AMG River Road Small Cap Value Fund

COMMENTARY | ASSET CLASS | SMALL CAP

Class N | ARSVX   Class I | ARSIX   Class Z | ARZMX

RIVER ROAD ASSET MANAGEMENT®

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

	Q2	YTD	1 yr	3 yr	5 yr	10 yr	Since Incpt.
ARSVX (Class N)	19.73	-19.54	-14.09	0.52	5.27	9.02	6.70[2]
ARSIX (Class I)	19.78	-19.43	-13.80	0.80	5.55	9.29	5.06[3]
ARZMX (Class Z)	19.80	-19.39	-13.82	–	–	–	0.42[4]
Russell 2000® Value Index	18.91	-23.50	-17.48	-4.35	1.26	7.82	4.94[2]

ARSVX (Class N) Expense Ratio (Gross/Net): 1.38%/1.38%
ARSIX (Class I) Expense Ratio (Gross/Net): 1.11%/1.11%
ARZMX (Class Z) Expense Ratio (Gross/Net): 1.03%/1.03%

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 River Road Small Cap Value Fund** (Class N) returned 19.73% for the second quarter of 2020, outpacing the Russell 2000® Value Index, which returned 18.91%. For the 12-month period ended June 30, 2020, the Fund returned -14.09%, compared with the Index return of -17.48%.

Market Overview

Stocks deliver strongest quarterly results in decades

Stocks rebounded sharply in Q2 as investors shifted focus away from the devastation of COVID-19 to progress on reopening, developing therapeutics, the unprecedented level of monetary and fiscal stimulus, and an improving economic outlook. Although the rally hit a speedbump late in the quarter as reported COVID-19 cases began to tick higher, stocks still managed to deliver their best quarterly performance in decades. The S&P 500® Index soared 20.54% in Q2, its best quarter since Q4 1998, while the Russell 2000® returned 25.42%, its best quarter since Q1 1991 and second best on record (since index inception in 1984)!

A steep rebound is interrupted by a resurgence of the virus

From our perspective, the quarter encompassed parts of two distinct phases. The first phase began prior to Q2, at the market low on March 23, and extended through June 8. This early stage recovery phase appears to be a compressed version of a classic bear market rebound, during which the S&P 500 and Russell 2000® returned 45.09% and 53.79%, respectively. In this period, "deep value" (very cheap, lower quality, high beta) stocks performed well, as did cyclical growth stocks. The Russell 2000® Value index experienced greater downside volatility than the Russell 2000® Growth but delivered a similar overall gain, returning +53.05% versus +54.41%.

We believe an important second phase of the recovery began on June 9, triggered by valuation concerns, an exhaustion of appetite for previously depressed low quality/high beta value stocks and, more influentially, fear that a "second wave" of COVID-19 was beginning to materialize. We view this phase as the first meaningful test of the nascent recovery. In the first few days of this period, the S&P 500 dropped -7.11% versus -11.74% for the Russell 2000® Index. The Russell 2000® Value continued to exhibit higher relative downside volatility, declining -14.22%. Stocks staged a partial rebound into quarter end but were unable to regain their prior momentum, especially small cap and value stocks. During this period to date (June 9 through July 9), the S&P 500 declined -2.33% versus -8.85% for the Russell 2000®. The Russell 2000® Value Index declined -15.68% versus just -2.86% for the Russell 2000® Growth.

[1] Returns for periods less than one year are not annualized.
[2] Since the inception of the Fund's Class N shares on June 28, 2005.
[3] Since the inception of the Fund's Class I shares on December 13, 2006.
[4] Since the inception of the Fund's Class Z shares on September 29, 2017.

Value indices lagged growth across all market caps for Q2; however, value factors performed relatively well

Value kept pace with growth early in the quarter but lagged badly during the market pullback. For Q2, the Russell 2000® Value returned 18.91% versus a stunning 30.58% for the Russell 2000® Growth. The surprising aspect of this gap is that valuation factors (as opposed to the style index) did well in Q2. According to Jefferies, the lowest price/earnings (P/E) stocks (first quintile) in the Russell 2000® Index returned 33.01% in Q2 versus 23.68% for the highest. The challenges for the Value index were its heavy weighting in the lagging utilities, financials, and real estate sectors and the strong performance among non-earners in the Growth index, which returned 39.78% in Q2. Within the Russell 2000® Value index, consumer discretionary (+63.58%) and health care (+34.00%) posted the highest total returns, while utilities (-4.84%) and communication services (+9.38%) posted the lowest.

