Punch

Small Cap Commentary
First Quarter, 2019

Overview

The first quarter of 2019 was a strong one for small cap stocks, with the Russell 2000 Index recouping 90% of its fourth quarter decline. Following a 20.2% downdraft last quarter, the index advanced 14.6%. First quarter returns were led by technology (+21.5%), energy (+20.2%), and healthcare (+17.5%) stocks while defensive areas like consumer staples (+7.2%) and utilities (+9.8%) lagged.

Portfolio Attribution

The Punch Small Cap Strategy gained 13.0% in the first quarter, slightly behind the Russell 2000 Index return of 14.6%. This underperformance was driven by stock selection (-1.6%) while sector allocation neither harmed nor helped us (0.0% contribution).

Small cap growth stocks once again performed significantly better than their value counterparts (+17.1% for the Russell 2000 Growth Index compared to 11.9% for the Russell 2000 Value Index), extending their decade-long outperformance streak that has been interrupted only in 2016 (see nearby chart). As we have detailed in the past, we believe that the Russell 2000 Index today is disproportionately populated by lower-quality, over-leveraged, unprofitable companies that have been helped by low interest rates and wide-open credit markets.

Growth vs. Value Since 2009

Russell 2000 Growth Index / Russell 2000 Value Index

Source: Punch & Associates and Bloomberg LP

7701 France Avenue South, Suite 300
Edina, MN, 55435
(952) 224-4350

Annualized Performance as of 3/31/2019 *(net of fees)*						
	Q1 2019	1 Year	3 Years	5 Years	10 Years	Since Inception*
Punch Small Cap	13.0%	-1.5%	11.0%	6.2%	14.0%	10.0%
Russell 2000 Index	14.6%	2.1%	12.9%	7.1%	15.4%	8.2%

**Inception date is 3-31-2002. Please see disclosures at the end of this commentary.*

Bottom Contributors: First Quarter 2019			
Holding	Average Weight	Total Return	CTR** (bps)
Nautilus Inc	1.0%	-49.0%	-73
Farmer Brothers Co	1.7%	-14.2%	-23
Deluxe Corp	1.2%	-9.9%	-22
Rignet Inc	1.1%	-22.7%	-21
Riviera Resources	1.1%	-11.5%	-14

***CTR represents the contribution to total attribution in basis points. Attribution data is reflective of a representative portfolio in the small cap strategy.*

We continue to be overweight the consumer discretionary (+13.5%) and financial (+4.7%) sectors while underweight healthcare (-10.3%), real estate (-7.4%), and technology (-5.7%). While every Russell 2000 sector was in the green for the quarter, sectors that performed worse than the benchmark overall included consumer discretionary, industrials, and financials—all overweight areas for us today.

Bottom Contributors to Return

The biggest detractor from performance in the first quarter was exercise equipment manufacturer **Nautilus, Inc. (NLS, $167 million market cap)**. After building a solid track record of hit products over the last several years, the company struck out in 2017 with a product that we believe was perhaps too challenging for their core demographic. With newer entrants in the space, like Peloton (the in-home studio cycling experience), Nautilus began to charge hard into the digital experience in 2018. Although we believe their new platform is well-aligned with their target market, the offering fell short of expectations in the critical holiday season. When poor fourth quarter results missed estimates, the stock declined more than 40%. Subsequently, the CEO resigned abruptly by way of a late Friday afternoon 8-K filing in March.

At this point, we are watching the company closely and will be getting to know the new CEO well. The balance sheet remains in strong condition with over one-third of the market cap in cash, and the company's operations produce a 6.5% free cash flow yield. The stock is cheap, trading at just 4.5x EV/EBITDA.

