Driehaus Small Cap Value Strategy

The fourth quarter of 2019 capped off a tremendous year of returns for stocks and virtually all asset classes. The Russell 1000 and the Russell 2000 returned 9% and 10%, respectively, for the fourth quarter. For the year, U.S. large cap (Russell 1000) stocks returned 31.4% while U.S small cap stocks (Russell 2000) trailed, returning 25.5%. It was the seventh best year for large cap stocks and the 11th best year for small cap stocks and the highest returns for U.S. stocks overall since 2013.

U.S. stocks were not the only asset class to perform well in 2019. Per the Wall Street Journal, "Analysts at Ned Davis Research tracked eight types of investments – large and small domestic stocks, developed and emerging market stocks, Treasuries, corporate bonds, commodities and real estate – going back to 1972. In 2019, all eight categories generated profits and – for the first time since 2010 – each rose 5 percent or more. In fact, the gains were much better than that, with a median gain of 21 percent for the eight asset classes."

Lest we forget, at the end of a lackluster 2018, stocks, bonds and commodities were struggling, as the market worried about slowing world economic growth, Brexit, global trade squabbles and the Federal Reserve (the Fed) had raised rates four times and was promising to raise more. 2019 brought relief in that economic growth stabilized, global trade tensions eased, and most importantly, the Fed surprised everyone with rate cuts and bought securities again in 2019, pumping about $60 billion into the bond markets every month. The Fed will certainly be viewed as the major cause of the great returns in 2019.

Interestingly, the market wasn't driven by earnings whatsoever. In fact, the market ignored some pretty sad earnings numbers put out by large and small companies. Large cap companies' earnings growth is forecasted to be about flat for 2019 while small cap and mid cap companies' earnings are expected to decline by 6.8% and 4.4%, respectively.

Exhibit 1:
Looks Like Another Ugly Reporting Season for Small Caps

	Earnings Growth (In %)								
				Small Caps		Mid Caps		Large Caps	
Quarter/Year	Small	Mid	Large	Growth	Value	Growth	Value	Growth	Value
1Q19A	-14.5	-1.5	-0.3	-11.2	-17.8	1.2	-1.6	-2.1	-3.1
2Q19A	-11.3	-4.5	-0.2	-10.9	-14.2	-2.1	-5.2	-1.1	2.3
3Q19A	-11.1	-11.1	-1.9	7.8	-15.9	5.1	-14.2	3.9	-3.6
4Q19P	**-13.1**	**-2.2**	**-0.8**	**-3.4**	**-12.1**	**0.1**	**-2.9**	**2.4**	**-2.3**
2019P	**-6.8**	**-4.4**	**0.1**	**-4.7**	**-9.8**	**-1.2**	**-5.5**	**1.7**	**0.0**
1Q20P	5.1	5.5	5.6	8.2	4.1	8.7	4.5	9.4	2.8
2Q20P	9.7	7.4	6.8	6.7	8.0	9.6	6.8	11.9	2.5
3Q20P	19.8	15.8	9.8	9.8	22.6	13.9	16.3	11.8	7.7
4Q20P	25.0	14.2	14.1	20.7	24.0	18.1	13.6	15.6	12.2
2020P	**15.7**	**9.1**	**7.7**	**11.2**	**16.7**	**11.7**	**8.4**	**10.5**	**5.4**

Source: FactSet, FTSE Russell, Standard & Poor's; Jefferies

So, what happens when U.S. stock prices soar while earnings remain flat or decline? At the end of the year, valuation metrics for U.S. stocks had expanded dramatically. The forward P/E of the Russell 2000 (R2K) now sits at 21.5X. This is its highest level since November of 2017. The forward P/E of large cap stocks, as measured by the Russell 1000, has also expanded and now stands at 20.8X. The last time the large cap index was this expensive was back in December of 2001. Other valuation metrics also stand out as being stretched for both large and small cap stocks, as seen in the Jefferies table reproduced below. In fact, small cap stocks stand in the 87th percentile in terms of overall valuation vs history while large cap stocks are in the 95th percentile – certainly nosebleed territory that is begging to be bailed out by higher earnings in 2020.

