Walthausen Select Value Fund

Quarterly **Fund Commentary**

Ticker Symbols: Institutional Class WSVIX | Retail Class WSVRX

As of December 31, 2017

Environment

In our last quarterly commentary, we touched on investor complacency and the eleven consecutive quarters of gains the broader indices had experienced. Now it is fourteen quarters of uninterrupted gains, and despite starting at a very lofty valuation, the market was up nicely again in 2017. As unemployment has moved down to very low levels, the specter of rising wages and their impact on costs and profits along with the potential for inflation taking hold should, we thought, have caused investors to pause. We acknowledge that by many measures, the market is efficient, but in the great tug of war between buyers and sellers the balance is, to a large degree, ruled by animal spirits. These spirits can shift dramatically, particularly when investors are taken off guard.

Naturally, markets go up when there are more buyers than sellers, but why are there currently more buyers than sellers? We think that there are numerous reasons, the biggest of which is the fear of missing out. Investors do not want to be left behind and seem to be compelled to jump on board the market train since it has been steaming ahead at full speed for fourteen consecutive quarters. Despite numerous voices, including ours, raising caution over complacency and the apparent disregard for escalating risks, it seems as though the consensus opinion is that a body in motion tends to stay in motion until acted upon by an outside force.

What force may affect the market and when? There is no question that the market momentum shows little sign of abating. The new tax bill is a big bonanza to the corporate sector and to the economy overall. On the surface, the lower tax rate will help. We have been analyzing the impact the new rates will have on the companies that we hold. For some companies, the benefit looks to be substantial. The longer term economic impact, however, is not so certain. Congruently, money has never been cheaper and more readily available, particularly to businesses. We have seen the post crisis caution evolve into a much more ebullient spirit. Not much of that, however, is in the form of big capital spending. We are seeing this gradually creep up but most firms have the necessary physical capacity. The constraint is in labor and labor productivity. As a result, companies are showing much more enthusiasm to grow by acquisition and many of these deals are as reckless as we have ever seen. The deals come with promises of large synergies with little evidence to support them. As demand is increasing with a tight labor supply and increased deficits, we believe increasing inflation and higher interest rates become increasingly more likely. As such, this may be one force to act upon the current momentum.

For the full year, virtually every area of the market showed a positive result. Large caps beat small caps and growth once again trounced value. The momentum toward passive vehicles seems likely to continue as investors are using algorithms (not technical analysis – its discredited ancestor) to divine the trend and capitalize on stock popularity based on various factors predicated on the idea that they can be one step ahead of the invisible hand by closely watching price trends.

We have been getting increasingly cautious for several years and at the start of 2017, we were convinced that the US equity markets were much more likely to fall than rise. We were wrong, however, despite our view we performed well, beating our benchmark by a reasonable level. Our duty is to examine companies whose value suggests investor skepticism and make judgments regarding their ability to create shareholder value over time while also balancing the risks involved in achieving that goal. Sometimes, that requires making judgments that are not shared by investors in general. This is what we do irrespective of sentiment. Year 2017 was no different and we did not make any unusual moves. We continued to cull names from the portfolio and replace them with names that met our criteria. We were more selective than ever, as we saw many management teams shifting from cost and debt reduction to a search for a dramatic and generally very risky deal. As we enter 2018, we expect to continue that process while believing that our strategy will be generally well positioned.

Performance Review

Portfolio Factors

The bulk of the outperformance for the quarter was due to sector allocation, with Materials leading the way. The closely related and more sizable weighting to Industrials also did well. We were about double the weight of the benchmark and our selections did well in that group. The worst performing sector in the index was Healthcare, and fortunately we were underweight and our selections performed well.

We also benefited from an absence of holdings in Utilities, Telecommunications Services and Real Estate, all of which performed poorly.

Stock Selection: Contributors

Our top performing stocks came from a variety of industries. The largest contributor was Westlake Chemical (WLK). It benefited from a strengthening market for their polymers and vinyl building materials, plus increasing evidence that their bold acquisition of Axiall in 2016 is working well.

We also did well with another long term holding, Primerica (PRI). This life insurance company continues to benefit from its ability to deliver small, inexpensive policies at reasonable prices. The stock recovered in the quarter as the threat faded that the Department of Labor fiduciary rule would undermine the investment product portion of the business.