Coffee foodservice company **Farmer Bros. Co. (FARM, $349 million market cap)** was another detractor from performance in the quarter. Farmer Brothers roasts and distributes coffee through a national footprint of direct store delivery and wholesale sales. The company had several large distractions over the last couple of years, including a headquarters move and a significant acquisition. The move and the integration are now behind them, but the price of coffee commodities have been weak for the past year. At times, the stock trades in high correlation with coffee prices. This appears to be one of those times. In the first quarter, coffee prices declined 7%. Fortunately, FARM hedges their coffee exposure and believes cheaper coffee prices is good for their business in the long run. In a recent face-to-face conversation with Farmer Bros. management, we came away more confident in their ability to execute their business plans successfully.

RigNet Inc. (RNET, $201 million market cap) was our third largest detractor to performance in the quarter. RigNet is a communications provider focusing primarily on the remote communication needs of the oil and gas industry. The underlying business is quite predictable: once RigNet product is installed on an oil rig, it is difficult to displace. Despite the sticky nature of RigNet's business and the steady increase in oil prices in the quarter, the company has significant potential damages to pay from arbitration, putting a hangover on the stock. In 2014, RigNet entered into a take-or-pay contract with satellite company Inmarsat to be a distributor of their GX network. After some issues with early trials, RigNet terminated the agreement. A dispute followed, as did arbitration. We believe the arbitration panel overstepped during the Phase I process. Phase I was supposed to determine only whether the contact commenced between RigNet and Inmarsat, but the panel also awarded damages to Inmarsat. RigNet does not dispute that the contract started, but they believe damages should be much smaller than the net present value of the entire contract value or about $51 million. Counterclaims will be presented during Phase II, which could reduce the damages currently awarded. We expect the arbitration to be resolved by the end of the calendar year. We also believe the worst-case scenario is already priced into the stock.

Top Contributors to Return

During the quarter, **Select Energy Services (WTTR)** was a top contributor to performance. As a reminder, this $1.3 billion market cap company headquartered in Houston, Texas holds valuable water rights to supply, transport, and dispose of water used by oil and gas companies during the hydraulic fracking process. In 2017, the two largest players in this niche industry merged together and went public, forming Select Energy Services.

Top Contributors: First Quarter 2019

Holding	Average Weight	Total Return	CTR** (bps)
Etsy Inc	4.5%	41.3%	177
Select Energy	1.1%	90.2%	75
EW Scripps	2.5%	33.8%	72
Sleep Number Corp	1.6%	48.1%	66
Varex Imaging	1.8%	43.1%	65

***CTR represents the contribution to total attribution in basis points. Attribution data is reflective of a representative portfolio in the small cap strategy.*

Throughout most of 2018, the stock languished despite posting strong revenue growth, margin improvement, and robust cash flow generation. Some of this negative market sentiment seems to have dissipated during the first quarter with a rally in both Select Energy Services stock price and the broader sector. The company posted another strong quarter in February capping off a good year, and management indicated that they plan to reinvest into growth projects while also returning capital to shareholders through stock repurchases. Despite the improved sentiment, WTTR still trades at an undemanding valuation of 6.8x EV/EBITDA while having a long runway with several large projects to help fuel growth in the coming years. We continue to believe the unique water assets create a competitive advantage allowing the company to benefit from growing demand for water services, ultimately generating strong cash flows while being less cyclical than a traditional oil and gas company.

Minnesota-based **Sleep Number Corp. (SNBR)** was a top contributor to our performance during the first quarter after starting to benefit from several positive changes at the company. Throughout the past few years, Sleep Number has worked to open over 100 new stores in all 50 states, consolidate its supply chain, and develop a new line of "360" Smart Beds. We believe that the smart bed technology is in the process of disrupting what has historically been a commoditized, slow-growing industry. Recent research revealed that over half of U.S. households are interested in buying a sleep tech device, validating the company's emphasis and spending on technology.

You may have seen Sleep Number's new creative "This Is Not a Bed" campaign on television. The advertisement features Minnesota Vikings players promoting the smart beds that can detect overnight restlessness and automatically adjust firmness to comfort the sleeper. With increased marketing efforts, the company has been able to transition consumer interest in sleep tech devices into double digit sales growth for the 360 Smart Bed product lineup over the last three quarters.