Low quality and high beta dominate in Q2

It was a challenging factor environment for the Portfolio as low quality and high beta factors led the benchmark (and broader market) in Q2. According to Jefferies, the highest return on equity (ROE) stocks in the Russell 2000® Value benchmark (first quintile) returned 25.51% for Q2 versus 38.39% for the lowest ROE (fifth quintile). Additionally, the lowest beta stocks in the Russell 2000® Value benchmark returned -0.39% for Q2 versus a stunning 66.71% for the highest beta. Also, the Portfolio's underexposure to leverage was a modest headwind, with the most leveraged stocks (top half) in the benchmark returning 20.77% versus 16.59% for the lowest (bottom half).

A strong quarter for active small cap value managers

Active small cap value managers delivered excellent results in Q2, with 71% outperforming the Russell 2000® Value Index (according to Jefferies). This lifted the total percentage outperforming year to date to a respectable 57%. Performance was largely driven by underweight positions in the lagging utilities and real estate sectors. Small cap growth managers also did well in Q2 and year to date with 60% and 67% outperforming, respectively. Conversely, core managers struggled with just 28% beating their index in Q2 and 23% year to date.

Performance Review

For Q2, the key drivers of relative performance included a lack of exposure to utilities and an underweight in financials; within financials, an underweight to banks and thrifts & mortgage finance had an especially large impact on results. Positive stock selection within information technology, consumer staples, and financials also contributed to the Fund's relative performance. Outperformance was partially offset by poor stock selection, primarily within the higher beta health care and consumer discretionary sectors.

Year to date, the key drivers of relative performance included an overweight to cash, which had a beginning weight of 9.7% and an average weight of 5.7% but ended the quarter at 6.3%; cash was just 1.4% on March 24, when the market recovery began. Strong stock selection and an underweight allocation within financials and an overweight allocation to consumer staples also contributed positively; within financials, the underweight to banks and thrifts & mortgage finance contributed a total of +236 bps. Outperformance was partially offset by poor stock selection, specifically within information technology, consumer discretionary, and health care.

What worked...

The top contributing holding in the Fund during Q2 was BJ's Wholesale Club Holdings Inc. (BJ, +46%), a warehouse club retailer with more than 200 stores primarily located in the eastern United States. Stay-at-home orders related to the COVID-19 pandemic have caused surging demand for grocery and certain consumer products. BJ reported very strong Q1 results (ended May 2, 2020) despite high expectations. Same-store sales increased 27% excluding fuel prices while cash from membership fee income increased 16%. Gross margin expanded as higher fuel margin more than offset lower merchandise margin, apparel markdowns, and increased distribution costs. Despite higher COVID-19-related expenses, SG&A leverage improved by +50 bps. As a result, EBITDA grew 56% year over year. Free cash flow was a massive $435 million versus just $8 million in the prior year quarter. For context, free cash flow for the full fiscal years 2019 and 2018 combined was $439 million. However, changes in working capital should reverse some of the Q1 2020 free cash flow gains in the following quarters. BJ is also playing offense by adding new vendor relationships and pursuing attractive real estate opportunities during this period of economic stress. We maintained the position during the quarter.

Another top contributor during the quarter was Cannae Holdings Inc. (CNNE, +23%), which owns a 19% stake in commercial data and analytics provider Dun & Bradstreet (DNB), an 11% stake in publicly traded HR software and services firm Ceridian (CDAY), as well as interests in life/health/retirement solutions marketer AmeriLife, restaurant brands (O'Charley's, 99), and two special-purpose acquisition companies. The stock marched steadily higher as management executed a series of transactions in the second quarter, including additional monetization of Cannae's stake in Ceridian for more than $230 million in gross proceeds, investing $225 million in two newly formed Bill Foley-led Special Purpose Acquisition Companies (SPACs), and completing a secondary offering of Cannae shares worth more than $400 million. Shortly after quarter end, CNNE launched the successful IPO of Dun & Bradstreet Holdings Inc. (DNB) and partnered with Senator Investment Group in a $4.4 billion hostile takeover bid for property analytics firm CoreLogic (CLGX). We reduced the position during the quarter.