Exhibit 2:
Absolute Valuations for Russell 2000 and Russell 1000

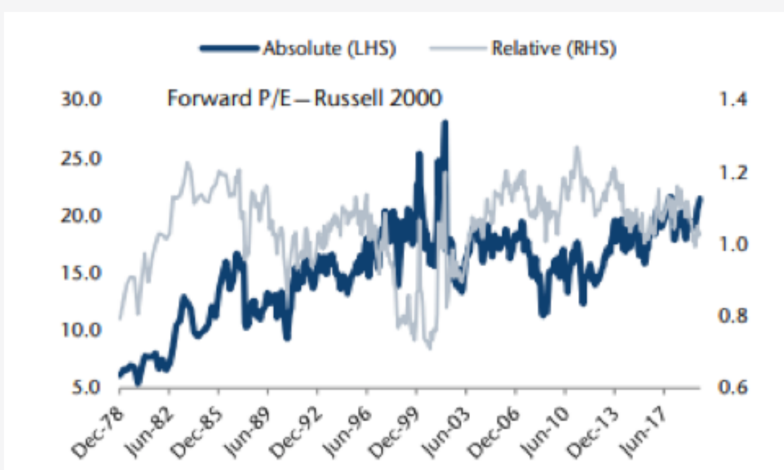
	Russell 2000			Russell 1000		
Valuation Metric	**Current**	**LT Avg**	**% Diff**	**Current**	**LT Avg**	**% Diff**
Trailing P/E (Non Negative)	18.3	17.5	4.4	23.4	17.6	33.0
Forward P/E	21.5	16.0	34.1	20.8	15.5	34.4
Price to Book	2.2	2.0	6.4	3.3	2.7	21.9
Price to Cash Flow*	21.7	16.6	30.9	15.5	12.6	22.8
Price to Sales	2.0	1.1	74.2	2.8	1.5	90.6
P/E to Growth	1.8	1.1	64.1	2.3	1.3	75.5

*Price to cash flow started in 2002. Note: From March 31, 2016 forward Jefferies estimates. Source: FactSet; FTSE Russell; Jefferies

Even though stock returns were uniformly high in 2019, we would be remiss if we did not discuss the relative returns of the various cap ranges of stocks and growth and value styles. As mentioned earlier, small cap stocks did slightly outperform large cap stocks in the fourth quarter, but large cap stocks won handily for the year by approximately 6%. This is the third consecutive year that small cap stocks have underperformed large cap stocks. One might conjecture that this is due to the relatively poor earnings growth exhibited by small companies vs. large companies over the last few years.

On a relative basis, Steve DeSanctis of Jefferies is optimistic that small cap stocks will outperform going forward due to the relative valuation discrepancy between small and large stocks currently and due to the expected better earnings growth of small companies vs. large companies as shown in exhibit 1. On a relative basis we don't disagree, but in absolute terms, our expectations are for low U.S. stock returns over the coming year.

Exhibit 3:
R2000 Now Above 21.5x, but Cheap vs Large



Note: Based on Jefferies estimates as of December 31. Source: FactSet; FTSE Russell; Jefferies

From a style point of view, growth trounced value for the quarter and for the year across all capitalization ranges. In small cap, growth outperformed value by 2.9% in the quarter and 6.1% for the year. Growth has now beaten value in eight of the last 10 years. In mid cap, growth outperformed value by 1.8% in the quarter and 8.4% for the year. And to complete the picture, in large cap, growth outperformed by 3.2% in the quarter and 9.9% for the year.

Exhibit 4:
2019 Growth vs Value

4Q 2019	Value	Blend	Growth
Large	7.4%	9.1%	10.6%
Mid	6.4%	7.1%	8.2%
Small	8.5%	9.9%	11.4%

2019	Value	Blend	Growth
Large	26.5%	31.5%	36.4%
Mid	27.1%	30.5%	35.5%
Small	22.4%	25.5%	28.5%

Source: FactSet, Russell Investment Group, J.P. Morgan Asset Management

In a quarter and year of such high absolute returns, it was sad to see that active managers for the most part, were unable to keep up with their style benchmarks. For the quarter, out of the nine style boxes promulgated by Morningstar, only mid-cap value managers outperformed their style benchmark and by a relatively small margin. In the other eight style boxes, the average active manager underperformed. It was a similar pattern for the year, as only the average small cap growth manager was able to outperform their style index of the R2KG. On balance, in the other eight style boxes the average active manager trailed their respective style indexes. Please see the Jefferies tables below:

Exhibit 5:
In 8 of 9 Lipper Boxes Managers Were Behind Their Benchmarks

	Percentage of managers beating their Index									
		Large			Mid			Small		
	Overall	Core	Growth	Value	Core	Growth	Value	Core	Growth	Value
4Q19	31	36	25	43	37	37	61	15	24	34
2019	**32**	**22**	**19**	**34**	**19**	**33**	**38**	**35**	**54**	**44**

Note: Performance is through December 31.
Source: FactSet; Lipper Analytical Services; FTSE Russell; Jefferies

From a top down point of view as to what worked and didn't work in the R2K in the quarter, it was clear that the fourth quarter was simply a continuation of what had begun in September. Namely, as the perception that trade talks with China were improving, culminating with the announcement that President Trump would sign a deal at the end of December, the market became very risk-on and high-flyers and lower quality stocks ruled the roost during the quarter.

