AMG Managers Skyline Special Equities Fund

COMMENTARY | ASSET CLASS | SMALL CAP

Class N | SKSEX · Class I | SKSIX · Class Z | SKSZX

Skyline Asset Management, L.P.

Average Annual Returns (%)[1] (as of 06/30/20)

	Q2	YTD	1 yr	3 yr	5 yr	10 yr	Since Incpt.
SKSEX (Class N)	26.11	-23.17	-17.02	-5.11	-1.03	9.01	10.42[2]
SKSIX (Class I)	26.18	-23.10	-16.86	-4.96	—	—	-4.21[3]
SKSZX (Class Z)	26.23	-23.06	-16.82	-4.87	—	—	-4.14[3]
Russell 2000® Value Index	18.91	-23.50	-17.48	-4.35	1.26	7.82	—
Russell 2000® Index	25.42	-12.98	-6.63	2.01	4.29	10.50	8.39[2]

SKSEX (Class N) Expense Ratio (Gross/Net)[4]: 1.21%/1.18%
SKSIX (Class I) Expense Ratio (Gross/Net)[4]: 1.05%/1.02%
SKSZX (Class Z) Expense Ratio (Gross/Net)[4]: 0.96%/0.93%

The performance data shown represents past performance. Past performance is no guarantee of future results. Current performance may be lower or higher than the performance data quoted. The investment return and the principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. For performance information through the most recent month end, please call 800.835.3879 or visit our website at amgfunds.com. From time to time the advisor has waived fees or reimbursed expenses, which may have resulted in higher returns.

The **AMG Managers Skyline Special Equities Fund** (Class N) returned 26.11% for the second quarter of 2020, outpacing the 18.91% return for the Russell 2000® Value Index and a 25.42% return for the Russell 2000® Index. For the 12-month period ended June 30, 2020, the Fund returned -17.02%, while the Russell 2000® Value Index returned -17.48% and the Russell 2000® Index returned -6.63%.

Market Review

During the second quarter, equities experienced a sharp rally across sectors and market capitalization ranges. The S&P 500® Index's quarterly gain was the largest in over 20 years, while the Russell 2000® Index's gain was the largest in almost 30 years. Stocks rebounded as investor panic subsided from its heightened first quarter levels.

Uncertainty remains regarding how severely COVID-19 and the efforts to mitigate it will impact the global economy. However, the worst case scenarios contemplated by investors late in the first quarter no longer appear likely. For example, economists were expecting May U.S. unemployment to reach 20%, but the official rate reported was 13.3%. Retail sales also rose at a record pace in May, far exceeding estimates. Measures of U.S. manufacturing and services sectors activity saw steady improvement throughout the quarter as well.

Among small cap stocks, sector performance reflected an economic environment that was better than feared. Economically sensitive sectors such as energy, materials, and consumer discretionary exhibited some of the sharpest rebounds. Defensive sectors like utilities and real estate were among the weaker performers. Health care stocks continued their strong relative performance, driven in large part by biotech stocks. Financials stocks lagged, as the combination of higher loan losses and lower interest rates weighed on bank valuations.

For the first six months of 2020, the Russell 2000® fell -13.0%, the Russell 2000® Value Index fell -23.5%, and the S&P 500 Index fell -3.1%. The strong second quarter rebound was not enough to offset steep first quarter declines, especially among small cap stocks and small cap value stocks in particular.

Health care was the only sector posting positive results in the Russell 2000® Index on a year-to-date basis, and information technology stocks performed relatively well, reflecting investor preference for growth-oriented stocks. Due to the plunge in oil prices, the energy sector was the worst performer year to date. Financials stocks were also poor relative performers for reasons stated above.

Despite their second quarter outperformance, small cap stocks have underperformed year to date, as indicated by the -13.0% decline posted by the Russell 2000® Index and the -3.1% decline registered by the S&P 500 Index. The first half performance extended the trend in place for most of the last three years, which has seen the Russell 2000® Index rise at a 2.0% annual rate and the S&P 500 Index rise 10.7% annually.

Growth stocks outperformed value stocks for the first six months of the year, as indicated by the -3.1% decline for the Russell 2000® Growth Index and the -23.5% decline for the Russell 2000® Value Index. Over the last three years, the small cap growth index has increased 7.9% annually, while the small cap value index has declined at a -4.4% annual rate. Growth stocks' earnings are expected to hold up better as the economy slows than those of their more economically sensitive value counterparts, contributing to their outperformance when investors become

[1] Returns for periods less than one year are not annualized.
[2] Since the inception of the Fund's Class N shares on April 23, 1987.
[3] Since the inception of the Fund's Class I and Z shares on February 24, 2017.
[4] The Fund's Investment Manager has contractually agreed, through at least May 1, 2021, to limit Fund operating expenses. The net expense ratio reflects this limitation, while the gross expense ratio does not. Please refer to the Fund's Prospectus for additional information on the Fund's expenses.

more pessimistic about the economy.

