NorthPointe Capital, LLC
Large Cap Value
4th Quarter 2017

Broad market indices gradually climbed higher throughout 2017, with only one month registering a negative return (and only slightly negative at that with the S&P 500 index down .04% during the month of March). Anticipation of domestic tax reform, continued strength in the U.S. economy and related confidence measures, as well as a global economic recovery were the most likely factors behind the strength. Given the high degree of optimism and momentum witnessed in the market, it was not surprising that growth stocks outperformed value. Contrary to 2016, large cap stocks outperformed small caps, with nearly half of the outperformance due to better returns and greater exposure to Technology stocks. And within this sector, nearly half of the outperformance came from just three stocks - Apple, Microsoft and Facebook - with each gaining more than 40% during 2017. It could be universally accepted that those three companies have proven business models, yet the market also seemed to reward unproven business models.

In addition to focusing on traditional fundamental and macroeconomic drivers (tax policy, unemployment, earnings growth, consumer confidence, etc.), investors – and the media – became enamored with topics such as block chain, crypto currency, and cannabis. The quarter witnessed dramatic price increases in securities related to, or even contemplating being related to, alternative currencies. An exchange traded fund established to track the price of a Bitcoin saw its shares rise 5x during the most recent quarter. Shares in a beverage distributor went from $2 to as high as $9 (while ending the year at $5) on the announcement that is was exploring opportunities in blockchain technology. It had yet to develop a product related to such technology, just that it was exploring opportunities in the field. Indeed, far from a proven business model, and yet, the stock more than doubled. An exchange traded fund that tracks securities in the cannabis industry nearly tripled. We have chosen to share these examples to highlight how speculative and momentum driven certain investors have become. We have not, and will not, join this crowd.

Large cap stocks, as measured by the Russell 1000® Index, posted gains of 6.59% and 21.69% for the fourth quarter and full year, respectively, compared to the 3.34% and 14.65% respective returns of the Russell 2000® Index. Growth stocks outpaced value stocks, as the Russell 1000® Growth Index returned 7.86% and 30.21% for the fourth quarter and full year, respectively, while the Russell 1000® Value Index had gains of 5.33% and 13.66%, respectively. Last year, value returns fell behind growth returns due primarily to the concentration of the high performing growth stocks.

The NorthPointe Large Cap Value Composite produced a gross return of 6.73%, which compares to the 5.33% return of the Russell 1000® Value Index. For the calendar year that was 2017, the NorthPointe Large

Cap Value Composite had a gross return of 15.95%, which compares to the 13.66% return of the Russell 1000® Value Index.

For the quarter, we experienced strong stock selection across the majority of the economic sectors. Selectivity was strongest in the Industrial and Consumer Staples Sectors, with both sectors contributing roughly 50 basis points in value add. Selection was weakest in the Information Technology Sector, costing the portfolio roughly 25 basis points in value. The Industrial Sector contribution was driven by XPO Logistics, a recent addition to the portfolio, and the timely trimming of a longtime portfolio holding, General Electric. XPO Logistics, a transportation and logistics company, was purchased in early October. We added the stock to the portfolio because we were attracted by its high ranking in our stock selection model driven by positive exposure to our value and momentum factors. Upon performing our qualitative review, we came to regard the company as having solved the "last mile" problem with e-commerce delivery. In our opinion, the prime catalyst for the shares rising nearly 37% from time of purchase was the report that Home Depot had internally discussed purchasing the company. This news resulted in significant unlocking of value as the investment community came to further understand the value of the company. We continue to hold XPO and will look forward to seeing what transpires in 2018. The other Industrial name worth mentioning this quarter is General Electric. Our adherence to our sell discipline is on display within the context of the drama surrounding GE's stock. The story of the drop in the stock has been widely reported. John Flannery, the new CEO of GE, came to power and announced significant changes to the course of direction at GE. In late July our process caused us to systematically reduce our position in GE. Initially, we took GE to a neutral position at $25.44. Subsequently, our expected return for GE continued to decline and in mid-October the position was taken to a significant underweight at $22.32/share. The share price ended the year at $17.45, representing a 31% decline from when we went neutral and a 22% decline from where we went negative. The net result of reducing our weight from 1.95% to .35% by year end, produced roughly 30 basis points of value creation/save. GE remains a significant under weight in the portfolio and is under close supervision.