Another positive contributor was Insperity Inc. (NSP, +75%), a professional employment organization (PEO) that provides value-added, full-service human resources to small and medium-sized businesses (SMBs). We initiated the position earlier in the year when elevated medical claims and COVID-19-related job losses caused negative sentiment for the industry and the stock. However, NSP's Q1 results were strong and supported our expectation for resilient pricing and lower insurance costs. The Paycheck Protection Program and sharp employment rebound also aided NSP. We continue to believe Insperity remains relatively protected from reduced SMB payrolls given its tilt toward white collar workers and lower share of leisure and hospitality jobs. We maintained the position during the quarter.

What didn't work...

The largest negative contributing holding in Q2 was Liberty Latin America Ltd. (Cl C) (LILAK, -8%), a provider of broadband, TV, fixed voice, and mobile services in Chile, Puerto Rico, Costa Rica, and the Caribbean. The company continued to grow broadband, video, and mobile subscribers organically, which drove constant currency EBITDA (earnings before interest, taxes, depreciation, and amortization) improvement of 4% year over year. However, Chilean peso depreciation relative to the U.S. dollar caused reported EBITDA to decline -1% year over year. Fears related to the company's leverage level (3.8x at quarter end) and exposure to markets reliant on tourism likely weighed on the stock as well. However, the company still expects to generate positive free cash flow in 2020. The CEO bought $100,000 of LILAK at the end of March and another $100,000 in mid-May. Additionally, the company repurchased a modest amount of stock in March and into Q2 (despite elevated leverage) which suggests management views the share price as highly attractive. The position was maintained as the stock continued to trade at a large discount to our assessed value.

Another poor performer was GrafTech International Ltd. (EAF, -2%), a manufacturer of graphite electrodes which are used for making steel in electric arc furnaces. During the quarter, COVID-19 caused global steel demand to fall, which pushed some of EAF's customers to claim force majeure and attempt to back out of 2020 contracted volume commitments. EAF's contracts explicitly state any volumes lost due to force majeure are tacked onto the end of the contract period. However, this will delay free cash flow collection which lowers the NPV of the cash flow stream. Nonetheless, EAF still generated free cash flow of $125 million during the quarter, which represented 6% of the June 30 market cap. Even if some of the contracted volumes are delayed or even lost due to customer bankruptcies, the contracts should position EAF to generate strong free cash flow through at least 2022. However, the capital allocation framework was changed. Instead of 50%–60% of free cash flow going toward buybacks and dividends, the primary use going forward will be debt paydown. The position was maintained as the stock continued to trade at a large discount to our assessed value.

Another bottom contributor during the quarter was Viad Corp. (VVI, -10%), a small conglomerate with an exhibition/conference services segment (GES) and a travel/hotel/attractions segment (Pursuit). Both of Viad's business segments are directly impacted by COVID-19. GES continues to experience conference and event cancellations and deferrals while Pursuit remains challenged by declines in tourism from the United States-Canada border closure as we move into the important summer season. Moreover, management continues to hold discussions with its lenders about covenant waivers beyond the recently completed quarter. Even with a waiver extension, Viad will likely raise capital to protect against a potentially prolonged period of negative free cash flow. Although visibility for a rebound at GES remains exceptionally murky, we are encouraged by management's ability to dramatically reduce variable costs, essentially placing the segment in "hibernation" until demand returns. We were also encouraged that Pursuit net bookings (booking minus cancellations) turned positive for some of its properties in early May. Accordingly, we believe any capital raise might be smaller and less punitive than the market is pricing into the stock. As noted in last quarter's commentary, while we recognize it could take longer for the GES segment to fully rebound, we believe Pursuit's collection of valuable assets in and around North American national parks is well positioned for a strong rebound during the 2021 high season, especially if consumers favor road travel over air travel. We took no action on the position during the quarter.

Activity and Positioning

In total, four new positions were established during Q2 and ten were eliminated. New positions established in Q2 include global coating systems manufacturer Axalta Coating Systems Ltd. (AXTA, $4.1 billion, 3.0 conviction), asset tracking solutions provider ORBCOMM Inc. (ORBC, $191 million, 3.0), information technology services and solutions provider DXC Technology Co. (DXC, $4.6 billion, 4.0), and technology solutions developer/distributor ePlus Inc. (PLUS, $954 million, 2.5). The large number of positions eliminated was mostly the result of exiting positions we began trimming in late Q1. Except for one holding (FG, takeover), all the positions exited were due to declining fundamentals, unrealized losses, or both. Positions exited during the quarter include the following tickers (convictions at time of sale are noted in parenthesis): BH.A (3.5), MPAA (3.5), MSGN (3.0), PICO (4.0), RGP (3.0), ATI (3.0), FG (3.0, takeover), MOD (4.0), SIX (3.5), and REZI (4.0).

