

Private Capital Management Value Fund (VFPIX)

A Sensible Approach: Fund Group Correlation Between Positive Alpha and Actively Managed Small-Cap Funds Focused on Smaller Stocks and Exhibiting More Portfolio Concentration

4 Factors Correlated with Positive Alpha

Factor 1 - Portfolio Concentration More concentration, particularly in the Top 10 holdings	Factor 2 - Market Cap Focus An average market cap below \$2bn
Factor 3 – Fund Size Assets of less than \$500m	Factor 4 – Active Share Higher active share

Correlation: a statistical term denoting a relationship between two different characteristics or variables. Positive correlation occurs when data show that the two characteristics are more likely to appear together than would occur on a purely random chance basis. While correlation indicates a relationship between two characteristics, it does not indicate that one positively correlated characteristic has caused the other.

For every active equity adviser, fund manager and asset allocator, the ultimate goal is to provide outperformance for clients. Investors want excess return or, as referred to in the investment literature, **positive Alpha**.

As everyone knows, the secret to obtaining positive Alpha is simple: pick stocks that go up more, or down less, than the broader market. Unfortunately, none of us has a crystal ball to know precisely what a particular stock or investment will do in the future. However, when it comes to smaller-company investing, there are some “non-performance” characteristics that – all else being held equal – tend to correlate with funds that generate positive Alpha (excess return vs. the market) for their investors.

We recently conducted an analysis¹ of highly-rated funds in Morningstar’s small-cap value and small-cap blend fund categories. An analysis of this data identified a number of non-performance fund characteristics that show correlation to funds that generated positive

¹ The analysis relied on a data set comprised of investor share class returns for all small-cap value and small-cap blend funds that received a 4-star or 5-star rating from Morningstar for the trailing 3-year period, along with all small-cap value and small-cap blend category funds that received a Morningstar Gold, Silver or Bronze analyst rating. The data set identified 45 as meeting the analysis criteria as of August 31, 2022. Growth category funds were excluded due to their unique valuation and trading characteristics.

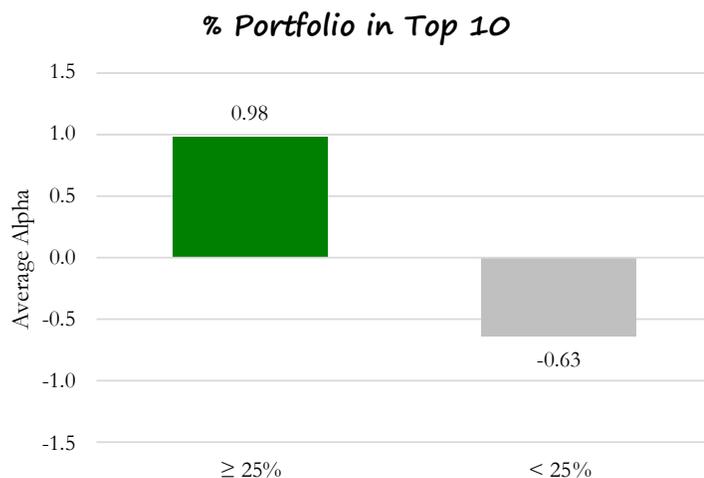
Alpha for their investors over a trailing 3-year period. The baseline benchmark for computing Alpha was the Russel 2000 (small company) index.² Non-performance characteristics showing correlation with positive Alpha include the following:

- Fewer total portfolio holdings
- More concentration among a fund's 10 largest positions
- A smaller fund market capitalization profile
- Fund assets of less than \$500 million
- A high portfolio active share percentage

None of these findings should be particularly surprising to investors who are familiar with small-cap investing. They are instead entirely consistent with the long-understood view that when it comes to investing in smaller companies, capable managers serve their clients well when they leverage their investment expertise by embracing a high "active share" philosophy and by responsibly concentrating portfolio assets around what they view as their best research ideas.

Portfolio Concentration:

The data displayed a positive correlation between funds that held fewer than 150 portfolio positions and trailing 3-year Alpha. On average, funds that held less than 150 positions generated positive Alpha (+0.07), while the average Alpha for those funds that held more than 150 names was negative (-0.58). Of course, a 150-position portfolio is not (at least in our view) particularly concentrated, which may account for why the correlation with positive Alpha is modest. The average number of portfolio holdings across the data set (which excluded index funds) was 347 positions.



As of August 31, 2022. Past performance cannot predict future results.

