Walthausen Small Cap Value Fund

Quarterly **Fund Commentary**

Ticker Symbol: WSCVX | **As of June 30, 2017**

Environment

Last quarter we commented that the honeymoon was underway. This quarter I can say without fear of contradiction that it is over. We had put a hopeful face on the situation of the Trump Presidency noting that by all indications of his past and present preferences he is neither a Democrat nor a Republican. That could have positioned him to create some surprising bipartisan steps forward. It suffices to say that it did not happen and it is not going to happen. While he has thrown in his lot with the Republicans and gone to war with Democrats, he is neither supporting nor leading the Republicans. As a result we have a government adrift.

In spite of this situation, the stock market has been hitting new highs. Does that mean that in an economy which can only be described as a mix of capitalism and government socialism that the government does not matter, or are we in one of those periods of time when the market speeds off without reference to the facts of the matter? Let's look! I think, though it is tempting, we should not look to compare the present situation to the last years of the Nixon Administration. Then, inflation was surging and interest rates moved to heights that no one had seen in this country. With that, equity markets plummeted. Today inflation remains below target levels and interest rates, though up from the lows, remain lower than any of us would have predicted a decade ago.

We think that the best comparison is to the dot com bubble. The pundits have all declared that this is not a bubble and we are certainly not seeing the flood of IPOs nor are we seeing the wide public's interest in buying individual stocks. What we are seeing is a narrowing in interest to the FANG stocks and a shadow equity market. New ventures, mostly using internet technology, are multiplying. Like the dot com period, there seems to be extreme concern for rapid growth and virtually no concern about when or if these companies will generate reasonable cash return to investors. While they are not public companies, many are widely held by institutions and even mutual funds invest often through private funds. It is shadowy and opaque. We can only speculate how much capital is pouring into these ventures and what valuations are being used but we must caution that though history does not repeat itself in this case we do hear an echo.

Will it end and when? Good question. We think it will but predicting when is beyond us. In the meantime we have been seeing small cap value stocks drifting. We have also been seeing fewer active institutional managers playing in the smaller end of small cap. This creates some disruption but we believe that longer term it creates opportunities.

Looking forward, we see ample reason to be on the cautious side. The equity markets are at very high levels while yields on bonds have made a move up. There are signs that the economy is at full employment. Market actions suggest that investors are complacent in the wake of a long economic expansion and the steady progress that the stock market has made. We see signs that consumer credit has again been overextended, particularly in automobile lending.

With all these factors in mind we are staying cautious in our portfolio. We continue with a usual tilt toward Industrials, Consumer Discretionary and Materials but looking a bit deeper we can say that we are biased toward fundamentally strong companies and away from cyclical names. We are staying light on Energy and while we applaud that US exploration companies are bringing down costs, particularly in the Permian Basin, we think that global excess supply will hold prices too low for them to prosper. We, as is typical, are absent REITs and believe that excessively loose credit has pushed real estate prices to excessive levels and rising interest rates make these securities vulnerable. In Financials we are sticking with a strategy of going for quality regional banks and insurance companies.

Performance Review

Portfolio Factors

It is easier to describe why your portfolio diverged from its benchmark when the divergence is favorable than when it is the opposite. With that in mind, we are delighted to report that the Small Cap Value Fund performed well versus the Russell 2000 Value benchmark. Delightful as this gain is, keep in mind that we invest for long term appreciation and spend little time dissecting the fashions and enthusiasms that affect the market in the near term.

Most of the gains came from market appreciation of our specific selections. That said, we were rewarded for an overweight position in Healthcare, the best performing sector in the benchmark and also rewarded for having very little invested in Energy stocks. We did give some back because of an overweight in Materials and for having very little in Utilities and almost nothing in Real Estate.

Stock Selection: Contributors

The best performer in the quarter was Albany Molecular Research (AMRI), a pharmaceutical development company which has agreed to be taken private. Two other health care companies, Kindred Healthcare (KND) and LHC Group (LHCG) also did well. Their strength seems to indicate that investors increasingly believe that no matter what changes take place in health insurance, companies that manage for patient outcomes within a continuum of care will play a larger part in coming years. We have stuck with those two holdings.

