Teton Advisors

KEELEY
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Small-Mid Cap Value

Third Quarter 2018 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 September 30, 2018, the Small-Mid Cap Value Strategy increased 1.09% gross (0.96% net of fees) versus a gain of 2.67% for the Russell 2500 Value Index. Year to date, the Strategy has appreciated 3.96% gross (3.58% net of fees) versus 5.75% for the Russell 2500 Value Index.

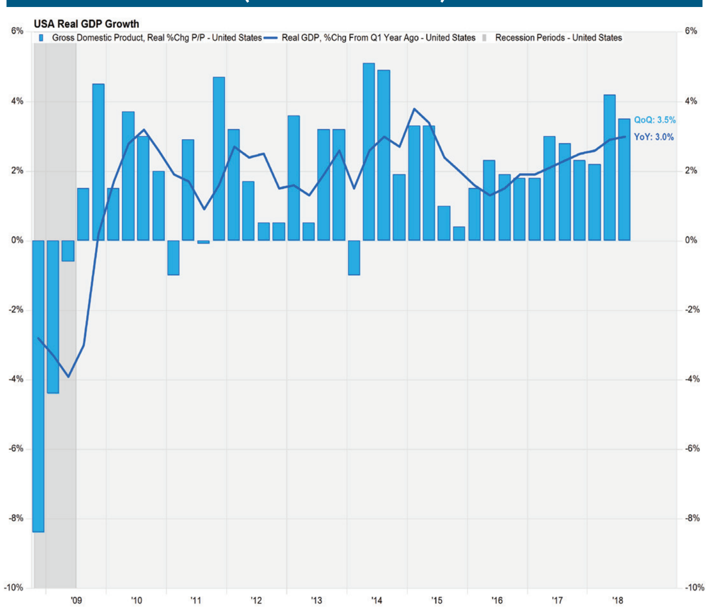
Macroeconomic Review

As we move towards the end of the calendar year, the economy continues to signal domestic strength. Chief among these positive statistics is the unemployment rate, which has declined to 3.7%, the lowest level since the Vietnam War. Yet, despite tight employment conditions where many companies cite talent acquisition as a strategic concern, hourly earnings growth and inflation remain at modest levels, which we believe supports the case that the economy is not overheating. Corporate tax reform has boosted earnings growth and contributed to a general willingness to increase business investment. Likewise, the ISM Non-Manufacturing Index, which also encompasses orders and business activity, marked the highest expansionary reading since mid-2005.

Market Performance

As of September 30, 2018	3 Months	YTD	1-Year
S&P 500 Index	7.7%	10.6%	17.9%
Russell 3000 Value Index	5.4%	4.2%	9.5%
Russell 3000 Index	7.1%	10.6%	17.6%
Russell 2500 Value Index	2.7%	5.7%	10.2%
Russell Midcap Value Index	3.3%	3.1%	8.8%
Russell 2000 Index	3.6%	11.5%	15.2%
Russell 2000 Value Index	1.6%	7.1%	9.3%
Bloomberg Barclays Agg. Bond Index	0.0%	-1.6%	-1.2%

USA Real GDP Growth (Q4 2008 - Q3 2018)



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

Stock indices, however, ended the quarter on the retreat after marking all-time highs earlier this summer. The impact was far more pronounced for small capitalization stocks. Reflecting back to the start of the year, the Trump Administration's opening of a two-front trade war—in China and North America—prompted investors to reallocate towards domestically-focused small caps, which are perceived as more insulated from such matters. We were supportive of the insulation thesis and felt it provided a reason to remain bullish. Yet in the final days of the quarter, the Trump Administration rather quickly resolved the war on one front as NAFTA was restyled the US-Mexico-Canada Agreement (USMCA). Largely perceived by investors and companies as having "dodged a bullet", the new agreement should allow for minimal disruption to existing supply chains and provide reasonable protections, rather than the punitive repudiations implied by earlier rhetoric. With this achievement, and its contemplation as a template for China, small caps lost their perceived competitive advantage over their larger, global brethren. We do remain concerned about the prickly sparring with China, predominantly over trade issues, recognizing both the exposure of technology supply chains and the threat to US consumers through higher price levels. We continue to proactively anticipate potential exposure among our holdings.

