CONGRESS ASSET MANAGEMENT COMPANY

Q2 2017

# Portfolio Commentary

# Mid Cap Growth

## Market Review

Contradictory forces seem to be at play in the domestic markets. On the one hand bonds rallied during the quarter with the ten-year yield falling to 2.15%, down from 2.40% in late March. The fall in yields would seem to indicate concerns for our economic vitality. On the other hand, stock returns indicate a more robust view of the future with the S&P 500 continuing to climb, up about 3% for the quarter. Movements in both markets merit comment.

In part, the bond rally likely reflects the subdued inflation readings reported over the past two months. Yet, the rally comes in the face of the Federal Reserve's fourth interest rate hike since December 2015 and confirmation that it is likely to begin shrinking its balance sheet later in the year. By shrinking the balance sheet, the Fed will start to unwind its quantitative easing programs. In so doing, it will also increase the inventory of government bonds available to investors…So why such a strong bond rally?

The world is still hunting for yield. A recent survey of sovereign debt indicated that the bonds of 13 countries sported negative yields out to five years. Argentina—a country that has defaulted seven times in 200 years—experienced robust demand for a recent 100-year bond issue. This hunt is driving foreign investors to U.S. shores for both yield and safety. According to Bloomberg, foreign central bank holdings of U.S. Treasuries stand at close to $3 trillion.

In contrast to bonds, the stock market eschewed economic concerns and rallied, once again with limited volatility. Corporate profits were up 12% over the prior year, which provided heft and supported the rise. The rally was broader than just the big tech companies, too. In fact, bolstered by the still expansionary policies of many central banks, stocks rallied globally with Europe up 18%, Japan up 22%, and emerging markets up 24%.

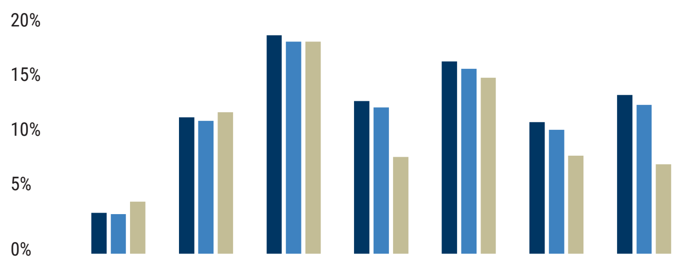
The hunt for yield drives down the cost of U.S. debt and indirectly supports the stock market as investors unhappy with low-yield options willingly take on more capital risk in an effort to increase their own capital base. For more than a year, stock market investors have been spreading their funds around and driving up global stock markets as a result. The coordinated efforts of the world's central banks may have finally hit the tipping point. The United States, Europe, and Asia appear to be growing at modest yet sustainable rates.

## Performance Overview

The Congress Mid Cap Growth Portfolio underperformed the Russell Midcap Growth Index during the second quarter. The portfolio returned approximately 3.26% versus the Russell Midcap Growth Index's return of 4.21%.

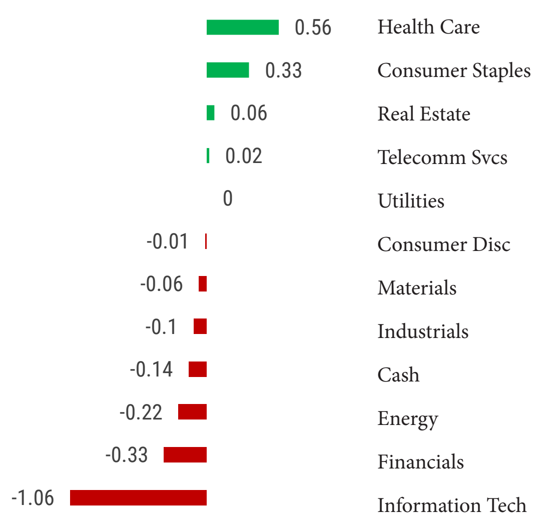
Stock selection drove the portfolio's performance. The portfolio benefited from positive security selection within the Health Care sector. Security selection within the Information Technology and Financial sectors lagged, however. Asset allocation detracted from the portfolio's relative performance due to the portfolio's overweight in the Industrial sector.

