

Environment

The second quarter of 2018 was an interesting quarter. Through rising rates and spiraling international discord, the US equity markets rose with smaller market cap stocks leading the way. My best guess is that the leadership of smaller stocks was based on the notion that these more domestically oriented firms will benefit disproportionately from the lower corporate tax rate. While that is a bit of a generalization, it is largely correct. The companies that are highly profitable, particularly those whose earnings come from domestic operations, should benefit.

I am pleased to see the country prospering and with unemployment rates falling further than I had thought possible. However, three factors worry me; tariffs, trade and taxes. Increasingly, trade has been a driver of growing prosperity across the globe. The few countries that have divorced themselves from world trade, like Cuba and North Korea, have drifted into deep poverty. China was poor and enjoyed a strict diet until they embraced trade. The US has benefited from lower barriers as costs of apparel, small appliances, televisions, computers, and virtually everything that we buy at Wal-Mart has fallen in real terms. US companies and workers benefit as well. An improved standard of living has increased demand for higher quality products where the US can excel and sell into a broader market. For example, a Timberland boot may be sold in France, designed and tested in the US and made in Vietnam but everyone prospers.

There is a thought that the loud push for trade reform is a well thought out strategy to improve the patchwork of trade agreements so that they are fairer to the United States. Though the popularity of trade reform may be a reaction to perceived loss of status as other countries flourish, I worry that the current threats of broad punitive tariffs and the counter threats will be real. Yes, I understand that threats of tariffs which originate outside of the World Trade Organization or other agreements may bring people to the negotiating table, and I do understand that US Trade Representative Robert Lighthizer is very able and well respected, but I wonder about the strategy's efficacy. While the US is well respected in most parts of the world, there has been resentment over our propensity to throw our weight around since the Second World War. Can Canadian Prime Minister, Justin Trudeau renegotiate NAFTA without looking like he has been pushed around? Will Canadian voters still support

their Prime Minister when our president has insulted him and his country? That is the risk. I think it is likely that the rhetoric has escalated to the point that negotiating with the US is politically too risky.

Tariffs are taxes. So then the question is, who pays the tax? Ultimately, I think that everyone does. If low cost imports are challenging US producers of an item, higher tariffs brings the price up for everyone. As tariffs go up it will be a tax on consumers throughout the world. With labor supply tight it could mean greater inflationary pressure, unless it first results in less consumption and a slower economy. Recent labor department data shows that voluntary job departures are steadily growing. The data also shows that the salary gain for quitting for a new job is advancing, and advancing more rapidly than wages in general. Though management teams thus far have not generally acknowledged that they are needing to make more attractive offers to recruit new workers, I am confident that salaries for new hires are rising and rising in excess of inflation.

Finally, I am concerned by the impact of the recent tax reforms. Setting aside that we are all delighted by a lower tax burden I feel that budget deficits need to be contained when the economy is strong. I subscribe to the tenet that when the economy is floundering you prime the pump by reducing taxes and increasing spending. The recent tax reforms stimulate just as unemployment is at very low levels. I recognize that I am an outlier on this point. I read that economists, with the benefit of sophisticated models, argue that we needn't worry about this because additional workers will appear as the discouraged workers return to the work force. I am not sure. My sense is that much of the past elasticity in the labor supply has been met with immigrant labor. Many observers also argue that the Federal Reserve will use higher interest rates to control growth and inflation. However, with unemployment at sustainable levels and the real interest rate at zero, I don't think that there is an appetite to cool the economy.

The future is murky and unknowable, but right now it seems unusually difficult to discern. I spend a lot of time listening to and observing company managements. They are acting in ways that confirm that the outlook is less certain than usual. I notice that corporate management has been aggressive in pursuing the risky option of increasing acquisitions.

At the same time they are personally purchasing less of their own stock.

We stress looking for companies that are well managed which have competitive advantages. This generally leads us to companies with managements who are good shepherds of shareholder capital who can also adjust prices and costs as circumstances demand. As the economy evolves and possibly faces the challenges of tariffs and/or inflation, we prefer to hold companies that possess these attributes.

Performance Review

Portfolio Factors

For the quarter, small cap was at an advantage versus mid and large cap. Even so we lagged and lagged badly. So let's take it apart. The best performing sector in the index was Energy, as companies responded to higher petroleum prices. The second best sector in the index was Real Estate. These companies typically are sensitive to rising interest rates. Why they did so well in the face of rising rates we do not know.

The worst performing group was the Financials. The sector is dominated by community and regional banks. Almost all these banks are entirely domestic, have little in the way of tax shields and are now nicely profitable. Yet the sector lagged the benchmark. Industrials, although more diverse and in general are showing good profits, also lagged. Looking at the Industrial companies that we own, they almost all pay meaningful taxes in this country and stand to benefit from the tax reform.

