Environment

The first quarter of this year was quite a surprise after the meltdown of the fourth quarter of 2018. Starting on the last days of the year, the market began a remarkable comeback which lasted through February. With that rebound the market regained most of what it had lost in the fourth quarter. But where are we now? Value seemed poised for a comeback as the Q4 meltdown (technically a bear market some say) put fear into the equation. Value investors rightly believed that the tone of the market was changing in their favor. It did not. Growth beat value again with the Russell 2000 Growth Index up 17.14% while the Russell 2000 Value Index was up only 11.93%.

We all wonder why value doesn't emerge. The long term data suggested that value always beats growth over long periods of time and small cap will generally exceed large cap over the cycle. However, the data for this cycle is a dramatic challenge to that thesis. Just looking at the Russell index data we can see that the core large cap index beats the core small cap over the 1, 3, 5 & 10 year periods. The same is even truer when you compare growth to value. We wonder whether this is a permanent change in how the market values companies or another of the anomalies which emerge from time to time in the stock market. If it is the latter, we think that we can look forward to a period of excellent relative performance for small cap value stocks.

When we look at the data again we see that the Russell 1000 Growth Index has been compounding at a 17.52% rate for the last decade while the Russell 2000 Value Index has compounded at 14.12%. Both are great returns, but when you take it out for the 10 years the returns are very different. The growth investor has $500 on the $100 invested while the small cap value friend has $375 and the difference has gotten worse in recent years. Over the last twelve months the large cap growth investor got a 12.75% return while the small cap value investor got almost nothing (0.17%).

To understand whether this is a permanent change to a new investment paradigm, or an odd and temporary situation, we need to look at what this cycle has been. It has been unusual, starting with the great recession where it appeared that the financial meltdown could rival, and perhaps exceed, the depression of the 1930s, with the remaining commercial and investment banks all toppling one after the other. Fortunately, the catastrophe was averted by forceful intervention here and around the globe. The banks were refinanced with TARP and the interest rates were brought down to unbelievably low levels. Quite correctly, corporation after corporation pulled back and worked hard to rebuild its balance sheet, holding off expansion plans and avoiding acquisitions. In order to get the economy moving the Federal Reserve kept interest rates low and the Federal Government accepted the inevitability of large fiscal deficits and gradually the economy began to revive. However, growth was slow and inflation tame so interest rates were kept low. Investors gradually learned that risk had very little penalty and corporations began to take on more risk via ever larger acquisitions and aggressive share repurchases. Unicorns began to bloom, bragging that growth was all important and that profitability was very secondary as it would inevitably follow hyper growth. The recent IPO of Lyft is a clear indicator that the risk that profits don't materialize is a minor concern.

We must ask whether this will change and when? Our experience has taught us that the markets and investor emotions move in cycles and that inevitably the exuberance that we see now will turn to fear. We are tempted to try to use data to predict when the "music" will stop but we know that economics is really a study of human behavior in the face of an uncertain future. At some point people will get more cautious. Right now people are feeling good. Wealth is high with higher stock markets and home prices inflated by low interest rates and the decade of stock appreciation. We think that more than enough complacency and debt has accumulated. We are worried.

We have always observed that the cheapest and most reliable source of capital is retention of profits and that small companies will be leaner, more flexible and less prone to hubris than the large companies. Further, we have concluded that the management of small companies, if they are good, are much closer to the customer and much closer to the pulse of the business than large ones.

Our investment discipline causes us to examine the companies that we invest in closely, looking to understand their potential to achieve high returns on invested capital and to have the plans and potential to reinvest the returns in building a stronger more profitable company. We want to own a position in these companies at a reasonable discount to the prospective value of the business. We would expect that after a decade of almost uninterrupted price appreciation of the market, it had become too difficult to find stocks with the characteristics that we seek at prices that we are comfortable. However, thanks in part to the poor performance of value names, we are able to build a portfolio that we are pleased with.

Performance Review

Portfolio Factors

The first quarter was a good period with great returns in January and February. In March, as the enthusiasm of the first two months faltered, we lost some of our relative performance. We were relatively pleased with this given that sector allocation was a major headwind. We were relatively pleased with this given that sector allocation was a major headwind. The biggest single headwind was our absence from Real Estate and an under allocation in Investment Technology. Our selections in that group were off the mark where it appears that we were too conservative. We also suffered from the cash carry. While our cash was a bit higher than usual, the impact was disproportionate because of the rapid appreciation of equities

Stock Selection: Contributors

We were pleased that the best performers were from diverse industries. The largest contributor, Triumph Group (TGI) had been our most difficult holding in the fourth quarter. But as success in implementing their turnaround became evident, the stock did quite well and we reduced our position. Great Lakes Dredging and Dock (GLDD) also did well. After noting that the Great Lakes have nothing to do with the company, we should say that we are pleased with the fundamental improvement in returns that this dredging company is achieving. Other solid contributors included Mercer International (MERC), a global pulp producer, M/I Homes (MHO), a homebuilder, and Silgan Holdings (SLGN), a manufacturer of cans and other containers.

