Walthausen Small Cap Value Fund

Quarterly **Fund Commentary**

Ticker Symbols: Institutional Class WFICX | Investor Class WSCVX

Q4 2021

Environment

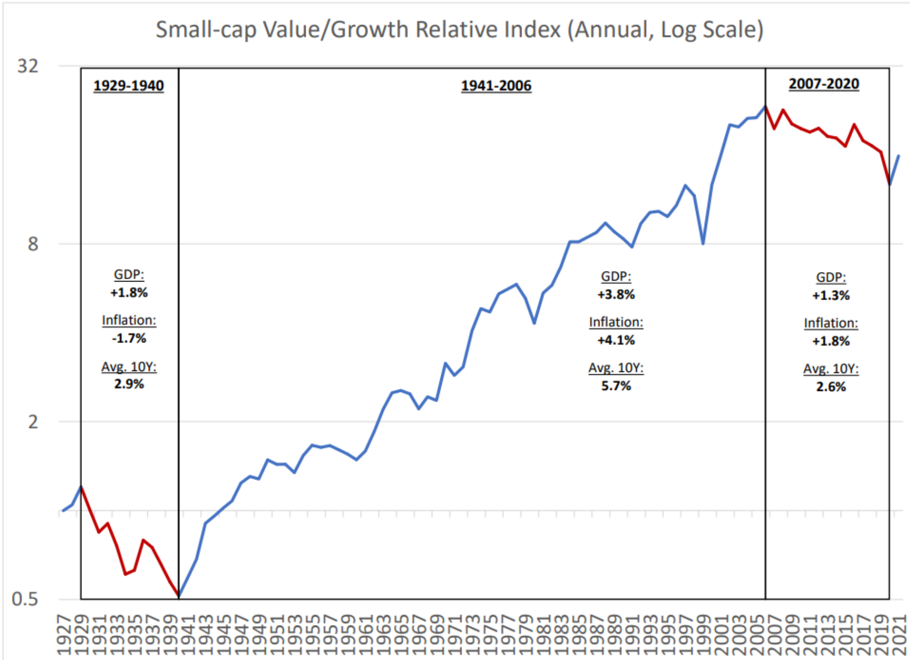
I am proud to say that 2021 was a good year for Walthausen & Co., with two of our three strategies beating their primary benchmark and our third missing out to its primary but beating its secondary benchmark. I am proud because at the mid-way point, it did not appear that success would be ours. We noted in the third quarter review that despite the benchmarks having been in a several month trading range, there were significant changes taking place. The most important being that companies bearing the markers often associated with "quality" (profitable, low volatility, dividend growth, high returns) were outperforming those that are most often categorized by more questionable traits (unprofitable, low ROE, highly shorted, high variability). To those of us that have been educated in the school of fundamental investing, it is accepted as a given that over time the higher returning, higher profitability company would produce the better investment return. However, for a long time that has not been a given.

At this year's halfway point, our Small Cap Value strategy was ahead of its benchmark by a respectable margin; however, our Focused Small Cap Value strategy and our Micro Cap Value Strategy were trailing by over 600 and 1200 basis points respectively. Trying to make up differentials of that degree is a mighty challenge. Asking to make it up in six months is out of the question. The Focused Small Cap Value strategy made up more than 500 basis points of its differential while the Micro Cap Value made up all of its differential and then some. How did this happen?

In the third quarter commentary we wrote, *"So, at least for a quarter it seems that fundamentals matter again. And as I stated in a recent client meeting, we feel like we're in a fair fight again"*. The fight remained fair throughout the fourth quarter, and we have always liked our chances in a fair fight. In a market where fundamentals and identifying companies poised to perform the best matters, we are happy to put ourselves up against the finest.

