NorthPointe Capital
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NorthPointe Capital, LLC
Large Cap Value
2nd Quarter 2018

Most broad stock market indices registered gains during the second quarter of 2018. Despite ongoing concerns of tariffs and global trade wars, stocks trended higher without the volatility experienced earlier in the year. Perhaps the fear of trade turbulence or the rising US dollar were behind the drive that pushed the Russell 2000® Index to an all-time high before pulling back in the final days of the quarter. Large cap stocks are generally considered to have more international exposure, so it appears investors gravitated to more domestic-focused small cap stocks in response to overseas concerns

During the second quarter of 2018, small cap stocks outperformed large cap stocks with the Russell 2000® Index gaining 7.75% relative to the 3.57% gain in the Russell 1000® Index. Growth stocks outperformed value stocks as the Russell 1000® Growth Index returned 5.76% while the Russell 1000® Value Index gained 1.18%. The Growth Index fared better than its value counterpart due to the outperformance of technology related shares.

A look at what worked during the quarter indicates that valuation was seemingly ignored. Stocks with higher P/E ratios did better than those with lower ratios. And what about stocks with no P/E ratio, implying no earnings at all? They were the best performers of the quarter, returning more than 3 times the return seen by the stocks in the lowest P/E quintile. We have invested in environments like this before and our experience has shown these periods tend to be short lived. Valuation is a significant component of our stock selection process. We continue to believe that the selecting undervalued stocks with identifiable catalysts will lead to attractive investment returns.

The NorthPointe Large Cap Value Composite produced a gross return of 0.32%, which compares to the - 1.18% return of the Russell 1000® Value Index. For the past twelve months, the NorthPointe Large Cap Value Composite had a gross return of 10.23%, which compares to the 6.77% return of the Russell 1000® Value Index.

For the quarter, selectivity was strongest in the Health Care, Real Estate, and Consumer Discretionary sectors. A standout performer for the period was General Motors. GM has been in the portfolio since it emerged from bankruptcy in 2010. GM has been held because it has consistently been what we term a triple threat. It embodies the three style characteristics that our process seeks to exploit: Value, Quality, and Momentum. On May 31 Softbank Vision Fund announced a $2.25 billion investment in GM's Cruise autonomous vehicle unit. The valuation placed on the Cruise unit propelled the shares sharply higher. The stock remains a core holding and a triple threat.

Stock selection was challenged within the Financial, Technology and Industrial sectors. ManpowerGroup, a leading provider of global workforce solutions, was the biggest detractor to portfolio performance during the quarter. On April 20th, ManpowerGroup reported quarterly results that beat expectations on both the top and bottom line. However, forward guidance brought investor focus towards future gross margin pressures and a potential deceleration of revenues sent the share price sharply downwards. We believe the action in ManpowerGroup's share price was a significant overreaction and thus ManpowerGroup remains a portfolio holding. The company's management is executing their business model at a high standard and the stock is selling at an extremely attractive valuation of just ten times 2018 forecasted earnings. Unum Group, a financial services firm that specializes in benefit protection solutions, declined because of a 1st quarter earnings missing. The company reported earnings of $1.24 that missed expectations of $1.25. Normally a penny miss in earnings would not trigger such a negative reaction. The earnings miss was driven by the performance of Unum's Long-Term Care (LTC) business. Industry wide concerns over LTC were brought into focus because of General Electric's 2017 LTC $6 billion charge off. Heightened investor concerns over LTC business units seemed to accelerate the sell off. Our work suggests that the selloff in the share price of Unum was overdone. Unum's LTC business is just 10% of the company, their core business is executing, and the stock is trading at 7.8 times 2018 forecasted earnings. Unum remains a portfolio holding.

Unum and ManpowerGroup are classic value stocks. The crowd has left them behind. Successful value investors take positions that the crowd will not. They do not seek to win popularity contests. Value investing demands independence of thought and steadiness of hand in face of challenge. We are following our investment process by continuing to hold these two value stocks. Our process protects against emotional overreactions and keeps our focus on making the sound investment decision. It often is not easy being a value investor and at times it can be downright painful. History has demonstrated that the temporary pain is worth the value that ultimately gets realized. We will continue to monitor Unum and ManpowerGroup closely.

The portfolio's second quarter results were dampened by the performance of our stock selection model and the negative impact of our selectivity derived from our qualitative overlay. Our selectivity was challenged early in the quarter, as evidenced by Unum and ManpowerGroup. During the month of June our model cost the portfolio roughly 83 basis points of value add. Our highest ranked securities, our 10 ranks,

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returned approximately .33% during the month. Our lowest ranked stocks, our 1 ranks, returned 2.69% during the month of June. During June three of our underlying sub models (Interest Rate Sensitive, Cyclical, and Fast Growth) were statistically significant negative performers. While we never like to witness model performance that June exhibited, this has happened in the past and it will likely happen again. Our models have been researched and develop to be resilient. We believe our track record strongly reflects this desired bounce back ability.

We appreciate the opportunity to provide you an update on the NorthPointe Capital Large Cap Value Strategy. We are excited about the portfolio's current positioning and we are confident in our ability to add value going forward. The current portfolio is selling at a multiple of 12.4 times its twelve month forecasted earnings, which compares to the 14.0 multiple for the strategy's benchmark. The fund has a ROE ratio, Return on Equity, of 16.2% vs. 12.2% for the benchmark. Both metrics suggest that the portfolio's characteristics are in a stronger position than when we wrote to you last quarter. In our view, the portfolio has embedded alpha.

Please rest assured that we shall remain focused on finding unique large cap companies that can grow their business and whose stock price trades below its intrinsic value. We embrace our responsibility to add value to your portfolio and look forward to continuing to attempt to do so for you. If you should desire any further information, please do not hesitate to contact us.

Respectfully,

Peter Cahill, CFA
CIO, Portfolio Manager