Two consumer names, ILG Inc. (ILG) and Bassett Furniture (BSET) both did quite well. We have exited ILG because it hit our price target and because we are concerned that Airbnb and other new services which open up a wider variety of vacation time options, will erode the time share model.

Portfolio Contributors – Q2 2017

Security	Average Weight (%)	Contribution
Albany Molecular (AMRI)	1.87	0.83
Kindred Healthcare (KND)	1.80	0.61
ILG, Inc. (ILG)	1.19	0.42
LHC Group (LHCG)	1.60	0.39
Bassett Furniture (BSET)	0.92	0.35

Stock Selection: Detractors

The two greatest detractors were two energy related companies, Era Group (ERA), a helicopter owner and operator, and Overseas Shipholding Group (OII), an operator of tankers in the US coastal market, which suffered from declining energy prices. We think that the asset base of both companies is sizable and the values are not reflected in the current stock prices. We were also hurt by a decline in the price of Orchid Paper Products (TIS). They are in the midst of bringing on a major new paper mill in South Carolina. It is a sophisticated mill for making various grades of tissue and paper towels. They have a top supplier for the equipment and a major customer is lined up but investors have fled the stock because of the uncertainty which always attends the startup of a major mill. We also saw Stoneridge (SRI) and Atkore (ATKR) dip on earnings disappointments. We are comfortable with and continue to hold each of the five stocks.

Portfolio Detractors – Q2 2017

Security	Average Weight (%)	Contribution
ERA Group (ERA)	0.95	-0.35
Overseas Shipping (OSG)	0.80	-0.31
Orchids Paper Products (TIS)	0.43	-0.26
Stoneridge (SRI)	1.31	-0.24
Atkore Int'l (ATKR)	1.41	-0.22

Portfolio Changes

Portfolio changes in the quarter were modest. We added Aerojet Rocketdyne (AJRD), a maker of engines for missiles and space vehicles. We were impressed with their portfolio of products and the major cost reduction efforts underway. We also added Andersons (ANDE) and Seacor (CKH) while exiting ILG Group and Triton (TRTN) as they hit our price targets, and Intrepid Potash (IPI) after observing that they were in a very difficult position with a major and much larger and richer competitor.