Looking forward, we believe the company is poised over the long-term to continue benefiting from coupling the Smart Bed technology with the company's strong brand recognition, showcased in a growing network of modernized stores. Additionally, we believe that management is incentivized through a shareholder-friendly compensation structure to generate long-term returns, driven by the improved operational efficiencies, declining transition costs, and smart bed growth.

The third notable contributor to performance in the first quarter was $1.2 billion market cap **Varex Imaging Corp. (VREX)**. This past fall our letter detailed the investment thesis for this manufacturer of x ray imaging tubes after the company had been battling numerous headwinds throughout 2018. The stock has since rebounded, and our investment team recently meet with the CFO to get an update on the business and its sizeable technology acquisition announced in March.

Varex posted solid performance in February, displaying the companies' ability to navigate tariff impacts and build some momentum in their Chinese business. During the quarter, the company also reported significant growth in CT tubes used for airport security scanning, representing a smaller but growing opportunity. Additionally, management later announced the $85 million acquisition of Direct Conversion, which is expected to bolster the company's current technology allowing for improved breast bone and spinal scans.

While we expect results to continue to be lumpy in the interim, we remain optimistic over the long-term given the growing opportunity in medical imaging, the industries high barriers of entry, and the low market valuation of Varex relative to peers. China continues to represent a significant growth opportunity as the country is amid a large multi-year digital imaging system upgrade cycle to support their growing and aging population. Finally, our investment in Varex is trading at a modest valuation of 2x sales and 17.7x EV/EBITDA, well below its peer group averages of nearly 5x sales and 26x EV/EBITDA.

Portfolio Activity

The Punch Small Cap Strategy ended the quarter with 45 total positions after four complete exits and one new addition to the portfolio. In addition to the one new investment, we added to several existing positions in the quarter.

Our active share continues to be high at 97.8%, and first quarter portfolio turnover was 28.5%.

We exited three holdings in January after the market started to recover from the prior quarter's seemingly indiscriminate decline. The first was **LSC Communications (LKSD, $218 million market cap)**, one of the largest manufacturers of books and magazines in the country. We were initially attracted to LSC as it was a spin-out operating in an out-of-favor sector and generating significant free cash flow. Our thesis was that the book business (particularly education) was experiencing more of a cyclical and not secular decline, cash flow would be relatively stable and, even without any multiple expansion, the investment would provide an attractive return. The education book business did not rebound as expected in 2018, and cash flow declined meaningfully. In addition, LSC was more acquisitive than we anticipated and increased its leverage to fund deals. Rising leverage with declining cash flows in a secularly challenged industry did not make for an investment that we were comfortable holding for the long term. In the fourth quarter of 2018, the company announced it will be acquired by its publicly-traded peer, Quad Graphics (NYSE: QUAD), with a deal close expected in mid-2019. Rather than be at risk of the deal falling apart for antitrust reasons, we elected to move on and will assess Quad Graphics as a potential investment opportunity once the acquisition is closed.

We also exited **Ring Energy (REI, $371 million market cap)**, an exploration and production company, in the first quarter. Ring Energy was part of an energy basket of companies that we have discussed previously. We were attracted to Ring Energy as it is a founder-led company that maintained a debt-free balance sheet and drilled in a less-followed area of the Permian Basin. The area of focus does not have headline-grabbing production figures but does have a lower cost to drill, This allows for the potential for strong returns to be generated. Ring Energy is the only publicly traded company focused on this area, and the thesis that the lower production levels are more than offset by lower drilling costs is still being proven out. In 2018, the company had a few wells that did not see returns in-line with previous wells and the stock price declined. In addition, Ring Energy started to take on debt to fund additional drilling. We elected to take our loss in Ring Energy and concentrate the capital in other energy names where we have more confidence.

