CONGRESS ASSET
MANAGEMENT COMPANY

**Q4 2016**
**Small Cap Growth**

# Portfolio Commentary

## Market Review

The November presidential election was the seminal event of the fourth quarter and may prove to be the most important single event since the financial crisis. The end of the campaign may have been a relief for the market. But relief does not explain the price swings between different asset classes or even between different stock market sectors. As December progressed, the S&P 500 closed most days near a record high and the Dow Jones Industrial Average marched inexorably towards the psychologically important 20,000 mark. Bond prices fell, leaving the ten year yield near 2.60%, a high for the year. The dollar, riding a wave of optimism and higher rates has risen to levels not seen in decades.

There were vast return differences within the stock market as well. Small company stocks, considered both a tax reform beneficiary and sheltered from a rising dollar have soared since the election. Bank stocks, weighed down by regulations and low interest rates for the past decade, sprung to life at the expense of utilities and other “bond proxy” stocks. The promise of robust government funded infrastructure projects helped support industrial and material stocks.

In the months leading up to the election and since, the election took on a life of its own. Lost in the election headlines were the more mundane measures of economic output that tell an interesting economic story.

The economy has grown at about a 2% pace since the recession ended in 2009, marking the slowest average rate of any expansion since at least 1949. Measures of economic activity, however improved notably as the year progressed. Gross domestic product (GDP), the broadest measure of our economy ended the 3rd quarter at 3.5% growth, the strongest level in two years and substantially better than the lackluster readings from earlier in the year. Another broad measure, the unemployment rate was similarly positive measuring 4.6% in December. There are jobs to be had and we have more employed than ever before.

In spite of the recent run up in interest rates, we remain in a historically low interest rate environment. Low rates combined with new job creation have had a sustained positive impact on the housing and auto markets. Millennials, for whom jobs were scarce five years ago, are finding work and creating new households providing a solid foundation for home sales and prices. Consumers are more positive than they have been in years, the December confidence expectations index jumped to the highest level since December 2003.

The negative effects of a deflationary energy market are largely behind us. With oil hovering around $55 per barrel, business investment is likely to increase. Business investment has not recovered from its unprecedented collapse during the financial crisis and has been a drag on economic growth. OPEC’s recent production agreement, their first in 10 years combined with non-OPEC producers’ similar agreement should provide a conducive floor for investment spending.

## Performance Overview

The Small Cap Growth Portfolio outperformed the Russell 2000 Growth Index® during the fourth quarter. The Small Cap Portfolio return was 6.47% versus the Russell 1000 Growth Index’s® performance of 3.57%.

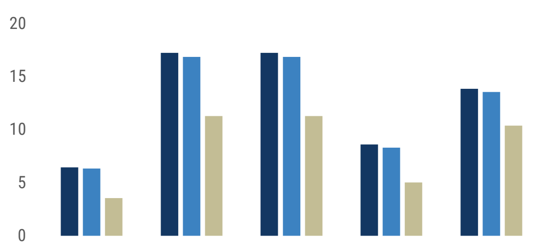
Security selection had the largest impact on performance. The Portfolio benefited from positive security selection within the Consumer Discretionary, Consumer Staples, and Health Care sectors. Security selection in Industrials and Information Technology detracted from performance. Asset allocation was an overall negative contributor due to the Portfolio underweight within Financials.

The holdings that made the highest contribution to the Portfolio’s quarterly performance were Marcus Corp. (MCS) +26.3%, Esco Technologies Inc. (ESE) +22.2%, Cambrex Corp (CBM) +21.4%, Bank of the Ozarks (OZRK) +22.9%*, and Cognex (CGNX) + 20.5%.

The holdings that detracted the most from the Portfolio’s performance were Silicon Motion Technology (SIMO) -17.6%, TASER Int’l Inc. (TASR) -15.3%, and PAREXEL Int. Co. (PRXL) -17.8%*.

