Teton Advisors

KEELEY
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Mid Cap Dividend Value

Fourth Quarter 2021 Commentary

Past performance does not guarantee future results. The performance data quoted represents past performance and current returns may be lower or higher. The investment return and principal will fluctuate so that an investor's portfolio, when liquidated, may be worth less than the original cost/balance. As with any investment, there is a potential risk of loss. Smaller and medium-sized company stocks are more volatile and less liquid than larger, more established company securities.

Performance

For the quarter ended December 31, 2021, the Mid Cap Dividend Value Strategy rose 8.76% gross (8.46% net of fees) compared to the 8.54% increase for the Russell Mid Cap Value Index. For all of 2021, the Strategy advanced 26.56% gross (25.29% net) compared to a 28.34% gain for the benchmark.

Macroeconomic Review

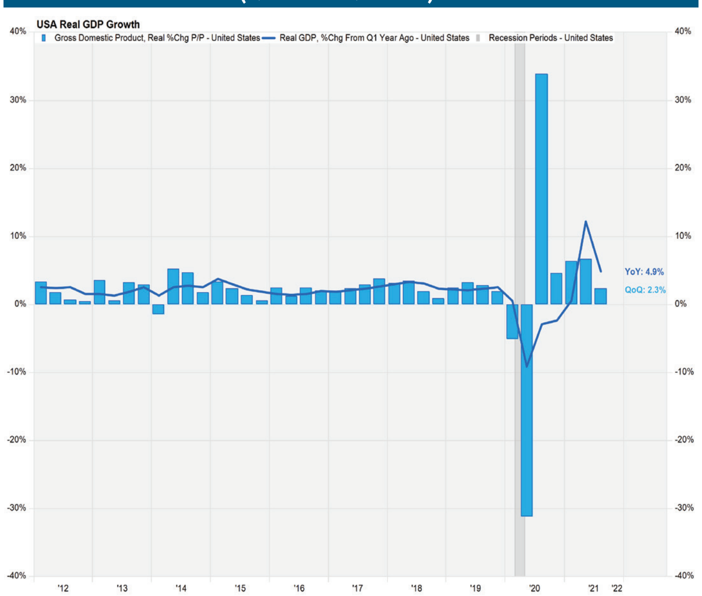
Stock markets around the world experienced strong gains. Among more than 40 major and minor stock markets around the world, we find only five posting a decline. In the US, all the major indices advanced. Large-cap, midcap, and small-cap stocks all rose. Value stocks gained, as did growth stocks. All eleven economic sectors rose at a double-digit pace with Energy leading the pack and Communications Services trailing.

Market Performance

As of December 31, 2021	3 Months	1-Year	3-Year
S&P 500 Index	11.0%	28.7%	26.1%
Russell 3000 Value Index	7.5%	25.4%	17.6%
Russell 3000 Index	9.3%	25.7%	25.8%
Russell 2500 Value Index	6.4%	27.8%	18.3%
Russell Midcap Value Index	8.5%	28.3%	19.6%
Russell 2000 Index	2.1%	14.8%	20.0%
Russell 2000 Value Index	4.4%	28.3%	18.0%
Bloomberg Barclays Agg. Bond Index	0.0%	-1.5%	4.8%

Source: eVestment.

USA Real GDP Growth (Q1 2012 - Q3 2021)



Source: U.S. Bureau of Economic Analysis, Factset. Grey represents recession periods.

The strong rebound in the economy on waning concern about the COVID pandemic and the Federal stimulus continued to drive a snapback in corporate earnings. Earnings for the S&P 500 look like they will increase 55% in 2021 from the 2020's depressed level. This is a full 32% more than what was expected at the beginning of the year. As a result, we actually saw P/E multiples contract despite the strong share-price gains.

The most interesting trend in the US market was the relative performance difference between growth and value across the market cap spectrum. When you look at performance by market cap, you see that large-cap stocks (Russell Top 200) gained 28%, far outpacing the 23% increase in midcaps (Russell MidCap) and the 15% lift in small caps (Russell 2000). By style, the Russell 3000, as well as its growth and value sub-indices all rose 25%-26%. This looks more interesting if you look a little deeper. Indeed, in the Russell Midcap and Russell 2000, value dramatically outperformed growth: 28% vs 13% in midcaps and 28% vs. 3% for small caps. In large caps, however, growth outperformed value, 31% vs. 23%.