In January we exited long-time holding **SP Plus (SP, $777 million market cap)**, one of the largest owners and operators of parking garages nationally. Its main business is managing, and not owning, parking garages so it has not been hit as hard as one may think by the shift in transportation trends caused from the "gig economy," but it has not been immune. The company missed its free cash flow estimates in 2017 and 2018 as it dealt with the shifting landscape. In addition, SP made a transformational acquisition in the fourth quarter of 2018 in a tangential but not completely similar business. We are skeptical as management had trouble integrating a prior large acquisition. Rather than wait to see how the integration works out this time, and with the market giving the company a fair valuation in our opinion, we exited the investment.

In February we exited another long-time holding, **Westwood Holdings Group (WHG, $319 million market cap)**, an institutional investment management firm which also offers wealth management services to individuals. The investment industry is contending with fee compression and the related skepticism towards active versus passive management. Westwood Holdings has not been immune and experienced significant declines in assets under management, including a 35% decline in its institutional assets in 2018. We no longer have confidence that the firm's brand is strong enough to command the loyalty needed to operate in the shifting industry environment and made the decision to exit the position.

Our new position is **BlueLinx Holdings (BXC, $249 million market cap)**, a building products distributor with operations throughout the United States. We first became aware of the company in 2017 when its long-time private equity sponsor exited its 50% stake in the company removing a large overhang on the stock. Shortly after, BlueLinx acquired a privately-held competitor that was nearly 50% larger than itself.

At the time of the acquisition, BlueLinx guided for $150 million of EBITDA based on the current earnings of the two entities and $50 million of identified cost savings tied to branches overlapping, redundant personnel, etc. The acquisition closed in April 2018 and the team is diligently working through integration. Based on progress to date and our research, we believe the $50 million target is very achievable over the next few years.

BlueLinx does not "screen well" from a quantitative perspective. The company owns $150 million worth of real estate that it is in the process of monetizing, $90 million of net operating losses (NOLs) to shield future profits from taxes, and we do not think the $150 million of EBITDA earnings potential is well-known. No sell-side analysts follow the company so there are no forward estimates or research available. We believe the housing industry is attractive given demographic shifts occurring in the United States and new housing starts remains well below past cycle averages. We expect BlueLinx will be a beneficiary if the housing sector returns to historic levels. Finally, we are encouraged by management's alignment with shareholders as there have been recent purchases by several in the C suite above the current stock price. Today the Company has an enterprise value of $980 million. We believe there is an attractive risk / reward based on the hidden real estate, current earnings power, magnified free cash flow thanks to the tax shield provided by the NOLs and expected earnings growth from merger cost savings and industry tailwinds.

Conclusion

On March 9, 2019, we officially crossed the 10-year anniversary of the stock market bottom during the last recession. Since 2009, the S&P 500 Index is up almost four-fold. Of course, some stocks are up significantly more than that, as the distressed market environment at the time was pricing many companies as though they were going out of business. When it became apparent that the financial world was not in fact ending, their valuations soared.

Given the once-in-a-lifetime returns that some of these stocks produced, an interesting question to ask might be, "What would returns have looked like from a portfolio of only the best-performing stocks over the past 10 years?" If you had perfect omniscience on that fateful day in March of 2009, which stocks would you buy?

A research firm called Alpha Architect recently conducted a study on the returns of the best-performing stocks not only over the past decade but also going back to 1920s. As you might expect, the performance of a hypothetical "God" portfolio was amazingly good. Over the past 10 years, a portfolio of the 100 best stocks in the Russell 1000 Index would have returned nearly 20 times that of the benchmark. Since 1929, a "God" portfolio would have produced nearly three times the annual return of the S&P 500 Index.

What the researchers found, however, is that while the long-term performance of this perfect portfolio was obviously stellar, the short-term performance often was not. In fact, each portfolio suffered significant drawdowns and underperformed the index for meaningful periods of time. In 2011, the "God" portfolio lagged the S&P 500 Index by as much as 10%. Since 1927, the worst peak-to-trough loss in the portfolio was -76%, and it lagged the index by 50% on multiple occasions. The study's authors concluded that, if God were a money manager, he would likely get fired multiple times over by his clients for short-term underperformance!