Evidence of this abounded during the quarter per statistics published by Jefferies. Non-earners, as defined by either operating earnings or GAAP earnings, were up dramatically during the fourth quarter, 18.1% and 21.7%, respectively. Stocks in the highest beta quintile were up over 20.7%. The smaller capitalization (stocks below $1B) of the R2K returned 12.8%, while the larger capitalization (stocks above $1B) of the R2K returned 9.2%. The smaller capitalization stocks were helped dramatically by the over $7B of flows into small cap ETFs that started during the fall and continued in the fourth quarter. And finally, those stocks that had no dividends were up 14.4% while low dividend yielding stocks were up 6.3% and those with high dividends were up only 5.5%.

We saw these factors affect sector returns for the quarter also. The preponderance of non-earners and high beta stocks reside in the health care and technology sectors. Accordingly, these two sectors were the best performing sectors, with health care returning 22.3% for the quarter and technology sporting the second-best return at 11.7%. Health care was particularly helped by record-breaking deals in the biotech area during the quarter that drove those industry returns up 30%. More defensive, higher dividend-paying and stable sectors such as utilities, REITs and staples exhibited poor returns of -1.6%, 3.4% and 6.9%, respectively for the quarter.

Up until the month of September and the follow-on performance of the fourth quarter, the year had been a decidedly higher quality rally. However, the risk-on nature of the market from September onward has colored the landscape dramatically and the year has turned out to be a mixed bag from a characteristic point of view with a decidedly lower quality tilt. Non-earners, due to the outsized performance in the fourth quarter, turned out to be great performers for the year – up over 30% vs. the 25.5% of the R2K. However, higher ROE stocks also outperformed (up 28%) but not by the same magnitude. The highest beta stocks turned out to be the best performers, returning over 38%. Larger capitalization stocks managed to outperform slightly as they were up 26.3%. Fourth quarter disparate returns overwhelmed dividend-paying stocks. For the year, those stocks that had no dividends were up 27.6% while low dividend yielding stocks were up 24.8% and those with high dividends were up only 22.1%.

PERFORMANCE REVIEW

As anyone who is familiar with our style of management may have guessed, the fourth quarter environment for our style was less than ideal to say the least and, consequently we underperformed, returning 5.3%, net of fees versus the Russell 2000 Value return of 8.5%.[1]

From a characteristic point of view, what we didn't own outperformed dramatically while what we owned tended to underperform. We always strive to avoid non-earners in our selection process and if they become non-earners, we promptly sell them. Non-earners, of course, returned approximately 20% during the quarter. From a portfolio point of view, we tend to have a lower beta than the market and again the highest beta stocks returned approximately 20%. What we own is a preponderance of higher quality, higher growing, non-high-flyer companies that tend to be slightly larger in size versus the R2KV and pay a typically higher than average dividend. Certainly, higher market caps and dividend paying stocks were the poorer performers this quarter.

Our stock selection was generally quite poor this quarter due to the fact that what we typically avoid buying and holding were the clear winners this quarter. For example, we owned none of the non-earners and lower quality names that dominated and boosted the performance of the health care and technology sectors and consequently those were some of our worst performing sectors from a stock selection point of view. We also exhibited poor stock selection in the

[1]The performance data represents the strategy's composite of small cap value accounts managed by Driehaus Capital Management LLC (DCM) (the composite). These returns are estimated for the period as all underlying accounts have not yet been reconciled. All rates of return include reinvested dividends and other earnings. Net of fee returns reflect the payment of advisory fees and in some instances, other fees and expenses such as administrative and transfer fees while the gross of fee returns do not. Both are net of brokerage commissions charged to the accounts. The performance data shown above represents past performance and does not guarantee future results. Current performance may be lower or higher than the performance data quoted. The performance results for the composite are shown in comparison to an index. The index is not actively managed and does not reflect the deduction of any advisory or other fees and expenses. While the securities comprising the index are not identical to those in the composite, DCM believes this comparison may be useful in evaluating performance.

real estate, industrials, consumer discretionary and energy sectors. Our only sectors of good stock selection were evident in financials and utilities. Sector allocation was not material to our performance this quarter.

