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 (%)[1,2] (as of 12/31/17)

	QTD	YTD	1 yr	3 yr	5 yr	10 yr	Since Incpt.
SKSEX (Class N)	0.91	8.39	8.39	7.30	14.27	10.13	1213[3]
SKSIX (Class I)	0.91	—	—	—	—	—	7.73[4]
SKSZX (Class Z)	0.97	—	—	—	—	—	7.78[4]
Russell 2000® Value Index	2.05	7.84	7.84	9.55	13.01	8.17	—
Russell 2000® Index	3.34	14.65	14.65	9.96	14.12	8.71	9.21[3]

SKSEX (Class N) Expense Ratio (Gross/Net)[5]: 1.19%/1.18%
SKSIX (Class I) Expense Ratio (Gross/Net)[5]: 1.04%/1.03%
SKSZX (Class Z) Expense Ratio (Gross/Net)[5]: 0.94%/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) generated a 0.91% return for the fourth quarter of 2017, compared with a 3.34% return for the Russell 2000® Index and a 2.05% return for the Russell 2000® Value Index. For the 12-month period ended December 31, 2017, the Fund returned 8.39%, while the Russell 2000® Index returned 14.65% and the Russell 2000® Value Index returned 7.84%.

Overview

During the fourth quarter, economically sensitive sectors performed best, while gains were more broad-based for the full year. The Fund underperformed both of its indexes due primarily to unfavorable stock selection. For the full year, the Fund underperformed the Russell 2000® Index due primarily to a lack of exposure to the high growth/high valuation stocks that drove much of the index's performance in 2017. The Fund outperformed the Russell 2000® Value Index for the full year due to advantageous sector allocation.

[1] Returns for periods less than one year are not annualized.
[2] Prior to February 27, 2017, the Fund's N shares were known as S shares.
[3] Since the inception of the Fund's Class N shares on April 23, 1987.
[4] Since the inception of the Fund's Class I and Z shares on February 24, 2017.
[5] The Fund's Investment Manager has contractually agreed, through at least May 1, 2019, 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.

The near-term outlook for earnings is positive given a favorable global economic backdrop and the expected benefits of corporate tax reform. However, valuations remain toward the high end of their historical ranges, leaving little downside protection in case of disappointments.

Market Review

Stocks rose during the fourth quarter, as indicated by the Russell 2000® Index's 3.3% increase, the 2.1% return generated by the Russell 2000® Value Index, and the S&P 500® Index's 6.6% increase. The solid fourth quarter performance helped drive gains for the year of 14.7% for the Russell 2000® Index, 7.8% for the Russell 2000® Value Index, and 21.8% for the S&P 500 Index.

Stocks responded favorably to an improving backdrop for earnings growth. Economies throughout the world are showing signs of acceleration. In the U.S., gross domestic product (GDP) grew at 3.3% during the third quarter,[6] its strongest showing in 3 years, and the Atlanta Federal Reserve's GDP model is projecting similar growth for the fourth quarter. U.S. manufacturing is strong, as indicated by September's ISM manufacturing purchasing managers index (M-PMI) reaching its highest level since 2004.[7] Outside the U.S., all 45 countries tracked by the Organisation for Economic Co-operation and Development (OECD) are expected to expand in 2017, something that has occurred rarely over the last 50 years and most recently a decade ago.[8]

Stocks also reacted positively as investors began to factor in the benefits of a decline in the statutory U.S. corporate tax rate to 21% from 35%. Not all of that benefit is likely to be reinvested by companies or competed away, providing a boost to earnings in 2018 and beyond.

During the fourth quarter, the positive outlook for global GDP led to strong performance by economically sensitive sectors such as energy, consumer discretionary, industrials and materials. More defensive sectors like real estate and utilities lagged during the quarter. Most sectors performed well for all of 2017, with health care and industrials particularly strong. Energy stocks were among the worst performers for the year, despite oil ending the year above $60 per barrel, the highest level in over two years.

Small cap growth stocks significantly outperformed small cap value stocks for both the fourth quarter and full year 2017. For the fourth quarter and full year the Russell 2000® Growth Index was up 4.6% and 22.2%, respectively, while the Russell 2000® Value Index was up a more modest 2.1% and 7.8%. Growth stocks outperformed their more value-oriented counterparts across most sectors during both time periods. Heavier weightings in the strong performing industrials, health care and information technology sectors also helped the growth index's year-to-date returns relative to the value index.

Large cap stocks outperformed small cap stocks during the fourth quarter and full year 2017. The Russell 2000® Index was up 3.3% for the quarter

[6] U.S. Bureau of Economic Analysis
[7] Institute for Supply Management
[8] Organisation for Economic Co-operation and Development (OECD)

and 14.7% for the year, while the S&P 500 Index rose 6.6% and 21.8% over the same time frames. Large companies grew their earnings faster than small companies, in part due to their greater percentage of foreign sales, which allowed them to benefit from improving overseas economies and a weaker dollar. In addition, the strong performance by technology/consumer mega caps—Apple Inc., Facebook, Inc., Amazon.com, Inc., Microsoft Corporation and Alphabet Inc. —accounted for almost one-quarter of the S&P 500 Index's return in 2017.