A few companies have already preannounced lower than expected results for the third quarter citing slower sales into China, tougher restrictions at Chinese customs, and higher raw material costs. With the US economy continuing to perform well and the Fed maintaining its rate hike path, investors have begun to question, "Can it get any better?" as sales growth slows and margins become squeezed by higher input costs (tariff impact on materials, oil as well as labor). The upcoming mid-term elections also add to this uncertainty, thus extending the environment where valuation metrics have been less relevant, with growth/momentum factors have outperforming value. On this point, the performance between the lowest and highest P/E stocks is the widest it has been since 1999.

In the third quarter, sector allocation was a positive benefit to the Strategy's performance due to our overweight position in the stronger performing Industrials (second best performing sector) and underweight two of the weakest sectors, Financials and Real Estate, although our underweight the best performing sector, Healthcare, was an offset. Strong stock selection within Real Estate led to positive contribution despite this sector being the second worst performing group in the third quarter. Healthcare REITS, Sabra and CareTrust, benefitted from strong execution after repositioning their property portfolios while Lamar posted better than expected second quarter results plus raised full year guidance on a rebound in advertising plus excellent expense control. Positive stock selection with Industrials was driven by a rebound at John Bean Technologies, which posted strong second quarter results proving weaker issues in the first quarter were temporary, as well as continued solid performance from ITT, Esco Technologies and KBR. NRG continues to be a stellar performer on its business transformation driving the Strategy's Utilities outperformance while Energen's takeover by Diamondback Energy led to positive selection in the Energy sector.

Unfortunately, the macro uncertainties of trade, tight labor markets and rising interest rates impacted stock selection within the Consumer Discretionary and Financials sectors. Trade issues have slowed auto sales in China leading to weakness in Visteon and Delphi. Concerns over tighter labor led to margin pressure at restaurants, including Del Taco, and fears of higher rates, despite a flattening yield curve, have punished homebuilder TriPointe Group along with the bank stocks.

Leading Contributors

NRG Energy, Inc. (NRG) is an independent producer of electricity with a portfolio of 44 Gigawatts (GW) of conventional generation and a seller of retail energy in deregulated markets. The company has benefitted from a restructuring of its operations that started over a year ago to reshape the company for better visibility, more stable earnings and higher cashflow. This included selling off non-core assets to reduce debt, simplifying its structure with the sale of an ownership interest in NRG Yield, and other operational improvements to enhance margins. Management appears to be successfully executing its plan which should eventually produce significant cash to be redeployed through accelerated share repurchases.

John Bean Technologies Corporation (JBT) is a technology solutions provider to food, beverage and air transportation industries. Its largest division, FoodTech, designs, manufactures, and services food processing systems for the preparation of meat, seafood and poultry products, ready-to-eat meals, packaged foods, juice, dairy, fruit and vegetable products. AeroTech supplies gate and ground equipment solutions to airlines, airports, the military and defense contractors. The company, which has been successfully consolidating the highly fragmented food prep industry, stumbled posting first quarter results lower than expected due to higher installation costs, weaker product mix and operational inefficiencies at some locations. The company addressed the installation issues and announced a new restructuring program to improve margins by 200 basis points by the end of 2019. Strong second quarter results proved that first quarter issues were temporary, and we believe that the company should continue to be a major beneficiary of rising global middle-class demand for safer foods.

Energen Corporation (EGN) is an oil and gas exploration and production company with assets in the Permian Basin of west Texas. The company became a pure play energy company after selling its Alabama natural gas utility operations. In addition to stronger oil prices in the quarter, Energen announced it agreed to be acquired by Diamondback Energy for a 16% premium back on August 14th. The deal is expected to close in 4Q18.