For the year, even though the overall environment turned out to be tilted towards lower quality (thanks to the September and onward risk-on dominance) our performance was quite good. We returned 27.9%, net of fees, for the year, which bested both the R2KV return of 22.4% and the R2K return of 25.5% and matched the performance of the R2KG of 28.5%. Given our style of management, we consider outperforming in a dramatically up year like 2019 to be quite the achievement. We are normally more accustomed to outperforming on this type of scale during a downturn.

As opposed to the fourth quarter, stock selection for the year was quite good, as we added value in most sectors including financials, industrials, consumer discretionary, health care, utilities, energy and REITs. Our lone major detraction in stock selection came in the technology sector where we didn't own the non-earners that dominated that sector and boosted its performance. Our sector allocation was an overall neutral factor though we did lose considerable value by being underweight in the best performing technology sector. We offset this by adding value by being underweight in the poor performing energy sector and by being overweight in industrials and health care.

POSITIONING AND OUTLOOK

We repositioned the portfolio quite a bit during the fourth quarter. We increased our exposure to financials by about 6%. After experiencing a reduction in interest rates throughout the year, we took the opportunity to add to our holdings in insurance companies, BDCs and banks, which would benefit if interest rates were to rise from here. We remain underweight in financials, which are an outsized percentage of the R2KV. We also increased our exposure to technology by approximately 3% which brings us equal to the weight within the R2KV.

We reduced our weighting by approximately 2% in consumer discretionary by harvesting some positions that have done well recently and, also some that had run into some operational issues. We remain overweight in this area. We eliminated a position in both communication services and consumer staples, bringing our weights to zero in both sectors and, obviously, we are now underweight here, though the weights in the benchmark are relatively small. We reduced our weighting in energy, as this area remains problematic and subject to extreme volatility. We remain underweight in this sector. We harvested a winning position in materials and are currently equal weight in that sector. And finally, we sold off yet another position in utilities and remain underweight in this sector as valuations are at extremely high levels here.

Looking forward, we are much less bullish than the usual pundits out there. We understand that the Fed has indeed once again provided a backstop to the market, goosing its returns. We also understand that forecasts are for earnings to get off the snide and start increasing, especially in the small cap markets where double-digit earnings gains are forecasted. And certainly, the economy looks to be on an even keel with the support of consumer spending. We acknowledge all of that and more and yet remain cautious. Valuations seemed strained vs. history, though low interest rates can certainly be seen to justify some of the market largesse regarding valuations, but you just can't deny that valuations are absolutely high. We seem priced for perfection at this late date in the cycle and returns, if positive, will likely be lower than the returns of the recent past. We are very satisfied with our process that generates a relatively high dividend yield forming a strong base for what we believe will be relatively low U.S. equity returns in the future. We also take comfort that if there were a downturn due to exogenous events such as impeachment, Middle East conflict or unexpected election results that our performance tends to hold up well during down markets.

PERFORMANCE[1] as of 12/31/19

				Annualized Total Return			
	QTR	YTD	1 Year	3 Year	5 Year	10 Year	Inception 8/1/13
Driehaus Small Cap Value Composite (Gross)	**5.42%**	**28.48%**	**28.48%**	**10.32%**	**11.06%**	----	**12.13%**
Driehaus Small Cap Value Composite (Net)	**5.33%**	**27.87%**	**27.87%**	**9.80%**	**10.59%**	----	**11.70%**
Russell 2000 Value Index	8.49%	22.39%	22.39%	4.77%	6.99%	----	7.75%
Russell 2000 Index	9.94%	25.52%	25.52%	8.59%	8.23%	----	9.06%

Data as of 12/31/19. Preliminary performance data. In US dollars.

Sources: Driehaus Capital Management LLC, Factset Research Systems, Inc., eVestment Alliance

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Per FactSet Research Systems Inc., the attribution report provides an in-depth analysis of relative performance. With this report one can research whether or not a portfolio outperformed a benchmark, and how each group contributed to performance. The performance data shown above is estimated and represents past performance and does not guarantee future results. Current performance may be lower or higher than the performance data quoted. The information presented is intended for informational purposes only.

