



## **NorthPointe Capital 3Q15 Small Cap Value Commentary**

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

“A Painful Quarter for Markets” read the headline of the Wall Street Journal the day after the third quarter came to an end. After continuing to trade in a relatively narrow range throughout July and early August, the broader market indices fell in excess of 10%; a move widely attributed to the unexpected currency devaluation in China and growth concerns in developing countries. A brief recovery occurred in September, but the decline resumed into quarter’s end, resulting in the worst quarterly return since 2011.

Small cap stocks underperformed large caps in the third quarter as the Russell 2000<sup>®</sup> Index fell 11.92% relative to the 6.83% decline in the Russell 1000<sup>®</sup> Index. Value stocks outperformed growth with the Russell 2000<sup>®</sup> Value Index declining 10.73% as compared to the 13.06% decline in the Russell 2000<sup>®</sup> Growth Index. Greater exposure to the outperforming Financials and Utilities sectors was behind the performance difference.

In the third quarter, each sector of the Russell 2000<sup>®</sup> Value Index had a negative return. The portfolio was not immune to the broad market decline as each of the portfolio’s sectors was also negative. However, the performance of each sector in the portfolio outperformed that of the index. While we certainly do not celebrate this fact, as we strive for absolute outperformance in addition to relative gains, we do believe it speaks to the merits of our investment process. By focusing on company fundamentals and stock specific catalysts, we hope to achieve superior investment performance. Our track record, we believe, supports our approach and we remain vigilant in researching attractive investment opportunities and optimally managing the collective portfolio.

### **Portfolio Commentary**

For the quarter ending September 30, 2015, the portfolio outperformed the benchmark, the Russell 2000<sup>®</sup> Value Index. The outperformance came entirely from stock selection, where the portfolio generated positive stock selection scores in every sector. Detracting from total performance was negative sector selection, as the portfolio was underweight the Financials and Utilities sectors. While each of these two sectors generated negative returns, the losses were less than that of the index as a whole.

The largest contributor to the portfolio’s performance was the investment in Aerie Pharmaceuticals, Inc. From the beginning to the end of the quarter, the stock was flat; however, during the quarter the stock jumped in excess of 70% on favorable drug trial results. We took the outsized gain as an opportunity to adjust the size of the investment position. The sell off at the end of the quarter, which was particularly dramatic for drug and biotech stocks, took the stock back down to levels seen before the drug trial news

was announced. We maintain a high conviction in the favorable outlook for Aerie. The investment in Synergetics USA, Inc. was also a strong performer, with the stock registering the largest gain in the portfolio (nearly 40%). Synergetics manufactures equipment used in eye surgeries and the Company agreed to be acquired by a competitor at an attractive premium to the current stock price. Information Technology holding, ShoreTel, Inc. was also a notable contributor. ShoreTel provides unified communication systems and has just launched a cloud-based offering that we believe will be well received by its customers.

The largest single stock detractor during the quarter was the investment in Genocea Biosciences, Inc. Genocea is developing vaccines using a unique T cell approach. The Company previously reported positive drug trial results for a herpes vaccine and we await results from a pneumococcal vaccine program. The stock declined as a result of an equity offering, which we participated in, but the decline accelerated into the end of the quarter as biotech stocks were broadly sold off. We maintain a positive outlook for the Company, based on the herpes vaccine alone.

At the end of the first quarter, the portfolio's largest investments were in the stocks of Renasant Corp., a provider of banking and insurance services, ShoreTel, Inc., a communication services provider, and Primoris Services Corporation, a specialty construction services company. All three stocks added to performance during the quarter, on a relative basis, with Renasant and ShoreTel generative positive absolute returns as well.

### **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. The broad based decline during the quarter provides an opportunity to review companies at lower prices; and some of the best opportunities may very well come from our existing holdings. The portfolio is constructed of companies trading at discounted valuations with identifiable catalysts. These companies are not dependent Chinese currency fluctuations, commodity price movements, or other macro factors. Our research will never be centered on such items; we believe better investment results could be obtained by analyzing the specific business environment of individual companies.

### **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 in the Information Technology and Consumer Discretionary sectors throughout the quarter. Exposure to Financials remained the largest underweight position. The portfolio continues to be underexposed to the Utilities and Consumer Staples sectors, with no investments in either sector at the end of the quarter. There were no other significant industry shifts.

*Past performance is no guarantee of future results.*

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*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*