



## **NorthPointe Capital 3Q14 Small Cap Value Commentary**

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

After an impressive advance in the back half of the previous quarter, small cap indices registered their first quarterly decline in over two years. With the exception of a minor rally in the month of August, small cap stocks moved lower throughout the quarter. Large capitalization stocks outperformed small caps during the third quarter as the Russell 1000<sup>®</sup> Index incurred a marginal loss of 0.19% while the smaller company Russell 2000<sup>®</sup> Index declined 7.36%. Value stocks underperformed growth as the Russell 2000<sup>®</sup> Value Index fell 8.58% relative to the 6.13% decline in the Russell 2000<sup>®</sup> Growth Index. The underperformance was a result of lower exposure to the outperforming Health Care sector and lower returns from the Energy and Industrials sectors.

As evidenced by the stark performance difference between large cap and small cap indices, investors became much less risk tolerant during the most recent quarter. A review of the portfolio's quarterly performance reveals a lack of outsized individual stock price gains. This should not be interpreted as a lack of progress within our holdings. In many cases, the opposite is true. As we review our investments, we are quite comfortable with the fundamental advancement of our names in general. We should not be, and are not, concerned that an overall negative market sentiment fails to recognize such progress over a limited 90 day period. We continue to believe strong fundamental performance combined with attractive valuations will deliver attractive investment returns over a longer time frame.

### **Portfolio Commentary**

For the quarter ending September 30, 2014, the portfolio underperformed the benchmark, the Russell 2000<sup>®</sup> Value Index. Results were primarily impacted by negative stock selection scores from the Energy, Financials and Information Technology sectors offset somewhat by strong stock selection in the Health Care sector. Sector allocation also contributed to the underperformance as the portfolio was underweight the outperforming Financials sector. Within Energy, the sharp drop in the price of crude oil – nearly 15% during the quarter – led to declines in the stocks of many energy exploration companies. The stock of Halcon Resources Corporation was a notable underperformer in the current quarter after the stock rose approximately 75% in the preceding quarter. Concerns over the potential of its acreage in the Tuscaloosa Marine Shale resulted in this stock returning all of its gains from earlier in the year. The negative performance in the Financials sector was driven by the decline in the stock of Tristate Capital Holdings, Inc., a bank holding company with locations in the eastern United States. Greater than expected loan losses

led investors to question the quality of the Company's credit portfolio. The removal of two significant contracts led to a sharp decline in the stock of Technology holding PDF Solutions, Inc. The loss of this business resulted in PDF Solutions, a provider of integrated circuit manufacturing services, to reduce 2014 revenue guidance.

The portfolio's holdings failed to produce any outsize stock price moves during the third quarter. Only one investment in the portfolio, LDR Holding Corporation, experienced a return in excess of 20%. LDR, a medical device company focused on spine products, performed well as we believe investors are beginning to recognize the differentiation of the Company's technology and appreciate the impressive operating results.

At the end of the first quarter, the portfolio's largest investments were in the stocks of Renasant Corp., LDR Holding Corporation and ExamWorks Group, Inc. The stock of Renasant declined during the quarter and marginally underperformed the overall Financials sector, while the stocks of LDR and ExamWorks rose during the quarter and were solid contributors to performance.

### **Research Efforts**

While headlines that tout geopolitical unrest and uncertainty over domestic monetary policy make for interesting reading, we continue to spend a majority of our research efforts on tracking the progress of individual companies. A soft market can provide opportunities to increase current holdings or initiate new positions in companies we have been tracking. Simultaneously, such markets heighten our awareness of the lagging stocks within the portfolio and cause us to continually reaffirm our understanding of the investment situation. Those stocks that no longer conform to the initial investment thesis are eliminated for better opportunities.

### **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. New investments in a clothing retailer and an auto components supplier resulted in an increased weight within the Consumer Discretionary sector, moving the relative position from underweight to overweight. Conversely, the sale of a diversified industrial manufacturer and reductions in several Industrials holdings resulted in a relative underweight position at quarter's end compared to an overweight position at the beginning of the period. 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.

*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*