Portfolio Contributors – Q1 2019

Security	Average Weight (%)	Contribution
Triumph Group	2.05	1.30
Great Lakes Dredge and Dock	2.17	0.65
Global Brass and Copper	1.99	0.62
M/I Homes	2.07	0.52
MGP Ingredients	2.09	0.51

Stock Selection: Detractors

The detractors primarily included companies where near term issues have resulted in them trading down in price. In particular, we are impressed with the outlook for Allied Motion (AMOT). The management team has built value here steadily, but a pause by the OEMs that buy Allied Motion’s motors and systems resulted in a disappointing quarter and the stock has suffered. We also were disappointed with CSS Industries (CSS), a maker of craft, gift and seasonal items. We are convinced that the changes underway will restore strong levels of profitability. The same applies to FreightCar America (RAIL), a rail car builder. The company is in the midst of major changes in car design and plant layout which will reduce costs dramatically. While this is happening the stock is languishing. John Wiley (JWA), a publisher of textbooks and academic journals, performed poorly as the shift from print to digital has created some issues. We are inclined to believe that given the strength of the franchise, their strategy will be fruitful. We did sell Unifi (UFI) as the competitive landscape seems to be too difficult for them to achieve reasonable returns.

Portfolio Detractors – Q1 2019

Security	Average Weight (%)	Contribution
Allied Motion Tech.	1.63	-0.42
John Wiley & Sons Class A	1.01	-0.21
CSS Industries	0.37	-0.11
Unifi	1.08	-0.11
Bassett Furniture	0.32	-0.03

Portfolio Changes

We did see the level of portfolio changes pick up in the first quarter with the exit from ten positions and the addition of six. The sales were uniformly due to increased skepticism about the ability of each of the company's to achieve the profit levels that could drive their share price higher. We sold Unifi, as we noted earlier, due to concerns about the competitive environment. Shortly after our exit the relatively new CEO departed. We sold Rayonier (RYAM) due to concerns that the continuing decline in the cellulose pulp market makes price pressure very likely in the coming years. We sold Bassett Furniture (BSET) as consistent returns prove to be elusive in spite of good levels of consumer spending. In the case of American Vanguard (AVD), we see recent acquisition activity as a diversion from the strategy of growing their portfolio of herbicides and pesticides. We exited Hain Celestial (HAIN) after concluding that we had invested too early before a clear turnaround plan was in place and showing signs that it would work. We sold Halcon Resources (HK) because acquisitions of additional acreage was straining the balance sheet of this exploration and production company. We sold Mueller Water (MLI), with regret, but had to conclude that the efforts to develop new product lines was too dilutive to earnings, with additionally, quite uncertain rewards. We sold Interface (TILE) due to concerns about the risk involved in a major acquisition. Finally, we sold Masonite (DOOR) because of a concern that our exposure to the building trades was a bit too high, and a conclusion that the near term potential of the holding was limited. We also concluded that while the outlook for infrastructure spending is good, we were not confident that Tutor Perini (TPC) can profitably execute the very complex projects that they are working on, so we exited that position.

We added six new names, mostly in the Consumer Discretionary sector. We added Dave & Buster's (PLAY), a chain of restaurants with an extensive offering of games which appeal to a broad audience. We also added Sally Beauty (SBH), a retail chain offering professional grade hair color, hair conditioning and related products. We like the high level of profitability and the initiatives underway to reduce costs and to make the stores more effective. We also added Universal Electronics (UEIC), the premier maker of remote controls for televisions and a variety of electronic devices used in today's home. We added Delphi Automotive (DLPH), a maker of integrated automotive power train systems, and MTS Systems (MTSC), a maker of non-destructive testing equipment and sensors. Finally, we added NMI Holdings (NMIH), a mortgage insurance company.

Portfolio Positioning

The portfolio is, as usual, smaller than the benchmark with both the weighted median and the weighted average market cap at less than 75% of the benchmark. We have shrunk the number of holdings a bit, exiting the quarter with 71 holdings. That was intentional as we felt that careful pruning of the portfolio will enhance returns. We intend to keep a leaner portfolio going forward. Valuation metrics are at a discount to the benchmark with a lower P/E, price to book value and price to sales. As usual, our ROA and ROE are significantly higher than the benchmark.

