William Blair

Third Quarter 2020

# William Blair Small-Mid Cap Value Fund
# Fund Manager Commentary

## Market Overview

Following the pandemic induced market decline in the first quarter, U.S. equities bounced back in the second quarter and continued to move higher in the third quarter, albeit at a more moderate pace than the previous quarter.

U.S. equities declined dramatically during the first quarter as economic activity was brought to an abrupt halt due to shelter-in-place directives directed to halt the further spread of COVID-19. This directive essentially shut down a large percentage of the economy, resulting in a decline in GDP and a spike in the unemployment rate to almost 15%. Unprecedented and aggressive stimulus measures, improving infection trends, progress toward economic re-opening, and vaccine development optimism sparked a risk-on market rally that delivered robust market returns in the second quarter.

Early third quarter returns were supported by continued improvement in the economy, progress towards the development of a vaccine, and positive trends in employment. Market returns were further fueled by a shift in Federal Reserve (Fed) policy to a flexible inflation averaging target, signaling the potential for Fed Funds rates to remain low for an extended period of time. This adjustment in Fed policy contributed to the risk-on tone of the market early in the quarter.

Although the positive trends in employment continued and the unemployment rate dipped to 8.4%, domestic equities declined in September. The initial market downdraft was the result of comments by the Fed that fiscal policy is necessary for further economic improvement and concerns of government gridlock that may impede progress on any stimulus efforts. Also contributing to market declines was the death of Supreme Court Justice, Ruth Bader Ginsburg, ultimately setting up a partisan battle to replace her and making an already partisan political environment more divided. The political quarrel may further dampen the prospects for a near-term fiscal stimulus package.

## Fund Performance

The William Blair Small-Mid Cap Value Fund (Class N shares) outperformed its Russell 2500 Value benchmark during the third quarter of 2020. While the strategy's larger market cap bias provided a tailwind during the period, it was partially offset by the headwind from our overweight to lower beta stocks during the period. At the sector level, Health Care was the largest contributor to relative performance due to an overweight to and stock selection within Life Sciences, Tools & Services and stock selection within Health Care Equipment & Supplies. Within Industrials, stock selection within Machinery and Road & Rail drove the relative outperformance within the sector. The relative outperformance within Consumer Discretionary, the best performing sector of the market, was the result of an overweight to and stock selection within Household

## Top 10 Holdings[1] as of 9/30/20

| *Company Name* | *% of Fund* |
|---|---|
| IDEX Corporation | 2.8% |
| The Toro Company | 2.4% |
| Dunkin' Brands Group, Inc. | 2.4% |
| Kansas City Southern | 2.3% |
| TopBuild Corp. | 2.3% |
| FMC Corporation | 2.2% |
| PulteGroup, Inc. | 2.2% |
| Westinghouse Air Brake Technologies Corporation | 2.2% |
| PerkinElmer, Inc. | 2.1% |
| Simpson Manufacturing Co., Inc. | 2.0% |
| **Total Top 10** | **22.9%** |

Durables. Communication Services was the largest detractor from relative performance due to the lack of exposure to Interactive Media. An overweight to and stock selection within Communication Equipment drove the relative performance within Technology. Within Energy, the worst performing sector or the market, an overweight to and stock selection within Oil, Gas & Consumable Fuels contributed to the relative underperformance within Energy. Looking specifically at stock selection, the strategy's largest contributors during the period were TopBuild (Consumer Discretionary), Toro Company (Industrials), and Dunkin' Brands (Consumer Discretionary. Somewhat offsetting these contributors were our investments in Ciena Corporation (Tech), Brady Corporation (Industrials), and Douglas Emmett (Real Estate).

## Outlook

While the market rebound was swift and heavily supported by aggressive stimulus measures taken to mitigate the economic impact of COVID-related shutdowns, the economy is still not close to being back to where it was at the end of 2019. The downdraft earlier in the year was not your "typical" economically driven downturn driven by excesses or over-

[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.

exuberance, rather it stemmed from an exogenous influence that ground economic expansion to a stand-still. Given that the current downturn is health care related and not an economically induced downturn, the standard playbook of cutting interest rates and providing an abundance of market liquidity may not provide a path towards a "normal" recovery. It will take time for the economy to heal, but better controlling the virus would go a long way in supporting a more broad-based economic recovery.

Markets generally like stability, but there are a number of uncertainties that are contributing to higher levels of market volatility and these risks could alter the trajectory of market returns and economic recovery. These aforementioned market risks include the upcoming U.S. presidential election (not only who will win, but will it be contested), re-escalation of trade tensions with China, increased partisan division resulting in further delays in additional fiscal stimulus, continued deterioration in virus trends, the pace of vaccine development, and mounting social tensions.

We continue to focus on companies with increasingly stronger balance sheets given our concern about corporate debt levels and expectations for continued market volatility. We believe these companies will be able to endure this unprecedented period and emerge from this crisis stronger and with increased market share, regardless of the trajectory of the broader economic recovery. Said differently, while the fund is defensively positioned currently, we believe we will participate in a variety of different market environments.

While non-fundamental factors can create short-term volatility, the foundational belief upon which our fund is built is that superior capital stewardship, as characterized by strong cash flows and improving or sustainable return on invested capital, are the determinants of long-term value creation and stock performance.

| | | | | Annualized | | |
|---|---|---|---|---|---|---|
| **Investment Performance (%)<br>Periods ending 9/30/20** | **Qtr** | **YTD** | **1 Y** | **3 Y** | **5 Y** | **Since Inception (12/15/11)** |
| William Blair Small-Mid Cap Value Fund (Class I) | 3.65 | -20.84 | -17.33 | -4.49 | 2.61 | 6.89 |
| William Blair Small-Mid Cap Value Fund (Class N) | 3.51 | -21.21 | -17.70 | -4.81 | 2.30 | 6.58 |
| Russell 2500 Value Index | 3.54 | -18.39 | -12.62 | -2.69 | 4.65 | 8.48 |

**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.**

**Expense Ratios (%)**

| | **Gross Expense** | **Net Expense** |
|---|---|---|
| Class I | 6.34 | 0.90 |
| Class N | 6.65 | 1.15 |

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 4/30/21.

## IMPORTANT DISCLOSURES

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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