William Blair

3Q 2018

Fund Manager Commentary
William Blair International Small Cap Growth Fund

Fund Performance & Positioning

The William Blair International Small Cap Growth Fund (Class N shares) underperformed its benchmark, the MSCI All Country World ex-U.S. Small Cap Index (net), during the third quarter. Underperformance was primarily driven by negative stock selection effects across most sectors amid the difficult style environment. Stock selection within the Health Care sector was particularly detrimental, as Dechra Pharmaceuticals PLC and 3SBio Inc detracted from relative results in the period. Based in the U.K., Dechra offers a wide range of animal pharmaceutical products across therapeutic categories (e.g., dermatology, endocrinology, and antibiotics), and its sales force and strong wholesaler/distributor relationships enable it to reach all of Europe with new product launches. In the U.S., the company was sub-scale until recently when it acquired Putney, a leading animal generic pharmaceutical company. This deal is transformational as it provides scale in the world's most valuable animal health market. While second quarter earnings results were in line with consensus, management noted that Dechra has experienced pricing pressures in the U.S. resulting from increasing consolidation of vet practices, which they have offset with higher volumes and operational efficiencies.

3SBio is a leading biotech company in China specializing in biologics, and has extensive experience in the manufacturing of these complex molecules. It has one of the biggest sales forces in Chinese healthcare with 2,000 representatives who provide nationwide coverage. The share price was hampered by weaker than expected sales growth in its biosimilar arthritis drug during the first half of 2018, which was a negative surprise given the drug's addition to China's National Reimbursement Drug List in 2017. We sold the position due to the uncertain growth outlook and elevated valuation risk. Partially offsetting these effects was positive stock selection within the Materials and Financials sectors. Within Materials, Nissan Chemical Corp bolstered relative performance. Nissan Chemical Industries is an innovative producer of niche chemicals that has upgraded its portfolio with new product launches and reduced exposure to basic chemicals. High R&D expenditures (8%-10% of sales) have supported the development of a deep product pipeline and growth from new launches over the past several years. Within Financials, U.K. litigation finance company Burford Capital's share price was bolstered by its solid first half 2018 earnings results. Burford is the largest investment manager in the sector and has continued to build scale. Litigation finance is a growing and increasingly important area of the business of law—moving into the mainstream of the legal industry. Recent fundamental trends have been strong, supported by the increasing size and scope of transactions, and improved diversification of investments.

Top 10 Holdings[1] as of 9/30/18

Company Name	***% of Fund***
SSP Group plc	2.0%
Beazley Plc	1.8%
Royal Unibrew A/S	1.7%
Burford Capital Limited	1.6%
Thule Group AB	1.5%
Evolution Gaming Group AB	1.5%
Fevertree Drinks PLC	1.5%
TIS Inc.	1.5%
Tokyo Century Corporation	1.5%
Indutrade Aktiebolag	1.4%
Total Top 10	**16.0%**

During the period, Health Care exposure was reduced through the liquidations of 3SBio Inc, Japan Lifeline Co Ltd and China Medical System Holdings. Materials exposure was also reduced during the period. These reductions were offset primarily by increases to Industrials and Real Estate. Within Industrials,

[1] Listed holdings are presented to illustrate examples of the securities that the Fund has bought and do not represent all of the Fund's holdings or future investments. 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 and are as of the date shown above. Top ten holdings are shown as a percentage of total net assets.

Grupo Aeroportuario del Sureste, Park24 Co Ltd and Bingo Industries Ltd were bought during the period. U.K. REITs Big Yellow Group PLC and Warehouses De Pauw CVA were new Real Estate sector purchases. From a geographic perspective, notable adjustments were increases to the U.K. and Latin America, offset by a decrease to Emerging Asia. The Fund's weighting in Emerging Markets approximated 15% at the end of the period, down from 17.5% at the beginning of the period.

Market Review & Outlook

Global equities advanced in the third quarter primarily driven by the U.S. significantly outperforming non-U.S. developed and emerging markets — continuing the trend of U.S. equity dominance. The U.S. bull market run became the longest in history despite escalating concerns on geopolitical tensions and rising interest rates, as Treasury bond yields surged higher in September.

U.S. equities extended year-to-date gains on robust strength in corporate earnings and positive signs of continued economic growth. Health Care and Information Technology drove outperformance. Mega-caps within IT, such as Amazon, Alphabet, and Apple, extended to record highs on consensus-beating quarterly results. This market cap leadership was representative of the broader U.S. market performance as large caps outperformed their small cap counterparts by approximately 3.2%, as measured by the MSCI U.S. Standard and Small Cap indices.

Non-U.S. developed market equity performance was mixed in the third quarter with positive performance in Japan and weaker returns in the U.K. Japanese equities rallied on the reelection of Shinzo Abe to the leadership position of the ruling Liberal Democratic Party; a positive signal to investors that Abenomics policies would continue. The reelection coupled with a weakening yen bolstered investor sentiment in September bringing Japanese equities into positive territory year-to-date. Within the U.K., the pound slumped to an 11-month low versus the U.S. dollar on Brexit uncertainty and growing fears about the potential collapse in talks. U.K. equities recovered in September, but remained down (-2.00% MSCI U.K. IMI) for the quarter.

