INVESTMENT COMMENTARY: SMALL CAP Q4 2018

January | 2019

Overview

Most investors couldn't wait for Q4 to end and for a new year of possibilities to begin. That's how challenging Q4 was for equities, which dipped into bear market territory for the first time in a decade. The S&P 500 lost 13.5% in Q4, the Russell 2000 lost 20.2%, and the Russell Growth index lost 21.7%. For the full year, the Russell 2000 was -11.0%, while the Russell 2000 Growth index was -9.5%. **Our Small Cap strategy returned -1.4% for the year.**

We achieved a significant milestone in 2018 as our track record passed the 3-year mark, a critical milestone for institutional investors considering our strategy. And while our official Morningstar SMA rating will not be released until February, we believe Morningstar's small cap mutual fund universe provides some valuable comparative information. As of 12/31/2018, our performance ranks in the 99th percentile in the Small Cap Blend category and in the 97th percentile in the Small Cap Growth category.

Annual Performance *(Dec 1 - Nov 30)*	Year 1	Year 2	Year 3	Inception	Std Dev
Van Hulzen Small Cap	20.8%	26.5%	12.0%	71.0%	14.8%
Russell 2000	11.5%	18.3%	0.6%	32.6%	14.7%
Russell 2000 Growth	3.7%	23.0%	2.6%	30.9%	15.3%

The reason we have started reporting Russell 2000 Growth figures in addition to our Russell 2000 benchmark is Morningstar has placed us in the Small Cap Growth category for rating purposes. We don't necessarily agree that this is appropriate, as our investment process allows us to fish in both ponds (growth and value). So the Core or Blend category seems more appropriate to us, but we will let our prospective clients decide that for themselves. We do want to point out that our standard deviation is considerably lower than that of the Russell 2000 Growth index.

Downside Capture: Just As Important As Upside Capture

As a firm, we are keenly focused on risk management. Our large cap covered call strategy is an industry leader for its leadership in downside capture. This mindset carries over to our small cap strategy. Despite being a "growthier" strategy and obviously not using options, the basic tenets of risk management are the same. We are well diversified, we limit position size, we establish downside targets for all holdings (using fundamental as well as technical analysis), and we rank ideas based on a ratio of upside potential divided by downside risk (as opposed to upside alone).

We are proud to report that this focus on risk management has paid off. For the 37 months ending December 31, 2018, our Upside Capture is 132%, while our downside capture is 86%. **This results in an Upside/Downside ratio of 1.5.**

132%	*Upside capture*
86%	*Downside capture*
1.5	***Upside/Downside Ratio***

Market Overviews

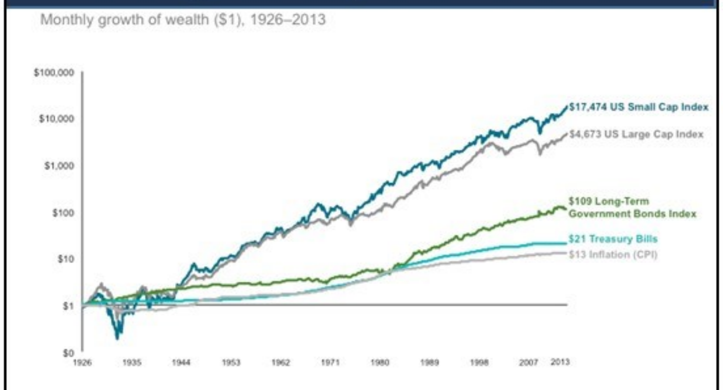
Clearly, the equity market is less certain than it was just 4 months ago. Slowing economic growth, rising interest rates, and global trade tensions have investors worried. But most economists still expect positive GDP growth and are not predicting a recession in 2019. And according to Barron's, 15 of the 23 bear markets since 1929 were associated with or resulted in recessions. That means that more than one-third of the time, stock declines didn't lead to a broader economic slowdown.

These conflicting data points have many investors wary of more potential turbulence but at the same time hoping for a signal that some of our temporary, “man-made” challenges (Fed actions and trade tensions) may resolve themselves without too much more market downside.

