HIGHLAND CAPITAL MANAGEMENT

Q3 2018

LONG/SHORT HEALTHCARE FUND

MARKET REVIEW

PERFORMANCE SUMMARY

The Highland Long/Short Healthcare Fund Class Z share ended the third quarter up 20.84% due to strong contribution across the portfolio, especially from therapeutics. The fund is up 29.84% YTD, outperforming the broader S&P 500 Healthcare sector, which was up 14.53% in the quarter and 16.63% for the year.[1] The third quarter saw a market with low volatility and all healthcare subsectors generated positive gains. The fund's top 5 performers for the quarter were: AMRN, NERV, HLS CN, BIO, and LHCG. Several of these names were best performers last quarter as well.

Last quarter we commented on the robust capital markets activity within the biotech sector. The IPO market remained open with high activity throughout 3Q. There have now been over 50 biotech IPOs this year. While we normally view increased biotech IPO activity as a positive indicator for investor risk tolerance and biotech sentiment, we are incrementally cautious that the pendulum may have swung too far. Many of the recent biotech IPOs have been earlier stage, pre-clinical assets with little to no human proof-of-concept data. This is an indication to us that investors are reaching beyond their normal boundaries to chase performance. As a result, the fund reduced overall exposure in 3Q. The short book increased in size and on the margin, we migrated to larger cap, profitable names. We would like to see expectations around IPOs moderate and small cap valuations come in before adding incremental exposure to the small cap space. Our portfolio adjustments should also position the fund to better respond to increased volatility around the mid-term elections. We believe an increase in volatility may create a more favorable environment for the long/short strategy.

TOTAL RETURN ANALYSIS (%)

AS OF 9/30/2018	Incept.	YTD	1-YR	3-YR	5-YR	10-YR	Since Incept.
Class A	5.5.08	29.50	30.96	2.98	5.99	5.97	7.05
Class A (w/load)	5.5.08	22.42	23.76	1.05	4.79	5.37	6.47
Class C	5.5.08	28.90	30.15	2.39	5.36	5.35	6.42
Class C (w/load)	5.5.08	27.90	29.15	2.39	5.36	5.35	6.42
Class Z[2]	5.5.08	29.84	31.45	3.39	6.41	6.34	7.43
S&P 500		10.56	17.91	17.31	13.95	11.97	9.68

TOP HOLDINGS (% OF NET ASSETS)

LONG

Minerva Neurosciences, Inc.	13.8
HLS Therapeutics, Inc.	11.2
Bio-Rad Laboratories, Inc.	6.3
Amarin Corp. PLC	6.2
Shire PLC	4.9

SHORT

Roche Holding AG	-3.1
AnaptysBio, Inc.	-2.0
DaVita, Inc.	-1.5
Tenet Healthcare Corp.	-1.2
Ionis Pharmaceuticals, Inc.	-0.9

As of 9/30/18

FEES AND EXPENSES

Gross: Class A 2.80, Class C 3.45, Class Z 2.45 Net: Class A 2.80, Class C 3.45, Class Z 2.45

Class A Max Sales Charge: 5.50%. Class C Contingent Deferred Sales Charge ("CDSC") is 1% within the first year from each purchase. Performance results reflect the contractual waivers and/or reimbursements of fund expenses by the Advisor. Absent this limitation, performance results would have been lower.

The performance data quoted here represents past performance and is no guarantee of future results. Investment returns and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. For performance data current to the most recent month-end, please visit our website at www.highlandfunds.com.

During the third quarter, the portfolio experienced particularly strong performance from a number of biotech names. Amarin (AMRN) was the best performing holding with a 450% move higher contributing 9.8% to the fund's performance. The fund has held Amarin since the fall of 2016 on the premise that the company's ongoing triglyceride (TG) lowering study (REDUCE-IT trial) would show a cardiovascular benefit in patients. When the company reported top-line results on September 24, 2018, the 25% relative risk reduction in cardiovascular events well exceeded our expectation for a high teens reduction. Full data from the REDUCE-IT study will be presented at the American Heart Association meeting in Chicago on November 10, 2018. We expect the data to receive a great deal of attention from the medical community and national media outlets as this magnitude of cardiovascular benefit has not been seen since the introduction of statins to lower LDL-C. The statin class went on to generate peak sale of over $34B a year. Despite Amarin's stock move to date, we believe investors are still underestimating the market opportunity for Amarin's TG lowering drug, Vascepa.

The second best performer in the quarter was Minerva Neurosciences (NERV) contributing 6.7% to the portfolio's quarterly performance. Minerva was up 52% in the quarter and is up over 100% for the year. This has been the fund's largest position for the last several quarters. As highlighted last quarter, Minerva is developing a therapy to treat the negative symptoms of schizophrenia. There are currently no drugs approved for this indication, which are responsible for the poor social capabilities of patients. The company has already reported positive Phase 2 data and expects to readout its pivotal study in the first half of 2019. We continue to maintain a position in the company.

The third best performer in the quarter was HLS Therapeutics (HLS CN), contributing nearly 5% during the quarter. HLS Therapeutics is a Canadian, specialty pharmaceutical company generating nearly $45M in EBITDA from drug sales. The company licensed Canadian rights to Amarin's Vascepa late last year. Last quarter we profiled the company because it was one of the largest detractors from 2Q performance. At that time, we mentioned the Amarin cardiovascular outcomes data would play a key role HLS' stock experiencing a quick recovery. Given the strong clinical data out of Amarin, HLS' stock reacted as expected. We have taken some profits following the stock move, but we continue to maintain a position in the company.

