

# SMALL CAP EQUITY FUND

1Q 2019 Commentary

## Markets Review

The small cap segment of the equity market, as measured by the Russell 2000 Index, produced a total return of 14.58% in the first quarter, good for its best start to a year since 1991 and best quarter overall since the final three months of 2011. The recovery in the U.S. equity market was a welcome one following the historic sell-off at the end of 2018, which saw small cap companies fall more than 20% over the last three months of the year. More recently, equities have been boosted by signals that the Federal Reserve will demonstrate more patience in regards to further rate increases and optimism surrounding trade negotiations between the U.S. and China. In our view, these positive factors have generally overshadowed potential areas of concern, such as slowing earnings growth and mixed economic indicators.

It is perhaps no surprise that in a rapidly rising market set against a backdrop of global economic growth concerns, higher growth companies regained their performance advantage in the first quarter (while value outperformed growth on the downside in the fourth quarter of last year, value leadership has been a rare occurrence in recent years). In general, growth outperformed value, in large part due to the strong relative performance of loss-making companies (companies with negative earnings), particularly within higher beta growth areas like biotechnology and software. This lower quality, higher growth leadership has been a frequent headwind for active management over the last several years.

## Performance Review

For the first quarter of 2019, the Aristotle Small Cap Equity Fund (ARSBX) generated a total return of 13.31% at NAV, underperforming the 14.58% total return of the Russell 2000 Index.

Relative performance for the quarter was driven by security selection and sector allocation. At the sector level, the Fund's holdings within the Real Estate, Consumer Discretionary, Materials and Energy sectors added the most value on a relative basis. Holdings within the Health Care, Consumer Staples, Communication Services and Financials sectors detracted from relative performance.

*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.*

| Relative Contributors    | Relative Detractors |
|--------------------------|---------------------|
| 1-800-FLOWERS.COM        | Nu Skin Enterprises |
| Euronet Worldwide        | MEDNAX              |
| MedEquities Realty Trust | Herbalife Nutrition |
| Rogers                   | ATN International   |
| Mercury Systems          | Dycom Industries    |

## CONTRIBUTORS

At the sector level, security selection within the Real Estate, Consumer Discretionary and Materials sectors had the largest positive impact on relative performance. At the company level, **1-800-FLOWERS.COM** and **Euronet Worldwide** were two of the largest contributors during the quarter.

- **1-800-FLOWERS.COM, Inc. (FLWS)**, an e-commerce provider of floral and gift products, benefited from strong growth in its gourmet food segment, a better-than-expected holiday season, and continued market share gains in its floral business. The company has been successful in capitalizing on the financial struggles and bank-imposed operating constraints of one of its largest competitors, FTD, by increasing its marketing spend to acquire new customers. We maintain our investment, as we believe the company's efforts to integrate all of its brands into a single website should drive several operational and marketing improvements that will enhance the firm's profitability and free cash flow generation.
- **Euronet Worldwide, Inc. (EFTT)**, an electronic transaction processing company, benefited from continued momentum across all three of its business segments: EFT processing, e-pay and money transfer. Expansion of the company's ATM network and execution of new non-mobile agreements in its e-pay business are among the recent drivers of the company's strong operating performance. We maintain a position, as we believe the company's own fundamental execution efforts and positive secular trends for most of its business segments will continue to create value for shareholders.

## DETRACTORS

Security selection within the Health Care, Consumer Staples and Communication Services sectors had the largest negative impact on relative performance. Lack of exposure to biotechnology and higher beta software and service names also created a performance headwind. At the company level, **Nu Skin Enterprises** and **MEDNAX** were two of the largest detractors during the quarter.

- **Nu Skin Enterprises, Inc. (NUS)**, a multi-level marketer of primarily personal care products, declined during the quarter due to regulatory uncertainty for direct selling companies in China, where the company has temporarily halted its operations as it awaits the resolution of an investigation from the government into direct selling practices of health products. While Nu Skin was not specifically targeted in the investigation, it will likely nevertheless impact the company's operating performance in the near term. We maintain a position, as we believe the company will continue to benefit from momentum surrounding recent product introductions and strong end-market demand, both domestically and in emerging markets.
- **MEDNAX, Inc. (MD)**, a provider of physician practice management services for neonatology, perinatology and anesthesiology medical practices, declined due to lower annual guidance for 2019. Despite posting strong operating results in the quarter, guidance was tempered due to weaker birth rates and cost pressure in its anesthesiology business. We believe these headwinds can be partially offset by the company's internal cost-cutting and efficiency initiatives. We maintain a position, as we believe management's long-term strategy of consolidating fragmented segments of the physician practice industry, along with the company's ability to take market share through organic cross-selling opportunities and acquisition activity, can create additional value for shareholders.

