Punch

Small Cap Commentary
Third Quarter, 2019

Overview

Despite rising recession fears, ongoing global trade uncertainty, and a presidential impeachment inquiry, the Russell 2000 Index ended the third quarter of 2019 about where it began, declining 2.4%. The smallest of small cap equities continue to languish, however, as the Russell Microcap Index declined 5.5% in the third quarter and now lags the Russell 2000 Index by 6.3% on a year-to-date basis (+7.9% vs. +14.2%). This underperformance continues a trend over the past several years.

Going back one, three, and five years, micro cap stocks have lagged the Russell 2000 Index by 7.1%, 10.3%, and 13.3% respectively. This lagging performance, which is more acute when compared to large cap equities, means that the Russell Microcap Index now trades at its cheapest valuation on record since the index began in 2005. While we are frustrated with the performance of the asset class recently, we are nonetheless optimistic that today's low valuations provide attractive opportunities for investment.

In an investing environment besotted with secular growth stories, profitless unicorns, and private market investments, we believe investors have left behind smaller public companies with any degree of cyclicality to their business, and current valuations reflect that preference. Where "secular growth" is a buzzword, "cyclical growth" is a stigma. We believe that many valuations for these cyclical companies already reflect the assumption that a recession is right around the corner. We are not so sure that one is in the offing, and if it does not materialize, valuations may shift accordingly.

Over the past several years, our focus on smaller small cap companies and our preference to purchase company shares when they are value-priced have been headwinds to our strategy. Today, 23% of the Punch Small Cap Strategy is invested in companies with market capitalizations under $500 million, compared to 9% for the Russell 2000 Index. We think that these companies generally have fewer analysts covering them, have fewer institutional shareholders, and are generally lesser known and often misunderstood. In the third quarter, we saw some evidence that smaller, value-priced stocks may be starting to do relatively better. But it is certainly too soon to tell whether or not this is the beginning of a larger trend.

Annualized Performance as of 9/30/2019 *(net of fees)*

	Q3 2019	1 Year	3 Years	5 Years	10 Years	Since Inception*
Punch Small Cap	-0.1%	-8.1%	8.6%	8.4%	11.0%	9.8%
Russell 2000 Index	-2.4%	-8.9%	8.2%	8.2%	11.2%	7.9%

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

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Portfolio Attribution

The Punch Small Cap Strategy returned-0.1% in the quarter, compared to a decline in the benchmark Russell 2000 Index of 2.4%. Year-to-date, our strategy is up 16.4% compared to 14.2% for the Russell 2000 Index. In the third quarter, security selection generated all of the strategy's outperformance while sector allocation was a slight detractor.

From a sector perspective, energy shares were the far-and-away loser of the small cap market in the third quarter, declining 20.9%. Year-to-date, energy has fallen 13.5% and is the only sector to be down meaningfully. While we continue to be overweight this beleaguered area, we have been slow to add to positions this year until we see some signs of stabilization in the operating environment.

As you might expect given rising macroeconomic fear in the third quarter, defensive sectors did relatively well, with the three best being utilities (+5.4%), real estate (+5.0%), and consumer staples (+4.1%). Healthcare has been a notable laggard, however, declining 9.5% in the third quarter and rising only 5.5% for the year; our notable underweight to this area has been an advantage for our strategy.

Bottom Contributors to Return

The largest detractor from performance in the third quarter was **Carbonite, Inc. (CARB, $537 million market cap)**, a data protection software company that provides backup, disaster recovery, and migration solutions to secure on-premise and cloud infrastructure for businesses and consumers. During the quarter, Carbonite reported better-than-expected second quarter results but lowered guidance for the remainder of the year, with organic growth coming in below expectations. The more significant news from the quarter was the voluntary departure of its CEO, Mohamad Ali, which was both surprising and disappointing. Mr. Ali was the architect of the company's transition from a consumer-centric business to a business focused on small and medium sized enterprise customers, and he had developed a reputation as a smart acquirer. We believe that the company has a robust platform that will survive this change in leadership, but Mr. Ali was certainly a key piece to the story. Several executives from recently-acquired Webroot have been promoted in the wake of events in the third quarter, and a formal CEO search is ongoing. We believe Carbonite has a strong foundation with recurring revenue that should continue to grow, but we are reserving judgment on the new strategy until the company announces its next CEO, and we can interview him or her.