Leading Detractors

Visteon Corporation (VC) designs, engineers and manufactures one of the broadest automotive cockpit electronics portfolios and is at the epicenter of the connected car revolution. Key products include instrument clusters, infotainment systems as well as autonomous driving systems. The company reported second quarter results that were below analyst expectations and lowered its forecast for the full year due to lower North American production plus a temporary slowdown in Europe which is currently undergoing a change in emissions standards testing. This coupled with negative sentiment toward auto stocks in general amid trade war fears impacting China volumes has led to further stock price weakness. However, we believe that results should improve once the company starts delivering on its high margin backlog of business it has won over the last few years. The company has also been aggressive at buying back shares recently completing a $400 million buyback program and announcing a new Board authorized $500 million buyback program.

Del Taco Restaurants, Inc. (TACO) develops, franchises, owns, and operates Del Taco quick-service Mexican-American restaurants. The stock has been under pressure as investor concern has been focused on labor cost inflation, especially in their California dominated company store base. A second concern has been the negative traffic at company owned stores, which is believed to be the result of a high level of discounting by larger quick serve (QSR) players. Further, delivery has been a strong growth driver for many of their peers and TACO will not have full delivery available to its California store base until late 2018. We expect this will aid traffic going forward, and we continue to believe the company is

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well positioned with its unique "fresh" menu offerings and has ample growth opportunities outside its core West Coast roots.

TRI Pointe Group Inc. (TPH) is a homebuilder that was formed after the economic downturn in 2008-2009 and later merged with the homebuilding operations of Weyerhaeuser via a reverse Morris Trust transaction. The company has a significant land bank of supply constrained, low cost basis, California assets with additional presence in growth markets such as Seattle, Colorado, Las Vegas, Phoenix, Texas and the MidAtlantic region. Despite posting better than expected results, orders were weaker in the second quarter due to the timing of new community openings which are more fourth quarter weighted. Additional macro concerns about higher mortgage rates and worsening affordability have weighed on the company as well as the entire housing sector. We view any slowdown to be related to buyers adjusting to the new environment and continue to believe that TriPointe is in an excellent position for future growth given its strong land bank and low cost real estate assets, which should improve margins and pricing power given its supply constrained markets.

Outlook

As we look to the end of the year 2018 and beyond, we do not think that the recent weakness is the start of a larger decline. That is not to say that a correction may not occur. We simply don't perceive the conditions that could lead to a 40%-50% drop like we saw in the 2000-2003 and 2008-2009 time periods. Our outlook remains balanced. On the positive side, the economy appears to be on solid footing, and this should benefit corporate earnings. On the political side, while there is a lot of noise, the Trump Administration appears to be making some progress on trade and security. On the negative side, some of that progress seems to come in "a one step back and two steps forward" manner. Other concerns include the remarkably easy credit market conditions, the likely impact of higher rates on US government budget deficits, and what we see as slightly elevated valuations for stocks.

In conclusion, we thank you for investing alongside us in the Small-Mid Cap Value Strategy. We will continue to work hard to justify your confidence and trust.

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Third Quarter Contributors and Detractors

Third Quarter Contributors

Top Contributors	Total Return (%)	Contribution to Return (%)
NRG Energy, Inc.	21.94	0.70
John Bean Technologies Corporation	34.32	0.64
Energen Corporation	18.33	0.42
ITT, Inc.	17.47	0.40
ESCO Technologies Inc.	18.10	0.35

Third Quarter Detractors

Largest Detractors	Total Return (%)	Contribution to Return (%)
Visteon Corporation	-28.42	-0.50
Del Taco Restaurants, Inc.	-16.71	-0.35
TRI Pointe Group Inc	-24.21	-0.32
Delphi Technologies Plc	-25.49	-0.28
Delek US Holdings Inc	-15.30	-0.24

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 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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