John Wiley & Sons, a new holding, also contributed. We believe that investors have misunderstood how far they have gone in converting from print to digital and what additional savings can be realized as they continue to move down this path. We also did well with Rogers Corp (ROG) and Winnebago (WGO), two stocks which we have held for a while. We continue to hold each of these stocks but have realized some gains in order to rebalance the portfolio and reduce risk

Portfolio Contributors – Q4 2017

Security	Average Weight (%)	Contribution
Westlake Chemical Corp. (WLK)	2.51	0.63
Winnebago Industries (WGO)	2.66	0.60
John Wiley & Sons, Inc. (JW.A)	2.15	0.57
Primerica Inc. (PRI)	2.45	0.56
Rogers Corp. (ROG)	2.60	0.56

Stock Selection: Detractors

Three of our largest detractors are stocks which we also held in the Small Cap Portfolios. We have exited Eagle Bancorp (EGBN), as mentioned earlier, and have held on to Vista Outdoor (VSTO) and Electronics For Imaging (EFII). We also saw Oceaneering International (OII) underperform. They are a provider of subsea services to the oil and gas industry and suffered as spending shifted more toward the onshore shale plays particularly the Permian Basin. We have exited that stock believing that it could be quite a while before the spending shifts back to the Gulf of Mexico and other offshore fields. The final underperformer was Loral Space & Communications (LORL). That stock does not develop much excitement and seemed to drift from a lack of enthusiasm rather than any adverse event. We continue to stick with that holding.

Portfolio Detractors – Q4 2017

Security	Average Weight (%)	Contribution
Vista Outdoor (VSTO)	2.05	-0.91
Oceaneering Int'l Inc. (SEAS)	1.29	-0.80
Electronics For Imaging (EFII)	2.37	-0.72
Eagle Bancorp Inc. (EGBN)	1.77	-0.49
Loral Space (LORL)	2.09	-0.27

Portfolio Changes

We were a bit more active than usual in the fund. In the Energy sector we sold our position in Oceaneering International (OII) and accumulated positions in Energen Corp (EGN) and Callon Petroleum (CPE). Both of these companies explore and produce petroleum, primarily from West Texas. We became more enthusiastic as it appeared that oil markets were firming and that political disruptions in the major producing areas had increased the potential that energy prices might surge.

We also added Simpson Manufacturing (SSD), a producer of metal connectors and truss plates for residential buildings. Our outlook on home building is good and a new CEO has identified a number of initiatives which can accelerate growth and improve margins.

Also added was John Wiley & Sons (JW.A), a stock which was mentioned earlier and Steelcase (SCS), a commercial office furniture manufacturer. We think that we are buying Steelcase at an attractive price as major customers were pending purchases due to a belief that the new tax law might make buying furniture more attractive in 2018. We believe that it has, and with employment tighter and corporate profits high, we believe that 2017 demand was weak not due to an aversion to spending, but to purchase deferrals. We also did a shift in the Financials, selling Assurant (AIZ), on value factors, and adding Amerisafe (AMSF). We concluded that this Louisiana based workers compensation insurer is very well managed.

We also sold Carters (CRI) as the stock hit our target and because we are generally very cautious about the retail space because of the disruption that Amazon and other on line sellers are causing. We also exited our position in Seaboard (SEB) as it appeared that the cycle of pork prices was turning against this quiet, yet well-run, company.