Emerging markets equities continued to decline in the third quarter and year-to-date amid heightened geopolitical tension and a strengthening U.S. dollar. The Turkish Lira plunged to record lows following the U.S.-imposed sanctions on Turkey for failure to release evangelical pastor Brunson. Russian and South Africa currencies sold off in solidarity with the Turkish Lira. Trade war rhetoric remained a headwind for China, compounded by concerns about decelerating macro indicators and the weakening renminbi currency, which further weighed on sentiment and Chinese equities broadly.

From a style perspective, value-oriented market leadership accelerated in September within non-U.S. developed and emerging markets. The broad sell-off of growth oriented stocks across emerging markets was most pronounced within China and India, as measured by the MSCI China IMI Growth and the MSCI India IMI Growth indices.

As we head into the final quarter of 2018, surveys suggest that global growth is likely to decelerate modestly into the remainder of this year. Specifically, purchasing manager surveys continue to point to deceleration in the pace of industrial orders growth and subsequent industrial production growth. Given substantial and relatively abrupt changes in U.S. trade policy, we now expect near term economic activity to slow somewhat as firms work out the new rules and adjust to the impact on their supply chains.

At the same time, we expect the growing divergence between the U.S. and other economies to begin to normalize. Specifically, in Q2 2018 the U.S. economy expanded at an annual rate of 4.2% — the rate of growth which we believe is likely to mark the cyclical high. Consistent with this high economy-wide growth rate, corporate earnings growth accelerated to 22% YoY, a decade high (excluding the post GFC bounce). Barring additional policy support, it is difficult to see U.S. corporates maintaining this rate of profit growth. If the rest of the world continues to grow at the current pace, while the U.S. economy slows marginally, the growth wedge and by extension the substantial outperformance of U.S. markets vis-à-vis the rest of the world is likely to moderate from here.

Rising U.S. yields and increasing fiscal deficits in emerging markets (EMs) have reduced U.S. dollar liquidity in 2018. More recently, higher oil prices in the wake of the U.S. re-imposing economic sanctions on Iran contribute to a more challenging macroeconomic environment for the EMs, as many are large energy importers. Beyond these broader macro headwinds, turbulence within EM equities and currencies has been largely idiosyncratic and self-inflicted: the South African government reopening the possibility of farm repossession, for example, and the upcoming presidential election in Brazil where the top two contenders are from the far-right and the far-left. Increasingly reckless economic policies in Turkey and the exposed fragility of the Indian financial system have also compounded EM underperformance versus developed markets.

On September 24th, the Trump administration implemented 10% tariffs on $200 billion worth of imported goods from China, which will increase to a rate of 25% on January 1st, 2019. This is in addition to the $50 billion of tariffs that were implemented in July and August. While the first set of tariffs was initially focused on industrial goods such as materials, machinery, and chemicals, the second round of tariffs is targeting over 5,700 consumer goods, including agricultural products, textiles, and furniture.

With the implementation of the second round of tariffs including consumer goods, we are expecting inflation from the additional tariffs to pick up in the near term. Corporations that are affected by the additional tariffs will either have to absorb the costs themselves, leading to a decrease in margins, or will pass along the additional costs to the end consumer to keep their profits intact. As cost increases are pushed to the consumer, we are expecting to see an uptick in inflation starting in 2019.

Through much of this year, China has been implementing significant and wide-spread changes in its tax structure, affecting both corporate and income taxes. Reducing taxes for households is expected to support consumer demand in China. We are not expecting China to implement a large stimulus, but slow policy changes have been made to keep growth steady. Year to date, the renminbi is down nearly 6% against the U.S. dollar. As the dollar strengthens, further depreciation cannot be ruled out.

From a portfolio strategy perspective, positioning within our ACWI-oriented funds has generally reflected our more cautious outlook, with reduced EM weightings in favor of increased developed market exposure. Within our dedicated EM funds, we have maintained overweighted positions in India and Mexico, and underweighted exposures in Korea and Taiwan. Within China, our positioning continues to emphasize domestically-oriented consumer, healthcare and technology companies that we believe are well positioned to benefit from the economy's ongoing transition to a consumption and services-driven growth model.

INVESTMENT PERFORMANCE % (as of 09/30/18)

	QTR	YTD	1Y	3Y	5Y	10Y
Class I (SI: 11/01/05)	-2.47	-6.45	-1.90	8.38	4.75	8.54
Class N (SI: 11/01/05)	-2.49	-6.65	-2.16	8.06	4.44	8.20
MSCI All Country World ex-U.S. Small Cap Index (net)	-1.51	-4.41	1.86	11.24	6.14	8.73

EXPENSE RATIOS (%)

	Gross Expense
Class I	1.16
Class N	1.47

Expenses shown are as of the most recent prospectus.

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.

DISCLOSURE

The Fund's returns will vary, and you could lose money by investing in the Fund. The Fund holds equities which may decline in value due to both real and perceived general market, economic, and industry conditions. International investing involves special risk considerations, including currency fluctuations, lower liquidity, economic and political risk. Investing in emerging markets can increase these risks, including higher volatility and lower liquidity. Investing in smaller companies involves special risks, including higher volatility and lower liquidity. Convertible securities may be called before intended, which may have an adverse effect on investment objectives. Diversification does not ensure against loss.

The Morgan Stanley Capital International (MSCI) All Country World Ex-U.S. Small Cap Index (net) is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of small capitalization developed and emerging markets, excluding the United States. This series approximates the minimum possible dividend reinvestment. 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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