Our takeaway from this is that the value rotation that started in the fourth quarter of 2020 seems to be continuing – for most stocks. Focusing on small- and mid-caps, we still find the absolute valuations average and the relative valuations compelling. At year-end, the forward P/E multiple on the Russell 2000 Value Index was 15.9x, slightly below its average since 1999. Midcap value stocks are slightly above their long-term average at 15.7x, but not high in an absolute sense. Relative to their comparative growth indices, they trade at 37% for R2V/R2G and 46% for RMV/RMG compared to long-term averages of 59% and 70%. While value outperformed growth in the smaller market caps by a wide margin in 2021, it appears there is plenty of room left to run. Exactly how the market fares will likely depend on the outcomes to key developments surrounding COVID-19, inflation, interest rates, and valuation.

- COVID-19 – As we write this letter, the Omicron variant has created a surge in cases that has eclipsed prior peaks. Fortunately, this variant appears to be less serious and is infecting a population with higher vaccination rates and better treatments for those becoming ill. With more people becoming infected and more becoming vaccinated, hopefully we will approach the long-awaited herd immunity and life can return to whatever new normal emerges. The potential negative path is that a newer variant comes forth that is more serious. Our view is that the former is more likely than the latter.

- Inflation – Inflation has clearly not been as transient as the Fed had expected it to be earlier in 2021. The rate of change in prices has run at levels not seen in a long time. While we expect the price increases to slow as we anniversary some of 2021's increases, we think that inflation looks more widespread and stickier than some of the surges in prices in the past. Almost every commodity we look at is up double-digit percentages from a year ago and most were up strongly in 2020. Wages are rising at the fastest rate in a long time and the labor market looks undersupplied with job openings near records and quit rates at records. It seems likely that wages will have to rise further to close these gaps. This seems likely to drive both cost-push and demand-pull inflation.

- Interest Rates – Real rates are negative and more negative than they have been in a long time. Even if we assume (as we do) that inflation will slow, real rates are still probably negative. With the Fed signaling that it plans to continue to taper its bond buying and that it expects to begin to raise the Federal Funds rate, rates seem likely to rise. While we do not think that rates will increase a great deal, it is worth noting that they peaked at over 3% in 2018 when inflation and unemployment claims were lower than where they are today.

- Valuation – As we pointed out above, smaller cap stocks and particularly small cap value stocks look attractive relative to larger cap stocks and growth stocks. The stocks that drive the overall market, however, look expensive. The S&P 500 and Russell Top 200 indices trade at 21.1x and 21.9x next twelve months (NTM) earnings. The Russell Top 200 Growth Index trades at 30.0x NTM earnings. The positive is that these are all flat/down from a year ago despite strong stock performance. The negative is that these are all 1.5-1.7 standard deviations above their average since 1999. With 2022 unlikely to see as much strength in upward earnings estimates as we saw in 2021, multiple contraction could weigh on stock performance for these key benchmarks. Regardless of whether it does, we believe that smaller company stocks will outperform. To the extent that money moves out of these larger companies into smaller stocks, the performance of small and mid-caps could be very good. We saw a lot of press stories at the beginning of the year about Apple surpassing $3 trillion in market cap. The market cap of the entire Russell 2000 is only about $3.6 trillion. It would not take much reallocation between the one stock and the 2000 stocks to move those 2000 stocks!

Portfolio Results

The Strategy performed in line with its benchmark, the Russell MidCap Value Index, during the fourth quarter. Interestingly, neither Sector Allocation nor Stock Selection had much impact on relative performance from an aggregate standpoint. Within Sector Allocation a small underweight in the poor-performing Communication Services sector helped a little, while a small underweight in the good-performing Information Technology Sector hurt a little. The neutral result in Stock Selection was the sum of strong results in Materials, Consumer Discretionary, and Energy offset by subpar outcomes in Real Estate, Health Care, Consumer Staples, and Technology. Our emphasis on dividend paying stocks was a slight benefit.

- Stocks in the Materials sector were the best performing for the Strategy and one of the best performing for the benchmark. Strength in the Strategy's holdings was broad-based with six of the Strategy's holdings appreciating more than 19% in the quarter and all generating positive returns. The gains were led by RPM International, a specialty chemicals company, which seems to be managing input cost inflation and raw materials shortages better than many peers and may be turning the corner on these challenges.

- The Strategy's holdings in the Consumer Discretionary sector also performed well by producing double-digit gains in a sector that lagged the 8.5% gain of the Russell MidCap Value Index. As with the Materials sector, strength was broad-based with all nine of the Strategy's positions either flat or up and five of the nine up more than 10%.

- Energy stocks were also good for the Strategy's relative performance. Gains were led by a trio of companies focused on producing oil from the Permian Basin in West Texas, Devon Energy, Diamondback Energy, and Pioneer Natural Resources. All three produced strong third quarter earnings, upped their cash returns to shareholders, and continue to demonstrate the capital discipline that underpins our investment thesis for these stocks despite higher oil prices.

