Core Equity

Portfolio Update: Second Quarter 2019

The Core Equity Portfolio (the "Portfolio") increased +5.45% gross of fees (+5.32% net of fees) in the second quarter of 2019, outperforming the +4.10% return of the Russell 3000 Index for the same period. Year to date, the Portfolio increased +25.34% gross of fees (+25.04% net of fees), outperforming the +18.71% return of the Russell 3000.

	3 Months	YTD	1 Year	3 Years	5 Years	10 Years	Since Inception (Annualized)
Core Equity Strategy	+5.32%	+25.04%	+10.71%	+18.58%	+10.31%	+13.48%	+8.12%
Russell 3000 Index	+4.10%	+18.71%	+8.98%	+14.02%	+10.19%	+14.67%	+8.94%
S&P 500 Index	+4.30%	+18.54%	+10.42%	+14.19%	+10.71%	+14.70%	+8.87%

Inception date: April 1, 2005. Performance is presented net of RMB Asset Management's maximum management fee and transaction costs. Performance is not net of RMB's Wealth Management advisory fee (if applicable). Please see important disclosures at the end of this document. Past performance is not indicative of future results, and there is a risk of loss of all or part of your investment.

We were pleased with both the Portfolio's absolute and relative outperformance in the second quarter, which built upon a strong first quarter. From a traditional attribution perspective, the Portfolio's outperformance in the second quarter was largely driven by sector allocation with a neutral contribution from stock selection. Our largest positive contributors were the industrials, health care, and consumer discretionary sectors, with negative detraction from the technology and communication services sectors. While it was a solid quarter and strong first half of the year for our relative performance, we remain focused on compounding shareholder capital over the very long run, measured in years, not quarters. In the quarter, we have begun to make some small changes to the Portfolio to take some macroeconomic-related risk off the table and make it moderately more defensive, including the sale of our most economically cyclical name, which we will discuss shortly. Shortly after quarter-end, we received the good news that one of our industrial holdings would be taken private in an all-cash transaction, which will also serve to lower our cyclical exposure. While we aren't making major wholesale changes across the strategy, we feel it is prudent to become a little more defensive in the current environment without changing our adherence to relatively low turnover by owning high-quality, long-term compounding business models. We will discuss individual holdings and their impact on performance in a bit.

The second-quarter market environment was a continuation of the rebound from the late 2018 selloff, with most major indexes approaching or exceeding new all-time highs. Keeping with the storyline from last year, domestic headlines continued to be dominated by the trade war between the U.S. and China, with the pendulum swinging between optimism and pessimism around the likelihood of an eventual deal. This overhang comes at a time when economic data continues to show more signs of slowing global growth. The U.S. has remained one of the strongest and most resilient economies in the world over the past couple of years, although recent domestic data points are pointing to some deceleration post a very strong 2018. This slowdown has been reflected in the bond market with the 10-year Treasury yield falling 40 basis points from 2.41% to 2.01% in the quarter and down from 3.06% just three quarters ago. A flattish yield curve is telling us that the bond market is pricing in an increased probability of an economic recession over the next one to two years. The Fed has also taken a dramatic change in its tone with the market expectation for two to three 25-basis point *cuts* in 2019. Remember it was only a year ago when consensus for the Fed policy direction was multiple *hikes* going forward. It's quite remarkable how quickly we've gone from a hawkish to dovish environment, and we'll get another update on Fed policy on the last day of July. Thus far, the stock market has applauded lower rates, outweighing slowing economic data and the higher recession risk implied by the bond market.

First-quarter earnings reports released in the second quarter saw revenues and earnings continue to surprise positively vs. low expectations, although year-over-year earnings growth for the market as a whole was actually negative. While there continues to be concerns under the surface about the sustainability of revenue growth and historically high profit margins, the market has largely shrugged this off thus far. With second-quarter earnings about to be reported as we write this letter, we harbor some concerns about the forward outlook for the second half of 2019 and 2020. Current consensus is for about 4% growth in operating earnings for the S&P 500 in the second half of 2019 (bringing the full year to only +3%), with 12% growth in 2020.

