NorthPointe
CAPITAL
39400 Woodward, Suite 190, Bloomfield Hills, MI 48304

NorthPointe Capital, LLC
Large Cap Value
1st Quarter 2017

The broader stock market indices moved higher in the first quarter of 2017. Daily or weekly fluctuations centered mainly around perceptions of the new U.S. Presidential administration's ability to enact meaningful legislation related to health care and taxes. After most major indices reached all-time highs in early March, the market gave up some gains in the final 30 days, but still finished the quarter on a positive note.

Small cap stocks underperformed large caps as the 2.47% gain in the Russell 2000® Index fell short of the 6.03% gain in the Russell 1000® Index. Several large growth companies (i.e., Apple, FaceBook and Amazon) had solid double digit gains for the quarter, which helped to drive the large cap index higher. Growth stocks outperformed value stocks with the Russell 1000® Growth Index returning 8.91% for the quarter relative to the 3.27% gain in the Russell 1000® Value Index. The growth index had significantly more exposure to the Information Technology sector, which was the best performing sector within each index. Additionally, the value index suffered from its higher weighting to the Energy sector, with that sector generating a -6.59% return for the Russell 1000® Value Index during the quarter.

Based upon our discussions with company management teams across our firm holdings, the business outlooks generally remain optimistic. However, there remain many areas of uncertainty in the investing landscape as events in our country and the world continue to produce headlines that can move the market. We remain steadfast in our belief that by focusing on individual companies, understanding their ability to create value over the near and long term and identifying stocks that have yet to be properly valued in the market, we will be able to provide attractive investment returns.

For the first quarter of 2017, the NorthPointe Large Cap Value Composite returned 1.84%, which compares to the 3.27% return of the Russell 1000® Value Index. The portfolio experienced underperformance in the months of January and February before outperforming during the month of March. Stock selection was the culprit, with the bulk of the underperformance occurring within our Macro Economic Interest Rate Sensitive Sector(IRS). As one may recall, NorthPointe classifies stocks into one of four macro-economic sectors based on industry membership: Interest Rate Sensitive, Cyclical, Steady Growth and Fast Growth.

Given the value nature of the strategy, the IRS Sector has historically been the portfolio's highest weighted sector. The sector currently represents more than thirty seven percent of portfolio. The macro-economic sector consists of all of the portfolio's Financial, Utility, and Real Estate companies. The chart below intends to provide insight to the challenges our stock selection model experienced within the IRS sector this past quarter. Several of our factors experienced weakness. Of special note, it was our alpha, which is our expected return based off the combination of the underlying factors, that sheds the best light as to what happened. Our alpha had statistically significant underperformance during the first quarter. Our work and our model have been suggesting that the rise in the financial shares post the U.S. Presidential election had room to continue higher. The new administration’s set back with the Health Care legislation shook the market’s confidence in our thesis. While tax reform and an infrastructure bill would certainly bolster our case, we believe regulatory relief and a stronger US economy should be sufficient to validate our thesis. To place our model’s quarterly result in historical context, the average quarterly return to IRS alpha model over the past seventeen years of managing this strategy has been 1.38%, compared to -2.31% for this period. This past quarter ranks in the 17th percentile over our history. While not a welcome result, it is within historical bounds. We will continue implement our time-tested investment process as we have always done.