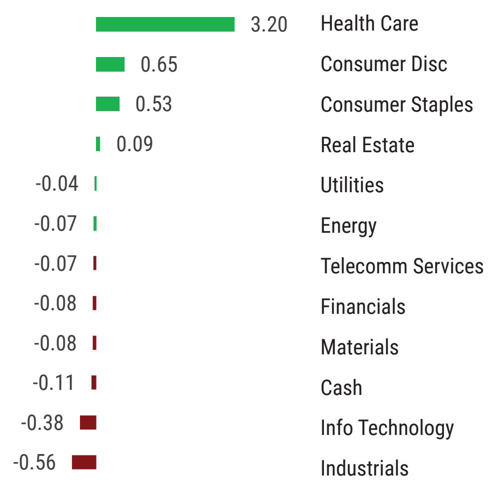
**sold during the quarter*

### Annualized Returns % as of 12/31/2016




| | QTD | YTD | 1 Yr | 3 Yrs | Inception |
|---|---|---|---|---|---|
| Small Cap Growth (Gross) | 6.5 | 17.3 | 17.3 | 8.6 | 13.9 |
| Small Cap Growth (Net) | 6.4 | 16.9 | 16.9 | 8.3 | 13.6 |
| Russell 2000 Growth ® | 3.6 | 11.3 | 11.3 | 5.1 | 10.4 |

### % Total Effect Portfolio vs. Index (9/30/2016 - 12/31/2016) (bps)



## Q4 2016 Attribution Highlights

### Overall Contributors

- Security selection in Health Care
- Security selection in Consumer Discretionary
- Security selection in Consumer Staples

### Overall Detractors

- Security selection in Industrials
- Allocation in Financials
- Security selection in Information Technology

## Top 3 Stock Contributors and Detractors

Contributors

| Stock | Ticker | Contribution |
|---|---|---|
| Marcus Co. | MCS | 0.75% |
| Cognex Co. | CGNX | 0.61% |
| Bank of the Ozarks, Inc.* | OZRK | 0.59% |

Detractors

| Stock | Ticker | Detraction |
|---|---|---|
| PAREXEL Int. Co.* | PRXL | -0.50% |
| Silicon Motion Technology Co. | SIMO | -0.49% |
| TASER Int., Inc. | TASR | -0.38% |

**sold during the quarter*

**Marcus Co. (MCS)** operates in two business segments: Theatres, and Hotels & Resorts. The Theatres segment runs multiscreen motion picture theatres in several Midwestern states, and a family entertainment center in Wisconsin. The Hotels and Resorts segment owns and manages a distinctive portfolio of hotels, resorts and other properties that are unique in their market. During the quarter, Marcus purchased 14 additional movie theaters. Marcus is a market leader in revitalizing their theater network by adding recliner seating and enhanced food and beverage initiatives. Marcus was up over 26% for the quarter.

**Cognex Co. (CGNX)** is a provider of machine vision products that capture and analyze visual information in order to automate tasks, primarily in manufacturing processes where vision is required. The Company's machine vision products are used to automate the manufacture and tracking of discrete items such as mobile phones, aspirin bottles, and automobile tires by locating, identifying, inspecting, and measuring them during manufacturing or distribution. The Company's products include vision software, vision systems, vision sensors, and ID products. Cognex returned over 20% for the quarter.

**Bank of the Ozarks, Inc. (OZRK)** is a bank holding company. The Company owns an Arkansas state chartered subsidiary bank, Bank of the Ozarks (the Bank). The Company, through the Bank, conducts operations through approximately 257 offices nationwide. It provides a range of retail and commercial banking services. Its deposit services include checking, savings, money market, time deposit, and individual retirement accounts. The probability of faster economic growth and a steepening yield curve sent bank stocks soaring following the culmination of the US presidential election. OZRK returned over 22% for the quarter.

**PAREXEL Int. Co. (PRXL)** is a biopharmaceutical outsourcing services company that provides clinical research, logistics, and medical communications consulting. During the last few quarters, PAREXEL has noted a negative pattern of trials turning off faster than in the past following a cancellation. The stock was down over 17% for the quarter.

**Silicon Motion Technology (SIMO)** is a fabless semiconductor company headquartered in Taiwan. The NAND flash controller chip is the Company's most important product (about 80% of total revenue), followed by its mobile communication business (about 15% of total revenue). Chip manufacturing is outsourced to TSMC. Samsung and Hynix are two of the Company's major customers. Silicon Motion came under pressure during the quarter, as two customers announced that they will produce NAND controllers in-house. The stock was down over 17% for the quarter.