Small Caps Win In The Long-Run

Small cap equities carry more risk than large caps and, over the long term, have delivered higher performance (nearly 4-to-1 on a cumulative basis, since 1926). But it is perhaps less widely known that large caps have actually out-performed small caps more recently. Small caps fell behind during the 1990s and still haven’t come close to making up the ground they lost. **Point to point, large caps have out-performed small caps more than 2-to-1 since 1982.**

Small caps have out-performed since 1926



Source: Coronado Times, Feb 20, 2015

Large caps have out-performed since 1982

Source: Bloomberg data, compiled by VAM

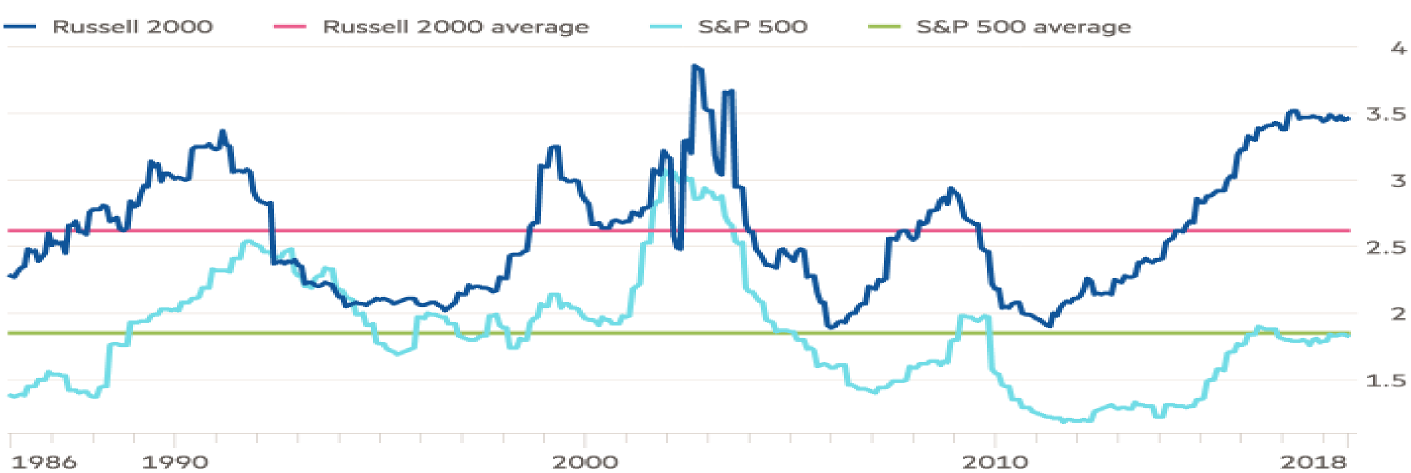
Most people are very surprised to hear this. Clearly, some of this out-performance was driven by “Big Tech,” both in the 1990s as well as more recent years. The key question is whether this trend can continue or if mean reversion will win out. We believe in mean reversion.

Leverage & Interest Rates

Last quarter we discussed our finding that rising interest rates (in moderation) have historically actually been good for stocks, particularly small cap stocks. One argument against that in today’s environment, of course, is that small companies have been taking on record levels of debt in recent years. See below.

Small caps pile on the debt

Net debt/EBITDA (ex-financials)



Source: FactSet, BofAML US Equity & US Quant Strategy
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As rates continue to move up, certain small-cap companies (many of whom have floating rate debt) could find themselves at risk. Of course, as active managers, we have the ability to screen for companies with stronger balance sheets (less debt), and we do just that. Leverage is a key screening variable for all of Van Hulzen's strategies. The average leverage in our small cap portfolio is 12.3%, versus 22.5% for the Russell 2000 and 16.5% for the Russell 2000 Growth index. It's also worth mentioning that, on average, stronger balance sheet companies have actually under-performed over the last 10 years. So once again we see the theme of potential mean reversion.

