

SMALL CAP EQUITY

1Q 2018 Commentary

Markets Review

The small cap segment of the equity market, as measured by the Russell 2000 Index, declined 0.08% in the first quarter, capping a three-month period of notable volatility as the market contended with several short-term geopolitical and technical headwinds that distracted from overall strong fundamentals. Small caps experienced their first negative quarter since the three-month period ended March 2016, highlighting the recent pickup in volatility after the relatively low levels seen in the last few years. Compared to their large cap counterparts, small caps held up relatively well during the quarter, with the Russell 2000 Index's total return of -0.08%, besting the -0.69% total return of the Russell 1000 Index.

Volatility resurfaced in the first quarter, driven by various geopolitical issues, technical factors and industry headwinds that offset strong fundamentals at both the corporate and macro levels. In fact, the bulk of the period could be characterized by the market seemingly shifting its focus (sometimes on a daily basis) from strong economic data and corporate earnings to worrisome news headlines and what we feel are shorter-term distractions from a relatively supportive environment in terms of fundamentals. While large daily and weekly swings in the market can be frustrating for investors, we believe it is important to put the recent volatility into historical perspective. Prior to the intraquarter correction from late January to mid-February, the small cap market had not experienced a correction of 10% or more in approximately two years, an abnormally long period of time between such declines, which typically occur approximately once per year. Many would argue that a correction was overdue after the strong calendar year returns in 2016 and 2017, and that a correction may actually be healthy for the markets in the intermediate term. Although fundamentals were often overshadowed during the quarter, equity prices were yet again supported by a strong corporate earnings environment, both in the small cap and large cap markets, as the majority of companies exceeded expectations for earnings and revenue growth. Economic data was also generally positive, with growth continuing to improve domestically and abroad.

At the sector level, eight of the eleven economic sectors in the Russell 2000 Index posted negative returns during the quarter. Energy (-11.42%), Real Estate (-8.13%), Utilities (-6.37%) and Consumer Staples (-5.37%) were the worst-performing sectors, lagging the overall index by a fairly significant margin. Conversely, Information Technology (+6.55%), Health Care (+6.24%) and Financials (+0.82%) were the only sectors to generate a positive return during the quarter.

Stylistically, growth continued to outperform value in the quarter, as evidenced by the Russell 2000 Growth Index's total return of 2.30% versus the -2.64% total return of the Russell 2000 Value Index. The market's preference for growth companies can be seen in relative performance at the sector level, as the Information Technology and Health Care sectors, which make up a larger portion of the growth index, were the best performers during the quarter. Conversely, the

Energy and Real Estate sectors, which make up a larger portion of the value index, were the worst-performing sectors. From a fundamental standpoint, companies with lower betas, higher market caps, and low or no dividend yields generally outperformed. Companies with negative earnings also outperformed, led by the strong returns of Biotechnology and Internet Software & Services firms, which were among the best performers during the quarter.

Portfolio Review

For the quarter ended March 31, 2018, the Aristotle Small Cap Equity Composite generated a total return of -0.61% gross of fees (-0.63% net of fees), underperforming the -0.08% total return of the Russell 2000 Index. On a relative basis, the portfolio's holdings within the Consumer Staples, Consumer Discretionary and Utilities sectors added the most value. Holdings within the Information Technology, Industrials and Health Care sectors were among the largest detractors.

CONTRIBUTORS

- **On Assignment, Inc. (ASGN)**, a leading specialty staffing company that places professionals in the technology, life sciences and digital marketing industries, benefited from positive operating results, which were driven by strong performance in its IT infrastructure segment, and the announcement of an accretive acquisition of a government IT solutions business. We maintain a position, as we believe the company's focus on highly skilled segments of the market and the high demand for temporary workers in these end markets should allow for additional shareholder value creation going forward.
- **Microsemi Corporation (MSCC)**, an analog and mixed-signal semiconductor manufacturer, appreciated after announcing that the firm would be acquired by Microchip Technology for cash. The deal is expected to close by the end of the second quarter.
- **Qidel Corporation (QDEL)**, a developer and manufacturer of medical diagnostic tests, benefited from better-than-expected progress in integrating recently acquired assets, as well as market share gains in its core influenza business. We maintain a position, as we believe the company's recent efforts to broaden its product portfolio and diversify the business should result in less volatile operating results and create additional value for shareholders.
- **Herbalife Ltd. (HLF)**, a multi-level marketer of nutritional and personal care products, benefited from strong operating results driven by positive business trends, as well as guidance of resumed growth in 2018. We maintain a position, as we believe recent operational changes implemented by the firm will enhance member and customer retention rates, which should create additional value for shareholders.