Trading around existing positions remained relatively modest during Q2 with only 9 positions strategically increased (net) and 11 decreased (net). The two largest net increases (conviction noted in parenthesis) were Axis Capital Holdings Ltd. (AXS, 3.0) and US Ecology Inc. (ECOL, 3.0). The two largest net decreases were both trimmed as a result of approaching their assessed values and include Cannae Holdings Inc. (CNNE, 1.5) and Murphy USA Inc. (MUSA, 2.0). As of June 30, the Fund held 62 positions, a decrease from the 69 held at the end of Q1. Cash in the Fund was 6.3% versus 1.7% at the end of Q1.

New purchase...

The largest new position added during the quarter was ePlus Inc. (PLUS). ePlus is a value-added reseller (VAR) that integrates and develops technology solutions for its customers' cloud, data center, security, and infrastructure needs. Its customer base of medium- and enterprise-sized businesses is well diversified and includes attractive end markets such as technology, telecom, media/entertainment, state and local government, education, healthcare, and financial services. The company also has deep strategic relationships with suppliers including Cisco Systems, Hewlett Packard, NetApp, VMWare, EMC, Microsoft, and Oracle. Founded in 1990, ePlus is based in Herndon, VA. Mark Marron (59), a 15-year ePlus veteran, took over as CEO in August 2016.

While small by market capitalization standards, ePlus is a top-10 player in the fragmented and growing ~$200 billion VAR channel. We believe PLUS has sufficient scale and expertise to continue to take market share as IT ecosystems grow increasingly large and complex due to the emergence of cloud computing, the need for improved security of mobile devices on company networks, and the threat of cyber attacks. Heavy investment in certifications, customer facing personnel, and managed service centers has allowed ePlus to grow its higher margin service businesses by providing integrated end-to-end customer consulting and solutions that generate sticky customer relationships and recurring revenue. Service revenue now runs roughly 12% of total revenue and is growing rapidly (+30% in FY 2020, 26% four-year CAGR).

Management has demonstrated a strong operating and capital allocation track record as top-line and margin execution, internal investment, and strategic M&A have combined to drive ROIC from high single digits to the mid-teen percentage range over the past eight years. Over the same timeframe, the company has repurchased nearly 2.8 million shares for $162 million (~$58 per share average), reducing shares outstanding by -11%. With more than $50 million of net cash on the balance sheet, we believe PLUS is well positioned to continue to invest for growth, both internally and through consolidation of the fragmented VAR industry.

The primary risk for the investment is weak IT spending. Furthermore, variances in shipments, revenue recognition, and business mix introduce occasional lumpiness in quarterly results with accompanying stock volatility. Fears that COVID-19 disruption would compress IT spending sent the shares sharply lower in March, but quarterly results announced in May surprised investors with revenue growth and margin expansion. ePlus's relatively low exposure to small businesses and the hardest hit retail, leisure, and hospitality verticals provides a degree of downside protection.

Using a 10x multiple on fiscal 2022 estimated EBITDA plus net cash, PLUS was trading at a 27% discount to our assessed value and had a conviction of 2.5 at the time of initial purchase. The company is followed by River Road Senior Equity Research Analyst Jeffrey B. Hoskins, CFA.

Outlook

A general sense of uneasiness...

Each quarter we plow through stacks of research and portfolio analysis in order to develop, confirm, and articulate our thoughts about the expected performance of small cap stocks. Typically, the narrative is derived from an alignment of data, insights, and intuition associated with experience and a model focused on five key market drivers: 1) valuations/earnings; 2) monetary policy/credit trends; 3) fiscal policy/Washington; 4) CEO/investor sentiment; and 5) any "wildcard" factors we believe may significantly impact equity returns in the months or year ahead. Although our primary focus and success as investors is centered on picking winning stocks, our views about the macro environment can have an impact on our stock valuations, conviction assessments, and individual positioning. Given our experience as portfolio managers and market observers, we typically emerge from this exercise with a reasonably confident perspective on markets. Unfortunately, that is not the case this quarter.