Looking Forward

We are seeing record demand for our large cap covered call strategy now that market volatility has picked back up, making yields more attractive than they've been in years. But we also believe it's a good time to consider our small cap strategy for your growth allocation. For all the reasons we've discussed above, we believe small caps could be due for some nice long-term relative out-performance once our current macro challenges subside. And our focus on quality & low leverage should continue to bode well for our strategy**.**

Portfolio Attribution

With the Russell down more than 20% in a single quarter, there was naturally a good bit of dispersion between individual holdings in 2018. Our healthcare names were the best performers, with 3 of our top 5 returns in that sector. Our biggest under-performers included a diverse group of companies (one industrial, one materials company, one consumer & two technology). We took action on all ten of these names in 2018, which is rare, but price movements like we've seen are pretty rare too. Of our top 5 winners, we trimmed two and sold three. Of the losers, we added to two and sold three for tax loss purposes.

Biggest Gainers YTD		Biggest Losers YTD	
BioTelemetry (BEAT)	134.8%	Patrick Industries (PATK)	-58.5%
Five Below (FIVE)	111.9%	Trinseo (TSE)	-56.8%
Willdan Group (WLDN)	80.3%	Hain Celestial Group (HAIN)	-56.0%
Ligand Pharmaceuticals (LGND)	61.7%	Applied Optoelectronics (AAOI)	-49.7%
LHC Group (LHCG)	53.9%	Control4 (CTRL)	-44.0%

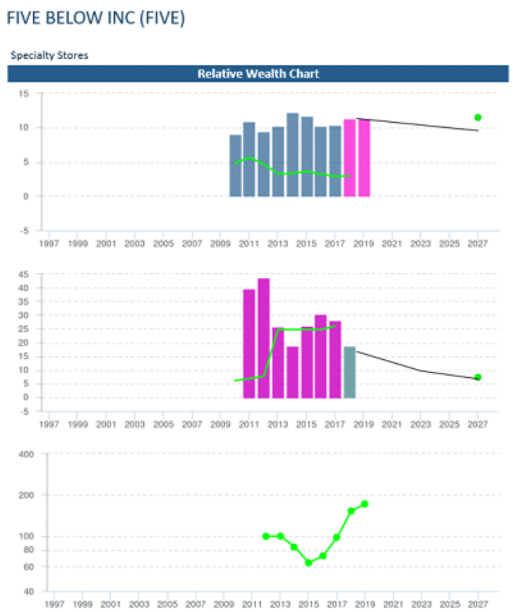
Past performance is no guarantee of future results. Indexes are not available for direct investment. Please see disclosures at the end of this presentation for more information.

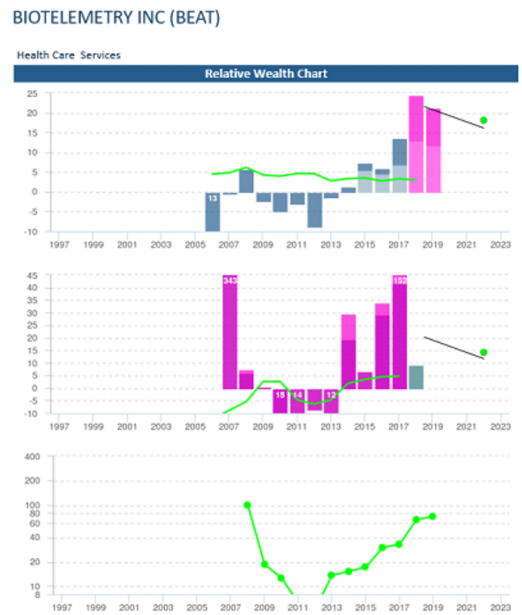
As always, we have reviewed our winners and losers, particularly scrutinizing our losers. We would like to highlight two from each category.

2018 Example Winners:

Five Below (FIVE) delivered +112% in 2018 and is up 223% since we first bought the name in 2016. We have trimmed this name twice since the original purchase, most recently in September at $131, and currently hold a 2.5% position. Five Below is a very unique business in that it has actually managed to make dollar stores "cool." Their stores price everything at $5 (or below) and cater to a younger customer (teens & pre-teens) than most dollar stores. They offer everything from sunglasses and jewelry to glitter lamps, cell phone chargers and sports merchandise. FIVE has achieved top line growth of well above 20% over the past 5 years, through a combination of store expansion and above average comp sales. We believe this concept has plenty of room for additional expansion and will likely continue to hold FIVE as long as it remains in the Russell 2000.