### Average Annualized Performance % - as of 6/30/2017 - Preliminary




| | QTD | YTD | 1 Yr | 3 Yrs | 5 Yrs | 10 Yrs | Inception |
|---|---|---|---|---|---|---|---|
| Mid Cap Growth (Gross) | 3.3 | 11.0 | 17.6 | 12.3 | 15.5 | 10.6 | 12.8 |
| Mid Cap Growth (Net) | 3.2 | 10.7 | 17.1 | 11.8 | 14.9 | 10.0 | 12.0 |
| Russell Midcap Growth® | 4.2 | 11.4 | 17.1 | 7.8 | 14.2 | 7.9 | 7.2 |

### % Total Effect Portfolio vs. Index (3/31/2017 - 6/30/2017) (bps)



## Q2 2017 Attribution Highlights

### Overall Contributors

- Security Selection in Health Care
- Allocation to Consumer Discretionary
- Allocation to Consumer Staples

### Overall Detractors

- Security Selection in Information Technology
- Security Selection in Financials
- Allocation to Industrials

## Top 3 Stock Contributors and Detractors

Contributors

| Stock | Ticker | Contribution |
|---|---|---|
| Mettler-Toledo International | MTD | 0.67% |
| IPG Photonics Corp. | IPGP | 0.58% |
| Cooper Companies, Inc. | COO | 0.52% |

Detractors

| Stock | Ticker | Detraction |
|---|---|---|
| Foot Locker, Inc. | FL | -0.82% |
| Scripps Networks Interactive | SNI | -0.33% |
| F5 Networks, Inc. | FFIV | -0.29% |

**Mettler-Toledo International (MTD)** is a multinational manufacturer of scales and analytical instruments. MTD continues to benefit from its strong execution of new product launches and market position within key geographies and end-users. Despite expected moderation, management increased its organic growth guidance and maintained ongoing margin improvements. Management is also excited about the long-term growth opportunity in China as many laboratories still have individual instruments shared by multiple scientists. Additionally, a larger government focus on food safety would drive greater penetration of MTD instruments. The company still sees the long-term opportunity to raise operating margins by 500 basis points.

**IPG Photonics Corp. (IPGP)** manufactures high-performance fiber lasers, amplifiers, and laser machine tools for diverse applications. IPGP reported very strong quarterly results as the company benefited from the accelerating replacement of conventional lasers with fiber lasers and non-laser-based technologies. In addition, management believes that the competitive environment appears to be shifting in its favor. Competitors are having difficulty matching IPGP's power advantage, global scale, low cost, and high quality. Elsewhere, China continues to be one of the company's fastest-growth areas as machine tool customers are quickly adopting IPGP's high-power lasers as the product of choice for cutting systems due to their faster performance and low power consumption.

**The Cooper Companies, Inc. (COO)** is a multi-national company in the medical specialties sector. COO continues to gain share in the contact lens market, driven by its unrivaled breadth and depth of product offerings. The company's advantages are derived from its continued innovation to capitalize on shifting consumer preferences, as well as investment in its "feet on the street" sales force. Further, competitor missteps due to internal dysfunction or lack of fresh products add to the appeal of COO. The company should benefit further as end-markets, particularly in the United States, are generally stable and the trend toward daily lenses as the preferred lens choice of both practitioners and wearers continues.

**Foot Locker (FL)** is an athletic shoes and apparel retailer. Company results, which were trending above expectations during early April, slowed considerably during the last 10 days of the month resulting in a quarterly disappointment. Margins were pressured due to higher markdowns in the Direct-to-Customer channel. Additionally, the guidance for the second quarter indicates further pressure and lack of visibility in the business. In spite of a tough first half of 2017, management expressed confidence that sales would bounce back during the latter part of the year, driven by the lifestyle category and growth in signature basketball sales.

**Scripps Networks Interactive, Inc. (SNI)** is a media company. The company's stock was hurt by broad industry concerns over slower advertising growth driven by lower viewership and continuous cord-cutting pressures. The company continues to outperform its peers by delivering above industry average advertising growth, a result of strong ratings for its primary channels and attractive demographics. Additionally, diversification into non-traditional channels and international markets should offset some of the headwinds from subscriber losses.

