



## NorthPointe Capital 4Q15 Small Cap Value Commentary

### General Market Commentary for the Fourth Quarter of 2015

Rebounding from a difficult third quarter, the stock market rallied throughout October. The remaining two months of the year saw most broad indices trade in a tight band while finishing the quarter in positive territory. Large cap stocks outperformed small caps as the Russell 1000<sup>®</sup> Index registered a quarterly return of 6.5% relative to the 3.59% increase in the Russell 2000<sup>®</sup> Index. Growth stocks fared better than value as the gain in the Russell 2000<sup>®</sup> Growth Index of 4.32%% beat the 2.88% advance in the Russell 2000<sup>®</sup> Value Index. The outperformance was the result of better returns and greater exposure to the Health Care sector (the best performing sector in the quarter) as well as less exposure to the underperforming Energy sector.

Investors continue to face an uncertain environment. How will the domestic monetary policy unfold and what impact will it have on the economy? What does a slowdown in the economic growth of China mean to the rest of the world? There is also a Presidential election on the horizon. Plenty of uncertainty, indeed. However, we take great comfort in our investment process that keeps us focused on individual opportunities that can be assessed by understanding businesses and the unappreciated changes taking place. This singular focus enables us to eliminate much of the “noise” that populates headlines and news broadcasts. By focusing on company fundamentals and stock specific catalysts, we seek to uncover attractive investment opportunities despite whatever fiscal or geopolitical impacts have on the overall investing landscape.

### Portfolio Commentary

For the quarter ending December 31, 2015, the portfolio underperformed the benchmark, the Russell 2000<sup>®</sup> Value Index. The majority of the underperformance came from poor stock selection within the Information Technology and Materials sectors. The stocks of Ruckus Wireless, Inc., a provider of wireless networking equipment, and Plexus Corporation, a contract manufacturer, declined as management of each company issued sales guidance that fell below consensus expectations. Offsetting some of the weakness within Information Technology was the portfolio’s investment in ShoreTel, Inc., a communication services provider. The stock responded well to strong earnings and excitement over the Company’s new cloud-based service platform. Underperformance in the Materials sector was mainly due to Flotek Industries, Inc., a manufacturer of specialty chemicals to the oilfield industry. The stock came under significant pressure as the Company’s value proposition was called into question by an analyst who was betting against the stock. We maintain the investment in Flotek as we believe the Company’s products do provide value and this will be proven out in future sales numbers. Also detracting from performance was the decline in the stock of Aaron’s, Inc., which was the worst performer in the portfolio during the current quarter. Aaron’s, which rents furniture and consumer electronics, reported disappointing quarterly earnings due to bad debt expense and a loss of market share. We exited this investment as we see no near term fix for such issues.

The largest positive contributor to performance was the investment in Stoneridge, Inc., a manufacturer of engineered components for the transportation industry. Better than expected earnings and a new CEO with a focus on margin improvement served to drive the stock's gain. The largest absolute percentage gain within the portfolio came from MGP Ingredients, Inc., a provider of distillery products. The stock of MGP advanced nearly 50% during the quarter as investors realized that the Company has shifted its exposure to the growing whisky and bourbon markets and away from less profitable commodity markets. Health Care holding Aerie Pharmaceuticals, Inc. was also a strong contributor as the Company announced successful results in the development of its glaucoma drug.

At the end of the fourth quarter, the portfolio's largest investments were in the stocks of BGC Partners, Inc., National General Holdings, and Kearny Financial Corp. Each of these financial service companies were strong performers during the quarter, both on an absolute and relative basis.

### **Research Efforts**

There has been no change to our research approach. We continue to apply our rigorous investment process to identify those companies where the stock prices are well below our estimate of true value. 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® Value Index. The portfolio also maintained notable overweight positions to the Information Technology and Consumer Discretionary sectors throughout the quarter. The addition of two chemical companies increased the overweight position in the Material sector, while the sale of a business services company resulted in an underweight position relative to the Industrials sector. Exposure to Financials remained the largest underweight position. Additionally, the portfolio continues to be underexposed to Utilities with no investments in this 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.*