BioTelemetry (BEAT) was our best performer in 2018 with a return of +135%. This is another name we have trimmed twice since the original purchase, most recently in November at $70.50. BioTelemetry is a mobile and wireless medical technology company that provides mobile cardiac and blood glucose monitoring (BGM). These devices are able to detect abnormalities in heart activity and relay information to healthcare professionals in real time. BEAT is a great example of the type of company we look for under our “Growth at a Reasonable Profile” approach. We only started watching the company in 2017, after it had achieved its cost of capital for two years and proven it can grow profitably and not just for the sake of growth. As always, the proof is in the numbers, not the sales pitch. The medtech space, and specifically the medical devise market, is rapidly expanding. We believe BEAT is an ideal acquisition candidate for a larger player looking for a new growth channel.



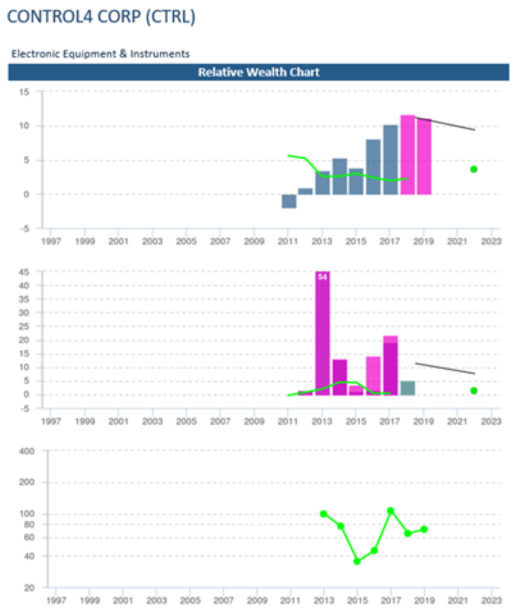


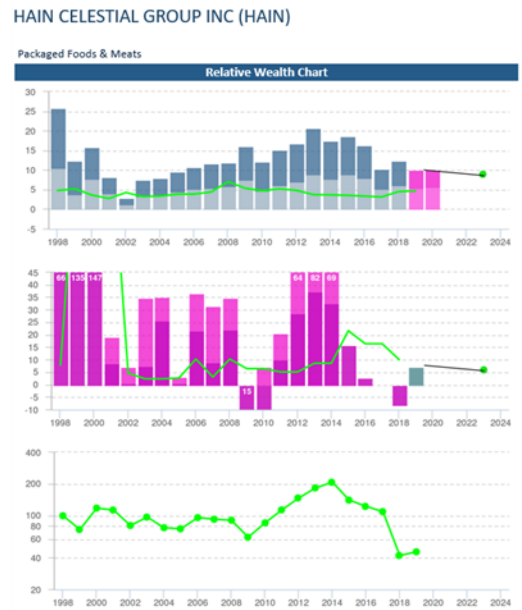
Source: Credit Suisse HOLT

2018 Example Losers:

Control4 (CTRL) is a microcap name that we have owned since 2016. It has been through several technical wave patterns since we originally purchased the stock, and it fell 55% in 2018 as anything “housing-related” got creamed. Control4 is a market leader in the “Smart Home” space that has grown its top line 15-20% (on average) over the past five years but still only has 1.6% market share. Management is keen to grow brand awareness and is launching a Control4 Certified Showroom concept to showcase their automated systems to homeowners. We don’t believe CTRL relies on new home sales for its growth strategy, as the home improvement market should provide plenty of opportunity as this concept catches on. We also believe CTRL could be an ideal acquisition candidate for one of the big Smart Home players like Amazon, Google or Philips. Our position in CTRL is up 20% since inception, even after a terrible 2018. Fundamentals continue to be strong. This is a hold for now, and a potential add on more weakness.