- Interestingly, the Real Estate sector was the strongest of the eleven sectors within the Russell MidCap Value Index. Unfortunately, the Strategy's holdings failed to keep pace with the overall sector as weakness in health care REIT Sabra Health Care and office REIT Hudson Pacific Properties offset strength in other holdings such as Iron Mountain and Brixmor Property Group.

- Health Care was also a challenging sector as the Strategy lost money in a sector that underperformed the overall benchmark. While Chemed, Steris, and Ensign were all bright spots, they were offset by double-digit declines in Perrigo and Encompass Health. These were two of the Strategy's worst performers during the quarter and are discussed later in this report.

- The Consumer Staples sector is a small one within the Russell MidCap Value Index and performed well during the quarter. The Strategy's investments, however, appreciated very little as they seem to have struggled more with input cost inflation than most other companies in the sector.

- The Strategy's holdings in the Information Technology sector failed to keep up with the very strong performance of the sector within the benchmark. While one of the Strategy's best performing investments in the quarter (Jabil Inc., discussed later in this report) helped the Strategy's relative performance, the other four holdings in the sector failed to keep pace and CDK Global actually declined.

During the quarter, the Strategy added one new position and sold one holding.

Leading Contributors

Olin Corporation (OLN) produces chemicals and has a leading position in the important chlorine and caustic soda markets. It has smaller businesses in epoxy resins and small caliber ammunition. Olin's earnings continued to benefit from higher prices for most of its chemical products as it was able to convert an increased amount of index-based contracts with customers to more negotiated prices. During its third quarter results earnings call, Olin allayed concerns about rising natural gas prices (a key input to chlorine and caustic soda manufacturing) as it said higher natural gas prices overseas will help keep imports out of Olin's markets. Subsequent to reporting third quarter results, Olin announced a $1 billion share repurchase authorization which could reduce sharecount (and boost EPS) by about 10%.

Jabil Inc. (JBL) is one of the largest contract manufacturers in the world with 260,000 employees in more than 100 facilities in 30 countries. It manufactures a wide variety of electronic and non-electronic products for customers in many industries. Jabil has performed well over the last year as it has been largely able to meet strong customer demand despite component shortages and work disruption due to the COVID pandemic. The September quarter continued this trend as it reported better than expected earnings and provided fiscal 2022 (ends September) guidance that was ahead of Wall Street expectations. Jabil has historically been a cheap stock (and it still is), but its ability to deliver in a challenging environment has allowed it to become a little less cheap.

Fortune Brands Home & Security (FBHS) is one of the leading manufacturers of plumbing products, cabinets, and doors & security used in repair and remodel (R&R) and new home construction. Fortune Brands continues to post solid results with revenue growth of 20% this quarter driven by its Plumbing segment, which posted a 26% increase in sales during the quarter. Management continues to navigate the inflationary environment well as the company aggressively implemented price increases to offset higher costs. The near-term outlook remains favorable as management raised full year sales guidance on a continuation of the strength in both the R&R and new construction markets.

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Leading Detractors

Perrigo Co. PLC (PRGO) manufactures self-care products and over the counter (OTC) health and wellness solutions. The company is undergoing a transformation that consisted of selling its generic prescription drug business, successfully resolving a large tax dispute, and the announced acquisition of HRA, a leading manufacturer of consumer self-care brands. That transformation process hit a bump in the road this quarter driven by supply chain issues. On its quarterly conference call with investors, CEO Murray Kessler summed the quarter up well stating it was "a punch in the gut" and this was not an understatement. The supply chain issues were mainly freight-related, and the cold/flu season started slowly – both of which weighed on margins. As a result of these issues, management reduced full-year guidance but remains confident that most of the impact of headwinds will be recouped next year. The setup for Perrigo in 2022 is favorable, but management will have to start delivering on its stated goals before the stock moves higher.

Encompass Health (EHC) owns and operates inpatient rehabilitation hospitals and provides home health and hospice services. Encompass lagged in the fourth quarter due to weaker patient volumes from the surge in COVID-19 cases in August, along with wage inflation and staffing challenges. The weakness was especially pronounced in the home health and hospice business which prompted management to lower revenue and profit guidance for the full year. In the fourth quarter, Encompass also announced plans to split the company into two, although the precise structure of the separation has not yet been announced. While this news should have pleased the investment community, the long delays in arriving at the announcement and the still-undetermined form of the separation likely constrained investor enthusiasm for the announcement.