It was a contrary quarter in that most active small cap managers, considering the challenges of rising costs of labor and materials and the prospect of higher interest rates, have tended to move to higher ground by selecting stronger companies. Thus, a shocking number of small cap value managers had a tough quarter.

In other words, while the outperformance of small cap in general, in some sense, was related to tax changes, it did not translate into performance of individual stocks. A good part of the underperformance can be attributed to sector allocation. Our overweight in Industrials and an absence from the REITS were the cause but the larger part was the specific selections. Unlike most times when selection has been disappointing, we

cannot lay it on any one or a few troubled stocks. Even if we were astute enough to avoid the ten worst performers, that would account for only about half of the short fall. It seems to be more a style issue as we noted that companies with losses or low return on invested capital seemed to do far better than the prosperous names. We stand by our belief that companies which provide a return on capital above their cost of capital will be in better condition when the economy inevitably falters.

Stock Selection: Contributors

We saw Mercer International (MERC), an old favorite, do well as paper pulp prices showed strength and the company continued to find opportunities to improve earnings. SeaWorld Entertainment (SEAS), which after quite a few quarters of poor performance and drifting stock price, rebounded nicely on some evidence of better park attendance. Stoneridge (SRI), a maker of electronic components for the automotive industry, did well with continued development of new more sophisticated products.

Portfolio Contributors – Q2 2018

<u>Security</u>	<u>Average Weight (%)</u>	<u>Contribution</u>
Mercer International Inc.	1.72	0.62
SeaWorld Entertainment Inc.	1.35	0.53
Stoneridge Inc.	1.97	0.50
Vishay Intertechnology Inc.	1.94	0.44
McGrath Rentcorp	2.00	0.36

Stock Selection: Detractors

Our worst performing stock was Rayonier Advanced Materials (RYAM). The stock dropped after they reported two separate production issues at the highly profitable High Purity Cellulose operation, an unexpected spike in natural gas prices at another facility and duties on newsprint shipped to the US from Canada. We also were hurt by our position in Triumph Group (TGI). This major aerospace supplier installed a new management group a few years ago to deal with some bad acquisitions and money losing contracts. They have accomplished that and are making good progress with some major program launches. We are satisfied that the new team is on track with this turn around though the market is less convinced. We were also hurt by Heritage-Crystal Clean (HCCI), M/I Homes (MHO) and Tutor Perini (TPC). The selections in Materials, Industrials and

Consumer names lack any common theme. We have retained our position in all of the five that we just mentioned. Their performance was not the result of any shift in our selection process or any slip in the quality of our work. Our best estimate is that it reflects a temporary shift in investor focus, largely to stocks offering yield and to stocks where the lack of profitability argues that it can only get better.

Portfolio Detractors – Q2 2018

Security	Average Weight (%)	Contribution
Rayonier Advanced Materials	1.54	-0.35
Triumph Group Inc.	1.39	-0.34
Heritage Crystal Clean Inc.	1.76	-0.31
M/I Homes Inc.	1.70	-0.30
Tutor Perini Corp.	1.58	-0.27

Portfolio Changes

Even though we largely left in place the positions in the best and the worst performing stocks, the pace of change picked up. We added eight new positions; two in Energy, SM Energy (SM) and QEP Resources (QEP), to increase our presence as the economics of petroleum extraction improved. We also added several Industrial companies as we found names that met our criteria of specialty businesses with unique skills or desirable market positions. Among them was a return to Standex (SXI). We had owned this stock very successfully in the past but sold when it hit our price target. We continued to watch it as we liked the portfolio of high return on capital specialty businesses but could not see the next act clearly. The stock stalled and they made some bold investments to grow their small reed switch business and we used the opportunity to buy the stock. We also acquired Quad Graphics (QUAD) because we are convinced that the company has a very effective multifaceted strategy to prosper in the printing industry, in spite of the

challenge presented by a gradual decline in industry volume. Other additions were Enpro (NPO) and Triton Group (TRTN). We added Kulicke & Soffa (KLIC), a tech name whose knowhow in bonding components and highly profitable model is not fully valued. We also added Hain Celestial (HAIN) as a management change offers potential for value realization.

We sold ten positions. The largest position sale was Addus Homecare (ADUS), which had moved beyond our price target as the stock finally got recognition. We also sold First Cash (FCFS) for the same reason. The sale of Winnebago (WGO) was more complicated. We had taken some profits earlier in the year and repurchased some when the stock retreated. We were somewhat concerned that RV dealers were going into the spring with excess inventory but decided to sell after they purchased Chris-Craft. While we respect the venerable brand name, we could not see the synergy and were disconcerted by management's staunch insistence to not discuss the terms of the transaction. We exited SJW Group (SJW), a water utility, as a bid for the company took the price well above our target. We sold Ferro (FOE) and Casella Waste (CWST) as the market brought them both to prices in excess of our targets. We have been disappointed with Steelcase (SCS). Typically, as employment grows and corporate profits expand, Steelcase and the other office furniture companies do well. This time it has not happened. We are not sure why office furniture purchases have not accelerated but have lost patience and elected to exit. We also sold ERA Group (ERA), a helicopter operator as the offshore exploration for oil continues in the doldrums. We sold Ciner Resources (CINR), a soda ash miner, and cleaned out a small position in CoBiz Financial (COBZ).