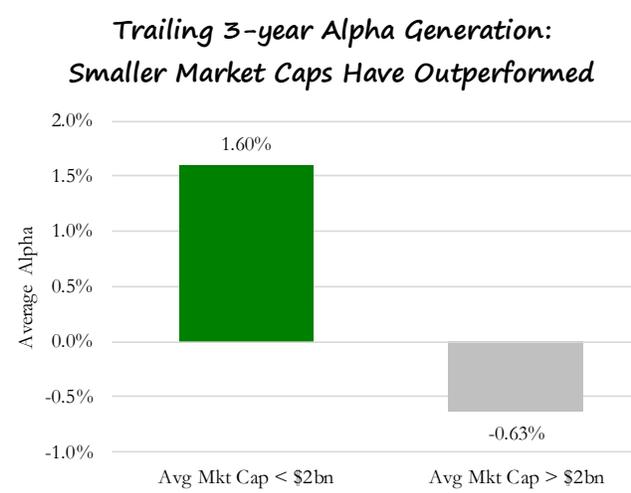
A more meaningful correlation emerged for the data set funds in connection with their top 10 holding concentrations – a hallmark for identifying higher conviction investors. Across the data set, top 10 concentration was actually less than one might have expected for seasoned small-cap investors. The average top 10 allocation for the data set as a whole was only 17%. In addition, more than a quarter of the data set funds held less than 10% of assets in their top 10 positions.

² The Russell 2000 Index is an unmanaged index consisting of the smallest 2,000 companies in the Russell 3000 Index, as ranked by market capitalization.

Nevertheless, the data revealed that on average, funds holding 25% or more of their assets in their top 10 investments generated positive Alpha of +0.98. Conversely, the average Alpha for the funds that held less than 25% of their assets in their top 10 positions was negative -0.63.

Smaller Can Be Better – Even for Small-Caps:

An interesting reveal in the data set was the significant correlation between positive Alpha and funds that invested a higher proportion of their assets in smaller companies. On average,



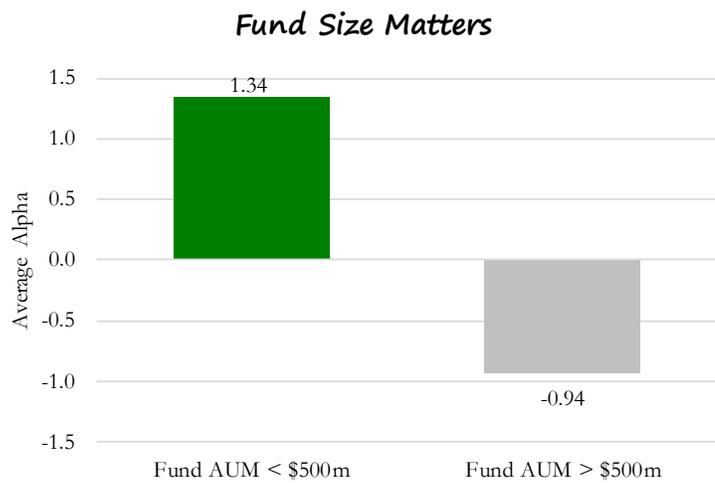
data set funds maintaining an average position market cap of below \$2bn yielded an average 3-year Alpha of +1.60. Conversely, the average 3-year Alpha for funds with portfolio market caps greater than \$2bn was -0.63. Smaller companies are generally understood to entail more risk for investors. However, results for the funds in the data set revealed that they can also provide committed and capable advisers more opportunity to “discover” value that markets may be overlooking. It is standard wisdom among small-cap value investors that promising opportunities frequently go unnoticed

among companies with market capitalizations of less than \$1bn, and that the lower market cap range of the small-cap segment offers an excellent value proposition for mindful investors.

As of August 31, 2022. Past performance cannot predict future results.

Fund Size – In Small-Cap, AUM Growth Can Cause a Head-Wind:

Of course, it is a mathematical fact that funds investing more assets may find it necessary to own more portfolio names (which can reduce concentration) or invest in larger companies that have more liquidity. Accordingly, it was not a surprise that funds in the data set with less than \$500m in AUM on average generated positive Alpha (+1.34), while the average Alpha for those investing more than \$500m was negative (-0.94).

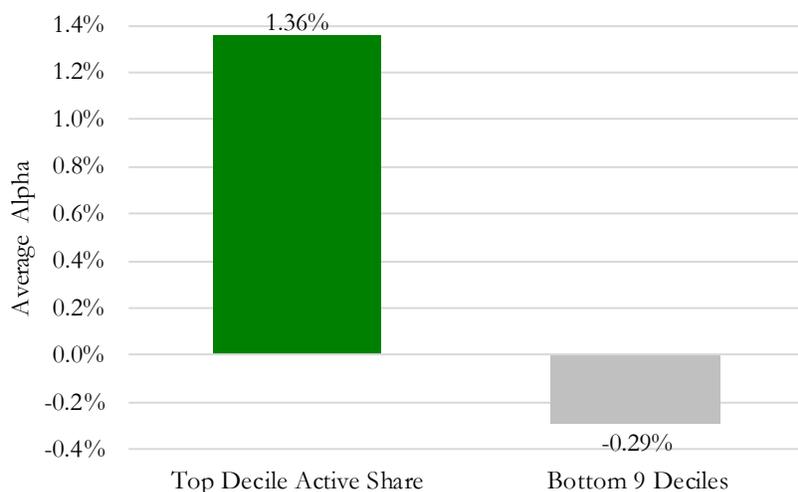


As of August 31, 2022. Past performance cannot predict future results.