After too many hours at the computer, we have a knot in our gut indicating something is off. We believe our uneasiness is the result of conflicting observations, such as an attractive portfolio discount to assessed value juxtaposed with obscene market valuations, and the dire state of the economy (albeit improved) contrasted with broad indices like the S&P 500 approaching all-time highs. Or maybe it is just quarantine-induced cabin fever. Whatever the cause, such uneasiness is rarely followed by a tame market.

Recovery hits a speedbump, dangerously concentrating leadership; memories of 1999–2000

As the past few weeks have shown, it is difficult to predict the path of the virus and, thus, the trajectory of the economic recovery. Although U.S. fatalities remain well below the peak, 34 states have recently shown an acceleration in positive cases of COVID-19, resulting in at least 10 states pausing their reopening plans. Six additional states recently closed indoor venues. The impact from these backsteps is showing up in a variety of high frequency economic data from affected areas, such as decreased credit card spending and fewer restaurant bookings. We suspect by the end of July, as these reversals become more pervasive, negative trends will become evident in broader economic data.

It is also difficult to predict the path of markets when the greatest health crisis in the past century triggers the steepest recession since the Great Depression, but is combatted with the greatest wave of monetary and fiscal stimulus in the history of mankind. During April and May, the market recovery appeared to be a classic, albeit robust, rebound led by the usual post-recession factors, including small cap, deep value, lower quality, cyclical, and high beta. However, since the number of COVID-19 cases began to tick up in June, market leadership has become increasingly narrow, in our view contributing to a dangerous concentration risk within the large cap indices. Today, the five largest tech/growth stocks (MSFT, AAPL, AMZN, FB, and GOOG/GOOGL) in the S&P 500 now account for a record 22% of the index—bigger than the five smallest sectors combined. Similarly, the largest 20 names in the Russell 1000® now represent 32% of the index, only slightly below the 35% peak experienced in 2000. The weighted average market cap of the Russell 1000® recently hit an all-time high of 168x the Russell 2000®. The average since 1986 is just 67x. This leaves us feeling uneasy.

However, before rushing into small caps based on a reversion to the mean, consider that non-earners in the Russell 2000® and Russell 2000® Growth indices are now at their highest weight ever. According to Leuthold Research, 38% of small caps were reporting trailing-year losses PRIOR to COVID-19. Additionally, leverage is at an all-time high among small caps, high yield issuance hit an all-time high in June, and spreads are beginning to widen. This also leaves us feeling uneasy. It is also why we believe now is a good time to invest in small caps but would avoid the low quality indices in favor of a more concentrated portfolio of higher quality small cap companies with better balance sheets, trading at reasonable valuations.

For those who managed capital in the late 1990s this should sound familiar, particularly since it was the last time the gap between growth and value was this wide. Unfortunately, gaps like the current one rarely close when stocks are going up. Hopefully, any meaningful correction sets the stage for a broad, sustainable recovery. If so, we believe high quality small cap value stocks should be well positioned, just as they were in the early 2000s.

Fund valuations are attractive, but we are less confident than usual in our assumptions

At quarter end, the discount to assessed value for the Fund's top 20 holdings was 76%, which is attractively centered around the midpoint of the historical 65%–85% range. However, our confidence in (and enthusiasm for) this figure is tempered by a lack of confidence in our underlying assumptions. This remains one of the most opaque forecasting environments in our collective careers. Our confidence has improved relative to last quarter, but only modestly as guidance from management teams remains very limited and the path of the recovery so uncertain. Our bullishness is further tempered by the relatively high multiples being used to calculate our discount to value, which at an average of 9.7x remain near their historical peak. This is not the level from which a new, sustainable cycle typically begins. (Again, an uneasy feeling.)

Earnings outlook remains grim

From an earnings perspective, the outlook remains pretty dim for small caps with consensus expectations down -55% for 2020 versus an estimated -22% for large caps. A decline of -55% would be nearly twice as bad as the decline experienced in 2009. On a positive note, these figures have been slowly improving. Perhaps a better comparison is 2021 consensus estimates versus 2019 actual, which still show small cap earnings down -16.5% (-7.3% ex energy) versus -0.6% (+1.8% ex energy) for large cap. According to Jonathan Golub, Chief U.S. Equity Strategist at Credit Suisse Securities, there have been 13 recessions since 1935 and, on average, it has taken two and a half years to regain a prior peak in trailing 12-month EPS.