- **World Wrestling Entertainment, Inc. (WWE)**, a media and entertainment company that operates, promotes, merchandises and licenses live wrestling events worldwide, appreciated after reporting strong operating results, which were driven by positive trends in its TV and digital content business. We maintain a position, as we believe the company's global reach and high-quality entertainment assets can allow the company to continue to monetize its content and create value for shareholders.

DETRACTORS

- **QTS Realty Trust, Inc. (QTS)**, a real estate investment trust that owns and operates data centers, declined after announcing a surprise restructuring that will see the company deemphasize its cloud solutions business to focus on its core hyperscale and colocation services. We maintain our investment, as we believe concerns about disruptions in the business as a result of the restructuring are overblown, and that the company is well positioned to take advantage of strong growth in data center demand nationally.
- **Hannon Armstrong Sustainable Infrastructure Capital, Inc. (HASI)**, a real estate investment trust that provides debt and equity financing for sustainable energy infrastructure projects, declined due to negative sentiment and concerns regarding the company's potential performance in a rising rate environment. We maintain a position, as we believe the company is taking appropriate steps to navigate the interest rate environment, and that its ability to deploy excess capital into cash flow-generating projects should create value going forward.
- **CAI International, Inc. (CAI)**, a freight container leasing and management company, declined due to concerns about increased competition in the container market. We maintain our investment, as we believe the company is well positioned to capitalize on the long-term trend of shipping companies outsourcing container ownership to independent third parties.
- **Rogers Corporation (ROG)**, a global manufacturer of highly engineered products, including high-performance foams, printed circuit materials and power electronic solutions for the telecom, technology, manufacturing and auto industries, declined. The company experienced volatile results in its advanced connectivity segment due to the telecommunication industry being in the early stages of transitioning from 4G to 5G technology. We maintain a position, as we believe the company will benefit from continued innovation and internal cost-savings initiatives intended to drive gross margin improvement.
- **Commercial Vehicle Group, Inc. (CVGI)**, a manufacturer of tractor and truck components, declined as disappointing margin guidance in the company's earnings report offset strong underlying demand trends. We maintain a position, as we believe the truck-production cycle remains intact, and that company-specific cost improvement initiatives will continue to help drive improved profitability.

BUYS

- **None**

SELLS

- **Great Western Bancorp (GWB)**, a South Dakota-based commercial bank, was removed from the portfolio on the belief that shares had been fully valued.

Outlook and Positioning

Although market volatility has increased, leading to the first negative return quarter in two years, we continue to believe the fundamental backdrop remains supportive of small cap equities going forward. We would not be surprised to see short-term volatility persist given various technical drivers, as well as the market's recent behavior of alternating its focus between strong corporate fundamentals and anxiety over rising rates, inflation and various geopolitical issues. However, we continue to see no indications of any type of widespread deterioration in fundamentals, either at the company level or with respect to the overall economy. If anything, there seems to be more optimism today based on our conversations with management teams for the companies in our portfolio and the companies we are actively exploring as potential investments. We believe the solid fundamental footing of our portfolio companies will provide a level of downside support should the market experience further declines.

