Q4 | 2018 AMG Managers Cadence Emerging Companies Fund

COMMENTARY

ASSET CLASS | SMALL CAP

Class N | MECAX   Class I | MECIX   Class Z | MECZX

CADENCE

Average Annual Returns (%)[1] (as of 12/31/18)

	QTD	YTD	1 yr	3 yr	5 yr	10 yr	Since Incpt.
MECAX (Class N)	-20.16	-6.12	-6.12	12.68	8.69	16.79	10.38[2]
MECIX (Class I)	-20.12	-6.03	-6.03	12.85	8.90	17.05	11.76[3]
MECZX (Class Z)	-20.11	-5.94	-5.94	–	–	–	6.77[4]
Russell Microcap® Growth Index	-24.93	-14.18	-14.18	2.27	1.41	12.04	–
Russell 2000® Growth Index	-21.65	-9.31	-9.31	7.24	5.13	13.52	7.37[3]

MECAX (Class N) Expense Ratio (Gross/Net)[5]: 1.20%/1.08%
MECIX (Class I) Expense Ratio (Gross/Net)[5]: 1.10%/0.98%
MECZX (Class Z) Expense Ratio (Gross/Net)[5]: 1.01%/0.89%

The performance data shown represents past performance. Past performance is not a guarantee of future results. 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 Cadence Emerging Companies Fund** (Class N) returned -20.16% in the fourth quarter of 2018, compared with the -24.93% return of its benchmark, the Russell Microcap® Growth Index. For the 12 months ending December 31, 2018, the Fund returned -6.12%, compared with the -14.18% return for the Index.

Key drivers of relative outperformance in the quarter were stock selection in healthcare, notably pharmaceuticals & biotech where the portfolio sidestepped significant weakness. Information technology and industrials also contributed through positive stock selection. The portfolio's quality orientation benefited results, though valuation proved to be of mixed benefit, surprisingly, as the market decline was broad-based.

Market Overview

U.S. equity markets fell precipitously in 4Q18, ranking it among the worst quarters by historical standards. Healthy year-to-date gains through September were reduced to losses by the close of the year. Financial markets suffered widespread declines, leaving cash at the top of the performance rankings. Oil prices captured headlines, with WTI plummeting -38% to $45 as oversupply concerns materialized. This abrupt fall came after oil finished the third quarter at $73, near its highs for the year.

Macro developments were a focus of the markets during the quarter, notably U.S./China trade policy and Brexit negotiations. Concerns of a global economic slowdown mounted, with news including slowing U.S. housing and auto sales, slowing Chinese industrial production, and growth forecast reduction by the European Central Bank (ECB) following its four-year stimulus program, to name a small sample. As expected, the U.S. Federal Reserve (the Fed) raised rates in December for the fourth time in 2018, though it reduced its forecast from three to two rate hikes in 2019. Interest rates (the benchmark 10-year treasury), which jumped as high as 3.25% during the fourth quarter and caused investor anxiety, retreated to 2.69%.

Despite significant financial market weakness and heightened volatility, the rise in credit spreads was relatively modest and remained well below the recent peak in early 2016. This suggests the credit markets were less concerned, for the time being anyway, about economic prospects and companies' general credit worthiness, a notable positive.

In the U.S. equity markets, size outperformed during the quarter and the year with large caps outperformed small and mid sized companies. Value outpaced growth during the quarter. For the year, growth beat value by a wide margin, except in micro-cap where value led for the year.

Performance Attribution

We have to acknowledge that positive relative performance, while an important driver of value over time, may offer little solace during this frustrating market decline. Positive stock selection was the primary driver of relative outperformance during the quarter. Quality performed well in the risk-off quarter; loss-makers gave up all of their outperformance from the first three quarters of the year, a supporting factor for the portfolio. Cyclicality performed poorly, which accounted for underperformance of some portfolio holdings given the portfolio's pro-cyclical positioning. Utilities were the only sector in the green for the benchmark. The portfolio's smaller size (market cap) worked against the portfolio relative to the "larger" small cap indices, as sub-$500 million market cap companies lagged notably. Some valuation factors did not perform well,

[1] Returns for periods less than one year are not annualized.
[2] Since the inception of the Fund's Class N shares on April 1, 1996.
[3] Since the inception of the Fund's Class I shares on June 25, 1993.
[4] Since the inception of the Fund's Class Z shares on May 31, 2017.
[5] The Fund's Investment Manager has contractually agreed, through at least October 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.

particularly price/earnings (P/E) ratios, somewhat surprisingly and an indication of the breadth of the decline.