Core valuations look very expensive; value appears relatively well positioned!

With stocks soaring and earnings depressed, nearly every traditional valuation measure for small caps (and the broader market) appears richly priced, which is a significant and negative change from the end of Q1. According to Steven DeSanctis at Jefferies, the Russell 2000® is currently trading at a forward P/E ratio of 25.1x, up from 21.5x at year end and the longer-term average of 16.1x. Current valuations are also well above the 11.6x experienced coming out of the Great Recession and the average of 13.8x coming out of small cap bear markets since 1987. Even the small cap bear market in 2016 saw a forward P/E of 15.8x. Fortunately, the Russell 2000® Value appears relatively well positioned, trading at just 17.0x versus a long-term average of 13.7x. Granted, forward expectations are distorted by the sharp contraction expected in Q2 earnings and it is difficult to determine an appropriate multiple when liquidity is abundant and rates are hovering just above the zero bound. Regardless, valuations seem terribly high for the core and growth indices to be starting a new and sustainable market cycle.

Fed and Treasury commit to 'whatever it takes'...

Last quarter, we described the U.S. Federal Reserve's (the Fed's) reaction to the COVID-19 pandemic as decisive and unprecedented. While borrowing a few pages from the 2008 playbook, the Fed went all in by cutting the federal funds rate to 0%; providing term repo funding on a massive scale; and launching what can effectively be called unlimited QE, buying everything from munis to investment grade corporate credit and, more recently, high yield bond ETFs. The Fed's Main Street Lending program was only a moderate success, but this is because the low interest loans were not forgivable as they were under the

Payroll Protection Program (PPP). Since the end of Q1, the Federal Open Market Committee (FOMC) has committed to keeping rates near 0% through at least 2021 and has flattened the yield curve. Quite simply, the Fed's actions provide half the explanation for why the economy stabilized so quickly and are the key driver of the stock market's astonishing rebound.

Round two from Washington

While the Fed's actions contributed greatly to stabilizing liquidity in financial markets, Congress stole the show with the Coronavirus Aid, Relief, and Economic Security (CARES) Act, which was equivalent to nearly 9% of GDP and got money into the hands of consumers quickly. CARES filled in the gaps and calmed consumer fears in a way the Fed could not accomplish. However, with unemployment lingering in the low double digits, PPP funds largely exhausted, and the expiration of enhanced employment benefits later this month, the continuing recovery likely depends on a second major round of stimulus. In May, the House passed a $3 trillion stimulus package. Even if modified in the Senate, a package will likely be required to boost employment going forward.

Tremendous uncertainty headed into fall

Although the recession may have ended in Q2, investors would be wise to temper their expectations of a V-shaped economic recovery. While the economy is improving as evidenced by the rebound in manufacturing and non-manufacturing data in June, the situation remains grim. Even if real GDP increases 20% quarter over quarter in Q3, it will be no higher than it was five years ago. Additionally, while continuing unemployment claims have plunged from 25 million to 18 million, they remain 10x higher than they were before COVID-19. Further, behaviors following the pandemic are likely to change. For households, we expect more savings. For corporations, we expect less business travel, more work-from-home arrangements, fewer buybacks and dividends, and higher medical benefit costs. There is also the risk of higher corporate taxes. Thus, while the deepest recession since the Depression may prove to be the shortest, we believe a full economic recovery is likely years away.

From a market perspective, we expressed our belief in April the market had rebounded too far, too fast—even if March 23 was sustained as the bear market low. We continue to believe this and look for a modest correction later this year. Last quarter, we pointed out there have been eight prior >15% drops for the S&P 500 since WWII; the index closed higher the following quarter seven out of eight times with an average gain of 5%; higher in the next two quarters by an average of 13%; and, finally, higher in the next year seven out of eight times by an average of 17%. With the S&P 500 returning 20% in Q2, the market could give back a lot over the next two quarters (or even years) and remain well ahead of the historical average return coming out of a major correction.

Lastly, the market is clearly assuming a vaccine will be developed and become widely available by 2021. This appears to be a reasonable assumption. However, there is some risk the vaccine is delayed or comes with serious side effects for a significant portion of the population. In our view, investors would be wise to not entirely dismiss this possibility.