**F5 Networks, Inc. (FFIV)** specializes in application delivery networking technology. FFIV reported a disappointing quarter and issued guidance that was below expectations. Management attributed the challenges to continued weakness in Europe, the Middle East, and Africa, as well as lower-than-expected services revenue. There seems to be some hesitancy among customers regarding public cloud migration, which does not bode well for future results.

*Information is as of 6/30/2017*

## Q2 2017 Transaction Summary

### Sector Allocation Changes

- Decrease in Consumer Staples & Health Care
- Increase in Materials

### Purchased

- PVH Corp. (PVH) - Consumer Discretionary
- WABCO Holdings Inc. (WBC) - Industrials
- Avery Dennison Corp. (AVY) - Materials

### Sold

- G-III Apparel Group (GIII) - Consumer Discretionary
- PAREXEL Int. Co. (PRXL) - Health Care
- Hain Celestial Group Inc. (HAIN) - Consumer Staples
- Robert Half Int. (RHI) - Industrials

## Purchased

**The Phillips-Van Heusen Corporation (PVH)** is a global apparel company. PVH has done an admirable job of navigating through a challenging retail environment. The company has begun to deliver on the desire for a globally controlled Calvin Klein brand to leverage a sharp marketing campaign and expanded distribution. Additionally, in contrast to most competing apparel firms, PVH's U.S. wholesale business has been a bright spot over the last year helping to offset shortfalls in its U.S. retail operations. PVH's combination of ever-improving brand presentation, consistently solid and strengthening non-U.S. performance, and effective category expansion should continue to allow the company to perform.

**WABCO Holdings Inc. (WBC)** develops, manufactures, and sells braking, stability, suspension, and transmission control systems, primarily for commercial vehicles. Two-thirds of all commercial vehicles that have advanced and conventional vehicle control systems are equipped with WBC products, making them one of the few trusted partners for Original Equipment Manufacturers (OEM) worldwide. While the truck and bus market is cyclical and varies by region, WBC has been able to outperform its end markets consistently. The secular drivers of increased safety, improving emission standards, and technological advancements (e.g., shift from conventional to electronic systems, driver's assistance, autonomous trucks, fleet management, and connectivity) should enable WBC to continue to increase its content per vehicle over time. Additionally, further geographic expansion into the Americas, China, India, and Eastern Europe offer other long term growth opportunities.

**Avery Dennison (AVY)** is a manufacturer and distributor of pressure-sensitive adhesive materials, apparel branding labels and tags, RFID inlays, and specialty medical products. Over the last 5 years, the company has done a commendable job of restructuring and realigning its businesses to improve its growth and margin profile. Today, AVY's strategy revolves around focusing its investments on higher value product lines (Industrial Tapes, RFID, Graphic Materials, Specialty) that have higher growth and margins, while driving productivity and costs out of its less differentiated categories (barcode labels, apparel tags) so it can compete more profitably. This strategy along with AVY's diverse geographic exposure, including approximately 30% to faster growing Emerging Markets, should enable the company to drive organic sales growth, expand margins, and maintain its top quartile returns on total capital. M&A is an option to augment this strategy.

## Sold

**G-III Apparel Group (GIII)** manufactures and markets a range of apparel products. Although the company continues to improve its performance in non-outerwear and wholesale channels, retail store closures and the DKNY acquisition will make 2018 a transition year. Management has not been aggressive regarding store closures or rebranding. The company's ability to generate strong free cash flow depends on how much investment is needed for growth initiatives, which might delay deleveraging.

**PAREXEL International (PRXL)** is a multinational life sciences consulting firm. We removed the name from the model portfolio after reports surfaced that the company was seeking bids and an activist investor took a large position. The company was eventually acquired by Pamplona Capital Management on June 20, 2017.

**Hain Celestial Group Inc. (HAIN)** is a food company whose focus is foods and personal care products. We removed the stock because of the company's ongoing lack of financial disclosures and managerial business updates and sluggish retail market data.

**Robert Half International Inc. (RHI)** provides staffing and risk consulting services in North America, Europe, Asia, and Australia. The company's lack of growth has been disappointing considering the strength of the labor market. RHI decided not to cut its headcount in the U.S. because of client optimism, but because this optimism has yet to turn into actual activity, RHI has been facing margin pressures. Additionally, the policy uncertainty from the new administration might delay or dampen the optimism of RHI clients, further pressuring growth rates.