Long-term success in investing often requires the patience and fortitude to endure periods of lackluster performance as stocks or investing styles or asset classes go in and out of favor in the market. No strategy can outperform in all environments—even a portfolio constructed with perfect foresight. By focusing on the true long-term and anchoring ourselves to a disciplined, sensible, and patient investment approach, we believe we can avoid the siren song of short-termism and attempt to achieve long-term investment success.

7701 France Avenue South, Suite 300
Edina, MN, 55435
(952) 224-4350

Punch & Associates Investment Management, Inc. (Punch & Associates) is a registered investment adviser; registration as an investment adviser does not imply a certain level of skill or training. Information presented herein is subject to change without notice and should not be considered as a solicitation to buy or sell any security. Information presented herein incorporates Punch & Associates' opinions as of the date of this publication and is subject to change without notice. Forward-looking statements are subject to numerous assumptions, risks, and uncertainties, and actual results may differ materially from those anticipated in forward-looking statements. As a practical matter, no entity is able to accurately and consistently predict future market activities. While we make efforts to ensure information contained herein is accurate, Punch & Associates cannot guarantee the accuracy of all such information presented. Material contained in this publication should not be construed as accounting, legal, or tax advice.

Composite performance is shown net of fees and brokerage commissions paid by the underlying client accounts. Certain client accounts have directed us to reinvest income and dividends, while others have directed us to not reinvest such earnings. As such, performance data shown includes or excludes the reinvestment of income and dividends as appropriate, depending on whether the account has directed us to reinvest income and dividends. Past performance is no guarantee of future results, and investing in securities may result in a loss of principal.

Punch & Associates claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS® standards. Please refer to the attached Composite Profile and Schedule of Performance for information regarding Punch & Associates' compliance with GIPS® standards.

The reference to the top five and bottom five performers within the Punch Small Cap Equity Strategy portfolio is shown to demonstrate the effect of these securities on the strategy's return during the period identified. Punch & Associates calculated this attribution data using a representative institutional client account which: 1) imposed no material restrictions related to investments made; and 2) was fully invested in the Punch Small Cap Equity Strategy during the entire time period shown. The holdings identified do not represent all of the securities purchased, sold, or recommended for advisory clients during the period of time shown. Past performance does not guarantee future results; therefore, it should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities in this list. Please contact Punch & Associates at andy@punchinvest.com or (952)224-4350 to obtain details regarding our calculation methodology or to obtain a list showing every holding's contribution to the overall strategy's performance during the period of time shown.

We compile company specific information referenced in this commentary from a variety of sources including SEC filings, quarterly and annual reports, conference calls, conversations with management teams, and Bloomberg LP.

*Any benchmark indices shown are for illustrative and/or comparative purposes and have only been included to show the general trend in the markets in the periods indicated. Such indices have limitations when used for comparison or other purposes because they may have volatility, credit, or other material characteristics (such as number and types of securities or instruments represented) that are different from those of the Composite and/or any client account, and they do not reflect the Composite investment strategy or any other investment strategies generally employed by Punch & Associates. For example, the Composite, or a particular client investment portfolio will generally hold substantially fewer securities than are contained in a particular index. *Inception of the Punch Small Cap Equity Strategy was March 31, 2002. **CTR represents the contribution to total attribution.*

**Some index performance information has been gathered from Furey Research Partners with permission.*

Punch & Associates Investment Management, Inc.
Punch Small Cap Composite
Composite Profile and Schedule of Performance as of 6/30/2018