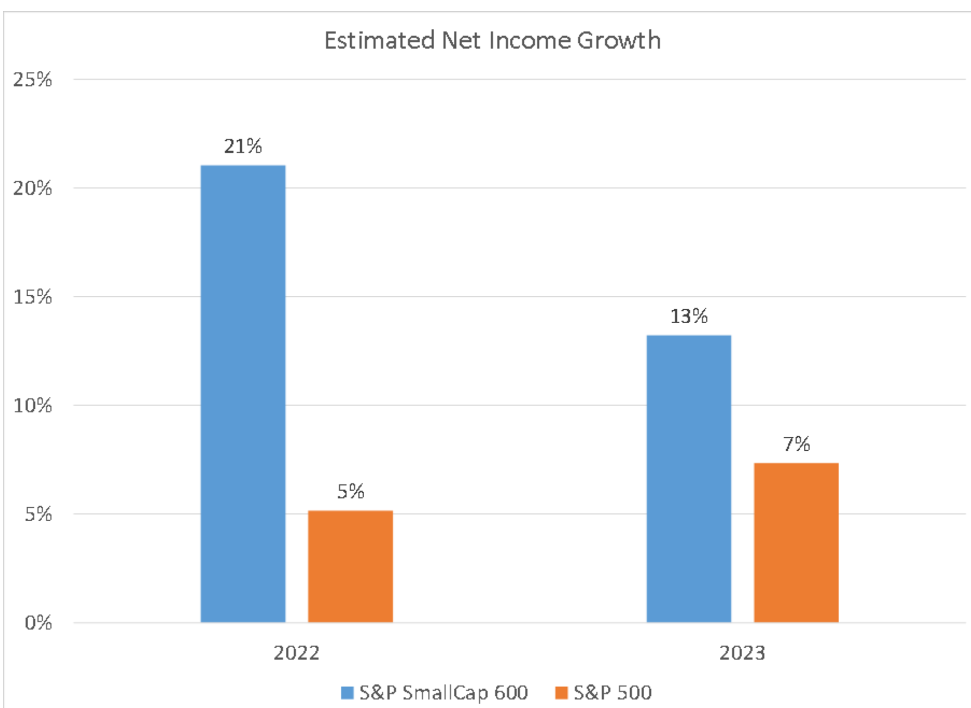
While the 2021 performance has us excited, we are even more excited for the future. The past decade has been an extended period of large cap equity performance beating small caps. It's been a period of growth investing beating value investing. The low GDP, low inflation, low interest rate environment of the past decade supported these results. Many talking heads have spoken to value investing making a comeback during the pandemic and small caps having moments of glory. We believe they are missing the bigger picture: that the pandemic changed both the way the public thinks and the resulting economic environment ahead which should be much more favorable for small caps and value strategies.

The pandemic's effect on the public psyche and the economy will be enduring. "COVID Consciousness" and "The Great Resignation" are two sides of the same coin. The public (the consumer) is going to make spending decisions that are definably different than those made of the past decade. Similarly, the workforce will be making decisions that are definably different than the past decade. Specifically, the work force will be demanding better work conditions, benefits, and pay. Compensation expense will grow at an annual rate that is significantly higher than what has been experienced in the past decade and this will flow through to inflation: not an extreme level of inflation, but an increase from the levels seen during that past decade. As we have discussed in previous missives, a higher inflation rate environment favors value investing.

