Walthausen Small Cap Value Fund

Quarterly **Fund Commentary**

Ticker Symbols: Institutional Class WFCIX | Investor Class WSCVX

As of December 31, 2018

Environment

The fourth quarter was a trying period in a trying year. We had been commenting for a few years that the market seemed frothy. Through much of this, our tried and true philosophy of buying stock where we could see signs that management was fundamentally building value, and where this value building process was not being recognized in the market, benefited our investors. In 2018, we continued to make such investments, and the companies, in large, met our expectations. However, the market neglected to recognize the progress that these companies made. Instead, the market rewarded Utilities and, until the fourth quarter, growth stocks as well.

We ask, why did the market melt down in the fourth quarter after having held up so well for so long? This question certainly provoked a lot of discussion in our shop and among investors. A number of factors were cited from uncertainty about the commitment by the Federal Reserve to raise rates, to concerns about trade barriers, to growing signs that the rapidly expanding Chinese economy was slowing, and to growing uncertainty about international relations and the United States role in that. We think that the answer is never certain or simple. Multiple factors do play a part and these factors can combine into a pessimism which pervades the market even when the economy is growing nicely.

As we sit here in early January, we need to ponder the question of where do we go from here. Without doubt the US economy is strong, but with unemployment at very low levels, can it get much better. Certainly the fiscal stimulus from the tax cuts will continue to help, but if the economy continues to grow in the face of low unemployment, won't interest rates continue to rise as the economy moves toward overheated.

But let's get to the core of the matter. Credit drives the world economy. Credit provides the funding for businesses and consumers to invest and spend. Few businesses expand and few consumers buy houses or autos without credit. Thus, the inversion of the yield curve is important. Simply stated, most financial institutions borrow short and lend long. Thus, when short term rates move up to parallel or exceed longer rates, then credit tightens and the economy can move toward contraction. For example, if you own a bond fund you probably are noticing that rates on bank CD's are rising but your returns on the bond fund are dropping. You are not alone in thinking of moving from the bond fund. So the bond fund shrinks a bit and their appetite for buying new bonds withers. The Bank that is accepting your deposit is not being more aggressive in lending. Their money is costing them and their peers more so they need to get higher rates and be more careful in their lending. We have already seen some of these effects as the new issuance of corporate bonds tightened in December.

Does this clearly predict that US equity markets will be down in 2019? No it does not. We are convinced that the market will shift back toward more normal behavior as money is less plentiful and has a cost. We think that the stocks of companies that do not make cash returns will be at risk. We know that markets do adjust but we believe that the market, up or down, will shift toward one that is less enamored with yield stocks like Utilities or REITs. The yield in short term money is now competitive, so there is much less call to buy Utilities. REITs look less interesting as their cost of money rises. As has been true in the past, our investment style tends to do best in more difficult times.

Performance Review

Portfolio Factors

The fourth quarter was a difficult period. Our benchmark Russell 2000 Value Index dropped significantly reflecting weakness in the US equity market. The smaller the stocks, the further they fell, a factor which contributed to our underperformance. Our Small Cap Value Fund slightly underperformed the weak benchmark. Both allocation and selection contributed to the shortfall. We were penalized by about 92 basis points by our virtual absence Utilities and another 42 basis points for having no REITs. We were also penalized by holding too many Materials names. This was offset by a nice gain from having no Healthcare names. We have tried to find names that we were comfortable with all year and suffered from underexposure for most of the year. We were glad that our caution was rewarded as the sector dropped almost 30% for the quarter.

Stock Selection: Contributors

For the quarter, we did have the benefit of one takeover as TransDigm Group (TDG) agreed to acquire Esterline (ESL), an aerospace supplier that we had held for a few quarters. We were glad to see our belief that Esterline's portfolio was quite valuable confirmed. Other contributors were a diverse selection from the Producer Durables sector. All three of these companies have well positioned service businesses. ABM Industries (ABM) was a recent addition. We noticed that the current management team is effectively building margins by better management and selective investment in technology to most effectively deploy this service company's massive work force. Heritage Crystal Clean (HCCI) also did well relative to the market as this environmental services business is successfully growing its parts cleaning business. Great Lakes Dredge and Dock (GLDD) is benefiting from a good market both of improving harbors and rebuilding shore lines. Williams Industrial Services (WLMS) has emerged from a very difficult restructuring as a strong provider of a technical workforce to the nuclear power and related industries.