*Information is as of 6/30/2017*

## Positioning

Investments are predicated on a company's future prospects rather than economic or market cycles. We seek companies with strong fundamentals, emphasizing earnings growth consistency, free cash flow, and solid balance sheet metrics. There were three purchases and four sales during the second quarter and they are reflective of this strategy. These combined transactions essentially reduced the Consumer Staples and Health Care weights while increasing the weighting in Materials.

## Outlook

The stock market's measured return so far this year highlights that the remnants of the financial crisis are receding at a quickening pace. The Fed's balance sheet reduction can be interpreted as a signal that the world's largest central bank is prepared to partially return the economic reins to consumers and businesses thus allowing more rational investing, spending, and savings decisions. The timing is propitious. Corporate earnings are growing at a reasonable rate, inflation is in check, and the consumer is in solid economic shape with good job prospects. The U.S. stock market remains the preferred asset class.

Congress Asset Management Co.
Mid Cap Growth composite
10/1/1999 - 3/31/2017

| Year | Total Return Gross of Fees % | Total Return Net of Fees % | Russell Mid Cap Growth Return % (dividends reinvested) | Composite Gross 3-Yr St Dev (%) | Russell Mid Cap Growth 3-Yr St Dev (%) | Number of Portfolios | Gross Dispersion % | Total Composite Assets End of Period ($ millions) | % of composite represented by non fee paying account | Total Firm Discretionary Assets End of Period ($ millions) | Total Firm Assets End of Period # ($ millions) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| YTD | 7.5 | 7.4 | 6.9 | n/a | n/a | 388 | n/a | 609 | n/a | 5,976 | 8,668 |
| 2016 | 13.9 | 13.3 | 7.3 | 12.0 | 12.2 | 105 | 0.54 | 431 | n/a | 5,693 | 8,139 |
| 2015 | 1.9 | 1.4 | -0.2 | 11.4 | 11.3 | 50 | 0.42 | 221 | n/a | 5,941 | 7,094 |
| 2014 | 13.0 | 12.4 | 11.9 | 10.8 | 10.9 | 41 | 0.51 | 145 | n/a | 6,328 | 7,449 |
| 2013 | 37.9 | 37.3 | 35.7 | 13.2 | 14.6 | 35 | 0.38 | 84 | n/a | 6,489 | 7,467 |
| 2012 | 10.4 | 9.8 | 15.8 | 17.0 | 17.9 | 26 | 0.46 | 43 | n/a | 6,755 | 7,498 |
| 2011 | 12.7 | 12.1 | -1.7 | 19.1 | 20.8 | 22 | 0.67 | 30 | n/a | 6,329 | 7,014 |
| 2010 | 40.2 | 39.4 | 26.4 | | | 15 | 0.65 | 20 | n/a | 6,416 | 6,678 |
| 2009 | 25.7 | 25.1 | 46.3 | | | 11 | 0.85 | 11 | n/a | 5,263 | 5,463 |
| 2008 | -43.9 | -44.2 | -44.3 | | | 9 | 0.55 | 7 | n/a | 4,292 | 4,371 |
| 2007 | 24.8 | 24.3 | 11.4 | | | 12 | 0.81 | 16 | 18% | 5,812 | 5,846 |
| 2006 | 7.7 | 6.6 | 10.7 | | | 7 | 0.28 | 13 | 22% | 5,464 | 5,469 |
| 2005 | 10.7 | 9.6 | 12.1 | | | 7 | 0.43 | 20 | 13% | 4,750 | 4,751 |
| 2004 | 14.7 | 13.5 | 15.5 | | | ≤5 | n/a | 15 | 15% | 3,844 | 3,844 |
| 2003 | 26.0 | 24.8 | 42.7 | | | ≤5 | n/a | 10 | 20% | 3,697 | 3,697 |
| 2002 | -10.6 | -11.5 | -27.4 | | | ≤5 | n/a | 4 | 36% | 3,312 | 3,312 |
| 2001 | 9.5 | 8.5 | -20.2 | | | ≤5 | n/a | 2 | 100% | 3,147 | 3,147 |
| 2000 | 35.4 | 34.1 | -11.8 | | | ≤5 | n/a | 2 | 100% | 3,183 | 3,183 |
| 4Q '99 | 19.9 | 19.6 | 39.5 | | | ≤5 | n/a | 1 | 100% | 3,002 | 3,002 |

