





is the most crowded trade I can remember in my 30 years of investing, more so than the dot.com era which was highly concentrated in technology.

To be sure, we have made mistakes in stock selection in the last several quarters, but in these environments, the high price of disappointment gets magnified, making smart investors look even more foolish. Conversely, the perceived reward for continued growth in revenues and stock prices is disproportionately high. It's a condition that cannot and will not last for long, but just long enough for investors to throw in the towel and say, "Value Investing is Dead." Valuation does matter and at this point in the cycle, valuation is the primary emphasis in your portfolio.

### **Portfolio Discussion:**

The NorthPointe Micro-Cap Portfolio underperformed the Russell Micro Cap Index in the third quarter by 2.4%, returning -1.6% vs .6% for the index. All of the underperformance came in the first two months of July and August, when growth stocks continued their dominance over value stocks and as indices moved higher. When the market rolled over in September, the portfolio outperformed by 1.25% beating both the Russell Micro Cap and Micro Cap Value Benchmarks. It is one datapoint, but indicative of how the portfolio is positioned.

All of the underperformance in the quarter can be explained by one area: Health Care. The Health Care sector was the second-best performing sector for the quarter, and our underweight, coupled with our "value" stock positioning in the space led to poor contribution. News of delays in additional FDA phase testing for Gemphire caused the stock to go down 79% in the quarter. The news did not invalidate nor threaten the long-term value of the stock, but in this momentum-driven, short-sighted market, some investors headed for the exit in a stampede. A value stock, Invacare (IVC), reported lackluster quarterly earnings causing investors, including us, to question the ability of management to drive enough fundamental improvement to draw meaningful investor interest. Finally, Capital Senior Living (CSU), and owner and operator of Independent/Assisted Living centers mainly in Texas, experienced intense competition and lower occupancy, causing the CEO to lose his job, and fundamentals to be uncertain for an indefinite period of time. We exited the idea for better ideas elsewhere.

To be sure, we had several strong winners in the quarter, and as we discussed last quarter, the top 10 contributors are beating out the bottom 10. However, the price of disappointment is still very high, making the hurdle of outperformance even higher. Yet, some of our newest investments, in companies such as Airgain (AIRG), Amyris (AMRS), Energy Fuels (UUUU), Minerva (NERV) and NuVectra (NVTR) performed very strong, up 42.9%, 21.2%, 44.5%, 52.0% and 43.7% respectively. And in the middle ground, it's a battle between momentum and value, with our positioning to the latter which continued to represent a headwind in the last three months.

### **Looking Ahead:**

The market decline that started in September has continued in October and the portfolio relative performance as a whole continues to improve. Several key indicators suggest that air may be coming out



of the momentum bubble with the S&P Biotech ETF down nearly 10%, the PHLX Semiconductor ETF down 8% and the QQQ Nasdaq 100 down over 6%. It's too early to say that the cycle is turning to value, but the speed at which these indicators are declining is not surprising to us given the "crowded" holdings of these ETFs.

Every quarter that goes by with growth outperforming value and momentum outperforming free cash flow only serves to increase our conviction in our current portfolio. With your portfolio holdings, we are considering what is best for the next three to five years, not the next three to five months or weeks. We remain confident in the team, the process and the holdings and where fundamental evidence corroborates our underlying theses, our conviction increases regardless of the near-term stock price performance.

We are also confident that patience will be rewarded as has been the case in past cycles, and that like 1999, now is the time to recognize the extreme narrowness of this market and go to those places where true, financial and economic rewards remain.

As always, I am happy to discuss in person or on the phone.

Sincerely yours,

Jeffrey C. Petherick, CFA  
Partner

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*The Russell Micro Cap® Index measures the performance of the micro-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.*