BWX Technologies (BWXT) provides nuclear components and products to the U.S. Navy, Canadian nuclear power markets, and the medical field for use in isotopes along with environmental site restoration services. The company's stock came under pressure in the quarter after posting results that were below consensus expectations driven by COVID-related disruptions domestically and timing of projects and lower government reimbursement in Canada. Despite these challenges, the stock remains attractive as the company is nearing an end to an elevated capital expenditure cycle that supported the growth of the Navy's shipbuilding needs. This should lead to accelerating free cash flow generation that could be used for share repurchases and dividend increases.

Outlook

Overall, the factors likely to influence the market in 2022 are not that different than those that impacted stock prices in 2021. Some are a little more favorable (COVID, valuation), some less favorable (interest rates), and some wildcards or mixed (geopolitics, inflation). Regardless of the outcome, our job is to find stocks where investors undervalue the future and buy those stocks before that changes.

In conclusion, thank you for your investment in the Mid Cap Dividend Value Strategy. We will continue to work hard to justify your confidence and trust.

Mid Cap Dividend Value

Fourth Quarter Contributors and Detractors

Fourth Quarter Contributors

Top Contributors	Total Return (%)	Contribution to Return (%)
Olin Corporation	19.60	0.35
Fortune Brands Home & Security, Inc.	19.84	0.33
Jabil Inc.	20.30	0.30
RPM International Inc.	30.46	0.29
Acuity Brands, Inc.	22.20	0.28

Fourth Quarter Detractors

Largest Detractors	Total Return (%)	Contribution to Return (%)
Perrigo Co. Plc	-17.34	-0.25
Encompass Health Corporation	-12.66	-0.16
BWX Technologies, Inc.	-10.74	-0.13
Discover Financial Services	-5.54	-0.09
Universal Health Services, Inc. Class B	-6.14	-0.08

Source: Factset

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Past performance is no guarantee of future results. As with all investments, there is a risk of loss. Any performance and/or attribution information contained herein are based on a representative account of the specific strategy discussed.

Market Performance presented solely for informational purposes. The S&P 500 Index is designed to act as a barometer for the overall U.S. stock market and consists of 500 stocks that are chosen on the basis of market size, liquidity, and industry grouping. The S&P 500 is a market value weighted index with each stock's weight in the index proportionate to its market value.

The Russell 2000® Value Index is an unmanaged index that measures the performance of the small-cap value segment of the U.S. equity universe and includes those Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values.

The Russell 2000® Index is an unmanaged index that measures the performance of the smallest 2,000 companies by market capitalization of the Russell 3000® Index.

The S&P SmallCap 600® measures the small-cap segment of the U.S. equity market and is unmanaged. The index is designed to track companies that meet specific inclusion criteria to confirm that they are liquid and financially viable.

The S&P MidCap 400® provides investors with a benchmark for mid-sized companies. The index, which is distinct from the large-cap S&P 500®, measures the performance of mid-sized companies reflecting the distinctive risk and return characteristics of this market segment.

The Russell 2500® Value Index is an unmanaged index that measures the performance of the small to mid-cap value segment of the U.S. equity universe and includes those Russell 2500 companies with lower price-to-book ratios and lower forecasted growth values.

The Russell 2500® Index is an unmanaged index that measures the performance of the 2500 smallest companies by market capitalization of the Russell 3000® Index.

The Russell Midcap® Value Index is an unmanaged index that measures the performance of the mid-cap value segment of the U.S. equity universe and includes those Russell Midcap companies with lower price-to-book ratios and lower forecasted growth values.

The Russell Midcap® Index is an unmanaged index that measures the performance of the 800 smallest companies by market capitalization of the Russell 1000® Index.

The Russell 1000® Index is an unmanaged index that measures the performance of the 1,000 largest companies by market capitalization of the Russell 3000® Index.

The Russell 3000® Value Index is an unmanaged index that measures the performance of the broad value segment of the U.S. equity universe and includes those Russell 3000 companies with lower price-to-book ratios and lower forecasted growth values.

The Russell 3000® Index is an unmanaged index that measures the performance of the 3,000 largest U.S. companies by market capitalization.

The Barclays U.S. Aggregate Bond Index is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM passthroughs), ABS, and CMBS.

A direct investment into any of these indices is not possible.

The opinions expressed in this document are those of Keeley Teton Advisors, LLC as of the date indicated and are subject to change without notice and are not intended as recommendations of individual securities.

The net performance numbers shown are for informational purposes only. Management fees are negotiable and a table of standard fees is contained in the Firm's Form ADV Part 2A, which is available at no cost at www.keeleyteton.com.

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