1 Year	26.98	23.38	15.24	1175
3 Years	26.02	22.54	17.12	890
5 Years	16.91	14.22	11.07	584
7 Years	18.84	16.31	16.43	241
10 Years	15.74	13.42	11.11	463
Since Inception*	13.60	10.83	9.83	377

### Calendar Year Performance

Periods Ending 12/31	Gross (%)	Net (%)	Index (%)	Excess Return (bps)
2017	35.43	31.52	14.65	2078
2016	18.55	15.09	21.31	(275)
2015	2.09	0.51	(4.41)	650
2014	7.31	5.57	4.89	241
2013	30.89	28.76	38.82	(793)
2012	13.75	11.80	16.35	(260)
2011	9.64	7.75	(4.18)	1382
2010	24.83	22.56	26.85	(203)
2009	31.80	29.72	27.17	463
2008	(28.15)	(29.36)	(33.79)	563
2007	3.25	1.71	(1.57)	481
2006	13.46	11.87	18.37	(491)
2005	7.87	4.63	4.55	331
2004	23.07	19.42	18.33	474
2003	35.02	31.19	47.25	(1223)
2002	(13.73)	(16.34)	(20.48)	675
2001	6.82	3.74	2.49	434
2000	20.98	17.42	(3.02)	2400
1999	7.02	3.93	21.26	(1423)
1998	20.98	17.42	(2.55)	2353
1997	21.00	17.45	22.36	(136)
1996	26.98	23.22	16.49	1049
1995	18.57	15.07	28.45	(988)
1994	2.75	(0.26)	(1.82)	457
1993	20.00	16.54	18.88	112
1992†	9.65	7.25	10.16	(50)

\*April 1, 1992

†Performance calculations are for the nine months ended December 31, 1992.

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**IMPORTANT RISK CONSIDERATIONS: Equity Securities:** The market price of equity securities may be adversely affected by financial market, industry, or issuer specific events. Focus on a particular style or on small or medium-sized companies may enhance that risk. **Limited Number of Investments:** Because the fund has a limited number of securities, it may be more susceptible to factors adversely affecting its securities than a less concentrated fund. **Industry/Sector Concentration:** A fund that focuses its investments in a particular industry or sector will be more sensitive to conditions that affect that industry or sector than a non-concentrated fund.

# Disclosure

## Small Cap Core Portfolio



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Investment Management

Kayne Anderson Rudnick Investment Management, LLC claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS® standards. Kayne Anderson Rudnick Investment Management, LLC has been independently verified for the period from January 1, 1999 through December 31, 2017.

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. The Small Cap Core Wrap Composite has been examined for the period from January 1, 1999 through December 31, 2017. The verification and performance examination reports are available upon request.

Kayne Anderson Rudnick Investment Management, LLC, a wholly owned subsidiary of Virtus Investment Partners, Inc., is a registered investment advisor under the Investment Advisers Act of 1940. Registration of an Investment Advisor does not imply any level of skill or training. Kayne Anderson Rudnick Investment Management, LLC manages a variety of equity and fixed-income strategies focusing exclusively on securities the firm defines as high quality.

The composite includes all fully discretionary Small Cap Core Wrap Portfolios. Small Cap Core Wrap Portfolios are invested in equity securities with market capitalizations consistent with the Russell 2000® Index, that have market control, rising free cash flow, shareholder-oriented management, strong consistent profit growth and low-debt balance sheets. For comparison purposes, the composite is measured against the Russell 2000® Index. The Russell 2000® Index is a market capitalization-weighted index of the 2,000 smallest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. The index is calculated on a total-return basis with dividends reinvested. Benchmark returns are not covered by the report of the independent verifiers. The composite was created in October 1995. A list of composite descriptions and policies for valuing portfolios, calculating performance and preparing compliant presentations are available upon request.

Beginning on January 1, 2006, sub-advisory wrap fee portfolios are also included in composite results. Each sub-advisory relationship is included in the composite as one account. Prior to January 1, 2011, accounts that experienced a significant cash flow, defined as aggregate flows that exceed 25% of the account's beginning of period market value, were temporarily removed from the composite. Prior to January 1, 2011, the composite minimum was \$100,000.

The standard wrap fee schedule in effect is 3.00% on total assets. Actual management fees charged may vary depending on applicable fee schedules and portfolio size, among other things. Additional information may be found in Part IIA of Form ADV, which is available on request. The performance information is supplied for reference. Past performance is no guarantee of future results. Results will vary among accounts. The U.S. dollar is the currency used to express performance. Performance results include the reinvestment of all income. Pure gross returns do not reflect the deduction of any expenses, including trading costs. Prior to December 31, 2005, net annual returns are calculated by deducting 1/4th of an assumed maximum annual wrap fee of 3% on a quarterly basis. Beginning January 1, 2006, net annual returns are calculated using actual fees incurred. If no fee data is provided by wrap sponsors, the maximum annual wrap fee of 3% is used to calculate net of fee performance. Beginning January 1, 2016, net annual returns are calculated by deducting 1/12th of an assumed maximum annual wrap fee of 3% on a monthly basis. Wrap fees include all charges for trading costs, portfolio management, custody and other administrative expenses.

Internal dispersion is calculated using the asset-weighted standard deviation of annual gross returns for accounts in the composite for the entire year. For those years when less than five accounts were included for the full year, no dispersion measure is presented. The three-year annualized ex-post standard deviation of the composite is presented starting December 31, 2012 because prior to January 1, 2010, the composite return was calculated quarterly and 36 monthly returns are not available.

3-Yr Annualized Standard Deviation (%)			Total Firm Assets (\$ millions)	Total Composite Assets (\$ millions)	Wrap Accounts as % of Composite Assets	Accounts at Year End	Pure Gross Annual Return (%)*	Net Annual Return (%)	Russell 2000® Growth Index Annual Return (%)	Internal Dispersion
December 31	Composite	Benchmark								
2012	15.37	20.48	3,445	469	100%	49	(28.15)	(29.36)	(33.79)	0.42
2013	11.96	16.68	4,010	565	100%	54	31.80	29.72	27.17	0.71
2014	9.77	13.31	4,729	659	100%	67	24.83	22.56	26.85	0.71
2015	11.15	14.16	5,232	846	100%	70	9.64	7.75	(4.18)	0.51
2016	12.19	15.99	6,545	1,073	100%	71	13.75	11.80	16.35	0.31
2017	11.38	14.11	7,841	1,336	100%	67	30.89	28.76	38.82	0.45
			7,989	1,294	100%	70	7.31	5.57	4.89	0.27
			8,095	1,023	100%	55	2.09	0.51	(4.41)	0.38
			9,989	1,222	100%	74	18.55	15.09	21.31	0.81
			14,609	1,778	100%	67	35.43	31.52	14.65	1.29

\*Pure gross returns are supplemental to net returns.

The Russell 2500™ Index is a trademark/service mark of Frank Russell Company. Russell® is a trademark of Frank Russell Company.