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

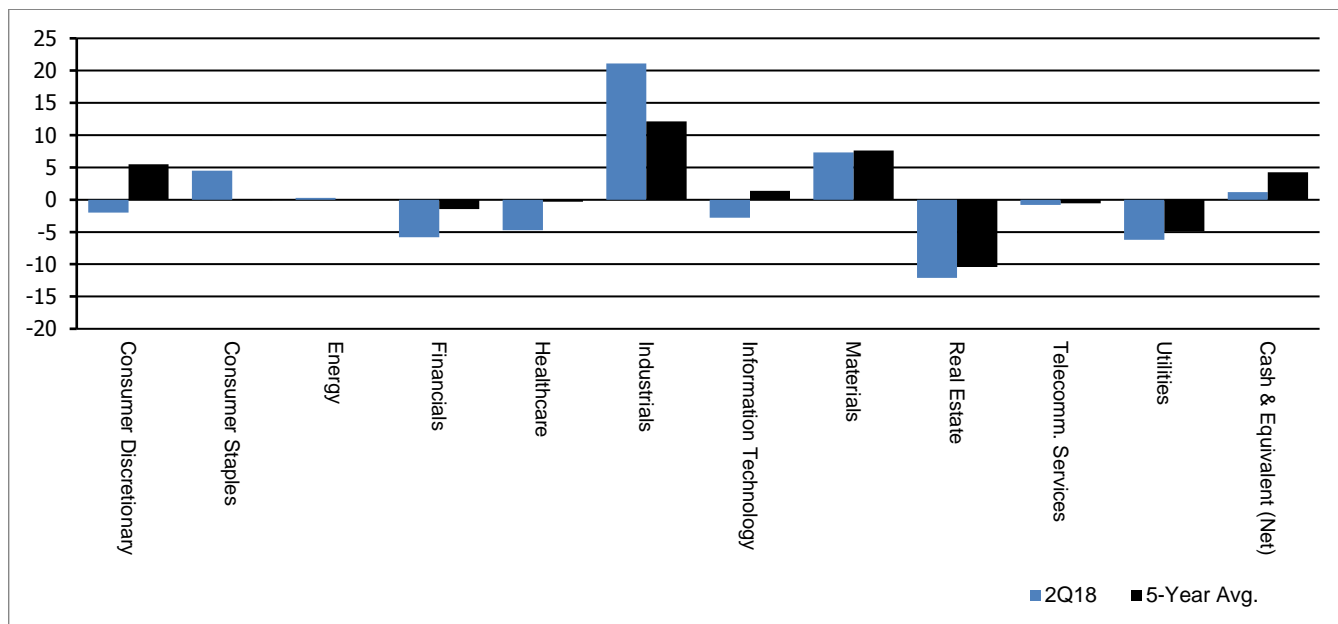


Exhibit 1 above highlights the fact that sector weight differentials between the Fund and the Russell 2000 Value Index benchmark have not changed greatly from today’s levels versus the five year average.

Top Ten Holdings (%)

Stoneridge Inc.	2.3
Vishay Intertechnology Inc.	2.2
Silgan Holdings Inc.	2.0
McGrath Rentcorp	2.0
Primerica Inc.	1.9
American Vanguard Corp.	1.8
Navigators Group Inc.	1.8
Mercer International Inc.	1.7
Interface Inc.	1.7
Heritage Crystal Clean Inc.	1.7
Total % of Portfolio	19.1

Fund Statistics

	Fund	Russell 2000 Value Index
Number of Holdings	75	1,364
Median Market Cap (Millions)	\$1,093.3	\$822.10
Weighted Avg. Market Cap (Millions)	\$1,470.1	\$2,061.4
Price/Book ¹	1.7	1.5
P/E using FY1 Estimate ²	15.7	15.2

Portfolio Performance

	Q2 18	1 Year	3 Year	5 Year	10 Year	Since Inception (2/1/08)
Walthausen Small Cap Value Fund	2.90	8.90	8.94	9.58	13.97	13.01
Russell 2000 Value Index³	8.30	13.10	11.22	11.18	9.88	8.61

Total Expense Ratio: 1.27%. Expense ratio per the June 1, 2018 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

¹Price/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.

²P/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.

³The 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.

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