	Annual Performance History			3-Year Standard Deviation			Year End	Year End		
Year	Gross of Fees	Net of Fees	Benchmark[1]	Composite[2]	Benchmark[2]	Number of Portfolios	Composite Assets (mil)	Firm Assets (mil)	% of Total Firm Assets	Dispersion[2]
2002 (since 3/31)	-15.21%	-15.85%	-23.53%	N/A	N/A	12	$5.1	$103.9	4.9%	N/A
2003	55.66%	54.22%	47.25%	N/A	N/A	29	$12.9	$167.3	7.7%	6.8%
2004	21.92%	20.67%	18.33%	N/A	N/A	52	$21.0	$206.2	10.2%	4.8%
2005	13.01%	11.81%	4.55%	N/A	N/A	67	$23.8	$258.7	9.2%	3.3%
2006	22.84%	21.74%	18.37%	N/A	N/A	98	$38.8	$335.0	11.6%	3.3%
2007	3.64%	2.66%	-1.57%	N/A	N/A	272	$103.9	$397.0	26.2%	3.7%
2008	-33.53%	-34.18%	-33.79%	N/A	N/A	243	$65.5	$261.5	25.0%	2.1%
2009	32.65%	31.40%	27.17%	N/A	N/A	257	$85.2	$340.4	25.0%	3.3%
2010	18.88%	17.78%	26.85%	N/A	N/A	283	$108.4	$395.6	27.4%	1.0%
2011	0.80%	-0.13%	-4.18%	20.7%	25.3%	284	$113.6	$475.6	23.9%	0.7%
2012	20.04%	19.01%	16.35%	17.4%	20.5%	292	$152.4	$613.6	24.8%	0.8%
2013	42.63%	41.54%	38.82%	13.6%	16.7%	320	$266.1	$832.7	32.0%	0.9%
2014	-0.21%	-0.90%	4.89%	12.8%	13.3%	328	$265.0	$905.7	29.3%	0.7%
2015	0.51%	-0.39%[3]	-4.41%[3]	15.7%	14.2%	330	$254.7	$938.1	27.2%	0.8%
2016	20.96%	19.94%	21.31%[3]	17.6%	16.0%	350	$307.4	$1,101.0	27.9%	1.2%
2017	12.96%	11.94%	14.65%	16.5%	13.9%	377	$340.3	$1,241.6	27.4%	0.4%
2018 (through 6/30)	11.58%	11.12%	7.66%	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Cumulative	540.55%	452.25%	302.88%							

	Annualized Performance History		
Period	Gross of Fees	Net of Fees	Benchmark[1]
1 Year	22.93%	21.88%	17.57%
3 Year	11.76%	10.79%	10.96%
5 Year	13.70%	12.76%	12.46%
Since Inception	12.11%	11.09%	8.95%

Punch & Associates Investment Management, Inc. (Punch) claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Punch has been independently verified for the periods from April 1, 2002 through June 30, 2018. Verification assesses whether (1) the Firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the Firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The Small Cap Composite has been examined for the periods from April 1, 2002 through June 30, 2018. The verification and performance examination reports are available upon request. N/A indicates statistics are not required to be presented for the time period pursuant to GIPS.

The Composite creation date is December 31, 2005. The creation date is the date in which Punch started reporting returns at the strategy level while they had previously been reported at the account level.

1 - The Russell 2000 Index is the Composite's benchmark.

2 - See Note 7 for discussion of the composite dispersion and 3-year standard deviation calculation.

3 - According to Punch's Error Correction Policy, this Schedule of Performance has been updated from prior versions which incorrectly displayed the 2015 Composite TWR (net), 2015 Russell 2000 Index, and 2016 Russell 2000 Index figures as -0.26 percent, -5.11 percent, and 20.35 percent, respectively.

Notes to Composite Profile and Schedule of Performance

Note 1. Organization and Nature of Business

Punch & Associates Investment Management, Inc. (Punch) is an investment adviser registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940. The term "Firm," as defined by Global Investment Performance Standards (GIPS), represents Punch & Associates Investment Management, Inc.

The Punch Small Cap Strategy (Small Cap Composite) invests in U.S. listed public companies with market capitalizations between $250 million and $2 billion. Companies from the small cap universe are selected on the basis of economically attractive business models, accelerating fundamentals, cash flow characteristics, valuation relative to cash flow, and general investor recognition.

