

Fund Manager Commentary

William Blair Macro Allocation Fund

Performance Summary

The Macro Allocation Fund (Class N) completed the quarter with negative performance, with both aggregate market and currency exposures detracting. Within markets, the Fund benefitted from long exposures to European equities like U.K., France, and Spain. Negative contributors to performance in the market strategy were long exposures to emerging market equities and sector positioning within U.S. equities. Within currencies, short exposures added value, particularly the New Zealand dollar, Thai baht, euro, and Czech koruna while long exposures in the Turkish lira, South African rand, and Great Britain pound detracted.

Fund Positioning

Market strategy remains long of equities, with an effective exposure of +22%, with exposures generally unchanged during the quarter. The Fund's largest exposures remain in developed Europe, U.K., and emerging equities. Market strategy is slightly short of fixed income with a net exposure of -8%, with short exposure primarily in European government bonds.

Within currencies, strategy remains long of emerging currencies such as the Turkish lira, Philippine peso, and Indian rupee with the largest short positions in the Thai baht, Swiss franc, and New Zealand dollar.

Review & Outlook

Global equities made modest gains in the second quarter and did not revisit the year's low point, which coincided with the end of a volatile first quarter of 2018. In currency-hedged terms, the MSCI All Countries World index (hedged into U.S. dollars) rose by 2.9%. Developed country markets were up 3.8%, though hedged emerging equities lagged and returned -3.6%. Bond yields moved higher (again) in the United States and in some European markets (Italy, Spain), but not for the eurozone as a whole and not in Japan.

¹ Information about the Fund's holdings should not be considered investment advice. There is no guarantee that the Fund will continue to hold any one particular security or stay invested in any one particular sector. Holdings are subject to change at any time.

² Reflected as 10-year exposures.

³ Unencumbered cash is residual cash and equivalents.

Fund Exposures (%) as of 6/30/18¹

Equity	22.1
U.S.	-0.3%
Canada	-3.6%
Europe (ex-U.K.)	9.4%
United Kingdom	6.4%
Asia Developed	-0.2%
Emerging	10.4%
Fixed Income	-7.9
U.S. ²	-8.1
Developed (ex-U.S. ²)	-0.5
Emerging	0.7
Unencumbered Cash³	26.7
Credit Detail	
U.S. Investment Grade Spread	5.3
U.S. High Yield Spread	-1.0
European Investment Grade Spread	2.2
Active Currency	
U.S. Dollar (USD)	-7.3
Canada Dollar (CAD)	0.0
Other Americas	12.5
Euro (EUR)	-8.0
Switzerland Franc (CHF)	-7.0
Great Britain Pound (GBP)	7.0
Other Europe	-0.5
Australia Dollar (AUD) and New Zealand Dollar (NZD)	-13.0
Japan Yen (JPY)	6.0
China Yuan (CNY)	-1.7
Asia (Excluding JPY and CNY)*	0.0
Other	12.0

FOOTNOTE TO FUND EXPOSURE TABLE

*Select Exposures	
India Rupee (INR)	7.3
Philippine Peso (PHP)	10.5
Singapore Dollar (SGD)	6.5

Against a basket of developed currencies, the U.S. dollar strengthened, reversing its fall in the first quarter and some of its decline in 2017. The dollar also climbed relative to emerging market currencies, in some cases (Turkey, Mexico) particularly steeply. Other emerging currencies (India, Indonesia) were more resilient,

particularly when their “carry” (nominal interest rate premium) is included.

Growth in the second quarter was mostly slower in advanced economies: both the United States and the eurozone posted weaker real GDP gains than in late 2017. In the United Kingdom, growth fell almost flat (partly attributable to bad weather). The larger developing economies, China and India, continued to expand relatively rapidly but India was not able to repeat its 2017 achievement of exceeding China. Among the slower-growing emerging economies, there was some acceleration in growth (from a low base) in Mexico and Brazil, while South Africa experienced a surprising slump. The International Monetary Fund, in its most recent update of its World Economic Outlook (in April), has become more optimistic about growth in 2018-19, though the IMF warned that risks to this improvement could come from trade tensions, asset market vulnerability, and geopolitical risks.

The Where stage of our investment process, which compares our estimate of fundamental value to current prices, suggests a medium amount of investment risk is currently appropriate in our portfolios. This applies to all of our risk budgets: systematic market (beta), unsystematic market (relative value), and currency. From a systematic market risk perspective, the Where stage informs us that equities in Europe (Italy, Spain, the United Kingdom, Greece) and select equity markets in the developing world are attractive while bonds are generally unattractive. From an unsystematic market risk view, unattractive equity markets in Canada, Japan, South Africa, and Mexico provide us opportunities to be short. Looking across our currency universe, we see a mix of attractive and unattractive currencies in both developed and developing areas, a marked difference from the opportunity set we saw just a few years ago when we were generally long emerging currencies and short developed ones.