Another area of strength was the Consumer Staples Sector. We wrote about one of this year's Consumer Staples standouts at the end of last year. This is what we wrote after the 4th quarter in 2016: "Tyson Foods, a food company operating Chicken, Pork, Beef and Prepared Food segments, came under pressure due to a miss of earnings expectations and claims of the price of Chicken being artificially manipulated by a handful of poultry companies. We continue to own Tyson as the sharp selloff seems excessive and Tyson's valuation, selling at less than 13 times this year's projected earnings looks attractive to us." Tyson returned a respectable 31% in 2017 and continues to be held in your portfolio. It remains a triple threat on our stock selection model, as it possesses positive factor exposures to value, quality, and momentum. Tyson fundamentally delivered this past year and we have reason for optimism in 2018.

The Information Technology Sector housed the weakest relative returns in the portfolio during the fourth quarter. The Sector cost the portfolio roughly 25 basis points in value add. The underperformance was contained in the Semiconductors and Semiconductors Equipment Industry. The benchmark Semi holdings were up slightly more than 20%, while the portfolio Semi holdings were up just 7.74%. This past quarter was a case of the rest of the industry playing catch up with the portfolio. Even trailing by just north of 12% for the quarter, the portfolio's Semis outpaced the benchmark holdings for the year (returning 47.43% versus 32.11%). We see a great deal of value and underlying business momentum in the portfolio's two standout Semi holdings: Micron Technology and Applied Materials. We will continue to hold these securities and we expect them to again be positive contributors to the portfolio in 2018.

The portfolio's fourth quarter results were supported by the robust performance of our stock selection model. Our highest ranked securities, our 10 ranks, returned approximately 2.5% per month during the quarter. Our lowest ranked stocks, our 1 ranks, returned just 1.6% during the period. This .90% per month discrimination between our highest and lowest stocks contributed roughly half of the quarter's excess returns. The remaining half of the portfolio's excess return can be attributed to our stock selection or selectivity, which is chiefly driven by of our qualitative overlay. Within our underlying sub models, three of our models (Interest Rate Sensitive, Cyclical, and Stable Growth) were positive performers. Our cyclical model produced the strongest results. Within our cyclical model, the top contributing factors were earnings momentum and price to cashflow.

We appreciate the opportunity to provide you an update on the NorthPointe Capital Large Cap Value Strategy. We are excited about the portfolio's current positioning and we are confident in our ability to add value going forward. The current portfolio is selling at a multiple of 14.46 times its twelve month forecasted earnings, which compares to the 16.30 multiple for the strategy's benchmark. The fund has a ROE ratio, Return on Equity, of 13.1% vs. 10.5% for the benchmark. Both metrics suggest that the portfolio's characteristics are in a stronger position than when we wrote to you last quarter.

Over the past 25 years, we have always tried to carefully reflect on our teams and how we can best allocate resources with a critical eye on investment talent. I am now excited to announce the addition of Bryan Franco to our firm effective 1/19/18. This is old home week for Bryan as he left us back in 2011 to co-manage a micro/small cap hedge fund portfolio in NYC and returned to pursue opportunities in Michigan. It must be the fabulous Michigan winters! Additionally, Steve Roberts, one of our micro/small cap analysts will be leaving the company. We wish Steve well in his future pursuits. We are anxious to welcome Bryan back to NorthPointe.

Please rest assured that we shall remain focused on finding unique large cap companies that can grow their business and whose stock price trades below its intrinsic value. We embrace our responsibility to add value to your portfolio and look forward to attempting to do so in 2018. If you should desire any further information, please do not hesitate to contact us.

Wishing you a safe and prosperous 2018,

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