# Value Equity Fund

1Q 2018 Commentary

## Markets Review

Equity markets recorded their first quarterly loss in over two years during a turbulent period in which the S&P 500 Index fell 0.76% and the Russell 1000 Value Index slid 2.83%. Stronger-than-expected wage growth ignited fears that rising inflation would force the U.S. Federal Reserve (Fed) to raise interest rates faster than previously anticipated and caused U.S. stocks to briefly fall into correction territory. Volatility, notably absent from the market's rally in 2017, returned abruptly. The CBOE Volatility Index, better known as the VIX, nearly doubled during the quarter. After equity markets regained their poise, they retested quarterly lows in March on news that President Trump would pursue tariffs on foreign steel and aluminum. Fears eased after it was announced that the United States and China, the world's largest economies, were trying to hammer out a deal that would allow U.S. companies greater access to Chinese markets.

Stylistically, growth stocks outperformed value for the fifth consecutive quarter. The Russell 1000 Growth Index gained 1.42%, putting growth in the lead by 4.25% year to date. The performance gap was even wider for the Russell 2000 and Russell Midcap style indexes (4.94% and 4.67%, respectively). In terms of capitalization, smaller caps better withstood the quarter's volatility than large caps, with both the Russell 2000 and Russell Midcap indexes beating the Russell 1000 Index. Within the Russell 1000 Value Index, only the Information Technology sector advanced, gaining 6.11%, although concerns about competition and political calls for greater regulation weighed on shares of technology firms as the quarter ended. Conversely, defensive sectors, particularly Consumer Staples, Real Estate and Telecommunication Services, were the worst performers.

A strengthening economy, more restrictive monetary policy and increasing inflation overrode concerns of rising equity market volatility and produced generally higher yields during the quarter, causing bond prices to fall. The yield on the benchmark 10-year Treasury note climbed to 2.74% after closing 2017 at 2.40%. Despite the increase in yields and an otherwise bullish economic backdrop, the U.S. dollar remained weak. The U.S. Dollar Index (DXY), which measures the value of the U.S. dollar against a basket of foreign currencies, fell nearly 2% during the quarter. Major commodities saw rising prices. WTI crude oil climbed above $65 for the first time in over three years on expectations that OPEC-led Saudi Arabia would continue with its production cuts into 2019. Gold prices pushed higher on elevated geopolitical tensions and stock market volatility.

Citing a brighter economic outlook at its Federal Open Market Committee on March 21, the Fed raised its target rate by 25 basis points to a range of 1.50% to 1.75%, its sixth increase since 2015 when rates were near zero. The Fed maintained its forecast of three rate hikes in 2018 and increased the number of expected hikes in 2019 to three. The annual pace of Gross Domestic Product (GDP) growth was 2.9% in the fourth quarter, and consumer spending was at its highest clip since 2014. The U.S. added more than half a million jobs in the first two months of 2018, jobless claims continued to trend lower and the participation rate ticked up to 63% in February—its best one-month gain in nearly eight years.

## Performance and Attribution Summary

For the first quarter of 2018, Aristotle Value Equity Fund (ARSQX) posted a total return of -0.79% at NAV, outperforming both the Russell 1000 Value Index at -2.83% and the S&P 500 Index at -0.76%.

*Performance data quoted here represents past performance. Past performance is no guarantee of future results. Investment return and principal value will fluctuate, so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance information quoted. To obtain current performance information to the most recent month-end, please call (844) 274-7868.*

The majority of the Fund's outperformance relative to the Russell 1000 Value Index for the quarter was the result of security selection decisions. Stock selection was strongest in Information Technology, Health Care and Consumer Staples. The overweight in Information Technology, the result of our bottom-up stock selection process and not a tactical decision, contributed to relative return, as the sector was the best performer in the Index. Stock selection in Financials, Materials and Consumer Discretionary detracted from relative return.

***Adobe Systems in Information Technology and Acadia Healthcare, an operator of behavioral health care facilities, were top contributors to relative return during the quarter.*** Computer software company Adobe was once again a main contributor, reporting solid quarterly results and executing well across its businesses, with steady Creative Cloud renewal rates and increasing penetration of Experience Cloud. Adobe continues to build on the vision of becoming the "Experience System of Record," bringing together the power of data, content and intelligent services to help companies become an "Experience Business." Adobe also announced a strategic partnership with company NVIDIA to enhance Adobe Sensei, its artificial intelligence system, which can deliver greater value to its customers through Creative Cloud, Document Cloud and Experience Cloud. This is another example of how the company enhances new tools and technologies to provide an improving experience to its customers.