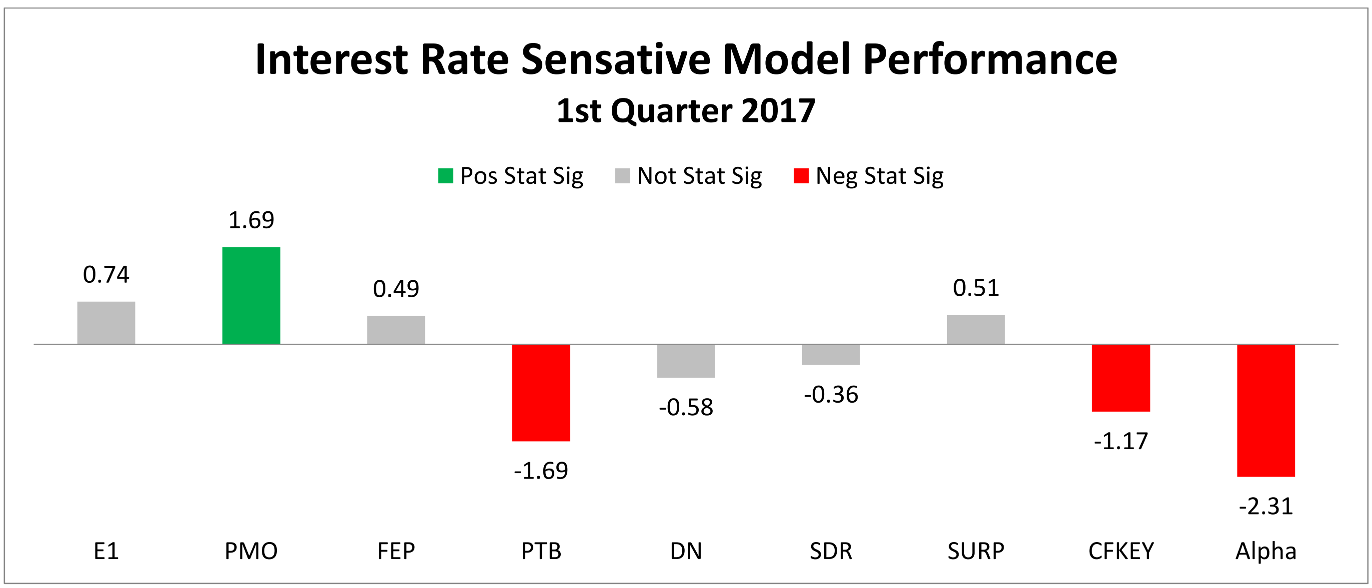

Chart reflects the compounded monthly regression coefficients for the first quarter in our Interest Rate Sensitive sub-model of the Large Cap universe. Two separate regressions are used – the first is a multifactor regression of factor performance on returns in excess of the Russell 1000 index including the eight model factors as well as industry indicator variables. The second regression regresses returns to our Alpha value on returns in excess of the Russell 1000 index when similarly controlled for industry indicator variables. Statistical significance is determined using a threshold of +/-1.96 on the regression coefficient t-statistic. All values internally calculated using FactSet.

One specific name in the IRS sector that is worth a deep dive this quarter is AmTrust Financial Services. Amtrust, a provider of worker’s compensation and specialty insurance services, was initially purchased for the portfolio in the fall of 2016. The stock declined nearly 32% during the quarter. The decline was caused by investor reaction to accounting issues centered on reserve strengthening in their specialty programs business, a delay in their 10-K filing, and discussion of prior year revenue restatements. We believe the company has properly reported its financial condition and remains an attractive investment. At the headline level, it made sense why the stock was down so much, however an understanding of the issues does not raise the level of uncertainty that warrants that large of a move in the stock price. Addressing each issue is relatively straightforward. First, reserve strengthening among insurance companies is akin to banks having elevated credit costs and saying it's only a one-term issue. Management has had an exemplary record at getting ahead of any unfavorable reserve development, and it is well recognized this is not a company that has a history of mispricing business. Instead, they have a long history of stepping away from business when pricing is poor. Secondly, AmTrust switched auditors last year from BDO to KPMG. This is the first annual audit by KPMG and their standards are higher. Finally, on the revenue recognition side, this issue relates only to the warranty business. With BDO, AmTrust recognized revenue when the retailer sold the warranty policy. BDO signed off on this, and there was never a comment from the SEC related to this practice. Apparently, the KPMG partner in charge of the AFSI audit was also the author of an article being considered by FASB for this type of fee recognition, and thus it was important for him to apply this change to AmTrust. It is not expected to be material in any given year, however any specter of revenue adjustments in prior years is always perceived as a negative, at least in the early days post the announcement. In addition, we believe lost on investors was management's commentary on the service business. A competitor of theirs in the warranty business sold for nearly 3x revenues, this would imply a $2-$3 billion price tag for AFSI business, and they believe they can separate it without any significant impact to their insurance business. An unlocking of this value, would further underscore how undervalued AFSI is a whole.

AFSI filed their 10-k in early April and there were few surprises. The bears on the stock are likely to continue to state that AmTrust had been overstating their profitability, and the 10-k seems to confirm this, although the amount is less than 10% of net income historically. The 10k also reveals very strong premium growth in their small commercial and specialty risk & warranty segments. With a revised estimate of $2.20/share in earnings for 2017 and assigning a conservative multiple of 10x we believe $22 is an achievable price target, currently the share price is $15.50. There is little question in our minds that the business is undervalued. The stock continues to score well on our stock selection model and we expect first quarter earnings to present a catalyst to propel the stock higher and ultimately to our target.

We appreciate the opportunity to provide you an update on the NorthPointe Capital Large Cap Value Strategy. We are confident in our ability to add value going forward. We remain focused on finding unique large cap companies that can grow their business and whose stock price trades below its intrinsic value. The current portfolio is selling at a multiple of 13.97 times its twelve month forecasted earnings, which compares to the 16.26 multiple for the strategy's benchmark. We view this valuation discount as significant embedded alpha. The fund has a ROE ratio, return on Equity, of 10.4% vs. 9.4% for the benchmark. The portfolio is therefore significantly undervalued and of high quality, at the same time. We love it when the portfolio is priced in this manner. Outperformance usually follows such pricing environments. We embrace our responsibility to add value to your portfolio and look forward to doing so in the upcoming quarters. If you should desire any further information, please do not hesitate to contact us.

Sincerely,

Peter Cahill, CFA
CIO, Portfolio Manager

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The Russell 2000® Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000® Index is a subset of the Russell 3000® Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership. The Russell 2000® Value Index measures the performance of small-cap value segment of the U.S. equity universe. It includes those Russell 2000® companies with lower price-to-book ratios and lower forecasted growth values.
The Russell 1000 Index measures the performance of the large-cap segment of the U.S. equity universe. It is a subset of the Russell 3000® Index and includes approximately 1,000 of the largest securities based on a combination of their market cap and current index membership