Walthausen Select Value Fund

Quarterly **Fund Commentary**

Ticker Symbols: Institutional Class WSVIX | Retail Class WSVRX

As of June 30, 2019

Environment

Three months ago I expanded on the astounding divergence of the performance of growth and value. That gap closed a bit in the second quarter but it remained meaningful, with the Russell 2000 Growth Index 137 basis points ahead of the Russell 2000 Value Index. The duration of this trend is disconcerting for value investors. Ten year annualized returns for the growth and value indices show a 200 basis point gap in favor of the small growth stocks. That triumph of growth comes mostly over the past three years but it is extraordinarily large and surprisingly durable. This makes me wonder, is growth the new paradigm and will the "old economy" die? We have heard "this time it is different" a good number of times. Always it has turned out that the economy was only evolving.

What is causing this disparity of performance between growth and value stocks? It is hard to know as the economy and the market contain so many variables that any observation can never rise beyond the status of thesis. Our thought is that it's the sustained low interest rate, with 10 year treasuries near the level of inflation. The cost of capital, and therefore the discount rate that is used to value any security, has fallen dramatically. Now it is just a thesis but it is one of the few that can explicate the high valuations accorded to growth companies with rapid revenue growth, current losses and the promise of massive earnings far in the future.

But this is just a thesis. If the time value of money is so little, why do most domestic energy stocks trade at a discount to their PV10 value? That calculation uses current oil and natural gas prices to discount the value of what the company may reasonably bring into production over the next five years using a 10% discount rate. And why have stocks of profitable, well financed dividend paying companies languished. Is this a case of too much money chasing a good idea? Is it similar to the dot com bubble? Is the rush of IPOs by venture capital backed startups a sign that smart money knows that the "Unicorn" game is about played out?

The good news is that while we, as value investors, have lost ground relatively, the companies that we invest in are generally doing well, generating healthy returns on capital and reinvesting for growth and good returns on capital. They appear well positioned to do that in the foreseeable future.

Performance Review

Portfolio Factors

After a very strong first quarter, the Russell 2500 Value Index produced what appears to have been a rather pedestrian return of less than 2% for the second quarter of 2019. A closer review of the second quarter reveals a period that was anything but dull as April had a strong result gaining 3.51%, followed by a drop of 7.54% in May, only to see a snap back in June of 6.47%. Given the manic backdrop that we had to work with we are pleased that the Select Value composite was able to outperform both the Russell 2500 Value and Russell 2000 Value benchmarks. All of the outperformance during the period can be attributed to stock selection, as every sector of which the Fund had exposure achieved a return that exceeded the corresponding benchmark sector return with the exception of financials where the results were nearly equal. A preponderance of the outperformance was derived from our efforts in the industrial sector, which was the best performing sector in the benchmark. The Fund's overweight, combined with greater stock selection performance produced this result. The energy sector was the one area that was a drag on performance and it is an area that we are monitoring closely.

Stock Selection: Contributors

Strong performance was achieved by World Fuel Services (INT), a new addition to the portfolio. The company is a physical fuel broker and logistics provider. They have a long history of growth in sales and earnings; however, in the period from 2013 to 2016 they completed a series of acquisitions that, while growing the overall business and geographic footprint, had a detrimental effect on their profit margins and earnings per share. Upon review, we found that management had acknowledged that mistakes had been made during the acquisition spree and we found their plan to correct these issues credible. Additionally, the marine market, which accounts for about a quarter of revenues, and an even greater percentage of profitability, is at the doorstep of a major change in the market due to the implementation of a regulation known as IMO 2020. This regulation decrees a reduction to the sulfur content of fuel used in marine transportation. We see the potential for this regulation to create some havoc in the marine fuel market and that the company, with its size and expertise, will win new business as lesser competitors find it difficult to source and provide fulfillment of the lower sulfur fuel.

Casey's General Stores, Inc. (CASY) is a gas station and convenience store operator with 2,150 locations through the mid-continent. We were able to purchase the shares of this long term outperformer last summer when the shares had pulled back due to several business headwinds that came together to hit CASY simultaneously; high retail gas prices, challenged farm incomes, and a highly promotional pizza market. (Casey's sells their own pizza and total sales rank them in the top 5 pizza chains in the US). We know this company to be well managed and quite capable to take on the challenges in front of them. Rarely do you get the opportunity to purchase the shares of this long term winner on a pull-back, but when we saw the opportunity we seized it and are quite happy that we did.

