

## MUTUAL FUNDS

### Small Cap Market Tilt: More Tailwind For Hot AMG Stock Mutual Fund?

BY PAUL KATZEFF

INVESTOR'S BUSINESS DAILY

Already performing well this year thanks to leading stocks like **PGT Innovations (PGTI)**, **Kinsale Capital Group (KNSL)**, **MCBC Holdings (MCFT)** and **Medifast (MED)** – which are up 10% for PGT to 70% for Medifast – small-cap growth \$121.8 million AMG Managers Cadence Emerging Companies Fund's (MECIX) managers see the market environment tilting more their way – more in favor of small-cap stocks.

"I would say the environment is friendly toward small-cap strategies right now," said Bob Fitzpatrick, a manager of the fund along with Michael Skillman and Robert Ginsberg. "Small caps can do well in a rising interest rate environment. Also, we have a focus on quality stocks, which are stocks that are less leveraged and more profitable. In this environment, quality stocks should see strong earnings growth, demand (for their products and services) benefiting from corporate tax cuts and rising M&A."

The fund managers are also counting on their valuation discipline to stay ahead of most rivals. "Our disciplined process is a conservative growth strategy," Fitzpatrick said. "As a more conservative growth fund, we differ from rivals that have a more aggressive approach."

As a result, GARP, or growth at a reasonable price, is a fair label for this portfolio's investment approach, Skillman says. "We're looking for growth, quality and valuation," he said. He added, "The price you pay determines your investment experience. It also provides downside protection, which can be important since smaller, rapidly growing companies can be volatile. It's also part of your offense. It can boost multiple expansion."

Going into Thursday, the fund's approach has it outperforming the S&P

#### AMG Managers Cadence Emg Cos I



**Bob Fitzpatrick Michael Skillman**

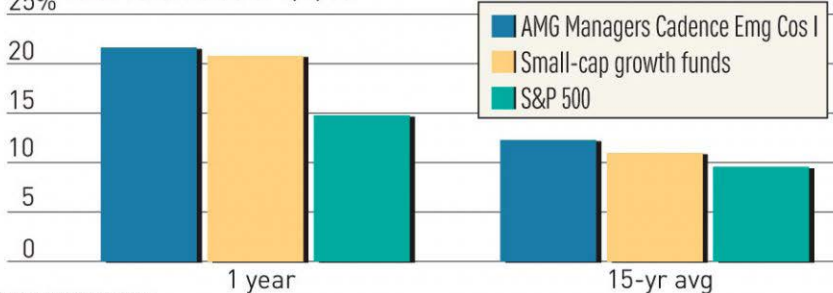
■ Load: None  
 ■ Expenses: 0.97%  
 ■ Symbol: MECIX

**Total returns as of 5/9/18**  
 2017: 22.41% 3-yr. avg.: 18.15%  
 YTD: 6.10% 5-yr. avg.: 17.32%  
 10-yr. avg.: 13.30%

#### Sector weightings as of 3/31/18

	% of stock assets	% of S&P 500
<b>Cyclical</b>	<b>38.75%</b>	
Basic materials	3.32	2.68%
Consumer cyclical	15.10	12.07
Financial services	18.09	16.90
Real estate	2.24	2.24
<b>Economically sensitive</b>	<b>36.80</b>	
Communication services	0.00	3.12
Energy	3.43	6.24
Industrials	14.48	10.34
Technology	18.89	21.99
<b>Defensive</b>	<b>24.46</b>	
Consumer defensive	2.90	7.45
Health care	20.37	14.05
Utilities	1.19	2.91

25% Total returns as of 5/9/18



Source: Morningstar Inc.

500 year to date as well as over the past one, three, five, 10 and 15 years.

#### Small-Cap Strategy

The fund's focus often takes the portfolio into unexpected areas. "We have good weightings in industrials and financials, which are not typical growth-manager sectors," said Fitzpatrick. He and his teammates are with Cadence

Capital Management, subadvisor for this fund.

PGT Innovations makes residential doors and windows. Earnings per share grew 80% and 171% the past two quarters.

"They make impact-resistant doors and windows, and they're based in Florida," Fitzpatrick said. "About 90% of their revenues are in Florida. The most recent storms heightened

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awareness of the need for protection against wind damaged and blown-out windows. That segment of the market is growing faster than the housing market. And it's growing faster than its category. They're facing some cost pressures like many companies, but they're executing well on their margins and they're deleveraging."

### **Specialty Insurer Kinsale**

Kinsale Capital, which is a specialty insurer, is one of the fund's financials. EPS grew 13% and 31% the past two quarters. "They operate in a niche of the insurance industry called 'excess and surplus,'" Fitzpatrick said. "They underwrite hard-to-place risks, like a small business that has an adverse claims history."

The company combines its niche focus with a strong management team. Fitzpatrick said, "They also have a strong technology platform that they view as a competitive advantage. It improves their underwriting accuracy, speed and efficiency."

Skillman added, "It enables them to undercut costs of rivals by as much as 20%."

MCBC Holdings, another industrial, makes recreational boats. EPS grew 17%, 7% and 62% in the past three quarters.

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**IBD'S TAKE:** *Kinsale Capital is ranked No. 1 in IBD's Insurance-Property/Casualty/Title industry group thanks to traits like four years in a row of earnings per share growth and 58% projected EPS growth this year. Learn more about how Kinsale stacks up against rivals in IBD's Stock Checkupfeature.*

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"They participate in the sports boat segment," Fitzpatrick said. "That segment is growing faster than the overall boat market." MCBC watercraft are popular among boaters who are young enough to enjoy wakesurfing, a sport in which a rider trails a boat, riding the steep face of the craft's wake. It's like surfing, using a boat to create a wave.