Portfolio Contributors – Q4 2018

Security	Average Weight (%)	Contribution
Esterline Tech. Corp.	1.57	0.39
ABM Industries, Inc.	1.27	0.10
Heritage-Crystal Clean, Inc.	2.21	0.08
Great Lakes D&D Corp.	2.18	0.05
Williams Industrial Svcs Group	0.18	0.02

Stock Selection: Detractors

As you might expect, many of our worst performers were Energy companies with the benchmark sector down over 40% in the quarter. They included SM Energy (SM), Halcon Resources (HK), and QEP Resources (QEP). We are, in general, satisfied with the progress which each has made in developing resources but their share price has suffered as petroleum prices have dropped. We have sold Halcon which appeared to be the most vulnerable if weak prices persist but have held the other names. Ironically, the worst performer was Triumph Group (TGI). Like our best performer, Esterline, Triumph is a supplier to the aerospace industry. Demand is healthy but both firms had struggled with some difficult programs. In Triumph's case, this included the completion of the Boeing 747 program and the launch of several business jet and commuter jet programs. They are through most of these issues but investors are impatient. Another underperformer was a recent investment In Quad/Graphics (QUAD), a well-run and highly profitable printing company. They are in the process of acquiring LSC Communications, a very sizable competitor, in a stock for stock deal. Given management's history of successful acquisitions and the reasonable valuation, we are enthusiastic. However, other investors seem to be not so enthralled. We have stayed with both holdings.

Portfolio Detractors – Q4 2018

	Average Weight (%)	Contribution
Triumph Group, Inc.	1.91	-1.17
SM Energy Company	1.73	-1.07
Halcon Energy Corp.	0.97	-0.82
Quad/Graphics, Inc. Class A	1.62	-0.73
QEP Resources, Inc.	1.26	-0.72

Portfolio Changes

In the fourth quarter turnover activity was at typical levels with the sale of six stocks and the purchase of six new stocks. The sales fell into three categories; takeovers, stocks which hit targets, and worrying outlooks. In the first group, we sold both Esterline and The Navigators Group (NAVG) because they were in agreements to be acquired. In the second group, we sold Materion (MTRN), a stock which we held for quite a while and had done well with, on a judgement that it had achieved a full valuation. We also sold Cannae Holdings (CNNE), again feeling that it had realized its potential. In the worrying group, we sold

Wabash National (WNC) because the truck trailer business tends to suffer early in any slowdown, and we sold Amkor (AMKR) because of concerning signs of slackening demand from some key customers.

The six stocks that we added were a diverse group. Our two largest new commitments were ABM Industries and Meredith Corporation (MDP). We previously noted ABM for its positive contribution to the quarter's performance. Meredith is a very strong magazine publisher with strong life style titles including Travel+Leisure, Parent's Magazine and Southern Living. They have been very adept at extending these franchises into other services including digital delivery. They recently leveraged up to acquire Time, Inc. They did that to acquire the very healthy People Magazine. Through the sale of other Time properties and cost reductions, they are very rapidly repaying debt. We also initiated a position in NBT Bancorp (NBTB), a well-run regional bank in Central New York state, and initiated positions in Alamo Group (ALG), a well-run maker of specialty equipment such as brush hogs, primarily to municipal customers, BMC Stock Holding (BMCH), a well-run distributor of components and lumber for home building, and Lydall (LDL), a well-run maker of filtration and thermal barrier materials.

These adjustments to the portfolio did not shift the characteristics of the strategy. We are still well diversified with stock on average (measured by the weighted average) smaller than the index. We are characterized as holding companies which have superior returns on invested capital but only average valuation multiples. Our long term preference for companies with identifiable competitive strength continues.