Fund Portfolio Review

The Fund is constructed to own stocks with the best combination of value and earnings growth. Therefore, it does not own the fastest growing small cap stocks (which typically carry high price-to-earnings ratios) that make up a portion of the core Russell 2000® Index. When growth stocks significantly outperform, as they did in 2017, performing well relative to the core index is challenging. At the same time, because we do incorporate a growth component into our investment philosophy, the Fund has tended to perform better than the value benchmark when growth stocks outperform.

The industrials sector contributed most to the Fund's absolute performance in the fourth quarter and for all of 2017. EnPro Industries, Inc., a manufacturer of gaskets, seals, and compressor components, was a solid contributor during both periods. EnPro reported better-than-expected earnings as the company was able to take advantage of improving industrial end markets.

Among individual stocks, The Children's Place, Inc., a retailer of children's apparel, contributed most to the Fund's absolute return for both the fourth quarter and year-to-date periods. Children's Place has delivered strong results despite the headwinds facing mall-based retailers by improving its systems and merchandising and taking share from weaker competitors. Virtusa Corporation, an offshore IT service provider, was a significant contributor to the Fund's absolute return for both the fourth quarter and full year periods. Virtusa reported better than expected earnings as strong organic growth with new and existing customers drove top-line growth and margin expansion.

The Fund underperformed the Russell 2000® Value Index during the fourth quarter but outperformed it for all of 2017. Adverse stock selection in the information technology and health care sectors hurt relative performance during the quarter. An adverse patent ruling at Veeco Instruments Inc., a manufacturer of equipment to produce LEDs, contributed to its weak price performance during the quarter and year. The uncertainty created by the ruling caused us to reassess our investment thesis, resulting in the sale of the stock. Within health care, Acadia Healthcare Company, Inc., an operator of mental health facilities, declined due to worse-than-expected results in its recently acquired U.K. operations.

The Fund's outperformance relative to the Russell 2000® Value Index for the full year was due primarily to advantageous sector allocation. A lack of exposure to the poor performing energy sector and a heavy weighting in the strong performing industrials sector were the main contributors.

The Fund underperformed the Russell 2000® Index during the fourth quarter and year to date. As mentioned previously, we typically are not able to invest in the fastest growing companies due to our valuation discipline. Those stocks performed well this year, and tend to be concentrated in the information technology and health care sectors. In addition, the Fund was negatively impacted by adverse stock selection within these sectors.

Outlook

We view the fundamental backdrop for earnings growth as positive. The global economy is experiencing its most synchronized expansion in a decade. U.S. GDP grew 3.3% in the third quarter, and we believe the outlook remains positive.[9] The current U.S. administration is committed to reducing the impact of regulations on businesses, and the passage late in the year of comprehensive tax reform, including a meaningful reduction in the U.S. corporate tax rate, should help the economy and corporate profits.

According to a leading small cap equity strategist, the combination of a strong global economy and lower corporate tax rates could lead to earnings per share (EPS) growth of greater than 20% in 2018, which would be a significant positive for small cap stocks.

In light of the positive outlook for earnings, small cap stocks continue to trade toward the high end of their historical valuation range. Even when factoring in the new, lower corporate tax rates, small cap valuations remain above their long-term averages. We believe current valuations are a reflection of the low returns available on alternative investments like bonds in a low interest rate environment. In our opinion, it is critical for companies to deliver their expected earnings, as there is little valuation support for disappointments.

We are confident the fundamentals of the companies in the Fund remain solid and their valuations are attractive relative to the typical small cap company. Because of our focus on finding the best combination of above average earnings growth and below average valuations, the Fund tends to be somewhat more economically sensitive than its benchmarks. We believe the Fund is well positioned to take advantage if earnings continue to improve as we expect.

The views expressed represent the opinions of the Skyline Asset Management, L.P., as of December 31, 2017, are not intended as a forecast or guarantee of future results, and are subject to change without notice.

[9] United States Department of Commerce

Top Ten Holdings (%)[10] (as of 12/31/17)

Holding	% of Net Assets
Children's Place Inc	2.39
BMC Stock Holdings Inc	2.31
Ferro Corp	2.14
Infinity Property & Casualty Corp	2.09
Rexnord Corp	2.04
Umpqua Holdings Corp	1.95
BancorpSouth Bank	1.93
First Busey Corp	1.91
Brunswick Corp	1.86
EnPro Industries Inc	1.84
TOTAL %	20.46

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.

A short-term redemption fee of 2% will be charged on shares held for less than 30 days.

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.

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. Unlike the Fund, the Russell 2000® Growth Index is unmanaged, is not available for investment and does not incur expenses.

The Standard & Poor's 500, often abbreviated as the S&P 500®, or just "the S&P", is an American stock market index based on the market capitalizations of 500 large companies having common stock listed on the NYSE or NASDAQ. The S&P 500® Index components and their weightings are determined by S&P Dow Jones Indices.

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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[10] 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.