PORTFOLIO CHARACTERISTICS[1]

	Strategy	R2KV	R2K
Number of Holdings	80	1,402	1,995
Price-to-Earnings[2]	16.8	12.5	15.1
Dividend Yield (%)	2.6	2.1	1.4
Return on Equity (%)	13.8	6.8	5.3
Debt to Total Capital (%)	42.20	44.77	43.23
Weighted Avg. Mkt. Cap ($)	3,800.2	2,182.3	2,466.5

SECTOR WEIGHTS

Month-End Absolute Weights (%)

	Comm. Services	Consumer Discretionary	Consumer Staples	Energy	Financials	Health Care	Industrials	Information Technology	Materials	Real Estate	Utilities	Cash
Strategy	0.0	13.9	0.0	2.6	26.3	6.0	19.1	10.0	4.8	13.2	3.1	1.1
R2KV	2.2	9.7	2.7	5.8	30.2	5.4	12.7	9.7	4.7	11.1	5.9	0.0
R2K	2.3	10.9	3.0	3.2	17.7	18.2	15.8	13.6	3.9	7.8	3.7	0.0

TOP 5 HOLDINGS[2] (as of 11/30/19)

Company	% of Strategy
Marriott Vacations Worldwide Corporation	1.8
Ensign Group, Inc.	1.7
Algonquin Power & Utilities Corp.	1.7
Toro Company	1.6
Chemed Corporation	1.6

Sources: Driehaus Capital Management LLC, Factset Research Systems, Inc., eVestment Alliance
Data as of 12/31/19. Benchmark: Russell 2000® Value Index
[1]Trailing 12-months, excludes negative values.
[2]Holdings subject to change.

Driehaus Capital Management LLC (DCM) is a registered investment adviser with the United States Securities and Exchange Commission (SEC). DCM provides investment advisory services using growth equity, value and credit strategies to individuals, organizations, and institutions. The firm consists of all accounts managed by DCM (the Company). Prior to October 1, 2006, the firm included all accounts for which Driehaus Capital Management (USVI) LLC (DCM USVI) acted as investment adviser. On September 29, 2006, DCM USVI ceased conducting its investment advisory business and withdrew its registration as a registered investment adviser with the SEC. Effective September 30, 2006, DCM USVI retained DCM as investment adviser to these accounts.

DCM claims compliance with the Global Investment Performance Standards (GIPS®).

COMPOSITE OBJECTIVE

The strategy began August 1, 2013 and includes portfolios that seek capital appreciation through the investment in U.S equity securities with above average dividend yields that are fundamentally undervalued, financially strong, and exhibit strong earnings growth and positive earnings momentum. The accounts will invest primarily in small capitalization U.S equity securities, as defined by the market capitalization ranges of generally followed small cap indices at the time of purchase. They may also invest, to a lesser extent, in mid capitalization stocks from time to time. The resultant portfolios will generally be fully invested and diversified by sector and security.

PERFORMANCE

Performance presented occurred while members of the portfolio management team were affiliated with Opus Capital Management ("Opus"). Such members of the portfolio management team were responsible for investment management decisions for the Opus Small Cap Value Plus Composite, renamed as of May 1, 2019, Driehaus Small Cap Value Composite. The decision making process has remained intact and independent within DCM. The performance presented is for those portfolios that were brought over to DCM from Opus. In DCM's opinion, such performance track record conforms to the GIPS standards with respect to the portability of investment performance results, and, as such, all historical performance results from the Opus will be linked to the on-going performance results of the composite. Performance records of Opus are available upon request.

Prior to May 1, 2019, monthly composite returns were calculated using the aggregate return method where all the composite assets and external cashflows are combined as if the composite were one portfolio. Time-weighted account rates of returns were calculated on a monthly basis and allowed for the effect of cash additions and withdrawals using the Modified-Dietz method. Portfolios were revalued for any cashflows in excess of 1% of the market value and at the composite level at 1% of the market value at the beginning of the month. A significant cashflow policy was also employed defined as a cash flow or aggregate of a number of cashflows within a calendar month that exceeds 35% of the market value of the composite at the beginning of the month. Any accounts exceeding this threshold were excluded from the composite during the month it occurred.

From May 1, 2019, monthly composite returns are calculated as the sum of the monthly returns of each account weighted by the account's beginning monthly value as compared to the Composite total. Account rates of return are calculated on a monthly basis by geometrically linking daily returns. Monthly composite returns are geometrically linked to determine annual composite returns.

Net of fee returns reflect the payment of investment advisory fees, custodial and trading expenses while the gross of fee returns do not. The annualized rate of return is presented as the level annual rate which if earned for each year in a multiple-year period, would produce the actual cumulative rate of return over that period.

Returns are computed and stated in US dollars. Leverage is not part of the investment strategy of this composite.

Additional information regarding policies for valuing portfolios, calculating and preparing compliant composite presentations are available on request. A complete listing and description of all composites is also available upon request. Please contact our sales, marketing and relationship management departments at 312-932-8621.

INDICES

The Russell 2000 Value Index (RK2V) measures the performance of the 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 2000 Index (RK2) is an index measuring the performance of approximately 2,000 smallest-cap American companies in the Russell 3000 Index, which is made up of 3,000 of the largest U.S. stocks.