

# FAM Small Cap Fund (FAMFX & FAMDX)



FAM FUNDS

In-depth research. Insightful investing.

## Quarterly Advisor Commentary

for Professional Investment Advisors  
data as of 12/31/18

### Portfolio Managers



**THOMAS O. PUTNAM**  
since  
1/2/1987



**ANDREW F. BOORD**  
since  
1/1/2016

### Fourth Quarter 2018

#### TOP CONTRIBUTORS (stock price change in %)

Monro	0.04%
Winmark Corp.	-0.02%
Hostess Brands	-0.05%
Hallmark Financial Services	-0.08%
Natus Medical	-0.22%

#### TOP DETRACTORS (stock price change in %)

Multi-Color Corp.	-2.24%
Matador Resources	-1.93%
Colliers International Group	-1.43%
Frontdoor	-1.38%
Carriage Services	-1.34%

### MARKET AND PERFORMANCE REVIEW

The fourth quarter of 2018 saw a sharp decline in U.S. equities, leading major indices into negative territory for the full year. After showing resilience in the face of adverse geopolitical headlines for much of the year, stocks moved lower in October on concerns that the U.S. Federal Reserve was preparing to exceed market expectations for interest rate hikes in 2019. The sell-off gained momentum as signs of slowing growth overseas highlighted the downside risks to a global trade war. Finally, the prospect of a government shutdown and uncertainty around the outlook for U.S. economic growth and corporate earnings in 2019 further weighed on sentiment as the year ended.

Reflecting the quarter's uptick in risk aversion, small-cap stocks lagged their large-cap peers with a return of -20.20% as measured by the Russell 2000 Index versus the -13.82% return of the Russell 1000 Index. Within small-cap stocks, the energy sector was the worst performer by a wide margin, which is no small statement as materials, healthcare, industrial, and consumer discretionary stocks all declined by more than 20%. Utilities led performance within the Index for the quarter, posting only a modest decline. In terms of style, the Russell 2000 Growth Index returned -21.65% while the Russell 2000 Value Index declined -18.56%.<sup>1</sup>

The FAM Small Cap Fund's return of -17.23% outperformed the return for the Russell 2000 benchmark for the quarter. Stock selection within healthcare led positive contributions to return versus the benchmark, followed by consumer discretionary and financials. Energy helped performance, due to its relative underweight, although this was largely offset by negative selection within the sector. Selection within real estate and information technology detracted, as did an underweight to utilities.

### NOTABLE FUND HOLDINGS

- While every stock held in the Fund declined in the quarter, one of our largest positions, auto repair chain **Monro (MNRO)**, fell notably less than the market. Thanks to a valuation-based trimming in the quarter, our Monro exposure produced a slight profit.
- Selection within healthcare was positive as our two holdings in the sector, medical device companies **AngioDynamics (ANGO)** and **Natus Medical (BABY)**, declined only modestly.
- Label manufacturer **Multi-Color Corp. (LABL)** was the biggest detractor in the quarter. The stock has declined considerably in recent months, likely due to concerns over a recent acquisition that added considerable debt to the balance sheet, along with expectations for a sluggish 2019 environment. We trimmed the position in December, primarily for tax purposes.
- A position in **Matador Resources (MTDR)** was the second largest detractor. As an oil producer, Matador's stock price was highly exposed to the drop in oil prices seen in the fourth quarter. Fortunately, Matador was one of our smaller positions. We purchased additional shares as the price declined.
- Funeral home company **Carriage Services (CSV)** was another notable laggard. While certainly not in a cyclical business, against a backdrop of increased risk aversion investors appeared to become wary of companies such as Carriage with relatively high debt.

<sup>1</sup>Bloomberg, 12/31/18

## Top 10 Holdings

Hostess Brands	5.44%
Frontdoor	5.02%
National Commerce Corp.	4.95%
CBIZ	4.88%
ExlService Holdings	4.86%
Choice Hotels International	4.71%
Monro	4.67%
Natus Medical	4.62%
Diamond Hill Investment Group	4.20%
Pinnacle Financial Partners	4.13%

## PORTFOLIO ACTIVITY

- The lone addition to the portfolio in the quarter was **Frontdoor (FTDR)**, the leading U.S. home warranty provider. We initiated the position shortly after Frontdoor was spun off from pest and termite control company ServiceMaster, and purchased additional shares on weakness after disappointing third quarter results were reported. Frontdoor has an effort underway to disrupt the broader home repair universe, utilizing technology and a network of more than 45,000 independent repair technicians. We believe they have the potential to greatly expand profits over time.
- We took advantage of the market decline to add to 10 existing positions during the quarter.
- Six positions were trimmed due to a combination of tax considerations and opportunities to reinvest the cash in better ideas.
- At year-end, the Fund's cash position was 2.42%, down from 11.5% at the end of the third quarter, reflecting more attractive valuations.

## OUTLOOK

It appears that economic growth is decelerating and that profit margins are contracting in many industries. The question is, "By how much?" Enough to trigger a recession or justify the sharp drop in stock prices? We don't know yet. Each company is impacted differently by such factors as tariffs, freight costs, wage increases, and more, so there is a lot of nuance to the analysis. In the coming weeks, we should learn a great deal as companies release earnings.

It should be noted that companies are adapting to new conditions, raising prices to offset higher costs, moving production out of China, or eliminating unnecessary costs. Many commodity prices are falling, such as for steel and oil, which should help profit margins at some firms.<sup>2</sup> Additionally, based on Fed communications, it is our viewpoint that they may be seeing data suggesting the economy might be slowing. As a result, they might raise short-term interest rates less than was expected a few months ago. Finally, self-preservation is usually a key consideration for politicians around the world, so new trade agreements are quite possible. In short, many of the worries overhanging the market may ease as 2019 progresses.

After such a large drop in small-cap prices, we are pondering the degree to which concerns around tariffs, slowing growth, and higher interest rates are "priced in." Many firms we like have pulled back from expensive valuations to levels that we view as reasonable, or even cheap. We believe that we have a nice collection of solid companies within the portfolio and they could achieve healthy, long-term returns from these reasonably attractive valuation levels.

<sup>2</sup>Bloomberg, 12/31/18

## Portfolio Information

**FAMFX** (Investor Shares)  
CUSIP: 314465501  
Inception Date: 3/1/2012

**FAMDY** (Institutional Shares)  
CUSIP: 314465600  
Inception Date: 1/1/2016

Fund Size: \$147,820,716

Past performance is not indicative of future results, current performance may be higher or lower than the performance date quoted. Investment returns may fluctuate; the value of your investment upon redemption may be more or less than the initial amount invested.

Please consider a fund's investment objectives, risks, charges and expenses carefully before investing. The FAM Funds prospectus or summary prospectus contains this and other important information about the FAM Small Cap Fund and should be read carefully before you invest or send money. The principal risks of investing in the fund are: stock market risk (stocks fluctuate in response to the activities of individual companies and to general stock market and economic conditions), stock selection risk (Fenimore utilizes a value approach to stock selection and there is risk that the stocks selected may not realize their intrinsic value, or their price may go down over time), and small-cap risk (prices of small-cap companies can fluctuate more than the stocks of larger companies and may not correspond to changes in the stock market in general).

To obtain a prospectus or summary prospectus and performance data that is current to the most recent month-end for each fund as well as other information on the FAM Small Cap Fund, please go to [famfunds.com](http://famfunds.com) or call (800) 932-3271.

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