One would have expected value stocks to outperform growth stocks during the second quarter when investors were becoming less pessimistic about the economy, but that was not the case. Although the more cyclical sectors did perform quite well during the quarter, this was offset by the heavy weighting of the poor performing financial, real estate, and utilities sectors in the value index. At the same time, the growth index benefited from the heavy representation of the outperforming heath care sector.

Portfolio Review

The Fund generated a 26.1% return for the second quarter, compared to a 25.4% return for the Russell 2000® Index and an 18.9% return for the Russell 2000® Value Index. Stock gains were broad based and the Fund participated in the gains.

The industrial sector contributed most to the Fund's absolute performance during the second quarter and was a major contributor to its performance relative to its benchmarks as well. Industrial stocks are tied closely to the global economy and rebounded strongly during the second quarter as investors became less pessimistic about the economic outlook.

Several of the Fund's building products companies, including BMC Stock Holdings, Inc., JELD-WEN Holding, Inc., and American Woodmark Corporation, were among the top contributors to the Fund's performance during the quarter. Signs of a rebound in the housing market benefited building products companies. In addition, surveys show that consumers expect to spend more money on home improvements in response to spending a greater amount of time at home due to the coronavirus.

The health care sector detracted most from the Fund's absolute and relative performance during the second quarter. Varex Imaging Corporation, a manufacturer of X-ray components, was the largest detractor to the Fund's performance. Although the company is seeing strong COVID-19 related revenues, it was more than offset by a decline in demand for products used in elective medical procedures, cargo screening, and oil exploration. We believe Varex remains well positioned in its markets and has the potential for significant margin enhancement as demand improves.

For the first six months of 2020, the Fund generated a -23.2% return, compared to a -13.0% return for the Russell 2000® Index and a -23.5% return for the Russell 2000® Value Index.

Skyline's investment process seeks to invest in companies with the best combination of valuation and earnings growth. Companies in sectors considered to have better growth prospects like health care and certain information technology subsectors tend to trade at valuations above what our investment discipline allows. Companies in sectors considered more defensive, like utilities, real estate, and consumer staples, tend not to have the growth characteristics we seek. As a result, Skyline's portfolios are typically heavily invested in sectors more tied to the U.S. economy. This focus on sectors that are more economically sensitive detracted from relative performance during the first quarter and the rebound in the second quarter was not enough to offset those losses.

The consumer discretionary sector posted the smallest year-to-date decline of any sector of the Fund. Winnebago Industries, Inc. and LCI Industries were among the handful of stocks in the Fund that posted stock price gains for the first six months of 2020. Both serve the recreational vehicle market. Demand for RVs has increased, as they provide an attractive alternative to families wishing to vacation but reluctant to fly or stay at hotels due to coronavirus-related concerns. Brunswick Corporation, a supplier of recreational products, also posted a gain for the first half of the year. Demand for Brunswick's marine-related products are strong, as boating is seen as one of the few recreational activities consistent with social-distancing guidelines.

Financials stocks detracted most from the Fund's absolute performance for the first six months of the year. Bank stock prices suffered due to the concerns that loan losses would increase meaningfully as many businesses fail to recover from the impact of coronavirus-related shutdowns. In addition, record low interest rates are expected to have a negative impact on banks' net interest margins. Hancock Whitney Corporation, a Gulfport, Mississippi-based commercial bank, was one of the biggest detractors to the Fund's performance year to date. In addition to the issues facing all banks, Hancock's exposure to the troubled energy sector is higher than its peers.

Outlook

Conducting an internet search for the phrase "disconnect between economy and stock market" generates 5.8 million results. The powerful rebound in stock prices during the second quarter pushed the technology-heavy NASDAQ Index to all-time highs, while the S&P 500 Index ended the quarter within 10% of its all-time high. This occurred as the global economy faced its worst contraction since the great depression. This apparent contradiction has been interpreted by the financial press as evidence that investors are optimistic that the economy will fully recover in relatively short order.

We interpret the data differently. The large cap indexes are dominated by a handful of companies—Alphabet (the parent of Google), Amazon, Apple, Facebook, and Microsoft—which make up 23% of the S&P 500 Index and 36% of the NASDAQ Composite. These stocks are among the biggest beneficiaries of the economic upheaval caused by the coronavirus. In our opinion, their advantages will be less pronounced after the crisis is over as most consumers revert to their pre-pandemic way of life. These stocks are trading at or near their all-time highs. They have seen their stock prices increase 285% over the last five years and trade at 40x forward earnings on average.