Given their greater exposure to domestic revenue sources and potential benefits from corporate tax reform, we also believe small cap companies are better positioned fundamentally than large caps. Additionally, as the Federal Reserve continues its gradual path toward interest rate normalization, and as company fundamentals and valuations become increasingly more important, we believe this development should be beneficial for fundamentally oriented, active managers. While we do not position our portfolio for regulatory or top-down events, we will attempt to incorporate these types of developments into our bottom-up fundamental analysis. In that regard, we remain focused on understanding how management teams plan to spend any capital that is freed up from paying a lower tax bill, which could be a potential source of shareholder value if management uses that capital prudently. Overall, with a reasonably favorable backdrop for small cap companies, we continue to identify what we believe to be attractively valued, long-term investment opportunities.

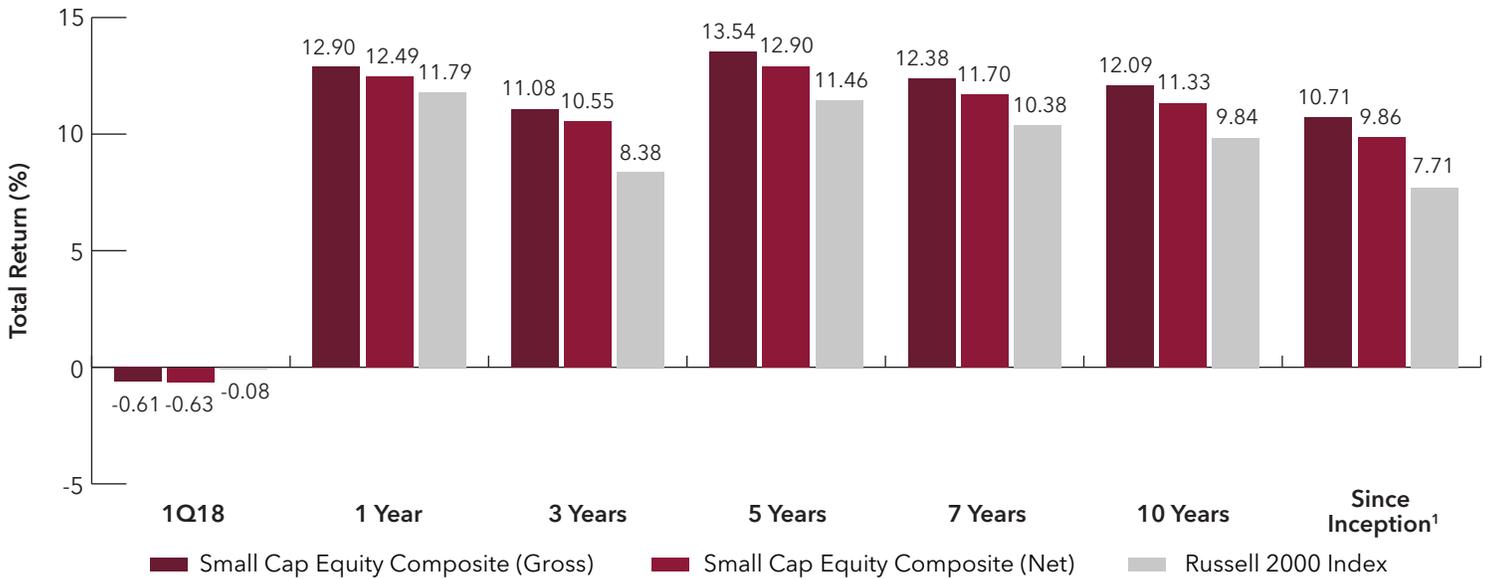
Our current positioning is a function of our bottom-up security selection and our ability to identify what we view as attractive investment candidates, regardless of economic sector definitions. Recent purchases have been spread across industries and are idiosyncratic in nature, as opposed to being tied to an outlook for a particular sector. Overweights in Industrials and Information Technology are mostly a function of the performance of our holdings in these sectors over the past few years. Conversely, we continue to be underweight the Real Estate sector due to a lack of attractively valued opportunities, but we maintain exposure to certain companies in the space that we feel offer attractive upside potential.

with limited downside risk. The strategy remains underweight in Consumer Discretionary, as we have been unable to identify compelling opportunities that fit our discipline given the rising risk profiles associated with many businesses due to the “Amazon effect.” As the current bull market approaches nearly a decade in length, we believe it is important to remain patient in identifying investment

opportunities to ensure they offer a compelling risk-reward trade-off and a sufficient margin of safety. Furthermore, we remain focused on trying to understand the risks associated with each investment position within the context of our fundamentally oriented research process and managing those risks through a disciplined approach to portfolio construction and management.

