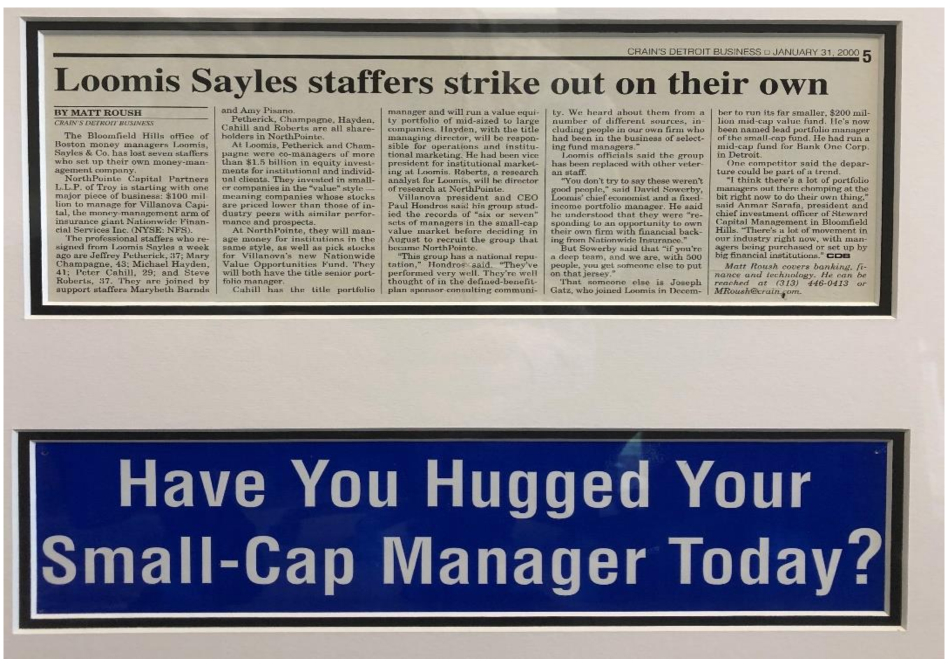
NorthPointe Capital
39400 Woodward, Suite 190, Bloomfield Hills, MI 48304

3Q18 SCV Commentary

In the NorthPointe Archives, we have a bumper sticker that reads, "Have you Hugged Your Small-Cap Manager Today?" It was sent to me in the summer of 1999 from Claudia Mott, the Director of Small Cap Research at Prudential Securities and a nine-year Institutional Investor All-Star analyst just a few months before she announced her retirement. The backdrop was the 1998-2000 Dot.Com era, an era that had many investors questioning the merits of small cap and value investing. Prominent financial publications even declared "Value Investing is Dead." I remember it distinctly. Why? Because just a few months later, our team struck out on its own to start a small-cap value shop called NorthPointe Capital. I was confident, despite warnings to the contrary, this was an opportune time to start a small/micro-cap, value shop.



CRAIN'S DETROIT BUSINESS □ JANUARY 31, 2000 5

Loomis Sayles staffers strike out on their own

BY MATT ROUSH
CRAIN'S DETROIT BUSINESS

The Bloomfield Hills office of Boston money managers Loomis, Sayles & Co. has lost seven staffers who set up their own money-management company.

NorthPointe Capital Partners L.L.P. of Troy is starting with one major piece of business: $100 million to manage for Villanova Capital, the money-management arm of insurance giant Nationwide Financial Services Inc. (NYSE: NFS).

The professional staffers who resigned from Loomis Sayles a week ago are Jeffrey Petherick, 37; Mary Champagne, 43; Michael Hayden, 41; Peter Cahill, 29; and Steve Roberts, 37. They are joined by support staffers Marybeth Barnds and Amy Pisano.

Petherick, Champagne, Hayden, Cahill and Roberts are all shareholders in NorthPointe.

At Loomis, Petherick and Champagne were co-managers of more than $1.5 billion in equity investments for institutional and individual clients. They invested in smaller companies in the "value" style — meaning companies whose stocks are priced lower than those of industry peers with similar performance and prospects.

At NorthPointe, they will manage money for institutions in the same style, as well as pick stocks for Villanova's new Nationwide Value Opportunities Fund. They will both have the title senior portfolio manager.

Cahill has the title portfolio manager and will run a value equity portfolio of mid-sized to large companies. Hayden, with the title managing director, will be responsible for operations and institutional marketing. He had been vice president for institutional marketing at Loomis. Roberts, a research analyst for Loomis, will be director of research at NorthPointe.

