

NorthPointe Capital, LLC
Small Cap Value
2Q2017

General Market Commentary for the Second Quarter of 2017

Most broad stock market indices traded in a tight range during the second quarter with an upward bias, leading to modest gains at quarter end. The financial press continued to discuss how investors have become complacent, pointing to low levels of volatility in the market. Such volatility is determined by the pricing of S&P 500 index options and is often referred to as the “fear” index. While we won’t go as far as to label investors as complacent, there does appear to be an optimistic outlook to the near term investing horizon. Indeed, in mid-May, concerns around President Trump and potential obstruction of justice charges led to the largest one day decline of the quarter. Albeit, the severity of this drop was limited to approximately 2 to 3% for the broad indices and the losses were recouped within a matter of days. While the indices have produced modest gains in the past quarter thereby promoting the complacency theory, a look at the underlying sectors proves otherwise. The price of crude oil fell nearly 10% during the second quarter, which punished the Energy sector down almost 20%. Conversely, a resurgence in biotech stock prices drove the Health Care sector higher.

Large cap stocks outperformed small caps as the Russell 1000[®] Index gained 3.06% compared to the 2.46% gain in the Russell 2000[®] Index. Growth stocks outperformed value stocks due to the greater exposure to the strong Health Care and Information Technology sectors and less exposure to the struggling Energy sector.

Portfolio Commentary

For the quarter ending June 30, 2017, the NorthPointe Capital Small Cap composite was down -0.48% compared to the Russell 2000[®] Value Index which gained 0.67%. The underperformance was due to unfavorable stock selection from the Financials, Materials and Information Technology sectors. Within Financials, the stock of Amtrust Financial Services, a company that provides workers compensation and specialty insurance products, continues to struggle. Despite raising cash through a sale of investments and a capital raise from insiders, investors continue to have questions surrounding the reserve status and financial disclosure of the Company. While we continue to believe the stock trades at a price well below the true value of the Company, we are closely monitoring this investment. After a strong first quarter of 2017, the stock of Flotek Industries, Inc. essentially gave back all its 2017 gains during the second quarter. Flotek, a provider of specialty chemicals, is classified as a Materials stock within the broader index, while its stock will move with the Energy sector as this is an important end market. The move lower was most likely due to macro factors, as oil declined nearly 10% over the second quarter. Indeed, on a fundamental level, Flotek announced a decent earnings report with revenue and earnings per share ahead of consensus expectations. Within Information Technology, the stock of NeoPhotonics Corporation continues to



struggle. NeoPhotonics provides optical communication equipment and the stock has been impacted by continued delays in expected large orders from Chinese telecommunication companies. We continue to believe the sales ramp is a matter of when, not if.

The best performing stock, on a relative and absolute basis, was Supernus Pharmaceuticals, Inc., whose stock advanced nearly 40% in the second quarter (and 70% year to date). While the stock did have favorable biotech sentiment at its back, the Company's main drug Trokendi XR was cleared by the FDA to be marketed to treat migraines, in addition to epilepsy. This new indication caused drug prescriptions to accelerate materially and resulted in an increase in earnings estimates. The Company continues to make progress on its drug pipeline, which we believe is still being undervalued by the public market. Also adding to performance was the stock of Industrial holding, Swift Transportation. Early in the quarter, Swift and Knight Transportation, a rival trucking company, revealed their intention to merge, forming the largest trucking company in the country. This all stock deal was favorably received by investors as the stocks of both companies continued to climb in the months subsequent to the initial announcement.

At the end of the quarter, the portfolio's largest investments were in the stocks of Supernus Pharmaceuticals, Inc., Franklin Financial Network, Inc. and CenterState Banks, Inc. As noted previously, the investment in Supernus was a strong contributor, while the investment in Franklin Financial, a bank holding company, also provided both absolute and relative outperformance. The investment in CenterState, was a mild detractor to performance during the quarter, with the stock declining 4%.

Research Efforts

While complacency may have settled in to certain corners of the market, it has no place in our investment process. We continue to evaluate current and potential holdings to ensure that the portfolio is comprised of only the most attractive investment opportunities.

Sector or Industry Shifts

The portfolio's investments in the Health Care sector remained the largest overweight exposure relative to the Russell 2000® Value Index. The portfolio also maintained a notable overweight position within the Consumer Discretionary sector throughout the quarter and an underweight position relative to the Real Estate sector. The purchase of company that operates pawn stores reduced the underweight to the Financials sector, while new investments in a pump & process equipment company and a trucking operator increased the overweight position within the Industrials sector. The portfolio continues to have no investments in the Utilities sector. There were no other significant sector shifts during the quarter.

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



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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