

Fund Manager Commentary  
 William Blair Small-Mid Cap Value Fund

**Market Review**

Sharply negative fourth quarter equity returns erased prior 2018 gains and U.S. equity indices ended the year in negative territory. Larger cap indices fared better as the S&P 500 Index narrowly avoided bear market territory, while the Russell 2000 Index declined more than 20% from its peak.

After a start to the year that included a spike in volatility amid concerns about rising input costs and elevated valuations, returns for the second and third quarters reflected a healthy domestic economy and strong corporate performance. Investors appeared to largely dismiss concerns about an escalating trade war and a flattening yield curve, which has sometimes preceded an economic slowdown.

In a sharp reversal, driven by downdrafts in October and December, equities declined dramatically in the fourth quarter. The market selloff was initially triggered by concerns about rising interest rates and inflationary pressure; risks that had previously been disregarded were now being priced into the market. Fundamentally, corporate earnings trends continued to be positive, supported by corporate tax cuts and a healthy U.S. economy. However, over the course of the fourth quarter, peak growth concerns overshadowed another solid corporate earnings period as consensus estimates declined and 2019 earnings growth estimates were revised downward and valuation multiples contracted significantly. At the same time, oil prices collapsed, the yield curve flattened further, and investors worried that softer than expected housing data may be the canary in the coal mine and indicate future weakness in the domestic economy. At the core of the reversal in market sentiment was investor concern surrounding continued and increasing U.S. political dysfunction, unresolved trade tensions with

<sup>1</sup> 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.

**Top 10 Holdings<sup>1</sup> as of 12/31/18**

<i>Company Name</i>	<i>% of Fund</i>
American Campus Communities, Inc.	1.9%
Brady Corporation	1.8%
The Toro Company	1.8%
Lamb Weston Holdings, Inc.	1.8%
PacWest Bancorp	1.7%
Vail Resorts, Inc.	1.7%
IDEX Corporation	1.7%
Healthcare Realty Trust Incorporated	1.5%
Atmos Energy Corporation	1.5%
American Assets Trust, Inc.	1.5%
<b>Total Top 10</b>	<b>16.9%</b>

China, continued monetary tightening by the Federal Reserve, and a weaker economic backdrop outside of the U.S. As market participants focused in on this expanding list of uncertainties, volatility rose and equity prices declined markedly, wiping out prior 2018 gains.

**Fund Review**

The William Blair Small-Mid Cap Value Fund (Class N shares) underperformed its benchmark, the Russell 2500 Value Index, during the fourth quarter. Underperformance during the period was driven by stock selection that more than offset a positive style tailwind given the Fund's larger market cap bias. At the sector level, the most significant detractor from relative performance was Financials as rates on the 10-year Treasury bill dropped 40 basis points during the quarter. Within the sector, a lack of exposure to Mortgage REITs and stock selection within Banks and Insurance were the main drivers of the relative underperformance. The relative underperformance within Materials was the result of stock selection within Steel and Specialty Chemicals. Within Energy, the worst performing sector of the market, stock selection within Exploration and Production drove the relative underperformance within the sector due to commodity prices that plummeted during the quarter. Real Estate was the largest contributor to relative performance due to broad-based stock selection within REITs as these stocks generally benefit from a lower interest rate

environment. Within Health Care, the second worst performing sector of the market, positive stock selection within Equipment and Supplies and a lack of exposure to Biotech and Pharmaceutical stocks contributed positively to relative performance within the sector. The relative outperformance within Consumer Staples was the result of stock selection within Food Products. Looking specifically at stock selection, the Fund's largest detractors to relative performance were WPX Energy (Energy), Parsley Energy (Energy), and Forum Energy Technologies (Energy). Offsetting these detractors were our investments in American Assets Trust (Real Estate), Lamb Weston (Consumer Staples), and American Campus Communities (Real Estate).

### Outlook

After nearly a decade of economic and stock market expansion, investor focus appears to have shifted back toward risks that could derail either. Notably, after raising the federal funds rate four times in 2018, the Fed communicated the potential for additional increases in 2019, while at the same time continuing to stabilize its balance sheet, further tightening monetary policy. If too aggressive, Fed action could provide a headwind to growth in 2019. Also prominent is the risk of continued political uncertainty, both in the U.S. and abroad. We closed 2018 with a shutdown of the Federal government, emblematic of the political "gridlock" that could continue into 2019 given the balance of power in congress and frequent changes of key personnel within the administration. Moreover, uncertainty with respect to Chinese tariff negotiations could thwart corporate productivity in the U.S., while escalation to an all-out trade war would have significant ramifications on domestic and global growth.

In reflection of the above, U.S. equity market valuation multiples contracted significantly during the fourth quarter. At the same time, consensus earnings growth estimates were revised downward and reflected a renormalization toward trend growth, likely in anticipation of a deceleration in U.S. economic growth, fading fiscal stimulus, and risks to margins including higher interest rates, input prices and wages. That being said, positive profit growth is still expected for 2019, albeit at a more moderate pace than previously witnessed in the first three quarters of 2018. In the absence of fundamental deterioration, valuation multiples and expectations have come down, leaving us constructive on equity markets as we look ahead. We

continue to be concerned about rising input costs and are focused on owning companies that have pricing power and are able to mitigate inflationary pressures via new products and price increases. As always, our focus remains on identifying quality companies at discount prices and corporate transformation opportunities, and we continue to find good ideas across sectors. Given our investment approach, we believe the Fund is well-suited to withstand a variety of market scenarios and add value over the long-term.

## INVESTMENT PERFORMANCE % (as of 12/31/18)

	QTR	YTD	1Y	3Y	5Y	Since Incep.
Class I (SI: 12/15/11)	-18.74	-15.03	-15.03	4.13	2.86	9.09
Class N (SI: 12/15/11)	-18.84	-15.32	-15.32	3.85	2.58	8.79
Russell 2500™ Value Index	-17.12	-12.36	-12.36	6.59	4.16	10.57

## EXPENSE RATIOS (%)

	Gross Expense	Net Expense
Class I	4.55	1.00
Class N	4.83	1.25

Expenses shown are as of the most recent prospectus. The Fund's Adviser has contractually agreed to waive fees and/or reimburse expenses to limit fund operating expenses until 4/30/19.

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](http://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. Investing in smaller and medium capitalization companies involves special risks, including higher volatility and lower liquidity. Small and mid-cap stocks are also more sensitive to purchase/sale transactions and changes in the issuer's financial condition. Convertible securities may be called before intended, which may have an adverse effect on investment objectives. Diversification does not ensure against loss.

The Russell 2500 Value Index measures the performance of the small to mid-cap value segment of the U.S. equity universe. It includes those Russell 2500 Index companies with lower price-to-book ratios and lower forecasted growth values. The Russell 2500 Value Index is constructed to provide a comprehensive and unbiased barometer of the small to mid-cap value market. The Index is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true small to mid-cap opportunity set and that the represented companies continue to reflect value characteristics. 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 and summary prospectus, which you may obtain by calling +1 800 742 7272. Read the prospectus and summary prospectus carefully before investing. Investing includes the risk of loss.***

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