Acadia's stock price recovered part of its losses from the previous quarters after reporting strong results with increased revenues in both its U.S. and U.K. operations. Revenues in the United Kingdom met the company's revised expectations, reflecting continued pressure from higher agency labor expense, primarily for nurses and other clinical staff, due to tightening in the U.K. labor market. As we mentioned in our previous commentary, U.K. wage issues represent what we view as one of the rare, tangible, negative side effects of Brexit-related uncertainty, as slowing immigration has created a shortage of nurses. Looking ahead, we continue to see increased awareness and de-stigmatization of behavioral health conditions, which supports the company's strategy of increasing partnerships with acute care hospitals to build behavioral wings, as well as growing the number of beds at Acadia's existing facilities.

***Industrials company Oshkosh and Energy company EQT Corporation were primary detractors from relative performance.*** During the quarter, Oshkosh reported strong orders in its Access Equipment, Defense and Commercial segments and increased its earnings outlook for the year. However, its shares declined with fears that the U.S. administration's planned tariffs on steel and aluminum could hurt the company's earnings given that these metals are main raw materials used by the truck manufacturer. We believe it is too soon to judge the impact of such tariffs on the company's margins and, ultimately, its earnings. In fact, President Trump has softened his stance on tariffs since announcing them, and now Mexico and Canada are exempt while others could receive passes, too. Rather than trying to determine outcomes based on policies that have yet to be defined, our investment team continues to spend its time monitoring what we believe to be Oshkosh's competitive advantages (e.g., pricing power, large barriers to entry and consistently positive cash flow), and that catalysts, such as cost optimization efforts and market share gains, continue to materialize.

EQT's stock price was down in line with peers due to negative sentiment toward natural gas. During the quarter, the company announced plans to separate its midstream business in a tax-free spinoff. EQT (upstream) will be the largest gas producer in the United States, and Newco (midstream) will be a C corporation midstream business. The rationale for the separation is that integration is no longer necessary as the company transitions into development mode of its vast asset base. The company also announced that, due to personal reasons, Steven Schlotterbeck had resigned as CEO, effective immediately. We continue to like EQT's unique, low-cost natural gas reserves and extensive, growing midstream business but are currently evaluating the company's proposed separation, as well as unexpected changes in management.

| Relative Contributors | Relative Detractors |
|---|---|
| Adobe Systems | Oshkosh |
| Acadia Healthcare | Ameriprise Financial |
| Microsoft | EQT Corporation |
| General Dynamics | Kroger |
| Microchip Technology | DowDuPont |

## Recent Fund Activity

During the quarter, we sold our position in First Republic Bank (First Republic) and invested the proceeds in East West Bancorp (East West). We originally invested in First Republic during the second quarter of 2011. Catalysts that materialized during our holding period include First Republic's successful expansion outside of the San Francisco area using its client-centric model to gain share in other cities such as Boston, New York and Los Angeles. We divested our position as the company's stock price reached our estimate of the full value.

### *East West Bancorp*

We have a long history with East West, having previously invested in the company, and have always admired what we believe is a unique bank in an otherwise homogeneous U.S. banking system. East West is headquartered in Pasadena, California and has over 130 locations in the United States and China. With more than $36 billion in total assets and more than 40 years of operating history, East West is the leading bank serving the Asian community in the United States and one of just three U.S. banks with a banking license in China.

The company began operations in 1973 as a savings institution serving the ethnic Chinese community in Southern California. Over the years, East West has grown into a full service commercial bank acting as the "bridge" connecting Greater China (East) and the United States (West), enabling the company to have sustainable long-term growth that has outpaced the industry. The transformative acquisition of competitor United Commercial Bank in 2009 allowed the company to further solidify its position in the Chinese and Chinese-American community.

*High-Quality Business*

East West possesses several characteristics we deem to be high quality, including:

- Dominant market share within the Asian community built over generations;
- Unique and difficult-to-replicate experience in customers' distinct culture, geography and business practices;
- Demonstrated cost discipline, as evidenced by the company's industry-leading efficiency ratio;
- A strong history of profitability above peer group while remaining conservatively financed; and
- An experienced management team with a strong track record of value creation and opportunistic capital deployment.

*Attractive Valuation*

We believe East West's current stock price is offered at a material discount to the company's intrinsic value given our estimates for higher normalized earnings.

*Compelling Catalysts*

Among the many catalysts we have identified for East West, which we believe will cause its stock price to appreciate toward our estimate of intrinsic value within our three- to five-year investment horizon, are:

- Continued leadership position as the financial "bridge" for customers doing business in the U.S. and Greater China, leading to sustained loan growth at above industry rates;

- Persistent market share gains, particularly in markets outside of California, including Texas and the Southeast and Northeast regions of the U.S.;
- Increased diversification of the company's loan portfolio; and
- A continued robust profitability profile with improvements as the interest rate environment normalizes.