"Wake boating is what the lake and river crowd like," Fitzpatrick said. "It's a youthful crowd like with many water sports."

Among other holdings, Medifast makes weight and disease management products. EPS growth has sped up, going from 0% four quarters ago to 8%, 76% and 98% the past three stanzas.

That growth stems from a focus on its Optavia brand, which is a product line of weight-loss foods sold by health "coaches" to customers globally, Fitzpatrick says. It also reflects the closing of numerous sales channels, making the surviving channels healthier financially.

### **Kemet's Cyclical Growth**

**Kemet (KEM)** makes capacitors used by the aerospace, automotive, computer, defense and telecom industries. EPS grew at a triple-digit pace in seven of the past eight quarters. A couple of those were profits from year-ago losses, so they weren't exactly profit increases.

"This electronics company is a cyclical grower," Fitzpatrick said. "Today's strong economic environment has a lot of components in short supply, which helps pricing and profits. Strong economic growth brings on new capacity (among customers), so demand exceeds supply for Kemet."

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Average Annual Returns (%)<sup>1</sup> (as of 03/31/18)

	QTD	YTD	1 yr	3 yr	5 yr	10 yr	Since Incpt.
MECAX (Class N)	0.33	0.33	18.07	14.80	15.66	12.69	11.09 <sup>2</sup>
MECIX (Class I)	0.36	0.36	18.19	15.03	15.90	12.96	12.44 <sup>3</sup>
MECZX (Class Z)	0.39	0.39	–	–	–	–	18.41 <sup>4</sup>
Russell Microcap <sup>®</sup> Growth Index	0.99	0.99	14.79	4.65	10.91	9.35	–
Russell 2000 <sup>®</sup> Growth Index	2.30	2.30	18.63	8.77	12.90	10.95	8.12 <sup>3</sup>

MECAX (Class N) Expense Ratio (Gross/Net)<sup>5</sup>: 1.20%/1.09%

MECIX (Class I) Expense Ratio (Gross/Net)<sup>5</sup>: 1.08%/0.97%

MECZX (Class Z) Expense Ratio (Gross/Net)<sup>5</sup>: 1.00%/0.89%

*The performance data shown represents past performance. Past performance is not a guarantee of future results. The investment return and the principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. For performance information through the most recent month end, please call 800.835.3879 or visit our website at [amgfunds.com](http://amgfunds.com). From time to time the advisor has waived fees or reimbursed expenses, which may have resulted in higher returns.*

The Fund had 93 holdings as of March 31, 2018.

Top Ten Holdings (%)<sup>6</sup> (as of 03/31/18)

Holding	% of Net Assets
Medifast Inc	1.90
Carbonite Inc	1.77
PRGX Global Inc	1.67
Vicor Corp	1.63
Abraxas Petroleum Corp	1.59
Orthofix International NV	1.58
CRA International Inc	1.52
US Physical Therapy Inc	1.52
Kinsale Capital Group Inc	1.45
Lawson Products Inc	1.41
TOTAL %	16.04

*Past performance is no guarantee of future results.*

The Fund is subject to the special risks associated with investments in micro-cap companies, such as relatively short earnings history, competitive conditions, less publicly available corporate information and reliance on a limited number of products.

The Fund is subject to risks associated with investments in small-capitalization companies, such as erratic earnings patterns, competitive conditions, limited earnings history, and a reliance on one or a limited number of products.

The Fund invests in growth stocks, which may be more sensitive to market movements because their prices tend to reflect future investor expectations rather than just current profits. Growth stocks may underperform value stocks during given periods.

<sup>1</sup> Returns for periods less than one year are not annualized.

<sup>2</sup> Since the inception of the Fund's Class N shares on April 1, 1996.

<sup>3</sup> Since the inception of the Fund's Class I shares on June 25, 1993.

<sup>4</sup> Since the inception of the Fund's Class Z shares on May 31, 2017.

<sup>5</sup> The Fund's Investment Manager has contractually agreed, through at least October 1, 2018, to limit Fund operating expenses. The net expense ratio reflects this limitation, while the gross expense ratio does not. Please refer to the Fund's Prospectus for additional information on the Fund's expenses.

<sup>6</sup> Mention of a specific security should not be considered a recommendation to buy or a solicitation to sell that security. Holdings are subject to change.

*The Fund is subject to special risk considerations similar to those associated with the direct ownership of real estate. Real estate valuations may be subject to factors such as changing general and local economic, financial, competitive, and environmental conditions.*

*Any sectors, industries, or securities discussed should not be perceived as investment recommendations. Any securities discussed may no longer be held in the Fund's portfolio. It should not be assumed that any of the securities transactions discussed were or will prove to be profitable, or that the investment recommendations we make in the future will be profitable.*

*The S&P 500 Index is a capitalization-weighted index of 500 stocks. The S&P 500 Index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.*

*The Russell Microcap® Growth Index measures the performance of the microcap growth segment of the U.S. Equity market. It includes those Russell Microcap Index companies with higher price-to-book ratios and higher forecasted growth values.*

*The Russell 2000® Growth Index measures the performance of the Russell 2000 companies with higher price-to-book ratios and higher forecasted growth values.*

*Unlike the Fund, the Indices are unmanaged, are not available for investment and do not incur expenses.*

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