Another detractor from performance in the quarter was **Malibu Boats, Inc. (MBUU, $629 million market cap)**, a vertically integrated power boat manufacturer that is a leader in the ski and wake category. The month of June accounts for approximately one-third of the ski and wake category annual sales, and when June results came out this past July with a powerboat year-over-year decline of 14%, the entire boat industry took a dive. MBUU

Bottom Contributors: Third Quarter 2019

Holding	Average Weight	Total Return	CTR** (bps)
Carbonite	1.8%	-40.5%	-106
Ferro Corp	2.3%	-24.9%	-70
Malibu Boats	2.4%	-21.0%	-63
Farmer Brothers	1.7%	-20.9%	-41
LendingTree	1.2%	-26.1%	-39

***CTR represents the contribution to total return in basis points. Contribution data is reflective of a representative account in the Punch Small Cap Equity Strategy.*

reported strong fiscal 2019 fourth quarter results in August, but that data was not enough to offset the stock price declines in July. Although sometimes seen as weak rationale, bad weather was a major driver of the June declines. We believe that buying behavior has returned to expected levels as a result of normalized weather with less rain following a soggy spring and summer boating season. We also believe that Malibu stock is cheap, and management seems to agree with us. They have said they favor stock buybacks over acquisitions today. We continue to be positive on the outlook for the boating industry in general and the ski and wake category in particular.

LendingTree, Inc. (TREE, $4.0 billion market cap), a leading online consumer platform that connects consumers with access to financial products including mortgage loans, home equity loans, lines of credit, auto loans, credit cards, and insurance quotes, was also a detractor from performance in the quarter. Despite strong top-line results, the company missed profit forecasts, which drove TREE shares down. The company also lowered full-year guidance, driven by a deceleration in the company's highest margin business of personal loans. Management plans to continue to spend on marketing for personal loans, which they expect to be a drag on margins for the rest of the year. A couple bright spots in the quarter included a sequential recovery in the mortgage business as well as continued better-than-expected performance from the recently acquired insurance business. We remain optimistic about the shares given that LendingTree's product portfolio is more diversified than ever, and the platform has the flexibility to deliver high profitability in both high and low loan origination volume environments.

Top Contributors to Return

Bluelinx Holdings, Inc. (BXC, $303 million market cap), a building products distributor, was the largest contributor to performance in the quarter. We like that the company is deleveraging its balance sheet through monetization of its real estate. During the quarter, the company reported that it sold four pieces of real estate and used proceeds to pay down debt. Over the last twelve months, the company's margins were pressured by falling lumber prices. Bluelinx is improving margins through driving operating efficiencies and focusing on higher margin products. In addition, the company gave positive commentary around margin stabilization due to lumber prices. We are impressed with management's ability to operate and execute in a challenging environment.

In general, housing-related companies did well in the quarter, and **Green Brick Partners, Inc. (GRBK, $549 million market cap)** was another top contributor for the Punch Small Cap Strategy. The company is a homebuilding and land development company with operations in Texas, Colorado, Georgia, and Florida. In 2018, Green Brick accelerated the number of community openings. As this strategy plays out, we believe earnings should accelerate in the last quarter of 2019 and into 2020. In addition, the company is offering a wide range of price points for homes, recently focusing on more affordable entry-level housing. Green Brick remains relatively under the radar with only four sell-side analysts, two of which started coverage in the last twelve months. Trading at less than 10x earnings, we believe valuation more than accounts for uncertainty in the housing market.

Alamo Group, Inc. (ALG, $1.4 billion market cap) manufactures heavy duty agriculture equipment and infrastructure maintenance equipment for government and industrial use. While not a top five contributor, we highlight Alamo Group to provide additional insight into the Punch Small Cap Strategy as we discussed several of the other top five contributors in recent updates. Alamo performed well as a result of a strong earnings report and announcing a large acquisition. It has been a challenging time to serve the agriculture market as commodity prices and the U.S.-China trade war are putting pressure on U.S. farm incomes. Alamo Group overcame that weakness with strong industrial sales. In addition, the company has a large repair parts and services segment of its business which helps cushion against industry pressures. Alamo Group has a track record of successful tuck-in acquisitions and the acquisition in the quarter is one of the largest in company history. As the company grows, diversifies its business, and shows revenue stability, we believe shareholders will continue to benefit.