## Outlook

At Aristotle Capital, we take a long-term view, paying little attention to the short-term distractions that may be prevalent at any given time. Our investment process is rooted in studying businesses that meet our high-quality criteria and we believe can generate strong, risk-adjusted investment performance over a three- to five-year time horizon. As always, we remain steadfast in our approach, regardless of the news of the day.

**Aristotle Value Equity Fund (Class I)**

Performance Update March 31, 2018

| Total Return | 1Q18 | 1 Year | Since Inception (8/31/16) | Gross/Net Expense Ratio |
|---|---|---|---|---|
| ARSQX Class I | -0.79% | 13.55% | 16.29% | 10.12%/0.78% |
| Russell 1000 Value Index | -2.83% | 6.95% | 10.78% | N/A |
| S&P 500 Index | -0.76% | 13.99% | 15.48% | N/A |

Performance results for periods greater than one year have been annualized.

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***The Fund's advisor has contractually agreed to waive certain fees and/or absorb expenses, through April 30, 2019, to the extent that the total annual operating expenses do not exceed 0.78% of average daily net assets of the Fund. The Fund's advisor may seek reimbursement from the Fund for waived fees and/or expenses paid for three years from the date of the waiver or payment. Without these reductions, the Fund's performance would have been lower. A redemption fee of 1.00% will be imposed on redemptions of shares within 30 days of purchase.***

Important Information:

There can be no guarantee that any strategy (risk management or otherwise) will be successful. All investing involves risk, including potential loss of principal.

The views in this letter were as of the date stated and may not necessarily reflect the same views on the date this letter is first published or any time thereafter. These views are intended to help shareholders in understanding the Fund's investment methodology and do not constitute investment advice.

Past performance is not indicative of future results. You should not assume that any of the securities transactions, sectors or holdings discussed in this report are or will be profitable, or that recommendations Aristotle Capital makes in the future will be profitable or equal the performance of the securities listed in this report. There is no assurance that any securities, sectors or industries discussed herein will be included in or excluded from the Fund. The opinions expressed are as of the date of publication and are subject to change due to changes in the market or economic conditions and may not necessarily come to pass. Aristotle Capital reserves the right to modify its current investment strategies and techniques based on changing market dynamics or client needs. This is not a recommendation to buy or sell a particular security. Holdings since the Fund's inception date are available upon request.

An investment in the Fund is subject to risks, and you could lose money on your investment in the Fund. The principal risks of investing in the Fund include, but are not limited to, investing in foreign securities, ETFs, small-capitalization, mid-capitalization and large-capitalization companies and value stocks.

Foreign securities have additional risks, including currency rate changes, political and economic instability, lack of comprehensive company information, less market liquidity, less-efficient trading markets, and differing auditing controls and legal standards. The use of ETFs may cause the Fund to have higher expenses than those of other equity funds. Investments in emerging markets involve even greater risks. The securities of small-capitalization and mid-capitalization companies may be subject to more abrupt or erratic market movements and may have lower trading volumes or more erratic trading than securities of larger, more established companies or market averages in general. On the other hand, larger, more established companies may be unable to attain the high growth rates of successful, smaller companies during periods of economic expansion. Value stocks are those that are believed to be undervalued in comparison to their peers due to adverse business developments or other factors. Value investing is subject to the risk that the market will not recognize a security's inherent value for a long time or at all, or that a stock judged to be undervalued may actually be appropriately priced or overvalued.

Definitions:

- The Russell 1000® Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 Index companies with lower price-to-book ratios and lower expected growth values.
- The S&P 500® Index is the Standard & Poor's Composite Index of 500 stocks and is a widely recognized, unmanaged index of common stock prices.

These indices have been selected as the benchmarks and are used for comparison purposes only.

- The Russell 1000® Growth Index measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.
- 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.
- The Russell Midcap® Index measures the performance of the 800 smallest companies in the Russell 1000 Index.
- Gross Domestic Product is the total value of goods produced and services provided in a country during one year.

The volatility (beta) of the Fund may be greater or less than that of the benchmarks. An investor cannot invest directly in these indices.

Portfolio composition will change due to ongoing management of the Fund. References to specific securities or sectors should not be construed as recommendations by the Fund, its Advisor or Distributor.

As of March 31, 2018, the Fund's holdings and their weights as a percent of total net assets were: Adobe Systems, 4.50%; Microsoft, 3.39%; Bank of America, 3.29%; Home Depot, 3.23%; Microchip Technology, 3.08%; Danaher, 3.01%; Ameriprise Financial, 2.82%; General Dynamics, 2.80%; Oshkosh, 2.79%; Amgen, 2.70%;

**Please consider the Fund's investment objectives, risks, charges and expenses carefully before investing. The prospectus or summary prospectus that contains this and other information about the Fund is available by calling (844) 274-7868, or by visiting www.aristotlefunds.com, and should be read carefully prior to investing.**

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