In contrast, the Russell 2000® Value Index of small cap value stocks is down -1.3% over the last fie years, remaining nearly 30% below its all-time high recorded in August of 2018, and trades at 16.5x forward earnings. Because of the size and sector representation of the companies that make up the index, the Russell 2000®

Value Index tends to be the most directly impacted by changes in the economic outlook. Its poor absolute and relative performance over the last several years and its relative low valuation, especially when considering that earnings are currently depressed, indicate to us that investors prefer stocks that benefit from the current environment and are not overly optimistic about a rebound in the economy.

The only period when the P/E of Skyline's portfolios has been lower relative to the S&P 500 Index was during the growth stock and internet bubble of the late 1990s. In addition, small cap value stocks tend to have greater earnings growth potential coming out of a recession. In our opinion, once this growth occurs, the wide gap in P/E multiples between large growth stocks and small value stocks will narrow, leading to big outperformance by small cap value stocks.

We believe the stocks in the Fund provide even greater upside than the average small cap value stock. We remain highly confident they have the managements, balance sheets, and market positions to survive the current crisis. In our opinion, they are selling at a deep discount to their long-term earnings potential despite the strong price gains posted in second quarter. On average, they are trading at 12x their pre-pandemic earnings levels. Their solid company-specific earnings growth drivers give us confidence that as the economy improves, they will return to and eventually exceed pre-pandemic earnings levels. This underpins the confidence we have in the long-term outlook for the Fund.

The views expressed represent the opinions of the Skyline Asset Management, L.P., as of June 30, 2020, are not intended as a forecast or guarantee of future results, and are subject to change without notice.

Top Ten Holdings (%)[5] (as of 06/30/20)

Holding	% of Net Assets
Essent Group Ltd	2.33
Aaron's Inc	2.32
Silicon Motion Technology Corp ADR	2.31
SPX Corp	2.24
Gibraltar Industries Inc	2.20
First Busey Corp	2.18
Focus Financial Partners Inc, Class A	2.17
BMC Stock Holdings Inc	2.15
Kemper Corp	2.12
Virtusa Corp	2.10
TOTAL %	22.12

Disclosure

Investors should carefully consider the fund's investment objectives, risks, charges, and expenses before investing. For this and other information, please call 800.835.3879 or download a free prospectus. Read it carefully before investing or sending money.

Past performance is no guarantee of future results.

The Fund is subject to risks associated with investments in small-capitalization companies, such as erratic earnings patterns, competitive conditions, limited earnings history, and a reliance on one or a limited number of products.
Companies that are in similar businesses may be similarly affected by particular economic or market events; to the extent the Fund has substantial holdings within a particular sector, the risks associated with that sector increase.
The Fund invests in value stocks, which may perform differently from the market as a whole and may be undervalued by the market for a long period of time
Market prices of investments held by the Fund may fall rapidly or unpredictably due to a variety of economic or political factors, market conditions, disasters or public health issues, or in response to events that affect particular industries or companies.
Price/earnings (or P/E) ratio is a comparison of the cost of the company's stock and its trailing 12-month earnings per share.

[5] Mention of a specific security should not be considered a recommendation to buy or a solicitation to sell that security. Holdings are subject to change.

The Russell 2000® Value Index is a market-capitalization weighted equity index maintained by the Russell Investment Group and based on the Russell 2000® Index, which measures how U.S. stocks in the small-cap equity value segment perform. Included in the Russell 2000® Value Index are stocks from the Russell 2000® Index with lower price-to-book ratios and lower expected growth rates.
The Russell 2000® Index is a small-cap stock market index of the bottom 2,000 stocks in the Russell 3000® Index. The Russell 2000® is by far the most common benchmark for mutual funds that identify themselves as "small-cap."
The Russell 2000® Growth Index measures the performance of the Russell 2000® companies with higher price-to-book ratios and higher forecasted growth values.
The S&P 500® Index is a capitalization-weighted index of 500 stocks. The S&P 500 Index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.
Unlike the Fund, the indices are unmanaged, are not available for investment, and do not incur expenses.
Any sectors, industries, or securities discussed should not be perceived as investment recommendations. Any securities discussed may no longer be held in the Fund's portfolio. It should not be assumed that any of the securities transactions discussed were or will prove to be profitable, or that the investment recommendations we make in the future will be profitable.
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