Aristotle Small Cap Equity Composite Performance

All Periods Ended March 31, 2018



Year	Small Cap Equity Composite (Gross, %)	Small Cap Equity Composite (Net, %)	Russell 2000 Index (%)
2018 YTD	-0.61	-0.63	-0.08
2017	18.98	18.48	14.65
2016	19.53	18.92	21.31
2015	3.20	2.72	-4.41
2014	3.32	2.45	4.89
2013	39.77	38.73	38.82
2012	17.39	16.58	16.35
2011	-0.85	-1.47	-4.17
2010	24.92	24.03	26.85
2009	39.37	38.11	27.19
2008	-34.27	-35.01	-33.80
2007	6.12	4.32	-1.55
2006 ²	7.31	7.31	2.97

Sources: Advent, Russell Investments

Composite returns for periods ended March 31, 2018 are preliminary pending final account reconciliation.

¹The Aristotle Small Cap Equity Composite has an inception date of November 1, 2006 at a predecessor firm. During this time, Jack McPherson and Dave Adams had primary responsibility for managing the strategy. Performance starting January 1, 2015 was achieved at Aristotle Boston.

²For the period November 2006 through December 2006.

Past performance is not indicative of future results. Performance results for periods greater than one year have been annualized.

Returns are presented gross and net of investment advisory fees and include the reinvestment of all income. Gross returns will be reduced by fees and other expenses that may be incurred in the management of the account. Please see important disclosures at the end of this document.

The opinions expressed herein are those of Aristotle Capital Boston, LLC (Aristotle Boston) and are subject to change without notice.

Past performance is not indicative of future results. The information provided in this report should not be considered financial advice or a recommendation to purchase or sell any particular security. There is no assurance that any securities discussed herein will remain in an account's portfolio at the time you receive this report or that securities sold have not been repurchased. It should not be assumed that any of the securities transactions, holdings or sectors discussed were or will be profitable, or that the investment recommendations or decisions Aristotle Boston makes in the future will be profitable or equal the performance of the securities discussed herein. Aristotle Boston reserves the right to modify its current investment strategies and techniques based on changing market dynamics or client needs. Recommendations for the last 12 months are available upon request.

Returns are presented gross and net of investment advisory fees and include the reinvestment of all income. Gross returns will be reduced by fees and other expenses that may be incurred in the management of the account. For example, a 0.5% annual fee deducted quarterly (0.125%) from an account with a ten-year annualized growth rate of 5.0% will produce a net result of 4.4%. Actual performance results will vary from this example.

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 2,000 of the smallest securities based on a combination of their market cap and current index membership. The Russell 1000® Index measures the performance of the large cap segment of the U.S. equity universe. The Russell 1000 Index is a subset of the Russell 3000 Index, representing approximately 90% of the total market capitalization of that index. It includes approximately 1,000 of the largest securities based on a combination of their market capitalization and current index membership. The Russell 2000 Growth® Index measures the performance of the small cap companies located in the United States that also exhibit a growth probability. The Russell 2000 Value® Index measures the performance of the small cap companies located in the United States that also exhibit a value probability. The volatility (beta) of the composite may be greater or less than the benchmarks. It is not possible to invest directly in these indices. Aristotle Capital Boston, LLC is an independent investment adviser registered under the Investment Advisers Act of 1940, as amended. Registration does not imply a certain level of skill or training. More information about Aristotle Boston, including our investment strategies, fees and objectives, can be found in our Form ADV Part 2, which is available upon request. ACBL-18-111

FOR MORE INFORMATION, PLEASE CONTACT

Phone: (617) 274-4300 | **Email:** info@aristotleboston.com | **Web:** www.aristotleboston.com