Active Share:

Finally, we move to the topic of "active share," which is an investment concept that measures how different a fund's portfolio is from its benchmark. In the small-cap fund space, a high active share portfolio refers to a selection of stocks that is materially different from the

High Active Share Can Be a Differentiator



As of August 31, 2022. Data Source: Morningstar
Past performance cannot predict future results.

Russell 2000. An investor in a high active share fund is getting exposure to a collection of securities at weightings that are materially different than would be the case of simply owning "the market" through a passive index investment. Results generated by funds in the data set, all of which maintained some level of active share, revealed a positive correlation between funds ranked in the top decile of active share and positive 3-year Alpha.

As shown in the graphic above, data set funds with a top decile active share averaged an impressive Alpha of +1.36, while the average Alpha for the remainder of the funds was -0.29. Interestingly enough, the top decile active share funds, on average, held 37% of their assets in their respective top 10 holdings and on average maintained portfolios of only 56 holdings. Again, portfolio concentration and high active share seem to work together.

So, how does the Private Capital Management Value Fund align with the non-performance factors discussed above? The table below highlights where we fall:

PCM Value Fund Profile

	Portfolio Concentration		MKT Cap Focus	Fund Size	Active Share
Study Group Criteria	Fewer than 150 Stocks	> 25%	Below \$2bn	< \$500m AUM	Top Decile Active Share
PCM Value	Holds 38 Stocks	47% in Top 10 Holdings	Average MKT Cap \$940m	VFPIX is Less than \$100m AUM	Highest in Study Group 0.989

PCM Value Fund Class I				
As of 6/30/2022	1- Year	Annualized Return Periods		
		3- Year	5- Year	10- Year
Class I	-9.21%	10.33%	8.62%	10.14%
Russell 2000	-25.20%	4.21%	5.17%	9.35%

The performance data quoted represents past performance. Past performance is no guarantee of future results. Investment return and principal value will fluctuate and shares, when redeemed, may be worth more or less than their original cost. The performance shown reflects fee waivers / reimbursements in effect, without which performance would have been lower. Total returns are based on net change in NAV with reinvestment of all dividends. Current performance may be lower or higher than the performance data quoted. The returns shown do not reflect a 2% fee applied to shares redeemed within 30 days of purchase. For performance current to the most recent month-end, please call 1-800-763-0337. The Fund's Gross Expense Ratio is 1.73%.

Investors should consider the relevant objectives, risks, charges, and expenses of the Fund carefully before investing. The prospectus contains this and other important information about the Private Capital Management Value Fund, and it may be obtained by visiting our website at www.pcmvaluefund.com. Read it carefully before investing.

Shares of the Private Capital Management Value Fund are distributed by Foreside Funds Distributors LLC, not an adviser affiliate.

Mutual Fund investing involves risk and it is possible to lose money by investing in a fund. The Fund frequently maintains a more concentrated portfolio than many diversified funds and its value may fluctuate more widely. The Fund may engage in strategies that are considered risky or invest in stocks of companies that are undervalued, which may result in greater volatility. The Fund invests primarily in small-cap companies, which involve additional risks such as limited liquidity and greater volatility. The Fund has a value-oriented approach and is subject to the risk that a security believed to be undervalued does not appreciate as anticipated or experiences a decline in value.

Definitions:

Alpha: A term used in investing to describe an investment strategy's ability to beat the market. $\text{Alpha} = R - R_f - \text{beta} (R_m - R_f)$ where R = Portfolio Return, R_f = Risk-free ROR, & R_m = Market Return. For instance, a hypothetical investment with an alpha of 1 indicates a 1% outperformance of the benchmark.

Active Share: A measure of the percentage of stock holdings in a manager's portfolio that differs from the benchmark index.

Market Cap: The total dollar market value of a company's outstanding shares of stock.

Morningstar Small-Cap Value Funds: Of 473 Small-Cap Value Funds, based on risk-adjusted returns, the top 90-100% (approximately 47 funds) receive 5 stars and the top 67.5-90% (approximately 59 funds) receive 4 stars.

Morningstar Small-Cap Blend Funds: Of 572 Small-Cap Blend Funds, based on risk-adjusted returns, the top 90-100% (approximately 57 funds) receive 5 stars and the top 67.5-90% (approximately 72 funds) receive 4 stars.

Morningstar Gold, Silver and Bronze Analyst Ratings: The top three ratings, Gold, Silver and Bronze, all indicate that Morningstar analysts rate the fund highly; the difference between designations corresponds to differences in the level of analyst conviction in a fund's ability to outperform its benchmark and peers through time, within the context of the level of risk taken. The Morningstar Analyst Rating does not express a view on a given asset class or peer group; rather, it seeks to evaluate each fund within the context of its objective, an appropriate benchmark, and peer group.

Sources: Investopedia, Morningstar