Exhibit 1: Sector Allocation - % over/underweight vs. Russell 2000 Value Index

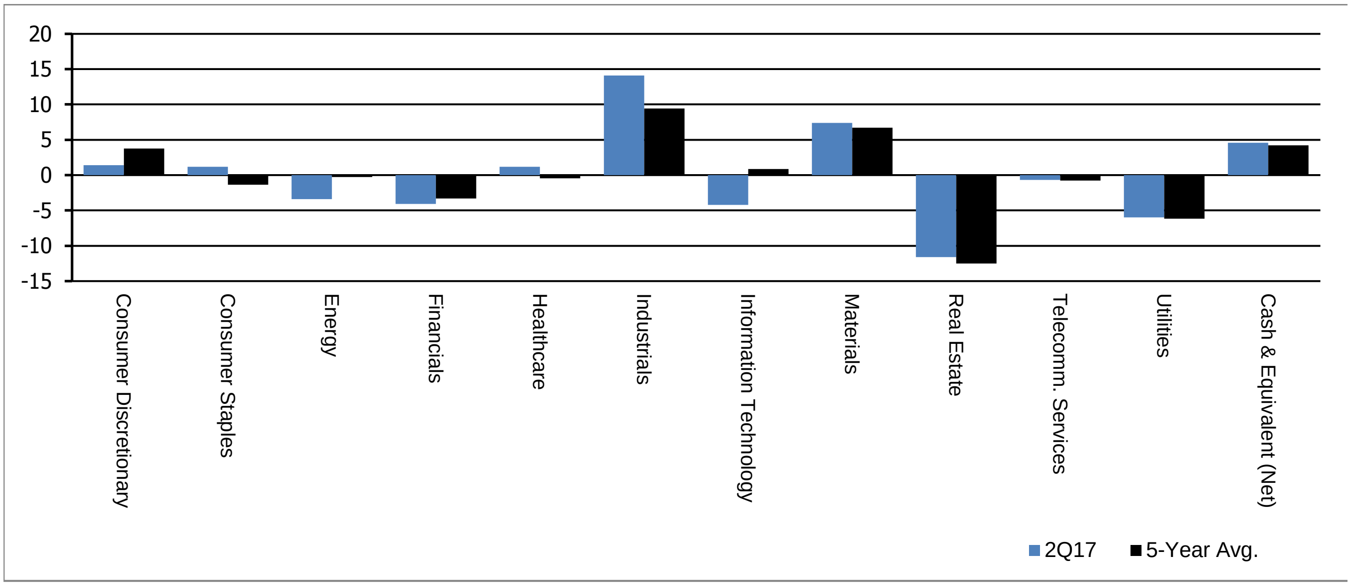

Exhibit 1 above highlights the fact that sector weight differentials between the Fund and the Russell 2000 Value Index benchmark have not changed greatly from today's levels versus the five year average.

Top Ten Holdings (%)

Albany Molecular Research, Inc.	2.2
Kindred Healthcare, Inc.	2.1
Ply Gem Holdings, Inc.	1.9
Southside Bancshares, Inc.	1.9
Casella Waste Systems, Inc.	1.8
MGP Ingredients, Inc.	1.8
Regal Beloit Corporation	1.7
FNFV Group	1.7
Navigators Group, Inc.	1.6
Ferro Corporation	1.6
Total % of Portfolio	18.3

Fund Statistics

	Fund	**Russell 2000 Value Index**
Number of Holdings	81	1,399
Median Market Cap (Millions)	$855.0	$680.9
Weighted Avg. Market Cap (Millions)	$1,260.5	$1,838.5
Price/Book[1]	1.7	1.4
P/E using FY1 Estimate[2]	18.3	17.4

Portfolio Performance

	Q2 17	1 Year	3 Year	5 Year	Since Inception (2/1/08)
Walthausen Small Cap Value Fund	4.18	28.20	4.68	14.21	13.45
Russell 2000 Value Index[3]	0.67	24.86	7.02	13.39	8.14

Total Expense Ratio: 1.28%. Expense ratio per the June 1, 2017 prospectus.

Performance data quoted represents past performance and does not guarantee future results. Investment returns and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. The current performance may be lower or higher than the performance data quoted. Investors may obtain performance data current to the most month-end by calling (888) 925-8428. Periods over one year are annualized.

Disclosures

[1]Price/Book measures the weighted average of the price to book value of all the stocks in the fund's portfolio, excluding companies with negative book values. Book value is the total assets of a company less total liabilities.

[2]P/E using FY1 Estimate is a ratio reflecting the amount of earnings estimated for next year per dollar of amount share price. For the fund, the individual P/E stock ratios are then weighted by their portfolio and market values to calculate a weighted average for the portfolio as a whole. Companies with negative earnings are excluded from the calculation. This ratio is not a forecast of the fund's future performance.

[3]The Russell 2000® Value Index measures the performance of the small cap value segment of the U.S. equity universe. It includes those Russell 2000 companies with lower price-to-book ratios and lower forecasted growth sales.

An investment in the Fund is subject to investment risks, including the possible loss of the principal amount invested. The Fund invests in the stocks of small capitalization companies, which may subject the Fund to additional risks. The earnings and prospects of these companies are generally more volatile, and they may experience higher failure rates than do larger companies. Their stocks are subject to a greater degree of volatility, trade in lower volume and may be less liquid. Investment in the Fund is also subject to common stocks risk, value investing risk, sector risk, securities lending risk, and investment management risk. Fund holdings and asset allocations are subject to change and are not recommendations to buy or sell any security.

Investors should consider the investment objectives, risks, charges and expenses of the Fund carefully before investing. The prospectus contains this and other information about the Fund. You may obtain a prospectus by calling (888) 925-8428. The prospectus should be read carefully before investing. Distributed by Rafferty Capital Markets, LLC – Garden City, NY 11530, Member FINRA.

Contributors and detractors performance data and analytics provided by FactSet. To measure performance for periods when portfolio holdings change, portfolio analysis calculates the security weights and returns on a daily basis, then geometrically link returns across the measurement period.

Walthausen Funds
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