Balance remains critical in this highly uncertain market

In the Fund, we are still seeking to maintain a balance between more defensive, stable companies and those with greater risk but more upside potential as the economy fully recovers. Despite recent gains, we believe the outcome remains a remarkably attractive balance of quality, growth, AND value in the Fund. According to FactSet, the Fund's quality, as measured by five-year average return on equity (ROE), is 10.4% versus 6.5% for the benchmark. The Fund's expected long-term growth (as measured by published long-term estimates) is a healthy 9.2% versus 7.1%. Finally, the Fund's valuation (as measured by our primary metric, EV/EBITDA) is less than the benchmark, at 7.7x versus 8.0x.[5]

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

[5] FactSet's calculation of EV/EBITDA is based on last reported EV and, thus, is subject to a lag effect. We consider the relative relationship of these figures to be an accurate portrayal of current conditions but, given the extreme move in markets during Q2, do not consider these figures to be an accurate portrayal of absolute valuations at the end of Q2.

Class N | ARSVX Class I | ARSIX Class Z | ARZMX

Top Ten Holdings (%)[6] (as of 06/30/20)

Holding	% of Net Assets
Cannae Holdings Inc	5.19
Air Transport Services Group Inc	4.19
Premier Inc, Class A	3.76
BJ's Wholesale Club Holdings Inc	3.71
UniFirst Corp	3.20
Hostess Brands Inc, Class A	3.07
Argan Inc	2.79
Cubic Corp	2.61
White Mountains Insurance Group Ltd	2.53
Computer Services Inc	2.51
TOTAL %	33.56

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.

The Fund is subject to risks associated with investments in mid-capitalization companies such as greater price volatility, lower trading volume, and less liquidity than the stocks of larger, more established companies.

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.

The Fund is subject to special risk considerations similar to those associated with the direct ownership of real estate. Real estate valuations may be subject to factors such as changing general and local economic, financial, competitive, and environmental conditions.

Investments in international securities are subject to certain risks of overseas investing including currency fluctuations and changes in political and economic conditions, which could result in significant market fluctuations.

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.

Beta measures the relationship between the portfolio's excess return over T-bills (representing a risk-free rate) relative to the excess return of the portfolio's benchmark. A low beta does not imply that the portfolio has a low level of volatility; rather, a low beta means that the portfolio's market-related risk is low. Beta is often referred to as systematic risk.

Price/earnings (or P/E) ratio is a comparison of the company's closing stock price and its trailing 12-month earnings per share.

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.

ROE is the percentage a company earns on its total equity in a given year. A common way to calculate this ratio is to divide debt-free net income by average total equity. ROE shows how much profit a company generates on the money shareholders have invested in the firm.

The Russell 2000® Value Index is an unmanaged, market-value weighted, value-oriented index comprised of small stocks that have relatively low price-to-book ratios and lower forecasted growth values.

The Russell 2000® Index is composed of the 2000 smallest stocks in the Russell 3000® Index and is widely regarded in the industry as the premier measure of small-cap stock performance.

The Russell 2000® Growth Index measures the performance of the Russell 2000® companies with higher price-to-book ratios and higher forecasted growth values. Unlike the Fund, the Russell 2000® Growth Index is unmanaged, is not available for investment and does not incur expenses.

The Russell 1000® Index measures the performance of approximately 1,000 of the largest securities based on a combination of their market cap and current index membership. The Russell 1000® represents approximately 92% of the U.S. market. Unlike the Fund, the Russell 1000® Index is unmanaged, is not available for investment and does not incur expenses.

[6] 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 Chicago Board Options Exchange (CBOE) Volatility Index® (VIX®) shows the market's expectation of 30-day volatility. It is constructed using the implied volatilities of a wide range of S&P 500 Index options. This volatility is meant to be forward looking and is calculated from both calls and puts. The VIX is a widely used measure of market risk and is often referred to as the "investor fear gauge."

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.

The MSCI EAFE Index (Europe, Australasia, Far East) is a free-float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. & Canada. Please go to msci.com for the most current list of countries represented by the index.

The MSCI Emerging Markets Index is a free-float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. Please go to msci.com for the most current list of countries represented by the index.

Unlike the Fund, the Indices are unmanaged, are not available for investment, and do not incur expenses.

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