Core Equity

These estimates have been slowly revised lower over the past few months, and we wouldn't be surprised to see them notched lower again after the current round of reporting. Estimates for 2020 particularly look overly optimistic at this point. Given high levels of uncertainty around global growth, we would expect management teams to remain on the conservative side when setting forward expectations and will watch closely for any change in management's tone toward demand for their products and services.

Our message about overall equity valuations is consistent with how we felt at the end of last quarter. While not overly expensive, especially given an even lower interest-rate backdrop, we are not finding bargains to be abundant by any means, particularly in our quality growth universe. From a bottom-up, individual company perspective, the Portfolio has more reward-to-risk ratios under one than it has greater than one. This was much different from where we stood at the end of 2018 after the big fourth-quarter selloff, which reflects the significant rebound in prices year to date without any upward revisions in earnings estimates. Said another way, the market return this year has come entirely from multiple expansion. From a longer-term perspective, we also must be cognizant of the fact that we are, more likely than not, in the late innings of a historically long positive economic cycle. While we do not necessarily see a recession as imminent, the probability continues to grow, and the bond market is sending a strong signal. As we have penned recently, the concept of "peak earnings" has remained a debate these days that, even if the U.S. does not roll into a meaningful economic recession, we could be close to the peak in corporate profitability given outside pressures on margins (particularly wage inflation) and weakening economies outside the U.S. As always, macro market predictions are very difficult to make with any hopes of being consistently accurate. We remain focused on bottom-up stock selection within a concentrated, yet diversified, portfolio of high-quality individual companies that can grow their earnings for years into the future and earn attractive returns on invested capital. No matter what happens with the current market cycle, we strongly believe the strategy positions us to outperform over the long run without taking undue risk.

Contributors and Detractors

The accompanying chart shows the Portfolio's largest contributors and detractors to performance during the second quarter. The largest contributor was MarketAxess Holdings Inc. (MKTX), an electronic trading platform for fixed-income securities. The stock rose as trading volumes grew at a healthy level aided by increased volatility in the bond markets as interest rates declined. We also are attracted to the longer-term secular growth story as fixed-income trading moves away from voice-based, broker-dealer trading toward electronic exchanges, similar to what stocks have done over the past couple of decades. We continue to like MarketAxess's long-term secular growth opportunity, although acknowledge that the run up in the stock has led to a very expensive valuation. We are considering taking down the position size but want to be cognizant of tax consequences and what we still see as the longer-term earnings power of the company several years from now. Steris PLC (STE), the leading provider of sterilization services and equipment to the healthcare industry, was the second-largest contributor. The stock continued its upward momentum with a very strong fiscal fourth-quarter earnings report that showed accelerating organic growth and solid margins. The Healthcare sector has had some pressure this year from

Core Equity
SECOND QUARTER 2019 CONTRIBUTION REPORT
Ranked by Basis Point Contribution

	Basis Point Contribution	Return
Top Contributors		
MarketAxess Holdings Inc. (MKTX)	+110	+30.85%
Steris PLC (STE)	+80	+16.58%
IHS Markit Ltd. (INFO)	+79	+17.18%
Fortune Brands Home & Security Inc. (FBHS)	+71	+20.51%
Cooper Companies Inc. (COO)	+66	+13.75%
Bottom Detractors		
Cognizant Technology Solutions Corp. (CTSH)	-83	-20.88%
Alliance Data Systems Corp. (ADS)	-70	-19.56%
Alphabet Inc. Class A & C (GOOG & GOOGL)	-52	-8.00%
SS&C Technologies Holdings Inc. (SSNC)	-39	-9.48%
Edwards Lifesciences Corp. (EW)	-16	-3.44%

Past performance is not indicative of future results, and there is a risk of loss of all or part of your investment. The above does not represent all holdings in the Portfolio. To obtain a copy of RMB's calculation methodology and a list of all holdings with contribution analysis, please contact your service team. The data provided is supplemental. Please see important disclosures at the end of this document.

chatter about potential policy changes from Washington D.C. regarding more price controls on drugs and "Medicare for All" from some of the Democratic Presidential nominees. As a provider of an essential service that doesn't have a lot of reimbursement risk, Steris stands out as a more defensive business model within the health care sector, which has also benefited the stock. Contact lens manufacturer Cooper, our fifth-largest contributor, has also benefited from this same dynamic. We continue to like the long-term prospects for Steris, although acknowledge that the current valuation has priced in a lot of good news.