Top Contributors: Third Quarter 2019

Holding	Average Weight	Total Return	CTR** (bps)
BlueLinx Holdings	1.5%	63.2%	74
B. Riley Financial	4.1%	16.1%	65
Callaway Golf	4.7%	13.2%	58
Green Brick Partners	2.2%	28.8%	55
Deluxe Corp	2.1%	21.7%	42

***CTR represents the contribution to total return in basis points. Contribution data is reflective of a representative account in the Punch Small Cap Equity Strategy.*

Portfolio Activity

The Punch Small Cap Strategy ended the quarter with a total of 44 positions, unchanged after exiting ARC Document Solutions, Inc. and starting a new position in shares of RadNet, Inc. Additionally, we trimmed five existing positions and added to one during the quarter.

Total turnover in the Punch Small Cap Strategy remains low at 13.2%, while our active share remained high at 98.2%. Our top ten holdings accounted for 37.8% of total exposure at quarter end.

We exited our holding in A**RC Document Solutions, Inc. (ARC, $66 million market cap)** during the quarter after the company's attempted turnaround continued to produce frustrating results. ARC is a provider of print and digital solutions to the architectural, engineering, and construction industry. Our initial thesis in the first quarter of 2015 was that ARC would be able to leverage their market-leading position in the legacy blueprint business for a transition into a modern digital platform.

Unfortunately, the erosion in the legacy print business has accelerated and growth from the new digital platforms are not keeping up. Over the past three years, we have patiently waited as ARC completed a sales force transformation intended to inject growth into the digital solutions and generate attractive recurring revenue streams. Despite industry growth during this transformation, ARC has been unable to leverage their customer relationships and industry reputation to drive meaningful growth in the digital business.

Members of our research team have either met with or spoke to management of ARC three times during the past year in addition to regular quarterly earnings calls. During our conversations, we have not only been discouraged by the progress but also do not believe that there is an adequate plan or sense of urgency necessary to improve its current operations. Therefore, we have elected to sell our shares, harvest a tax loss, and move on to more promising opportunities.

Our patient research style is exemplified well in our position in **RadNet, Inc. (RDNT, $730 million market cap)**, an owner and operator of medical imaging centers. While this is a new position for the Punch Small Cap Strategy, the business is not new to our research team. We first met with management of RadNet in the second quarter of 2015.

We have followed the business for several years and believe there is now a unique opportunity to capitalize on a trend of patients seeking lower-cost care outside of hospitals. RadNet is the largest owner and operator of fixed-site medical imaging centers in the country with 340 locations. They offer services such as X-rays, ultrasounds, and MRIs at a fraction of the cost for the same service provided at a hospital. Large health insurers have started to take notice and are increasingly requiring doctors and hospitals to refer patients to outpatient clinics like RadNet when possible.

As the largest player in this niche space, RadNet dominates certain heavily-populated geographic markets such as New York and California, creating a natural moat and we believe positions it as the de facto acquirer for small operators in the area. We expect the business to continue to acquire some of the nearly 6,000 imaging locations across the U.S. at attractive valuations below their current market multiple of 8.9x EV/EBITDA. Furthermore, experienced co-founder and largest shareholder, Dr. Howard Berger, operates the business along with his long-tenured management team. Finally, we believe that RadNet will benefit over time from a growing and aging U.S. population in search of affordable health care options.

Conclusion

In the immediate wake of the 2016 presidential election, a wave of anticipation swept through capital markets in hopes that a new, more business-friendly administration would accelerate economic growth, roll back burdensome regulations, and reduce taxes. Smaller public companies, which are especially sensitive to the domestic economy, responded in kind. In 2016, the Russell 2000 Index of small public companies jumped 20%, nearly twice the return of large cap companies, mostly in response to this expected stimulus.

