

General Market Commentary for 2017 and 4Q17

Broad market indices gradually climbed higher throughout 2017, with only one month registering a negative return (and only slightly negative at that with the S&P 500 index down .04% during the month of March). Anticipation of domestic tax reform, continued strength in the U.S. economy and related confidence measures, as well as a global economic recovery were the most likely factors behind the strength. Given the high degree of optimism and momentum witnessed in the market, it was not surprising that growth stocks outperformed value. Contrary to 2016, large cap stocks outperformed small caps, with nearly half of the outperformance due to better returns and greater exposure to Technology stocks. And within this sector, nearly half of the outperformance came from just three stocks - Apple, Microsoft and Facebook - with each gaining in excess of 40% during 2017. It could be universally accepted that those three companies have proven business models, yet the market also seemed to reward unproven business models.

In addition to focusing on traditional fundamental and macroeconomic drivers (tax policy, unemployment, earnings growth, consumer confidence, etc.), investors – and the media – became enamored with topics such as block chain, crypto currency and cannabis. The quarter witnessed dramatic price increases in securities related to, or even contemplating being related to, alternative currencies. An exchange traded fund established to track the price of a Bitcoin saw its shares rise 5x during the most recent quarter. Shares in a beverage distributor went from \$2 to as high as \$9 (while ending the year at \$5) on the announcement that it was exploring opportunities in blockchain technology. Really, a beverage distributor moving to block chain technology? It had not developed a product related to such technology, just that it was exploring opportunities in the field. Indeed, far from a proven business model, yet the stock more than doubled. An exchange traded fund that tracks securities in the cannabis industry nearly tripled. We have chosen to share these examples to highlight how speculative and momentum driven certain investors have become. We have not, and will not, join this crowd. We focus our efforts on identifying unknown or misunderstood investment opportunities. These opportunities most likely won't be highlighted on TV shows or promoted on Internet blogs. We believe, over time, the opportunities we have identified, will deliver attractive returns.

Small cap stocks, as measured by the Russell 2000[®] Index, posted gains of 3.34% and 14.65% for the fourth quarter and full year, respectively, compared to the 6.59% and 21.69% respective returns of the Russell 1000[®] Index. Growth stocks fared better than value stocks as the Russell 2000[®] Growth Index returned 4.59% and 22.17% for the fourth quarter and full year, respectively, while the Russell 2000[®] Value Index had gains of 2.05% and 7.84%, respectively. Value returns fell behind growth due to value stocks greater exposure to the underperforming Financials and Real Estate sectors as well as lower returns and less exposure to the Industrials sector.

Portfolio Commentary

For the quarter and year ending December 31, 2017, the NorthPointe Capital Small Cap composite lost 1.56% and 2.02%, respectively, while the Russell 2000[®] Value Index gained 2.05% and 7.84%, respectively. The underperformance in the fourth quarter was driven by stock selection. The stock of Genmark Diagnostics, Inc. suffered when the Company announced challenges to the adoption of its new molecular testing platform. We had been long term believers in the Company and the product; however, the latest developments caused us to exit our position as we have little visibility on when such challenges will be resolved. The investment in Nautilus, Inc., a maker of fitness equipment, also suffered as the Company lowered sales guidance. We reexamined our investment thesis, including a trip to Nautilus headquarters to review new products, and came away with increased conviction that the outlook for Nautilus shares remain bright. Another detractor to the portfolio was the investment in Horizon Global Corp., a global leader of towing accessories. Horizon has made several strategic acquisitions which we believe will greatly benefit the Company; however, the stock suffered when the Company reported a quarter with strong revenues but below estimated margins. We have analyzed the reasons behind the margin shortfall and find them to be temporary in nature. As such, we have maintained our investment in Horizon. Technology stocks such as Fabrinet, a manufacturer of communications equipment and Tivo Corporation, a provider of entertainment technology, also disappointed investors with their near-term earnings potential.

The largest positive contribution to performance was the investment in SPX Flow, Inc., a manufacturer of flow control products. SPX Flow was spun out of SPX Corporation in 2015 and the Company is starting to realize the benefits of being a more focused entity at a time when its major end markets (energy, industrial, and food & beverage) appear to be improving. We have followed the Company since the spin, but initiated our investment in 2017 as we foresaw near term catalysts that were not, in our opinion, being properly reflected in the stock price.

Team

Over the past 25 years, I have used these challenging periods to carefully reflect on our team and how we allocate resources with a critical eye on investment talent. I am now excited to announce the addition of Bryan Franco to our team effective 1/19/18. This is old home week for Bryan as he left us back in 2011 to co-manage a micro/small cap hedge fund portfolio in NYC and returned to Michigan for personal reasons. It must be the fabulous Michigan winters. Additionally, Steve Roberts, one of our analysts will be leaving the company. We wish Steve well in his future pursuits. Mary, Mike, and I are anxious to welcome Bryan back to the team and to integrate him into the process.

As always, I am available to meet with you in person or over the phone to discuss changes to the team and our commitment to an improved client experience.

Sincerely yours,

Jeffrey C. Petherick, CFA
Partner

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® 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.