We are pleased with the portfolio and feel that we are well positioned whether the economy grows nicely or falls short of expectations.

We thank the patient investors who continue to invest with us. We know from past experience that our investing skills are much more evident in periods of worry and turmoil than in times of exuberance. We think that the length of this expansion, the enormous underperformance of value in the last five years, and the excessive risk taking we are seeing, are setting the stage for a period when you will want to be invested in well managed small cap value stocks.

Walthausen Small Cap Value Fund

Quarterly **Fund Commentary**

Ticker Symbols: Institutional Class WFICX | Investor Class WSCVX

As of March 31, 2019

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

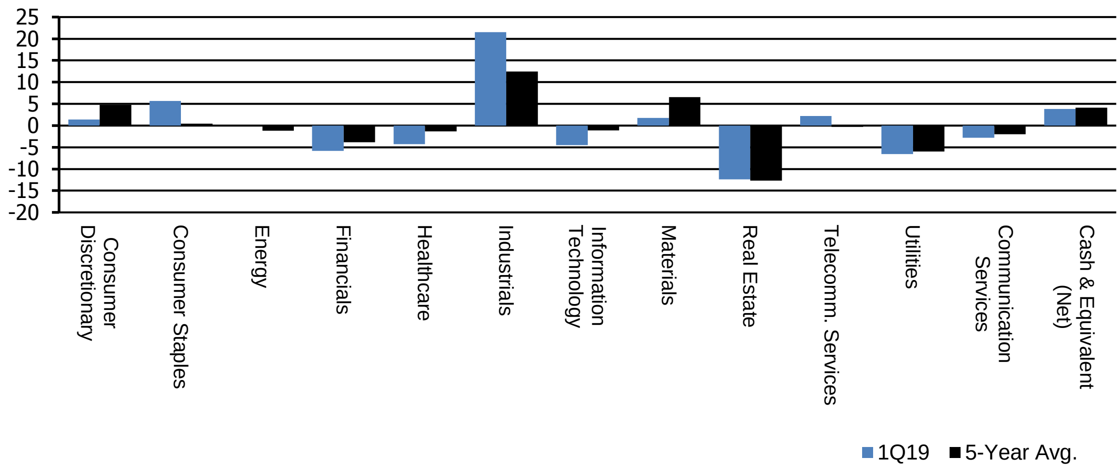

Exhibit 1 above highlights the fact that sector weight differentials between the Fund and the Russell 2000 Value Index benchmark have not changed greatly from today's levels versus the five year average.

Top Ten Holdings (%)

ABM Industries, Inc.	2.8
MGP Ingredients, Inc.	2.7
Meredith Corp	2.5
Great Lakes Dredge & Dock Corporation	2.4
Primerica, Inc.	2.4
Landec Corp	2.3
SeaWorld Entertainment, Inc.	2.3
Kulicke & Soffa, Inc.	2.3
Global Brass and Copper Holdings, Inc.	2.2
Kelly Services, Inc. CL A	2.1
Total % of Portfolio	24.0

Fund Statistics

	Fund	Russell 2000 Value Index
Number of Holdings	71	1,366
Median Market Cap (Millions)	$1,120.7	$688.1
Weighted Avg. Market Cap (Millions)	$1,452.7	$2,079.7
Price/Book[1]	1.5	1.3
P/E using FY1 Estimate[2]	12.5	13.8

Source: FactSet Research

Portfolio Performance

	Q1 19	1 Year	3 Year	5 Year	10 Year	Since Inception	Inception Date
Walthausen Small Cap Value Fund: Investor Cl	12.39	-7.09	9.72	3.55	17.50	11.06	2/01/08
Russell 2000 Value Index[1]	11.93	0.17	10.86	5.59	14.12	7.26	
Walthausen Small Cap Value Fund: Institutional Cl	12.39					12.39	12/31/18
Russell 2000 Value Index[1]	11.93					11.93	

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.

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

The Russell 1000® Growth Index measures the performance of the large cap growth segment of the US. equity universe. It includes those Russell 1000 companies with higher price/book ratios, higher predicted and historical growth rates.

Price to Sales (P/S) ratio is a valuation ratio that compares a company's stock price to it revenues.

Return on Assets (ROA) is a profitability ratio that indicates how profitable a company is relative to its total assets.

Return on Equity (ROE) is a profitability ratio that measures the ability of a company to generate profits from its shareholders' investments in the company.

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
(888) 925-8428
www.walthausenfunds.com