Exhibit 1: Sector Allocation - % over/underweight vs. Russell 2500 Value Index

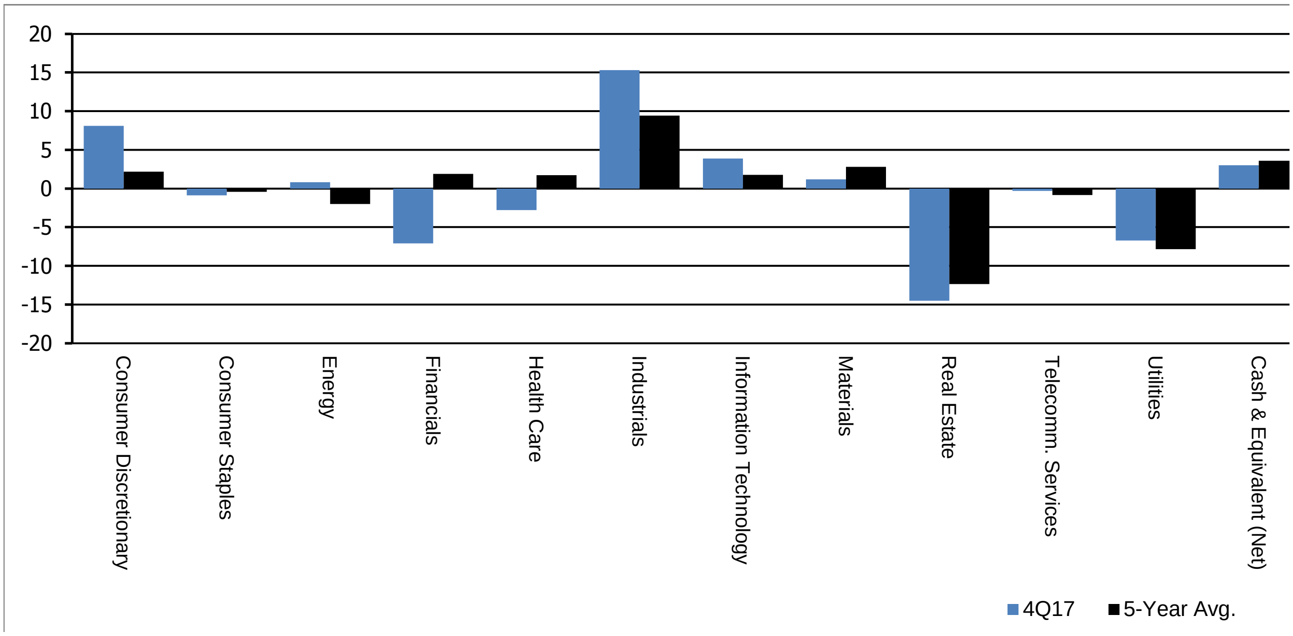

Exhibit 1 above highlights the fact that sector weight differentials between the Fund and the Russell 2500 Value Index benchmark have not changed greatly from today's levels versus the five year average.

Top Ten Holdings (%)

Callon Petroleum Co.	2.9
John Wiley & Sons Inc. Class A	2.8
EMCOR Group Inc.	2.8
Milacron Holdings Corp.	2.8
Westlake Chemical Corp.	2.7
HealthSouth Corp.	2.7
Deluxe Corp.	2.6
Snap On Inc.	2.6
Energen Corp.	2.6
Avery Dennison Corp.	2.6
Total % of Portfolio	27.1

Fund Statistics

	Fund	**Russell 2500 Value Index**
Number of Holdings	41	1,752
Median Market Cap (Millions)	$2,949.9	$1,060.3
Weighted Avg Market Cap (Millions)	$3,819.0	$4,814.2
Price/Book[1]	2.2	1.7
P/E using FY1 Estimate[2]	19.3	18.4

Source: FactSet Research

Portfolio Performance

	Q4 17	1 Year	3 Year	5 Year	Since Inception (12/27/10)
Walthausen Select Value Fund: Institutional Class	4.62	17.51	7.62	12.68	11.40
Walthausen Select Value Fund: Retail Class	4.53	17.13	7.35	12.40	11.10
Russell 2500 Value Index[3]	4.25	10.36	9.30	13.27	11.50

Total Expense Ratio: 1.36%. Net Expense Ratio: 1.11% for Institutional Class, 1.36% for Retail Class. Expense ratio per the June 1, 2017 prospectus.

The Net Expense Ratio includes a waiver. The Advisor has contractually agreed to waive Services Agreement fees to the extent necessary to maintain total annual operating expenses of the Institutional Class Shares, excluding brokerage fees and commissions, taxes, borrowing costs (such as (a) interest and (b) dividend expenses on securities sold short), the cost of acquired funds and extraordinary expenses at 1.10% of its average daily net assets through May 31, 2018. The Advisor may not terminate the fee waiver before May 31, 2018. The Trustees may terminate the expense waiver upon notice to the Advisor. From the prospectus dated June 1, 2017.

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 2500® Value Index measures the performance of the small cap value segment of the U.S. equity universe. It includes those Russell 2500 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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