



## **NorthPointe Capital 1Q15 Small Cap Value Commentary**

### **General Market Commentary for the First Quarter of 2015**

The stock market, as measured by the broader indices, traded in a relatively narrow range during most of the first quarter of 2015 before moving higher in March. With the strong advance in the value of the US dollar, continually depressed commodity prices and talk of bubbles forming in certain subgroups – the most notable being the biotech industry – investors had plenty to consider from a macro perspective.

Small cap stocks outperformed large caps in the first quarter as the Russell 2000<sup>®</sup> Index generated a return of 4.32% relative to the 1.59% increase in the Russell 1000<sup>®</sup> Index. Value stocks trailed growth as the gain in the Russell 2000<sup>®</sup> Value Index of 1.98% was bested by the 6.63% advance in the Russell 2000<sup>®</sup> Growth Index. The underperformance was a result of less exposure to Health Care (the best performing sector during the quarter), and greater exposure to the underperforming Financials sector.

The portfolio's performance during the most recent quarter, in our opinion, highlights the attractiveness of our company-centered investment approach. We continue to focus on opportunities available at the individual stock level, rather than attempting to predict macro trends. Despite the Energy sector declining in excess of 7% during the quarter, all of the portfolio's Energy investment advanced, with a total return in excess of 30%. And while the Health Care sector was very strong with a gain of 10%, relative to the nearly 2% advance in Russell 2000<sup>®</sup> Value Index, the portfolio's Health Care stocks advanced a cumulative 17%. Certainly performance like this cannot be anticipated to occur each quarter (though we will attempt to do so!); however, we believe it confirms our mantra that no matter the investing environment, there will be opportunities for stock pickers to outperform.

### **Portfolio Commentary**

For the quarter ending March 31, 2015, the portfolio outperformed the benchmark, the Russell 2000<sup>®</sup> Value Index. The majority of the outperformance came from solid stock selection within the Energy sector and the strong returns from Health Care stocks. Not only did the portfolio benefit by being overweight the Health Care sector, which had the best performance within the index with a return more than twice that of the second best sector, but stock selection from this sector was also a large contributor.

After the Energy sector-driven setback the portfolio experienced in the previous quarter, several adjustments were made which led to impressive gains from the Energy holdings in the current quarter. Indeed, each of the portfolio's Energy stocks experienced gains in

the first quarter – with the stock of Sanchez Energy Corp. leading the way with an advance in excess of 40%. We find this performance to be impressive, given that the overall Energy sector declined, being the only sector within the index to do so in the current quarter. The portfolio exited positions in several oil and gas producers, who stand to be harmed the most by the lower price of oil, and reinvested the proceeds in a refiner, Delek US Holdings, Inc. and a fuel service provider, World Fuel Services Corp. Each of these companies could benefit from lower commodity prices. Notably, the Energy stocks that were sold in the previous quarter continued to underperform in the current quarter with an average decline of 20%, while the sole stock the portfolio carried over into 2015, Sanchez Energy (as previously discussed), performed quite well.

Within Health Care, the stock of Novavax, Inc. advanced nearly 40% as investors became more familiar with the Company's novel vaccine platform. Additionally, the stock of Supernus Pharmaceuticals, Inc. gained nearly 50% and was the portfolio's best performing stock during the first quarter. Supernus continued to report solid progress on the launch of two epilepsy drugs and made advancements in its drug pipeline, primarily focused on ADHD.

On the negative side, the stock of Stoneridge, Inc., a manufacturer of auto and truck components, was the largest detractor to the portfolio. While continuing to build a backlog of orders, the timing of these orders has been pushed into 2016 and the Company continues to struggle with an aftermarket parts unit in Brazil. We still maintain a very favorable view of the Company's potential and, as such, it remains the largest weighting within the Consumer Discretionary sector. The decline in the stock of Calix, Inc., a provider of communications equipment and software, also impacted performance. Investors were disappointed in the Company's guidance which is being impacted by greater investment in the sales force as well as international expansion.

At the end of the first quarter, the portfolio's largest investments were in the stocks of AtriCure, Inc., Headwaters, Inc. and Supernus Pharmaceuticals, Inc. All three stocks generated positive absolute returns during the quarter with Headwaters, a building products manufacturer, and Supernus providing some of the highest relative returns in the entire portfolio. AtriCure was a relative underperformer within the strong performing Health Care sector.

## **Research Efforts**

We continue to focus our research efforts on identifying companies that have specific near term catalysts whose stocks are currently being undervalued by the market. No matter the macroeconomic environment or current investor sentiment, the universe of small cap stocks is broad such that we are confident our due diligence process will continue to discover attractive investment opportunities.

For current holdings, we remain vigilant in monitoring valuation levels relative to the catalysts that have occurred, or are expected to occur, to ensure that the portfolio contains only the most attractive investments.

### **Sector or Industry Shifts**

The portfolio's investments in the Health Care sector remained the largest overweight exposure relative to the Russell 2000<sup>®</sup> Value Index. The portfolio also maintained notable overweight positions to the Information Technology and Materials sectors. Exposure to Financials remained the largest underweight position. The addition of several Energy holdings caused the portfolio to shift from an underweight position to an overweight by the end of the quarter. Additionally, the portfolio sold the stock of an entertainment company resulting in an underweight position relative to the Consumer Discretionary sector. The portfolio continues to be underexposed to the Utilities and Consumer Staples sectors, with no investments in the latter sector. There were no other significant industry shifts.

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*The Russell 2000<sup>®</sup> Index is a subset of the Russell 3000<sup>®</sup> Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.*

*The Russell 2000<sup>®</sup> Value Index measures the performance of small-cap value segment of the U.S. equity universe. It includes those Russell 2000<sup>®</sup> companies with lower price-to-book ratios and lower forecasted growth values.*

*The Russell 1000 Index measures the performance of the large-cap segment of the U.S. equity universe. It is a subset of the Russell 3000<sup>®</sup> Index and includes approximately 1,000 of the largest securities based on a combination of their market cap and current index membership*