This description of products and services of the Small Cap Composite (the Composite) is not an offering. Past performance is not an indication or a guarantee of future results. Investments are subject to risk and may lose value. A list of our composite descriptions and our policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

Note 2. Performance Presentation Standards

This report includes all of GIPS' mandatory disclosures as well as additional disclosures deemed prudent by Punch's management. Investment philosophies did not change materially during the reporting periods or from period-to-period.

Note 3. Accounting Policies

All assets and liabilities in the Composite are reported on a fair value basis using U.S. Generally Accepted Accounting Principles. Investment transactions are recorded on a trade date basis. Dividends are reported on pay date basis. Punch's policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

Note 4. Valuation Methodologies

The Composite values all of its investments at fair value in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification 820 (Fair Value Measurements) and the GIPS Valuation Principles. The Composite invests in Level 1 securities (i.e. marketable securities for which prices are readily available).

Note 5. Calculation of Rates of Return

The portfolio returns for the period are based in U.S. dollars and have been calculated using a time-weighted, monthly, geometrically linked rate of return formula to compute quarterly percentage returns. Each portfolio's monthly rate of return is the monthly percentage change in the market value, including earned interest and dividends, after allowing for the effects of cash flows.

The monthly composite rate of return calculation is weighted by beginning values. This results in an asset's size-weighted rate of return. Security transactions and any related gains or losses are recorded on a trade-date basis.

Note 6. The Composites

Punch has established composites for all fee-generating portfolios for which it has full discretionary investment decision-making authority. Punch's client base within the composites was comprised of institutional and individual investors with a minimum asset balance of $100,000. No alterations have been made to the composites as a result of changes in investment professionals. In addition, Punch is the investment adviser to transitory portfolios that were not eligible for inclusion in any composite because the portfolios are either new for the month first funded, or the portfolios had restructuring which took place during the month.

The Small Cap Composite is one of several composites managed by Punch. Punch's list is available upon request.

Performance is based on total assets in the portfolio, including cash and substitute securities. Generally, a portfolio will enter a composite on the first day of the first full month following its inception. A portfolio is removed from a composite as of the last day of its last full month. Historical performance results include the results of clients who are no longer clients of Punch. Each composite is comprised of separately managed portfolios.

The Composite is subject to Punch's large cash flow policy which defines a cash withdrawal of more than 10 percent of the portfolio's market value as a large cash flow which requires the Composite to be valued at the date of the withdrawal. This policy has been in effect for the periods from April 1, 2002 through June 30, 2018.

Note 7. Composite Dispersion

Composite dispersion measures represent the consistency of a firm's composite performance results with respect to an individual account's portfolio returns within a composite. Account dispersion is measured by the standard deviation from the central tendency (mean return).

The dispersion of the annual returns of the Composite is measured by the asset-weighted standard deviation method. Standard deviation attempts to measure how much exposure to volatility was taken historically by the implementation of an investment strategy. Only portfolios that have been managed for the full year have been included in the annual dispersion calculation of the Composite. Effective for the year ended December 31, 2011, GIPS requires the presentation of the three-year annualized standard deviation. This statistic measures the volatility of returns for the Composite and benchmark over the preceding 36-month period.

Note 8. Investment Management Fees

The net performance results set forth in the Schedule of Performance reflect the deduction of actual investment management fees. The standard fee structure is based on 1 percent of assets per annum on all discretionary assets unless otherwise specified. Prior to December 31, 2005, the fee structure was variable based on strategy and account size, not to exceed 1.5 percent per annum.

Account minimums and fees are negotiable on a case-by-case basis due to potential growth, size and services rendered.

Note 9. Comparison with Market Index

Punch compares its Small Cap Composite returns to a certain market index management believes has similar investment characteristics. The returns of this index do not include any transaction costs, management fees or other fees. This index is the Russell 2000 Index.