However, all three items mentioned in the IMF update (trade, market vulnerability, and geopolitics) also provide reasons why the risk taken in our strategies is lower than the “untainted” or pure valuation opportunity would warrant. This is not to ignore valuation altogether, but to take into account headwinds in our Why stage that, in most cases, are currently blowing in the opposite direction to the gradual pull of value. These headwinds are more prominent than was the case in 2017. Put simply, a widening opportunity set (price moving away from value) presents a challenging environment for

fundamental investors. In such an environment, we do not necessarily avoid risk altogether, but rather we are more deliberate in accumulating active risk. We are then armed with ample dry “risk” powder so that we may appropriately take on more risk after such headwinds have created larger opportunities than were present before. We can take each of the three categories of investment headwind in turn.

Reductions in the volume of global trade, brought on by higher barriers to trade such as tariffs, are generally a growth-hampering impulse. Higher trade barriers have been both implemented and threatened in recent months, mostly led by the U.S. administration’s more protectionist stance under President Trump, and involving Canada and Mexico (via the North America Free Trade Agreement or NAFTA), China, and recently Europe. The geopolitical dynamic of trade disputes is best appreciated by analysis of the incentives facing the governments that are involved. “Nobody wants a trade war” is a truism deriving from the assumption that, in aggregate, all parties suffer a negative growth outcome the more free trade is impaired, but at the same time it is well understood that in gametheoretical terms, one player’s best reply to another’s raised trade barrier is to reciprocate, leading to a pattern known as “tit-for-tat.” Therefore, uncertainty and risk is increased by the deliberate actions of the players, even though their encompassing best interests would be better served by not escalating and indeed deescalating the situation. For these reasons, we are negative on trade-sensitive markets and have reflected this in our portfolios— we are less long of Chinese equities and the Mexican peso than fundamentals suggest, and we are more short of Canadian equities than we would be without this elevated risk. We do not, however, expect a dramatic and negative trade war as a base case, and this is due to the encompassing best interest noted above. In this vein, dialing down of trade threats (U.S.-China) and/or delaying their implementation have also been features of political maneuvers in recent months. But the bottom line is that this aspect of global policy is producing increased uncertainty (a headwind) that was not present in recent years.

We share the IMF’s concern about market vulnerability for reasons outlined in our first-quarter letter. The experience of 2017, when we saw little-to-no volatility and high equity returns, still renders market prices fragile, we believe. This is especially the case because of the large growth of passive, or rule-following, strategies, and the corollary of potentially significantly lower discretionary liquidity being available (an evolution

also driven by market regulation of recent years) should the market conditions that have rewarded passive strategies end, or reverse. This vulnerability had already become more visible in the first quarter of 2018. But, notwithstanding market events in February and June, this situation (much rules-based trading, less room for liquidity expansion) has not yet been stressed, making its potential impact substantially unknowable. Although we find reason to be concerned about market fragility, it is costly, over time, to protect against adversity by buying options (which for a premium can automatically reduce long exposure to markets that fall). Our approach to the vulnerability concern has been (i) to carry less systematic risk in portfolios than valuation justifies, and (ii) to hold long option protection against a large adverse market move, that would not particularly change portfolio behavior in the case of moderate or normal downside volatility, and which, therefore, does not cost so much in option premium. Our option positions are dispersed across asset classes: protection on small-cap eurozone equity, on three emerging currencies (Chinese yuan, Philippine peso, Indian rupee), and long optionality to the spread of high yield over investment grade fixed income. In each case, our analysis anticipates that “riskoff” market behavior would result in all three effectively reducing portfolio downside beta (sensitivity to falling equities).

Thirdly, geopolitical risk remains pronounced across our investment universe. In particular, politics has added to investor uncertainty in the most recent quarter and contributed to price weakness in both Italy and Turkey. In Italy’s case, a general election in June that produced a hung parliament led to almost three months of negotiations before a government comprising Italy’s two largest populist parties was finally formed. During this negotiation period, fears were raised both about Italy remaining in the eurozone (to which the new government committed, but not until early June), and likely fiscal expansion by the government breaching the zone’s deficit limits and adding to the country’s very high public debt load. Italian government bond yields jumped higher, and equities, which had performed well until early May, dropped. We cut our long exposure to Italian equity before the sell-off (having increased it in the prior quarter and benefiting from market strength at the time), such that Italy becomes another market in which we have dampened risk relative to the opportunity, this time owing to geopolitics. In Turkey, President Erdogan called a snap election in April (one year early), and while campaigning in May stated that he would seek to influence the central bank to lower interest rates despite high inflation caused in

part by depreciation of the Turkish lira. This frightened market participants and gave the lira a further sharp fall, with the consequence that the central bank stepped in to increase interest rates, twice, quite probably by more than would have been the case absent Mr. Erdogan’s verbal interference. We made two increases to the Fund’s long lira exposure through this episode, and at quarter end, it was our largest long exposure. Looking forward, substantial political risk remains in respect of Turkey, but we believe that May’s experience with the lira largely reduces the danger of renewed rhetoric that would compromise monetary policy. Put bluntly, Mr. Erdogan “played chicken” with the currency market and lost. Hence we are content to increase our exposure to a now very large divergence between currency value and price.