Rounding out the top five performers are Bio-Rad Laboratories (BIO), which is a provider of life-science, research products, and LHC Group (LHCG), a home-health provider. Bio-Rad continues to benefit from margin improvement and the growth in bio-production. We modestly reduced our position size during the quarter to capture some profits on the strong move the stock has had to date. We continue to like the name but we are looking for a more attractive entry point to add to our position. On the healthcare provider side, home health has been a key macro theme of ours and it continue to perform well. LHC Group completed its merger with Almost Family at the end of the first quarter and the integration has begun. Payers continue to look to reduce medical costs and moving patient care to a lower cost home setting is one solution. This too is a name that we reduced over the course of the quarter just given the out-sized move it has had to date. We continue to like the macro theme but valuations may have temporarily gotten ahead of the fundamentals.

The biggest detractors from the third quarter performance were Amino, Radius Health (RDUS) and Clovis Oncology (CLVS). Amino has seen slow adoption of its price transparency product offering, however, the company hopes to gain traction with the 2019 selling season. Radius Health and Clovis are both biotechnology companies with approved drugs but experiencing slower than anticipated product launches. We continue to like both names, especially Clovis which we believe may present strong prostate cancer data in late October. Given the dispersion in healthcare performance, we continue to look for opportunities to exploit the changing dynamics in the healthcare sector.

As we focus on the end of 2018, the fund has adjusted portfolio allocation to be a bit more defensive. We have reduced overall exposure to small cap biotech stocks in anticipation of increase volatility surrounding the election and year-end positioning. Our short book has increased in size as more attractive downside opportunities have presented in some names with lofty valuations. Large cap biotech/pharma valuations, which we discussed last quarter, largely closed the valuation gap by the end of 3Q compared to where they were entering 3Q. As a result, the fund reduced some of the large cap biotech exposure that was added a quarter ago. While we still have a favorable long-term view across the healthcare space, we believe it is prudent to reduce risk in the short term. We have expected an increase in M&A activity but up to now, an increase in activity has largely been absent. We believe the uncertainty with the mid-term elections may put some deals on hold. Other acquisition opportunities in the biotech space may be stifled by the quick pace of innovation that can result in a therapy becoming obsolete quicker than in past years. The lack of long-term visibility makes it difficult for parties to agree to a purchase price. Ultimately we believe the sector needs consolidation to drive long-term fundamentals so we will continue to watch for signs of activity.

RISK CONSIDERATIONS

Before investing in the Fund, you should carefully consider the Fund's investment objectives, risks, charges and expenses. For a copy of a prospectus or summary prospectus which contains this and other information, please visit our website at highlandfunds.com or call 1-877-665-1287. Please read the fund prospectus carefully before investing.

The information herein contains forward-looking statements. These forward-looking statements are based on our current expectations and assumptions regarding the fund's portfolio and performance, the economy and other future conditions and forecasts of future events, circumstances and results. As with any projection or forecast, they are inherently susceptible to uncertainty and changes in circumstances. The fund's actual results may vary materially from those expressed or implied in its forward-looking statements.

Derivatives Risk. Derivatives, such as futures and options, are subject to the risk that changes in the value of a derivative may not correlate perfectly with the underlying asset, rate or index. Derivatives also expose the Fund to the credit risk of the derivative counterparty. Derivative contracts may expire worthless and the use of derivatives may result in losses to the Fund.
Leverage Risk. Leverage may increase the risk of loss, cause fluctuations in the market value of the Fund's portfolio to have disproportionately large effects or cause the NAV of the Fund generally to decline faster than it would otherwise.
Micro, Small and Mid-Cap Securities Risk. Investments in securities of companies with micro, small or medium capitalizations involve certain risks that may differ from, or be greater than, those for larger companies, such as higher volatility, lower trading volume, fewer business lines and lack of public information.
Non-Diversification Risk. As a non-diversified fund, the Fund may invest a larger portion of its assets in the securities of one or a few issuers than a diversified fund. A non-diversified fund's investment in fewer issuers may result in the fund's shares being more sensitive to the economic results of those issuers. An investment in the Fund could fluctuate in value more than an investment in a diversified fund.
Non-U.S. Securities Risk. Investments in securities of non-U.S. issuers involve certain risks not involved in domestic investments (for example, expropriation or political or economic instability).
Short Sales Risk. The risk of short sales theoretically involves unlimited loss potential since the market price of securities sold short may continuously increase.
Hedging Risk. Although intended to limit or reduce investment risk, hedging strategies may also limit or reduce the potential for profit. There is no assurance that hedging strategies will be successful.

EBITA: Earnings before interest; refers to a company's earnings before the deduction of interest, taxes, and amortization expenses.

Morningstar Long/Short Category Average is an average monthly return of all funds in the Morningstar Long/Short Equity Category, including the Fund. The Long/Short category includes funds that employ portfolio strategies combining long holdings of equities with short sales of equity, equity options, or equity index options. The funds may be either net long or net short, depending on the portfolio manager's view of the market.

S&P 500 Total Return Index is an index of a basket of 500 stocks designed to provide a broad snapshot of the overall U.S. equity market. The total return index series reflects both ordinary and special dividends. Investors cannot invest directly into an index.

S&P 500 Healthcare Index comprises those companies included in the S&P 500 that are classified as members of the GICS® health care sector.

1 Source: Morningstar Direct as of 9/30/18
2 Only eligible investors may purchase Class Z Shares. Please refer to the prospectus for information and conditions.

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