Hain Celestial (HAIN) was a deep value/turnaround idea we initiated back in July. And we’re not afraid to admit we were too early on this one. But we do still think this name offers enormous upside once they push through their current challenges. Hain is a leading organic and natural foods company that was a market darling until mid -2015 but has experienced turmoil in the leadership ranks and has seen sales fall off across most of its brands. An activist investor took a large stake in 2017 and ultimately pushed out Hain’s Founder & CEO. The Company brought on a new team from Pinnacle Foods, a very successful grocery food business that was acquired by Conagra last year. This new team is extremely customer-focused and has a vision for revamping the US sales strategy (the former CEO of the US business has recently been pushed out as well). This turnaround could take some time. We sold our position in December for tax loss purposes but will be watching for fundamental catalysts and technical indicators that might signal a reentry point.





Source: Credit Suisse HOLT

Top Ten Holdings

Our top 10 holdings currently include three tech names, two healthcare, two consumer discretionary, one financial, one consumer staple and one industrial name. The median market cap is approx. $1.2 billion.

Company	Business description	Weight	Size ($mm)
Supernus Pharma (SUPN)	Specialty pharma (CNS)	4.9%	1,850
TopBuild (BLD)	Building supplies	4.9%	1,750
Primo Water (PRMW)	Filtered water	4.8%	600
Control4 Corp (CTRL)	Smart home technology	4.6%	510
LogMeIn (LOGM)	Remote access software	4.6%	4,410
Axos Financial (AX)	Consumer banking	4.5%	1,670
Pet Med Express (PETS)	Pet meds & supplies	4.4%	490
iRobit (IRBT)	High tech appliances	4.4%	2,440
SP Plus Corp (SP)	Parking management	4.3%	710
Carbonite (CARB)	Backup/disaster recovery	4.1%	780

Supernus Pharmaceuticals
Control4
taste perfection PRIMO
axos BANK
LogMeIn

Conclusion

We believe there continues to be a big opportunity in the small cap space and, as discussed above, expect this category to out-perform large caps and global stocks over the long run. However, quality will be a critical theme going forward, and the most successful managers will be those who are able to navigate the risks of the category, particularly leverage risk. This type of risk management is central to our process.

We also believe our rigorous approach to stock selection and strong track record of alpha generation make us an attractive choice for clients. It’s not hard to find small cap managers who are willing to speculate, but we believe quality always wins in the end.

Strategy Overview

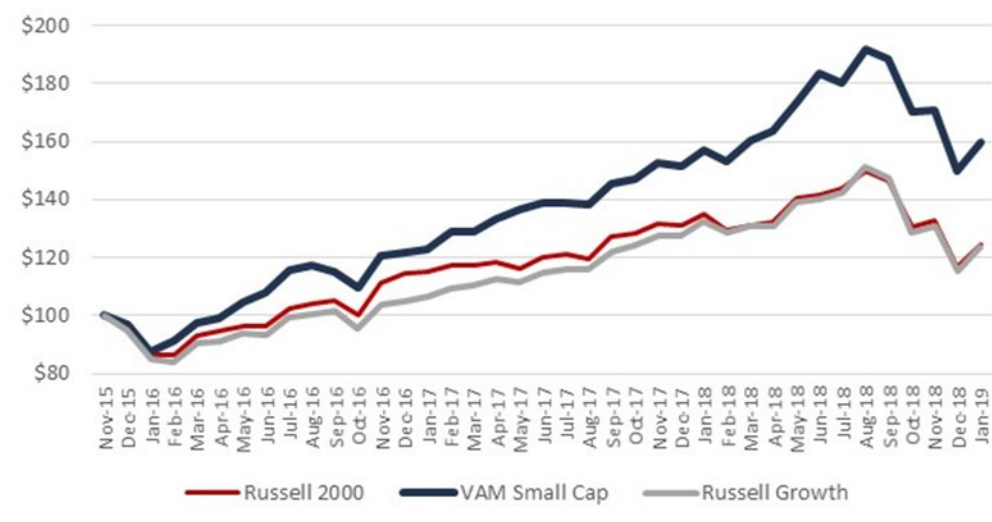
We continue to see nice organic growth in AUM and are starting to look for the right distribution partner(s).