**#The "Total Firm Assets" column is provided as supplemental information and also includes unified managed account (UMA) assets**

**Congress Asset Management claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Congress Asset Management has been independently verified for the periods 12/31/95 – 12/31/16. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The Mid Cap Growth Composite has been examined for the periods 10/1/99 – 12/31/16. The verification and performance examination reports are available upon request.**

**Firm Information:** Congress Asset Management Co. (CAM) is an investment advisor registered with the Securities and Exchange Commission under the Investment Advisors Act of 1940. Registration does not imply a certain level of skill or training. CAM manages a variety of public equity, private equity, fixed income and ETF managed portfolios for private and institutional clients. CAM acquired Prelude Asset Management, LLC on March 15, 2010. CAM merged with Congress Capital Partners, LLP on June 30, 2015.

**Composite Characteristics:** The Mid Cap Growth Composite was created on October 1, 1999. This inception date reflects the first full month in which an account was fully invested in the strategy and met the inclusion criteria. The composite includes all fully discretionary accounts with a value over $100 thousand (US dollars) managed in the mid cap growth style for a minimum of one consecutive month. The mid cap growth strategy invests in the equity of high quality companies with market capitalizations between $1 billion and $12 billion (at the time of purchase) exhibiting consistent earnings growth. Accounts with wrap commissions are excluded from the composite. Prior to January 1, 2016 the composite minimum was $500 thousand (US dollars). Prior to September 1, 2005 the composite did not include private client accounts or accounts with less than $1 million. The primary composite benchmark is the Russell Mid Cap Growth Index. The benchmark returns are not covered by the report of independent verifiers. Closed account data is included in the composite as mandated by the standards in order to eliminate a survivorship bias. A complete list and description of all firm composites is available upon request.

**Calculation Methodology**: Valuations and returns are computed and stated in U.S. dollars. The firm uses the Modified Dietz formula to calculate monthly returns and links these returns geometrically to produce an accurate time-weighted rate of return. The composite is also revalued intra-month in cases where cash flows in excess of 10% of the composite's value occur. Composite returns are asset-weighted. Gross of fees returns are calculated gross of management and custodial fees and net of transaction costs. Prior to 2007 net of fees returns are calculated by reducing gross returns by the highest management fee in the Mid Cap Growth composite, which is 1.00%. Effective January 1, 2007 net of fees returns are calculated using actual management fees. The composite results portrayed reflect the reinvestment of dividends, capital gains, and other earnings when appropriate. Accruals for equity securities are included in calculations. A maximum of 5% of the portfolio may be invested in the ADR's of foreign companies. Internal dispersion is calculated using the asset-weighted standard deviation of annual gross-of-fees returns of those portfolios that were included in the composite for the entire year. For those years when less than six portfolios were included in the composite for the full year, no dispersion measure is presented. The three-year annualized standard deviation measures the variability of the composite and the benchmark returns over the preceding 36-month period. The standard deviation is not presented for 1999 through 2010 as it is not required for periods prior to 2011.

**Fee Schedule:** The firms' individual account fee schedule is as follows: 1.00% for first $1 million, 0.80% for next $4 million, 0.60% for next $5 million. Management fees for individual accounts with assets under management exceeding $10 million, and for institutional accounts are negotiated. The individual account fee schedule may be subject to negotiation where circumstances warrant. As fees are deducted quarterly, the compounding effect will increase the impact of the fees by an amount directly related to the gross account performance. For example, an account earning a 10% annual gross return with a 1% annual fee deducted quarterly would earn an 8.9% annual net return due to compounding.

**Other Disclosures:** Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request. Past performance does not guarantee future results. This performance report should not be construed as a recommendation to purchase or sell any particular securities held in composite accounts. Market conditions can vary widely over time and can result in a loss of portfolio value.