On the negative side of the performance ledger, we had several names that detracted from performance, with the top two names being by far the largest detractors. Cognizant Technology Solutions Corp. (CTSH), a large information technology consulting and business process outsourcing provider, was the Portfolio's largest detractor in the quarter. The stock declined after a very weak first quarter in which Cognizant's new CEO took down its intermediate-term outlook with little hope for a rebound in spending from its key financial service and health care end markets. We—and the market—were surprised by the magnitude of the problems within the business and decided to exit our position intra quarter. We reallocated some but not all of the proceeds into higher-conviction ideas post our sale. Alliance Data Systems (ADS), a provider of private label credit cards and marketing services, was the second-largest detractor. The stock declined further after a lower reset to 2019 earnings guidance post the sale of their Epsilon marketing services segment. The strategic decision to sell this business is sound, and the earnings dilution from the sale should be somewhat temporary as debt paydown, stock buybacks, and corporate cost reductions will offset the lost earnings next year. That said, the messaging behind the disclosure wasn't optimal. Further, a surprise change in leadership was announced post the quarter in which ADS's long-time CEO will be departing the company. Our confidence in ADS as a long-term holding has been diminishing over the past few quarters, although we have held off selling the position given we believe the stock sells below intrinsic value, and we could get a better price with a little more patience. That said, we see a high likelihood of exiting the position prior to year-end, which will also have the benefit of realizing a tax loss. As of the quarter-end, on a composite basis, ADS is the only name in which we have a tax loss that can potentially be harvested.

Portfolio Activity

During the fourth quarter, the Portfolio purchased two new securities, Jack Henry & Associates Inc. (JKHY) and SVB Financial Group (SIVB). We also exited two names, United Rentals Inc. (URI) and Cognizant Technology Solutions Corp. (CTSH). Our sale of URI is an acknowledgement that we are likely in the later stages of the economic cycle, and as our most cyclical position that also has a reasonable amount of financial leverage, it was time to take some risk off the table for the benefit of the overall Portfolio. While we still have a positive view toward URI and believe the non-residential construction cycle may very well continue to be in their favor for the next few quarters, we'd prefer to be early in our exit than wait for confirmation that the cycle is waning. The following is a brief description of Jack Henry and SVB Financial Group and our thesis on each name.

TOP 10 HOLDINGS AS OF 6/30/19

Company	% of Assets
Visa Inc. (V)	6.07%
Steris PLC (STE)	5.37%
IHS Markit Ltd. (INFO)	5.11%
Cooper Companies Inc. (COO)	5.05%
Danaher Corp. (DHR)	4.89%
Middleby Corp. (MIDD)	4.60%
MarketAxess Holdings Inc. (MKTX)	4.25%
Edwards Lifesciences Corp. (EW)	4.20%
Booking Holdings Inc. (BKNG)	4.09%
Fortune Brands Home & Security Inc. (FBHS)	3.98%

Holdings are subject to change. Portfolio characteristics are intended to provide a general view of the entire portfolio, or Index, at a certain point in time. Characteristics are calculated using information obtained from various data sources. Past performance is not indicative of future results, and there is a risk of all or part of your investment. The data provided is supplemental. Please see disclosures at the end of this document.

Jack Henry provides information technology solutions and payment processing services to over 1,000 banks ranging from community banks to multi-billion-dollar institutions. The company develops and licenses software and distributes hardware used for processing transactions, automating business processes, and managing information. It also provides information processing services through an outsourced model where Jack Henry runs the data processing infrastructure. These products and services serve community banking needs and allow their clients to streamline their services and operate in a more efficient manner than trying to do this on their own.