## Recent Portfolio Activity

| Buys/Acquisitions  | Sells/Liquidations |
|--------------------|--------------------|
| Diamond S Shipping | ArcBest            |
| Veritex Holdings   | Green Bancorp      |
|                    | Solar Capital      |

### BUYS/ACQUISITIONS

- **Diamond S Shipping, Inc (DSSI)**, one of the largest crude oil and refined product shipping companies in the world, was added to the Fund as a result of existing holding Capital Product Partners L.P.'s decision to spin off and merge its crude and product tanker business with DSS Holdings L.P.
- **Veritex Holdings, Inc. (VBTX)**, a Texas-based regional bank that provides personal and commercial banking services to individuals and small- to medium-sized businesses, was added to the Fund by virtue of its acquisition of Green Bancorp.

### SELLS/LIQUIDATIONS

- **ArcBest Corporation (ARCB)**, a domestic trucking and logistics services company, was sold from the Fund due to our belief that shares were fully valued as well as concerns about industry dynamics.
- **Green Bancorp, Inc. (GNBC)**, a Texas-based regional bank, was removed from the Fund after being acquired by Veritex Holdings.

- **Solar Capital Ltd. (SLRC)**, a business development company that invests primarily in private middle market businesses, was removed from the Fund in the first quarter.

## Outlook and Positioning

While the equity market continues to be driven by macroeconomic and geopolitical issues in the short term, we believe business fundamentals will ultimately determine equity values in the long run. As such, we remain optimistic on the prospects for small cap equities going forward, given our views on overall fundamentals at this stage in the market cycle. While the significant rebound in equity prices in the first quarter may limit further appreciation in 2019, we view the fundamental outlook as positive, driven by a domestic economy that appears stronger relative to other markets (recall that small cap companies derive a greater portion of their revenues domestically compared to large cap companies), corporate earnings growth that remains compelling, and valuations near post-recession lows. With that said, there are certain areas of the market which appear to be stretched in terms of balance sheet quality and valuation levels, and the small cap market continues to have a high percentage of negative earning companies. We believe these conditions, along with the heightened market volatility, will provide opportunities for active management to add value over the next few years.

Our current positioning is a function of our bottom-up security selection process and our ability to identify what we view as attractive investment candidates, regardless of economic sector definitions. While we do not position our Fund for macroeconomic issues or events, we will attempt to incorporate these factors into our bottom-up fundamental analysis whenever possible. Given our focus on long-term business fundamentals, patient investment approach and low fund turnover, the Fund's sector positioning does not change significantly from quarter to quarter. 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 in the Health Care sector due to our lack of exposure to early-stage biotechnology companies, which generally do not fit our discipline due to their elevated levels of binary risk. The Fund also 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."

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 fund construction and management. Overall, with a reasonably favorable fundamental backdrop for small cap companies, we continue to identify what we believe to be attractively valued, long-term investment opportunities.

## Aristotle Small Cap Equity Fund (Class I)

Performance Update

March 31, 2019

| Total Return       | 1Q19   | 1 Year | 3 Years | Annualized Since Inception (10/30/15) | Gross/Net Expense Ratio |
|--------------------|--------|--------|---------|---------------------------------------|-------------------------|
| ARSBX Class I      | 13.31% | -0.07% | 11.65%  | 8.90%                                 | 4.97%/0.97%             |
| Russell 2000 Index | 14.58% | 2.05%  | 12.92%  | 10.13%                                | N/A                     |

*Performance data quoted here represents past performance. Past performance is no guarantee of future results. Returns over one year are annualized. 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 Fund's advisor has contractually agreed to waive certain fees and/or absorb expenses, through April 30, 2028, to the extent that the total annual operating expenses do not exceed 0.90% 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. 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 Boston 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 Boston 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 made in the last 12 months 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 small-capitalization companies and ETFs.

The securities of small-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. In addition, such companies typically are more likely to be adversely affected than large capitalization companies by changes in earning results, business prospects, investor expectations or poor economic or market conditions. The use of ETFs may cause the Fund to have higher expenses than those of other equity funds.

## Definitions:

- 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 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, 2019, the ten largest holdings in the Fund and their weights as a percent of total net assets were: QTS Realty Trust, 2.09%; ALLETE, 2.00%; 1-800-FLOWERS.COM, 1.99%; Monro, 1.97%; Euronet Worldwide, 1.97%; Merit Medical Systems, 1.92%; Bottomline Technologies, 1.87%; National Bank Holdings, 1.83%; Carter's, 1.73%; and Mercury Systems, 1.67%.

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](http://www.aristotlefunds.com), and should be read carefully prior to investing.

The Aristotle Small Cap Equity Fund is distributed by IMST Distributors, LLC.

ACB-1904-64