**Taser International Inc. (TASR)** is engaged in the development, manufacture, and sale of conducted electrical weapons (CEWs) designed for use by law enforcement, military, corrections, security personnel, and private individuals for personal defense. The Company also productes connected wearable on-officer cameras, which utilize its cloud-based digital evidence management solution (Axon solution). During the quarter, the NYPD chose a competitor's product for body camera/evidence management. Taser was off over 15% for the quarter.

## Q4 2016 Transaction Summary

### Sector Allocation Changes

- Increase in Energy and Consumer Discretionary
- Decrease in Health Care

### Purchased

- Dril-Quip Inc. (DRQ)
- Duluth Holdings Inc. (DLTH)
- Eagle Bancorp Inc. (EGBN)
- Five Below Inc. (FIVE)
- Sapiens Int'l Co. NV (SPNS)

### Sold

- Bank of the Ozarks Inc. (OZRK)
- PAREXEL Int. Co. (PRXL)
- Perficient Inc. (PRFT)
- Popeyes Louisiana Kitchen Inc. (PLKI)

## Purchased

**Dril-Quip Inc. (DRQ)** is a leading manufacturer of highly engineered offshore drilling and production equipment, which is well suited for use in deep water, harsh environment, and severe service applications. The Small Cap IPC believes that Dril-Quip is well positioned to benefit from the recent turnaround in the energy market.

**Duluth Holdings Inc. (DLTH)** is a lifestyle brand of men's and women's casual wear, workwear, and accessories sold through the company's own direct and retail channels. The Company's product assortment includes shirts, pants, underwear, outerwear, footwear, accessories, and hard goods. They offer a range of products, such as its Longtail T-shirts, Buck Naked underwear, and Fire Hose work pants, which are branded under its Duluth Trading brand name. Duluth Holdings is one of the few compelling growth opportunities in the specialty retail segment.

**Eagle Bancorp Inc. (EGBN)** is a bank holding company for EagleBank (the Bank). The Bank is the company's principal operating subsidiary. The Bank is a chartered commercial bank, which operates over 20 locations in Maryland, the District of Columbia, and Northern Virginia. It offers a range of commercial banking services to its business and professional clients, as well as consumer banking services to individuals living or working within its service area.

**Five Below Inc. (FIVE)** is a niche specialty retailer catering to teens, pre-teens, and their parents. Everything, every day, is just $5 and below. Its stores are a vibrant, colorful, and high-energy destination. Five Below's unique assortment features leading brands such as Lego®, Wilson®, Hasbro™, and Peeps® and hot licenses from Disney® and Marvel® such as Frozen, Despicable Me, Avengers, and Star Wars.™ FIVE is growing their store base in addition to rolling out television advertising and e-commerce initiatives. They are growing their top-line 20% plus, generating consistent positive free cash flow, and have zero debt.

**Sapiens Int'l Corp. NV (SPNS)** sells software solutions to the insurance industry. It offers core, end-to-end solutions to the global general insurance, property and casualty, life, pension and annuities, reinsurance and retirement markets, as well as business decision management software. Today's market challenges and trends are driving companies to update their legacy software to cope with the changing regulatory environment, add differentiation to better compete, and to improve efficiency of operations. SPNS has a solid blue-chip global customer base with a 34 year history of operating in a highly attractive and growing market. SPNS expects to grow the top line in the high double digits.

## Sold

**Bank of the Ozarks Inc. (OZRK)** reached our maximum market capitalization of $5 billion during the quarter, and was sold due to this self-imposed limit.

**PAREXEL Int. Co. (PRXL)** is a biopharmaceutical outsourcing services company. During the last few quarters, Parexel has noted a pattern of trials turning off faster following a cancellation. This factor, as well as higher project cancellation rates, led to the removal of PAREXEL from the portfolio.

**Perficient Inc. (PRFT)** is an information technology and management consulting firm. Perficient reported lower profits and lower sales during the quarter, as a result, the Small Cap Committee felt that a quick rebound in business prospects was doubtful.

**Popeyes Louisiana Kitchen Inc. (PLKI)** operates and franchises quick-service restaurants under the trade names Popeyes Louisiana Kitchen and Popeyes Chicken & Biscuits. The quick-service restaurant industry has become increasingly competitive with numerous viable players. Like their competitors in this environment, Popeyes will face many challenges trying to maintain same store sales growth in the coming year.