Since then, the tables have turned. Over the past almost three years, large cap stocks have returned twice that of small cap stocks, rising over 40%. While the S&P 500 Index is up 4% over the past year, the Russell 2000 Index is *down* 9%. What are we to make of this disappointing performance from an asset class that was supposed to benefit so directly from an improved domestic economy?
While it is true that some of the hoped-for economic changes happened and economic growth accelerated over the past couple of years, there is concern that the "sugar high" of stimulus is quickly wearing off and that the effects of global trade

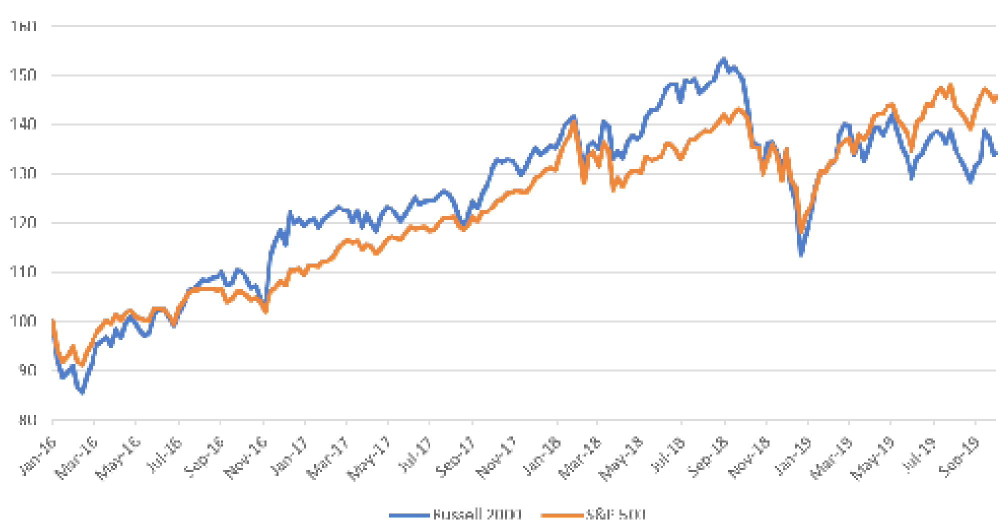
conflicts are taking their toll on American consumers and producers. Talk of recession is growing, and many companies that are especially cyclical have seen their share prices decline. We think that these concerns are likely overblown given what we are hearing from many companies directly.

Whether or not a recession occurs in the U.S. soon, we believe that the stock prices of many smaller public companies already reflect that anticipated outcome. The Russell 2000 Value Index, which is largely populated with the shares of banks, manufacturers, and real estate companies, was down over 15% from its high at one point this quarter, and now trades at the same price-to-earnings ratio that it did back in 2012. The index trades at 14x earnings, a 28% discount to the S&P 500 Index at 19.5x earnings.

In the Punch Small Cap Strategy, we do not attempt to make predictions about markets or economies and do not invest according to where we think they might be headed in the near term. Instead, we look for strong companies with loyal customers that produce regular cashflow and that have reputable management. We try to invest in these companies when their shares are out of favor, unknown, or just plain cheap. Today, many smaller companies with some degree of cyclicality in their businesses fit into this category.

Over long periods of time, history shows that small cap companies do outperform large cap companies. Since 1999, the average annual return of small companies has been 8% compared to just over 6% for large businesses. This premium comes with higher volatility, though, and small cap companies can have cycles in which performance diverges from large cap companies. We believe that we are in one of those periods today, but, given attractive valuations and the prospect for improved performance, we remain excited about small cap investing.

Small Caps vs Large Caps
Russell 2000 Index vs S&P 500 Index
12/31/2015 to 9/30/2019



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See disclosures at the end of this commentary

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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.

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

Punch

Year	Annual Performance History			3-Year Standard Deviation		Number of Portfolios	Year End Composite Assets (mil)	Year End Firm Assets (mil)	% of Total Firm Assets	Dispersion[2]
	Gross of Fees	Net of Fees	Benchmark[1]	Composite[2]	Benchmark[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%							

Period	Annualized Performance History		
	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%, -5.11%, and 20.35% 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.