We cited in last quarter's commentary some indications of investor ebullience [e.g., high percentage of money losing initial public offerings (IPOs), Apple's heralded $1 trillion market cap, very low credit spreads]. Several decisions earlier in the year to reduce or exit positions worked out well with the passing of time. Many of these actions added value for the full year period as well as the quarter.

During the quarter, two portfolio holdings, Cambium Learning Group and Civitas Solutions, announced their acquisition by private equity investors for +20% premiums, bringing to four the number of holdings acquired for premiums during the year. The promise of acquisition is never a central thesis for investment, but history has shown that some portfolio holdings get acquired by both strategic buyers and private equity investors.

Healthcare was the standout relative positive contributor for the quarter. The portfolio's pharmaceutical & biotech holdings fell 7%, much less than the benchmark's 30% decline. The underweight also helped. The industry group was the top relative contributor for the full year, as well.

Information technology was a positive contributor due primarily to software and services, where the portfolio's holdings fell 9.7% compared to the benchmark's 22.8% fall. Two of the portfolio's six holdings in the industry group finished the quarter with small gains, a statistic which is typically not remarkable but becomes so now given this quarter's severe, broad-based decline. The other two information technology industry groups (hardware and semiconductors) also contributed positively due to stock selection.

Industrials was a positive relative contributor due to good stock selection and avoidance of the transportation industry group which was the benchmark's second worst performer. For the full year, the capital goods industry group was the second-best relative contributor due to positive stock selection, which overcame the negative allocation effect from overweighting an underperforming group.

Financials detracted from relative performance for the quarter. Banks underperformed due to disappointing earnings results (margin pressure) reported in the third quarter, and multiple contraction exacerbated the situation as investors seemed to believe earnings pressure will persist. We exited one position, bringing the portfolio's number of banks from six to five. Following their slide from mid-year 2018 highs, banks have now given up much of their 4Q16 "Trump bump" gains. The portfolio's weight declined from 5.5% entering 2018 to 4.8%.

Consumer durables and apparel performed poorly due to cyclical concerns and was the industry group which most detracted from relative results. Boat manufacturers, for example, fell due to concerns over a slowing economy and rising interest rates. Housing came under pressure for similar reasons, and while we believe it is likely we are experiencing a pause rather than the beginning of a sharp downturn in housing, we did nevertheless reduce exposure by exiting two positions, one with a gain and one with a loss.

Market Outlook

While recession does not look likely in the near term, there is no doubt that economic conditions have softened. Uncertainty has risen as well, given the macro circumstances mentioned above. We anticipate a period of moderate downward adjustment to earnings forecasts. Indeed, this has already begun, according to anecdotal observations as well as Citi's earnings revision index. On the positive front, valuations have fallen broadly to reasonable levels by historical standards, and now small cap and micro-cap indices trade at a discount to large and mid-cap. Earnings are expected to continue their growth in 2019. Investor sentiment has become notably more guarded, creating conditions for an upward move in equity prices should some key issues be resolved favorably during the year. Thus, we expect continued volatility as investors evaluate economic progress and policy resolution.

We remain focused on the implementation of our disciplined investment process, centered around bottom-up investment decision making, which over the long term and short term has generated alpha from strong stock selection.

The views expressed represent the opinions of Cadence Capital Management, LLC, as of December 31, 2018, are not intended as a forecast or guarantee of future results, and are subject to change without notice.

Top Ten Holdings (%)[6] (as of 12/31/18)

Holding	% of Net Assets
PRGX Global Inc	1.77
Kingstone Cos Inc	1.68
Willdan Group Inc	1.65
Crocs Inc	1.61
Upland Software Inc	1.56
QuinStreet Inc	1.53
BioSpecifics Technologies Corp	1.48
HealthStream Inc	1.44
Care.com Inc	1.44
Vanda Pharmaceuticals Inc	1.44
TOTAL %	15.60

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 the special risks associated with investments in micro-cap companies, such as relatively short earnings history, competitive conditions, less publicly available corporate information and reliance on a limited number of products.

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 invests in growth stocks, which may be more sensitive to market movements because their prices tend to reflect future investor expectations rather than just current profits. Growth stocks may underperform value stocks during given periods.

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.

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

The Russell Microcap® Growth Index measures the performance of the microcap growth segment of the U.S. Equity market. It includes those Russell Microcap Index companies with higher price-to-book ratios and higher forecasted growth values.

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 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.

AMG Funds are distributed by AMG Distributors, Inc., member FINRA/SIPC.

[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.