



## **NorthPointe Capital 2Q14 Small Cap Value Commentary**

### **General Market Commentary for the Second Quarter of 2014**

Small cap indices declined throughout the first half of the current quarter while the larger company indices remained within a tight trading range. However, small caps bucked the “Sell in May” adage as a mid-May recovery drove the broader indices higher through the end of the second quarter. Large capitalization stocks outperformed small caps during the second quarter as the Russell 1000<sup>®</sup> Index returned 5.1% as compared to the 2.05% from the smaller company Russell 2000<sup>®</sup> Index. Value stocks outperformed growth stocks on a quarterly basis for the third consecutive quarter as the 2.38% return in the Russell 2000<sup>®</sup> Value Index beat the 1.72 % gain in the Russell 2000<sup>®</sup> Growth Index. This outperformance was a result of greater exposure to the top performing Utilities sector and better returns from the Consumer Discretionary, Health Care and Industrials sectors.

While concerns about the strength of the U.S. economy abound, the stock market continues to grind higher. Are earnings estimates are too high for the second half of 2014? Perhaps - perhaps not. The answer to this question will not determine the performance of our portfolio. We continue to focus on investments at the individual company level. The portfolio virtually matched the benchmark while not holding a single stock in the best performing sector in the Russell 2000<sup>®</sup> Value Index, the Utilities sector. Utilities as a group were strong because interest rates fell. We did not, and will not, have a “call” on interest rates. Our success will be determined by the individual companies and we continue to believe that time spent focusing on individual company fundamentals will lead to successful investment results.

### **Portfolio Commentary**

For the quarter ending June 30, 2014, the portfolio’s results nearly mirrored the benchmark, the Russell 2000<sup>®</sup> Value Index. Performance was positively impacted by strong stock selection within the Health Care, Energy and Industrials sectors. Leading all holdings with a gain in excess of 50% during the quarter was Akorn, Inc., a maker of branded and generic pharmaceuticals. The management team at Akorn has done a remarkable job positioning the Company for strong earnings growth and several acquisitions announced during the most recent quarter only served to solidify this fact among investors. Another strong performer within the Health Care sector was the investment in Supernus Pharmaceuticals, Inc. The Company has recently begun selling two drugs for the treatment of epilepsy and has two interesting future products that, in our opinion, are still not reflected in the stock’s valuation. Energy holding Sanchez Energy Corp. was also a strong performer with the stock gains driven primarily by the acquisition of additional acreage in the attractive Eagle Ford shale formation in Texas, as well as

higher oil prices. Within Industrials, the stock of NN, Inc. was also a notable contributor. NN, a manufacturer of bearings, advanced as management reported earnings in excess of expectations and continues to move the Company away from commodity products.

The portfolio was negatively impacted by an investment in World Wrestling Entertainment, Inc. The stock suffered as expectations for a new broadcast contract and the launch of a new wholly-owned network were far too optimistic, with the reported results falling short of expectations. As we now believe it will take longer for the Company to achieve our initial earnings expectations, if at all, we eliminated this position. Also detracting from performance was the investment in Extreme Networks, a provider of network switching products. The stock declined as investors were disappointed with earnings guidance as the Company attempts to integrate a large acquisition. We sold the stock as we no longer have confidence that management can deliver the expected financial performance.

At the end of the first quarter, the portfolio's largest investments were in the stocks of Renasant Corp., Atricure, Inc., and Kennedy-Wilson Holdings, Inc. The former two holdings were mild underperformers during the quarter, while the stock of Kennedy-Wilson was a solid contributor with the stock gaining nearly 20%. We opportunistically increased our position in Atricure as the stock sold off nearly 25% in the first half of the quarter, only to reverse the downtrend and gain 30% in the back half of the quarter.

### **Research Efforts**

We will continue to apply our rigorous investment process to identify those companies where the stock price is well below our estimate of true value. The strong market has caused us to continue our vigilance in monitoring current holdings, particularly as they approach our valuation targets. We spend a good deal of time collectively debating the risk reward potential of the current holdings and remain committed to ensure that the portfolio consists of 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 Materials and Information Technology sectors. Exposure to Financials remained the largest underweight position; however the extent of the underweight was reduced as the portfolio initiated new positions in a bank and an insurance company. The exit of an unprofitable investment in the Consumer Discretionary sector reduced the overweight position to that sector. The portfolio continues to be underexposed to the Utilities and Consumer Staples sectors, with no investments in these classifications. There were no other significant industry shifts.

*Past performance is no guarantee of future results. The value of investments may go down as well as up and investors may not get back their original investment. Performance is shown gross of fees and charges. The opinions expressed herein are those of NorthPointe Capital, LLC as of the date of this report and are subject to change at any time. Although the third party information has been obtained from and is based on sources the Firm believes to be reliable, the Firm does not guarantee the accuracy of the information, and it may be incomplete or condensed. This report is for informational purposes only, and is not intended as a recommendation with respect to the purchase or sale of any security. A list of all recommendations made within the last 12-months is available upon request. It should not be assumed that any of the securities transactions or holdings discussed will prove to be profitable, or that investment decisions or recommendations made in the future will be profitable or will equal the performance of the securities discussed herein. The securities discussed do not reflect the entire portfolio and in the aggregate may represent only a small percentage of the portfolio's holdings.*

*The Russell 2000® Growth Index measures the performance of the small-cap growth segment of the U.S. equity universe. It includes those Russell 2000® companies with higher price-to-value ratios and higher forecasted growth values. The Russell 2000® Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000® Index is a subset of the Russell 3000® 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® Value Index measures the performance of small-cap value segment of the U.S. equity universe. It includes those Russell 2000® 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® Index and includes approximately 1,000 of the largest securities based on a combination of their market cap and current index membership*