Worthy of note is that performance was assisted when Electronics for Imaging (EFII) was bought out by a private equity firm. Admittedly, this was not one of our more successful investments, as the actions of management to get the business back on track and investors' appreciation for new products took longer than expected. However, we are satisfied that other knowledgeable investors took note of the value inherent in the company and were willing to speak with their checkbook, acquiring the company at a premium.

Portfolio Contributors – Q2 2019

Security	Average Weight (%)	Contribution
Electronics For Imaging	1.37	1.05
World Fuel Services Corp	2.44	0.67
EMCOR Group	3.16	0.62
Casey's General Stores	2.94	0.61
NCR Corporation	3.45	0.47

Stock Selection: Detractors

Southwestern Energy Company (SWN), an E&P company whose revenue stream is derived predominantly from natural gas production, was the largest drag on performance in the quarter. We saw an opportunity for this investment as we foresaw a strengthening natural gas market due to a growing demand from the burgeoning US LNG industry. The LNG industry is growing pretty much as expected; however, the overall supply of natural gas has grown faster. Currently, the company is trading at an enterprise value that is less than their in-ground reserves at current commodity prices. So, while we have recognized that we were wrong with our thesis on the strength in the commodity, for the moment we are not inclined to sell this investment at a value that is below its asset value.

Dave & Buster's Entertainment, Inc. (PLAY) was also a challenge to performance this period. The company was added to the portfolio in the previous quarter when we saw that a period of declining same unit revenues had come to an end. A deep analysis of this restaurant entertainment concept identified very strong cash flow economics, a business trait that we find very attractive. Management's plan to focus on revamping the menu, improved marketing, the introduction of virtual reality games to the entertainment offering and a historically low valuation had us excited about this investment. With a quarter of improving sales registered we saw it as the right time to buy the shares. During the recent quarter, it came to light that the unit sales were again disappointing, and we realized we had stepped in a bit early. This is one of the many trials and tribulations of being a value investor. Businesses do not always move along in a straight line. We have taken a blow from our investment recently but anticipate that management's efforts to get sales back on a growth track will be successful.

Portfolio Detractors – Q2 2019

Security	Average Weight (%)	Contribution
Southwestern Energy Corp	1.95	-0.79
Dave and Buster's Entertain.	2.60	-0.58
Whiting Petroleum Corp	1.72	-0.55
Callon Petroleum Corp	1.87	-0.27
Darling Ingredients	2.81	-0.24

Portfolio Changes

We exited from four holdings during the quarter and added three. The reason for the sale of three of the four companies was valuation. All three were successful investments that had reached what we feel were full valuations leaving little room for upside and a greater amount of valuation risk in the portfolio. The fourth was the buyout of EFII that was previously discussed.

Of the three additions to the portfolio, one resides in the energy sector, World Fuel Services (INT), previously discussed, another resides in the Consumer Discretionary sector, Cavco Industries (CVCO), and the third is found in the financial sector, First American Financial (FAF).

Cavco is the nation's third largest builder of manufactured and modular homes. The company produces high quality homes for the first time homebuyer segment of the market, a segment that we believe to be underserved at the moment. For twenty years prior to 2000, manufactured homes represented more that 20% of all new homes built on average. This number dropped to 10% during the sub-prime housing boom and to-date has only gotten back to 13%. And while the press is pointing out that millennials don't have the desire to purchase that first home as had previous generations, we see part of the problem simply being the lack of affordable inventory to buy. A challenge to manufactured home sales has been readily available financing. We see the current efforts of the national home lending agencies as a beginning of a positive change to this headwind.

First American Financial is a title insurance company that has proven themselves to be a very profitable underwriter. Title insurance protects property buyers and mortgage lenders against problems with a title when there is a transfer of property ownership. The company's business is dependent upon activity levels of the residential housing market. As lending rates were increasing during 2018, market participants determined that this would result in a reduction in the residential activity therefore impeding the company's business. A careful review of their reserves leads us to believe that their conservative reserving culture will result in a continued growth in earnings throughout any soft housing activity period. Additionally, the recent decline in interest rates should have a positive effect on both housing activity and their business.