In the United Kingdom, negotiations with the European Union about the United Kingdom’s departure (“Brexit”) became dominated by a near-unanimous political imperative to avoid re-establishment of a customs border between Northern Ireland (part of the United Kingdom) and Ireland, which was removed when the EU’s “single market” was created in 1993 and would need to be reinstated if the United Kingdom exited the single market, as is official government policy. The reason almost all parties are distinctly unwilling to countenance a new border is that it would echo (in sentiment) a military border that divided the countries during the Northern Ireland “Troubles” (ethno-nationalist conflict involving paramilitary groups), which have been over since a 1998 peace accord was reached. The interest in the objective of no border appears to have greater compulsion across political “players” than the coalition that favors what is known as “Hard Brexit,” involving the United Kingdom leaving with nothing similar to the single market, or existing customs union, in place. The political outturn from this has been general delay since a solution is not apparent that reconciles both interests; we also conclude that the likelihood of “Soft Brexit” has risen. The latter is preferable to the former from a market perspective, both as it relates to U.K. equity and the British pound (both of which we regard as attractive relative to fundamental value). We maintain both of our long exposures. In the larger picture, our longer-term investment objective is to deliver positive investment returns above inflation through a market cycle. We remain grounded in fundamental valuation as our first step—we strive to only take compensated risk and are unwilling to extend exposures unduly in a reach-for-yield that would be dictated not by opportunities and risks but by very low real interest rates. There will be

environments in which we conclude that macro markets do not provide returns and risks compatible with portfolio objectives alongside other periods where compensation is abnormally high. During the last decade, the challenge of navigating these evolving environments has remained a significant component in the investment landscape, but we find our investment process, dialogue, and decision-making well-equipped to meet this challenge in an appropriate way. We remain vigilant as we assess new and relevant information to capture future investment opportunities in a timely manner and will continue balancing the relationship between risk taken and compensation expected.

INVESTMENT PERFORMANCE % (as of 06/30/18)

	QTR	YTD	1Y	3Y	5Y	Since Incep.
Class I (SI: 11/29/11)	-2.01	-1.52	0.97	-1.40	2.29	4.87
Class N (SI: 11/29/11)	-2.02	-1.60	0.63	-1.68	2.00	4.60
BofA Merrill Lynch 3-Month U.S. Treasury Bill Index	0.45	0.81	1.36	0.68	0.42	0.34

EXPENSE RATIOS (%)**

	Gross Expense	Net Expense
Class I	1.18	1.18
Class N	1.53	1.47

**Expenses shown are as of the most recent prospectus and include acquired fund fees and expenses. The net expense ratio reflects that the Fund's Adviser has contractually agreed to waive fees and/or reimburse expenses to limit fund expenses until 4/30/2019. The investor will pay the net expense ratio. The Adviser has contractually agreed to limit the Fund's operating expenses (excluding acquired fund fees and expenses, borrowing costs, brokerage commissions, taxes, other investment-related costs and extraordinary expenses) to 1.00% and 1.25% of average daily net assets for Class I and Class N shares, respectively, until 4/30/2019. Please refer to the Fund's Prospectus for more information on the Fund's expenses.

Performance cited represents past performance. Past performance does not guarantee future results and current performance may be lower or higher than the data quoted. Returns shown assume reinvestment of dividends and capital gains. Investment returns and principal will fluctuate with market and economic conditions and you may have a gain or loss when you sell shares. For the most current month-end performance information, please call +1 800 742 7272, or visit our Web site at www.williamblairfunds.com. Class N shares are available to the general public without a sales load. Class I shares are available only to investors who meet certain eligibility requirements.

DISCLOSURES

The Fund involves a high level of risk and may not be appropriate for everyone. You could lose money by investing in the Fund. There can be no assurance that the Fund's investment objective will be achieved. The Fund holds equity exposures, which may decline in value due to both real and perceived general market, economic, and industry conditions. Investing in bond markets is subject to certain risks including market, interest-rate, issuer, credit, and inflation risk; investments may be worth more or less than the original cost when redeemed. Derivatives may involve certain costs and risks such as liquidity, interest rate, market, credit, management and the risk that a position could not be closed when most advantageous. Investing in derivatives could lose more than the amount invested. Investment return, principal value, and yields of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Investments are subject to a number of types of risk, including counterparty and contractual default risk. For a more detailed explanation and discussion of these and other risks, please read the Fund's Prospectus. The Fund is designed for long-term investors.

The Bank of America Merrill Lynch 3-Month U.S. Treasury Bill Index measures total return on cash, including price and interest income, based on short-term government Treasury Bills of about 90-day maturity. The Index is unmanaged, does not incur fees or expenses, and cannot be invested in directly.

This content is for informational and educational purposes only and not intended as investment advice or a recommendation to buy or sell any security. Investment advice and recommendations can be provided only after careful consideration of an investor's objectives, guidelines, and restrictions.

Please carefully consider the Fund's investment objectives, risks, charges, and expenses before investing. This and other information is contained in the Fund's prospectus, which you may obtain by calling 1-800-742-7272. Read it carefully before you invest or send money. Investing involves the risk of loss.

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