Some Quick Highlights about this strategy:

- Fundamental stock selection process uses the same framework as our other (large-cap) work;
- This framework (HOLT) is ideally suited to finding value in smaller, undiscovered companies;
- Results have been GIPS verified as of 12/31/17 (track record is real, not pro forma);
- Strategy has remained fully allocated (90-100%) over the entire track record measurement period and has held a similar risk profile as the benchmark throughout the time horizon.

Full Track Record

We have achieved excellent results thus far, out-performing the Russell 2000 by nearly 9% annually over our first 37 months (35% cumulative outperformance). We have not taken excessive risk in order to achieve these results (standard deviation is in line with the benchmark). Please see our strategy fact sheet for complete performance information and risk statistics.



	Return
Van Hulzen Small Cap	59.8%
Russell 2000	24.7%
Russell 2000 Growth	23.4%
S&P 500	32.1%

Returns are net of fees (11/30/15-11/30/19)

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Approach

The strategy uses a "Growth At A Reasonable Profile" approach, which basically means we are not speculative. Just like you've come to expect from us in the large cap space, our focus is on quality first. But in the small cap space, we are just as open to growth and momentum stocks as we are value stocks. A "reasonable profile" means the business must be established and already profitable, earning returns above its cost of capital. Beyond these simple parameters, we look for companies that are leaders in their industries, expanding rapidly (2-3x the market), and consistently beating expectations for growth.

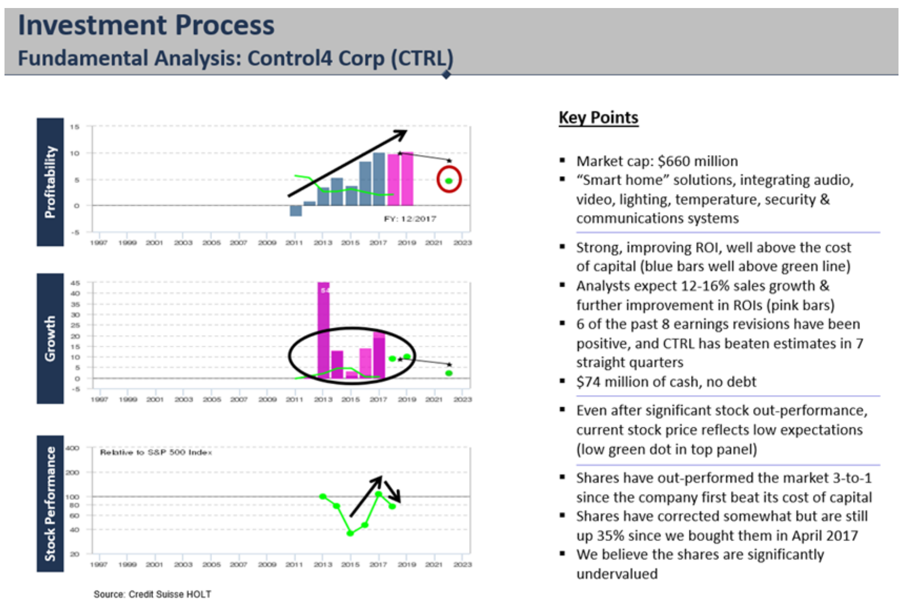
Portfolio Construction

Our strategy is well diversified, with a max position size of 6% and broad representation across sectors. We believe in long term value creation based on a disciplined capital allocation process. A handful of lucky concentrated bets is not the path to achieving long-term goals. We target companies with market caps between $500 million and $3 billion and have a below average portfolio turnover profile.

Fundamental Analysis

Fundamentals come first. Always. But we also incorporate technical analysis into our investment process, to provide key downside/support levels and also to provide confirmation of buy/sell signals. Small-cap stocks can be volatile and technical analysis provides information into position sizing, entry and exit decisions and can trigger due diligence reviews.

We'd like to highlight one of our portfolio holdings (CTRL) to demonstrate our investment approach. Control4 (CTRL) is a "smart home" solution provider that has provided us with a 60% return since inception but that we believe is still significantly undervalued. It is a market leader and a very profitable business that is growing 12-16% per year. With a market cap of just $660 million, we believe it is an ideal takeover candidate.



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