Villanova president and CEO Paul Hondros said his group studied the records of "six or seven" sets of managers in the small-cap value market before deciding in August to recruit the group that became NorthPointe.

"This group has a national reputation," Hondros said. "They've performed very well. They're well thought of in the defined-benefit-plan sponsor-consulting community. We heard about them from a number of different sources, including people in our own firm who had been in the business of selecting fund managers."

Loomis officials said the group has been replaced with other veteran staff.

"You don't try to say these weren't good people," said David Sowerby, Loomis' chief economist and a fixed-income portfolio manager. He said he understood that they were "responding to an opportunity to own their own firm with financial backing from Nationwide Insurance."

But Sowerby said that "if you're a deep team, and we are, with 500 people, you get someone else to put on that jersey."

That someone else is Joseph Gatz, who joined Loomis in December to run its far smaller, $200 million mid-cap value fund. He's now been named lead portfolio manager of the small-cap fund. He had run a mid-cap fund for Bank One Corp. in Detroit.

One competitor said the departure could be part of a trend.

"I think there's a lot of portfolio managers out there chomping at the bit right now to do their own thing," said Anmar Sarafa, president and chief investment officer of Steward Capital Management in Bloomfield Hills. "There's a lot of movement in our industry right now, with managers being purchased or set up by big financial institutions." CDB

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Why do I recall this story? Because the current environment is a similar to the environment we experienced in 1998-2000, and it is inflaming my intuitional senses that have also served me well over the years. I believe, as I did back in 1999, that now is an incredibly opportune time for investors to plow money into "value' stocks. It may not turn on a dime, but it will turn. Five to seven years from now, investors will look back and wonder how things managed to get this extended. "Did someone really think Tesla was worth $425 per share?" I am reminded by an old market adage I learned many years ago: *The market always does its best to accommodate the least.* The momentum trade, both in price and earnings, 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 Commentary

For the quarter ending September 30, 2018, the NorthPointe Capital Small Cap composite underperformed the Russell 2000® Value Index. The portfolio was hurt by stock selection in the Health Care, Energy and Financials sectors. The largest detractor to performance during the quarter was related to the investment in Clearside Biomedical. Clearside has developed a treatment that delivers steroids to the back of the eye through what is known as the Suprachoroidal Space. Utilizing this approach, Clearside is attempting to address serious eye diseases without the adverse effects of delivering steroids to healthy ocular tissue. The Company has already produced positive clinical trial data for the treatment of uveitis (swelling of the middle layer of the eye). When this news was announced in March 2018, the stock price of Clearside more than doubled to $14. We initiated our position after the stock had pulled back subsequent to raising additional capital. Clearside then announcement positive clinical data for another indication, diabetic macular edema, in May 2018, but investors were confused with the objective of the trial and how the data was communicated. The stock declined nearly 30% following this announcement and has settled in at the new level given the lack of news flow. However, data from another clinical trial is due in the fourth quarter of 2018 and this should serve as a catalyst for the stock. We maintain that the current market cap of Clearside dramatically understates the value of the Company with only one successful eye indication, much less the three that the Company is targeting.

An additional Health Care investment in Invacare Corporation was also a significant detractor. Invacare, a producer of powered wheel chairs and other durable health care equipment, is exiting a multi-year turnaround phase, yet the stock declined nearly 20% during the quarter as investors questioned whether the turnaround was making enough progress. We maintain that the turnaround is on track and look for more tangible results in 2019. Within Energy, the stock of Highpoint Resources Corporation was a notable underperformer. Highpoint, an oil & gas exploration company, saw its stock decline because of lowered production guidance.

The portfolio's best performance, from a contribution perspective, came from Circor International, Inc., a producer of industrial valves. In the final weeks of the previous quarter, the Company undertook a stock offering for a large holder who received shares as a result of a sale of a business unit to Circor. While this action temporarily depressed the stock, it subsequently recovered with a quarterly gain of nearly 30%. The greatest individual stock price advance came from Health Care holding, Nuvectra Corporation, whose stock climbed nearly 45%. Nuvectra has developed a neurostimulation product to treat pain that is taking share from larger industry participants who utilize dated technology.

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At the end of the quarter, the portfolio's three largest positions were the stocks of Magnolia Oil & Gas Corporation, Carpenter Technology Corporation and Hercules Capital, Inc. All three of these investments delivered positive returns, on both an absolute and relative basis, for the quarter.

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 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.