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

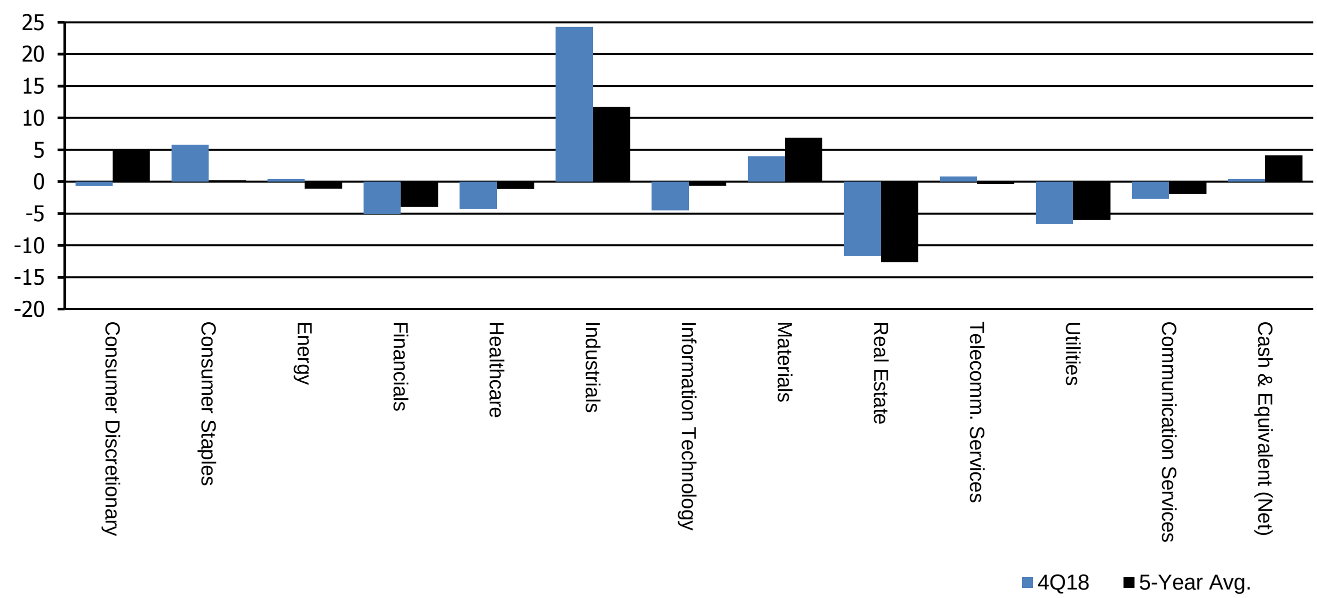

Exhibit 1 above highlights the fact that sector weight differentials between the Fund and the Russell 2000 Value Index benchmark have not changed greatly from today's levels versus the five year average.

Top Ten Holdings (%)

Primerica, Inc.	2.7
Darling Ingredients, Inc.	2.7
Great Lakes Dredge & Dock Corp.	2.4
McGrath RentCorp	2.4
ABM Industries, Inc.	2.2
Triton International Ltd.	2.2
Southside Bancshares, Inc.	2.2
Kulicke & Soffa, Inc.	2.1
The Andersons, Inc.	2.1
Kelly Services, Inc. Class A	2.0
Total % of Portfolio	23.0

Fund Statistics

	Fund	**Russell 2000 Value Index**
Number of Holdings	74	1387
Median Market Cap (Millions)	$850.0	$607.4
Weighted Avg. Market Cap (Millions)	$1,261.7	$1,816.3
Price/Book[1]	1.3	1.2
P/E using FY1 Estimate[2]	11.9	12.3

Source: FactSet Research

Portfolio Performance

	Q4 18	**1 Year**	**3 Year**	**5 Year**	**10 Year**	**Since Inception (2/1/08)**
Walthausen Small Cap Value Fund	-20.95	-19.05	5.45	1.24	13.70	10.14
Russell 2000 Value Index[3]	-18.67	-12.86	7.37	3.61	10.40	6.32

Total Expense Ratio: 1.27%. Net Expense Ratio: 0.99% for Institutional Class, 1.22% for Investor Class. Expense ratio per the December 31, 2018 prospectus.

The Net Expense Ratio includes a waiver. The Advisor has contractually agreed to waive Services Agreement fees and Management Fees to the extent necessary to maintain total annual operating expenses of the Institutional Class shares and Investor 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 0.98% and 1.21% respectively, of its average daily net assets through May 31, 2020. The Advisor may not terminate the fee waiver before May 31, 2020. The Trustees may terminate the expense waiver upon notice to the Advisor. From the prospectus dated December 31, 2018.

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.

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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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