Jack Henry operates in a fairly rational oligopolistic industry with two other principal competitors (Fiserv and Fidelity Information Services) and holds a dominant market position with smaller-sized banks. The combination of very high customer switching costs and a "build it once, sell it many times" software model allows it to achieve very attractive mid 20's operating margins and low 30's returns on invested capital. The banking industry has been going through a decades-long secular shift away from in-house transaction processing to outsourcing where JKHY provides all the services (at a higher margin than in-house arrangement deployments), as well as a need for increased technology services, such as on-line and mobile banking, which JKHY can provide. Its revenues are very highly recurring in nature with little economic cyclicality. We believe revenues can continue to grow organically in the mid-to-high-single digits for the foreseeable future with the potential to supplement growth with smaller bolt-on acquisitions. We are also attracted to a positive operating margin inflection that should occur in the next few quarters as Jack Henry streamlines its transaction processing platform as well as a nearly debt-free balance sheet. While the stock is by no means inexpensive today, we think the current valuation allows for a reasonable entry point for long-term investors. We also like the impact JKHY will have on reducing the Portfolio’s overall macroeconomic cycle exposure.

SVB Financial, aka "Silicon Valley Bank," is a commercial bank focused on lending to various components of the "innovation economy." While it is dominant in Silicon Valley and Northern California, it also has a global presence (the U.K., Israel, Germany, Canada, China, and Hong Kong). For more than 35 years, SVB has been dedicated to helping support entrepreneurs and clients of all sizes and stages throughout their life cycles, primarily in the technology, life science/healthcare, private equity (PE)/venture capital (VC), and premium wine industries. SVB derives about 70–75% of revenues from net interest income (NII) and the other 25–30% from non-interest income (fees). The bank has a very low loan-to-deposit ratio, and this also shows up in loans constituting only 55% or so of earning assets (vs. around 80% for the average bank). This implies that provision and charge-off ratios have a lesser impact on profitability than it would for a bank that is much more 'lent out.’ SVB's securities portfolio is made up of U.S. Treasurys and agency-issued mortgage-backed securities (MBS) and collateralized mortgage obligations (CMOs). Loan growth and mix has been skewed in recent years to capital call lines of credit—over half its book. This loan class carries a lower yield but commensurately lower risk profile. These loans are made into VC and PE funds and are paid off as capital calls replace them over time. They are used to add nimbleness to execution (i.e., deploy funds when they need to rather than waiting for capital to fund deals).

We believe that SVB is a highly differentiated business model from your typical bank and has a distinct, dominant position within the innovation economy. We believe that SVB has strong insight and understanding of its client base that has been built through decades of cultivating relationships that has given it a real competitive advantage. It has an estimated 50% lending market share of the early-stage companies and 30% deposit market share in the San Jose-Sunnyvale-Santa Clara metropolitan statistical area (MSA). Wells Fargo is #2 with 20% deposit share. This strong position within its end market has led to significantly higher growth in overall client assets, deposits, and loans than most banks. Further evidence of a strong competitive position is the bank's low cost of funding, which has consistently been lower than peers. The migration of client lending toward lower-risk capital call lines of credit and away from early stage venture lending should lead to better credit results in the next down cycle than previously experienced. More recent bank technology investments will improve customer experience and should also lead to better efficiency as the investments scale. Finally, SVB is putting more emphasis on growing their private bank as they can tap into an existing high profile commercial client base.

In the low $200s, we believe we are able to purchase SVB at an attractive price (10x current-year earnings and 1.7x tangible book), as the stock has sold off substantially with the recent decline in interest rates. The Portfolio has been considerably underweight financials, which has benefited our year-to-date performance, but we believe we can now find pockets of value within the sector. In short, SVB is a "high-quality, growth bank at a value price" for long-term investment. While not core to our investment thesis, we also think SVB could be an attractive asset in a potential takeover at some point in the future.

Outlook

From when we last wrote you three months ago, market conditions have remained about the same with the addition of further declines in long-term interest rates and an increasingly accommodative Fed. Market volatility has dampened somewhat, although picked up late in the quarter heading into earnings season. The upcoming corporate earnings report season that is about to kick off will once again refocus the market back on individual company fundamentals, which we think are generally decent for U.S. companies, but we have some areas of concern. Inflationary pressures from a tighter labor market, overseas demand levels, and the shorter-term impact from tariffs will be areas of focus. Given a fair amount of macro uncertainty, we think management teams will continue to have an extra level of conservatism embedded in their 2019 guidance, consistent with the tone that we got last quarter. Near-term U.S. economic data points have generally been decent, although they have decelerated from first-quarter levels. Employment in the U.S. remains quite healthy with improving labor participation rates. However, with unemployment so low, increasing scarcity for skilled labor in various industries is a real problem as many job openings are going unfilled. Real wage growth and consumer confidence should continue to be positive for consumer spending. Consumers in the lower half of income levels should be healthier than they have been in recent years given rising wages and very low unemployment. Rising wages do present a challenge for corporate margins, which have been at or near peak levels. Business confidence remains at high levels, although well off peak, and we have seen some signs that capital investment is no longer accelerating. Much of this near-term slowdown and uncertainty could be attributable to the trade war with China, thus some type of resolution could improve the near-to-intermediate term U.S. economic outlook. We can't ignore that 2020 is a presidential election year, and any type of stimulus to help the economy, including a trade deal, can have an impact on the election.