## 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 five purchases and four sales in the Portfolio during the quarter, and they are reflective of this strategy. These combined transactions essentially increased the Energy and Consumer Discretionary sector weights while decreasing the Health Care sector weight.

Sources: Congress Asset Management (CAM) PSN and Factset. The views expressed in this document are as of publication date and are subject to change at any time due to changes in market or economic conditions.

## Outlook

In our opinion, economic prospects are strengthening, not-withstanding the proposals proffered by President-elect Trump to jump start the economy. Trump's proposals, if made policy, could bolster growth but probably not as fast or to the degree many envision. The proposals are far reaching impacting fiscal, tax, and trade policies. For that reason, forecasting the impacts on our economy or the markets is inexact at best.

One thing is almost certain, there will be less regulation emanating from Washington. In the wake of the financial crisis, the regulatory burden on business increased considerably effecting small businesses disproportionately. Less regulation would allow small businesses to hire more freely, positively impacting job growth, increasing competitiveness and fostering innovation. Financial firms, and banks in particular, would also benefit from an easing regulatory environment.

Trump's fiscal spending plans are less clear. The last big infrastructure plan was initiated in the early stages of the Obama administration and included "shovel ready" projects. Trump's fiscal spending plan appears similar to the Obama plan and promises improved roadways, airports, and rail services. These type of initiatives usually take longer to implement and take root. Furthermore, repairing existing infrastructure has a more muted economic benefit than new greenfield projects. In this regard, new plans agreed to in 2017 would benefit 2018 and beyond.

A proactive fiscal spending plan may reduce dependency on the Federal Reserve Bank's (Fed) monetary programs, a welcome outcome in our view. After eight years of monetary expansion and quantitative easing, the Fed's ability to kick start growth has waned. A more aggressive fiscal policy may help limit any negative effect of Fed's latest increase in the federal funds rate.

Trump's tax proposals are ambitious and encompass broad corporate tax reform and lower tax rates for individuals. Broad tax reform is often discussed but has eluded the previous four administrations. With party support in both houses of Congress, we should experience, at a minimum, lower personal and corporate tax rates. Lower rates would bolster spending and provide some growth at the possible expense of lower federal tax revenues.

As we enter 2017, the driving factors behind our economic picture are largely established. Job growth and low interest rates are supporting enhanced growth. Wages are trending up, supporting an already optimistic consumer. Interest rates are likely to gradually increase reflecting a stronger economy. The new administration's policies, if enacted as proposed, would likely benefit the latter half of 2017 and 2018.

Stocks remain the preferred asset class. Policy uncertainty has increased and will present opportunities as the year progresses but valuations are reasonable and the prospects for earnings growth are sound.

Congress Asset Management Co.
Small Cap Growth composite
6/30/2013 - 12/31/2016

| Year | Total Return Gross of Fees % | Total Return Net of Fees % | Russell 2000 Growth Return % (dividends reinvested) | Composite Gross 3-Yr St Dev (%) | Russell 2000 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) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 2016 | 17.3 | 16.9 | 11.3 | 16.2 | 16.7 | 15 | n/a | 9 | 1% | 5,693 | 8,139 |
| 2015 | 3.0 | 2.8 | -1.4 | n/a | n/a | ≤5 | n/a | 1 | n/a | 5,941 | 7,094 |
| 2014 | 6.1 | 5.9 | 5.6 | n/a | n/a | ≤5 | n/a | 0.6 | n/a | 6,328 | 7,449 |
| 6/30/13 - 12/31/13 | 23.0 | 22.9 | 22.0 | n/a | n/a | ≤5 | n/a | 0.6 | n/a | 6,489 | 7,467 |

**#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 – 6/30/16. The verification report is available upon request. 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. Verification does not ensure the accuracy of any specific composite presentation.**

**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 Small Cap Growth Composite was created on July 1, 2013. This inception date reflects the first full month 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 small cap growth style for a minimum of one consecutive month. The small cap growth strategy invests in the equity of high quality companies with market capitalizations between $250 million and $4 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 $50 thousand (US dollars). The primary composite benchmark is the Russell 2000 Growth. The benchmark returns are not covered by the report of the 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. 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 prior to 2016 because 36-month returns were not available

**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.