Portfolio Position

Similar to last period, with the exception of P/B, the portfolio is at or below the benchmarks in all pertinent valuation metrics. As a result of the few changes made, the average weighted market cap did fall a bit to $3.4 billion. Additionally, there was a slight uptick in the overall strength of the balance sheet as the portfolio LT Debt to Capital ratio fell below 30% as measured at the end of the quarter. National and international economic news has been chaotic at best. The current environment reminds me of an old football adage; the best offense is a good defense. As I review the portfolio and recognize the strength of businesses that we have invested in, I realize that this adage has been adhered to. We are confident that this portfolio will serve us well regardless of what path the economy takes. We thank you for the confidence that you have shown in investing with us.

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

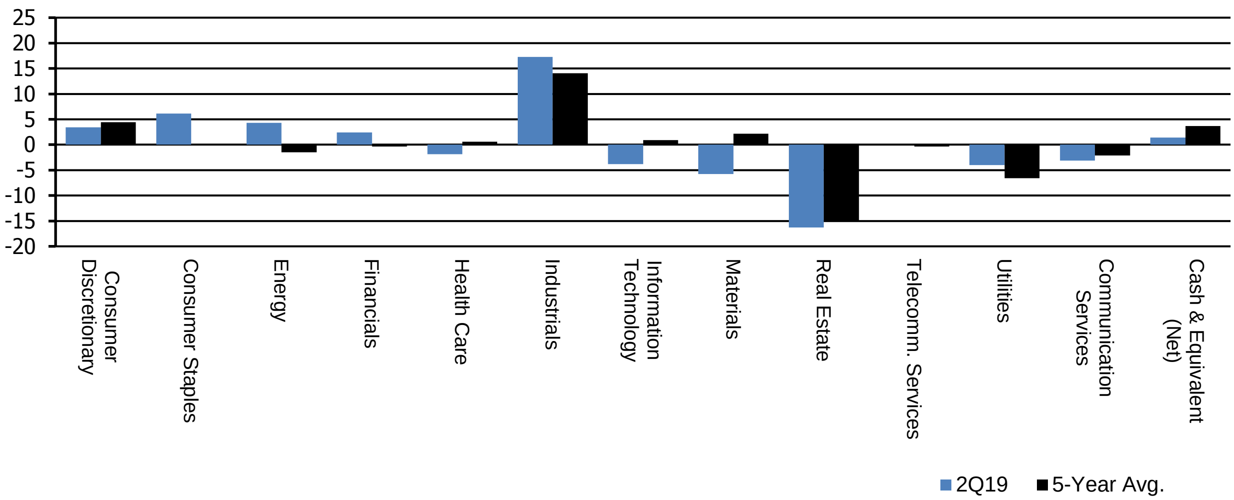

Exhibit 1 above highlights the fact that sector weight differentials between the Fund and the Russell 2500 Value Index benchmark have not changed greatly from today's levels versus the five year average.

Top Ten Holdings (%)

Oshkosh Corporation	3.9
McGrath RentCorp	3.8
Granite Construction, Inc.	3.7
PacWest Bancorp	3.6
World Fuel Services Corp.	3.6
Moog, Inc. Class A	3.4
Encompass Health Corp.	3.4
MDC Holdings, Inc.	3.3
Amerisafe, Inc.	3.3
Bank of Hawaii Corp.	3.3
Total % of Portfolio	35.3

Fund Statistics

	Fund	Russell 2500 Value Index
Number of Holdings	35	1,701
Median Market Cap (Millions)	$2,956.3	$1,046.5
Weighted Avg Market Cap (Millions)	$3,389.8	$5,163.5
Price/Book[5]	1.8	1.6
P/E using FY1 Estimate[6]	13.9	15.2

Source: FactSet Research

Portfolio Performance

	Q2 19	1 Year	3 Year	5 Year	Since Inception (12/27/10)
Walthausen Select Value Fund: Institutional Class	5.91	-1.35	9.85	3.68	9.51
Walthausen Select Value Fund: Retail Class	5.87	-1.54	9.57	3.43	9.23
Russell 2500 Value Index[1]	1.89	-1.92	8.98	5.55	9.51
Russell 2000 Value Index[2]	1.38	-6.24	9.81	5.39	8.60

Total Expense Ratio: 1.35%. Net Expense Ratio: 1.10% for Institutional Class, 1.35% for Retail Class. Expense ratio per the June 1, 2019 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, 2019. The Advisor may not terminate the fee waiver before May 31, 2019. The Trustees may terminate the expense waiver upon notice to the Advisor. From the prospectus dated June 1, 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 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.

[4]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 values.

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 U.S. equity universe. It includes those Russell 1000 companies with higher price/book ratios, higher predicted and historical growth rates.

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
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