Overall, we have some reservations about the momentum in U.S. corporate earnings growth, which is the biggest long-term driver of stock prices. We all knew that 2019 earnings growth would slow dramatically as the lower corporate tax rate hit its first-year anniversary, but, as mentioned earlier, there are other sources of risks to revenue growth and margins. Over the past three quarters, market earnings estimates for 2019 have fallen from 10% growth to about 3% growth currently. The cycle of Wall Street earnings estimates being too optimistic and having to be ratcheted back is a recurring pattern that the market typically sees through, but this is still a major reduction in growth expectations. With the overall market multiple having re-inflated from 2018 year-end levels, it now sits a bit under 18x 2019 and 16x 2020. The long-term average for the market is around 16x, but given we may be nearing peak earnings, there might not be a whole lot of value implied in current market expectations. As always, while we may opine on our view of the overall market, we do not pretend to have any ability to predicting where the market is heading in the short or intermediate term. Market timing is a very difficult, if not impossible, task to add value with. We continue to focus the Portfolio's efforts on owning companies with good secular growth prospects, strong economic moats, underleveraged balance sheets, and superior management teams. These are companies we believe can compound value for shareholders for years into the future. The opportunities to find high-quality growth companies selling at attractive valuations is not very abundant after the recent run up, but we will continue to use our "bottom-up" search to optimize the Portfolio. Our disciplined investment process focuses more on individual company fundamentals and less on the overall market. We also believe that a strategy focused on high-quality companies can distinguish itself in a more volatile market environment.

Thank you for the continued trust you place in us to manage your assets. If you have any questions, please do not hesitate to contact us.

Sincerely,

Todd Griesbach
Portfolio Manager

Core Equity

Past performance is not indicative of future results, and there is a risk of loss of all or part of your investment. The opinions and analyses expressed in this letter are based on RMB Capital Management, LLC's ("RMB Capital") research and professional experience and are expressed as of the date of our mailing of this letter. Certain information expressed represents an assessment at a specific point in time and is not intended to be a forecast or guarantee of future performance, nor is it intended to speak to any future time periods. RMB Capital makes no warranty or representation, express or implied, nor does RMB Capital accept any liability, with respect to the information and data set forth herein, and RMB Capital specifically disclaims any duty to update any of the information and data contained in this letter. The information and data in this letter do not constitute legal, tax, accounting, investment, or other professional advice. The information provided in this letter should not be considered a recommendation to purchase or sell any particular security. There is no assurance that any securities discussed herein will remain in the Portfolio at the time you receive this letter or that securities sold have not been repurchased. The securities discussed do not represent the entire Portfolio and, in the aggregate, may represent only a small percentage of their holdings. It should not be assumed that any securities transaction or holding discussed was or will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein. A complete list of security recommendations made during the past 12 months is available upon request. An investment cannot be made directly in an index. The index data assumes reinvestment of all income and does not account for fees, taxes or transaction costs. The investment strategy and types of securities held by the comparison index may be substantially different from the investment strategy and types of securities held by your account. The Russell 3000 measures the performance of the largest 3000 U.S. companies, representing approximately 98% of the investable U.S. equity market. The Russell 3000 Index is constructed to provide a comprehensive, unbiased, and stable barometer of the broad market and is completely reconstituted annually. The S&P 500 includes 500 leading companies in leading industries of the U.S. economy. The S&P 500 focuses on the large-cap segment of the market and covers approximately 75% of U.S. equities.