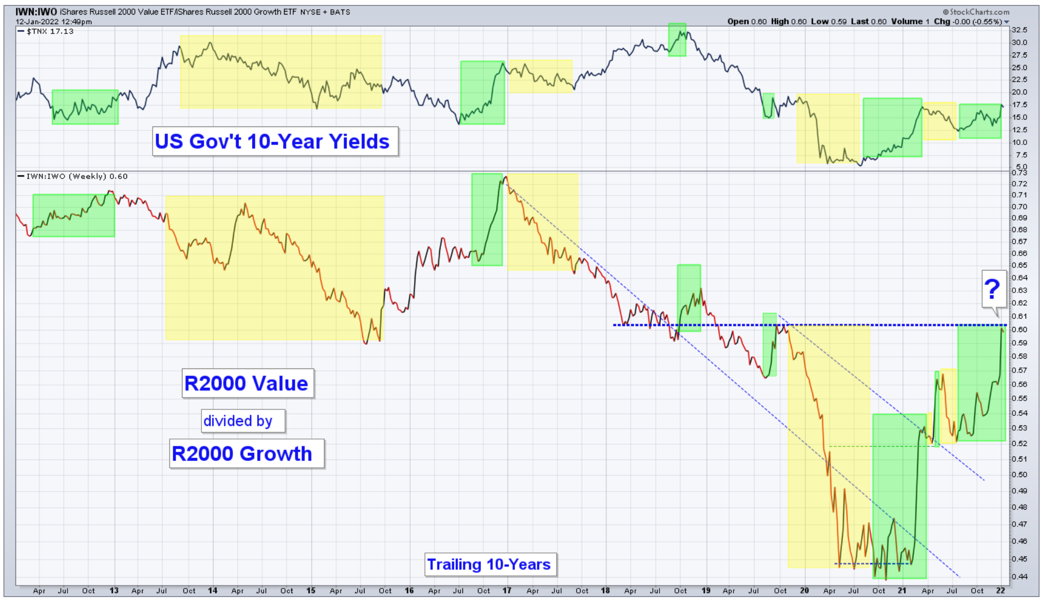


Source: FRP, FactSet, Morningstar; as of 12/31/21

With higher GDP and inflation comes pricing power. With pricing power comes margin support and earnings growth. One of the most basic beliefs of the fundamental investor is that stock prices follow earnings growth. For the past decade, large cap companies have had a higher earnings growth rate than small caps. As seen below, a reversal is forecasted with the growth of earnings of small caps expected to significantly outperform that of large caps.

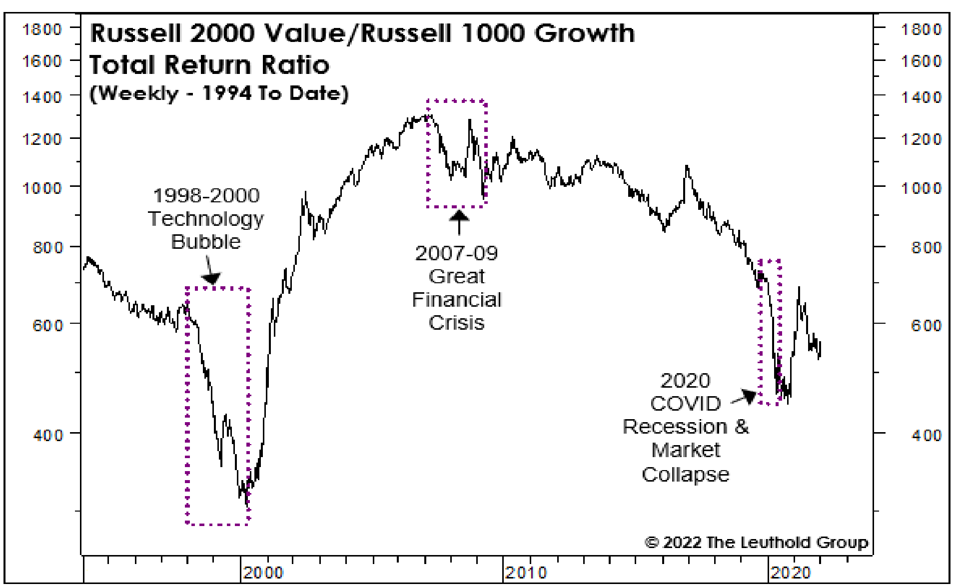


Additionally, with modest inflation and stronger earnings, we should also expect increasing interest rates. Generally speaking, over the past decade we see a pretty strong correlation between periods of rising 10-year treasury yields and value investing outperformance.



Source: Furey Research Partners and StockCharts.com

Major market inflections - messy though they may be - can have a long-term effect on how the market goes about its business. It's easy to talk about but more powerful to see. Look at how the market, significantly small value, outperformed large growth after the Dot Com Bubble. And small value kept on winning right up until the Great Financial Crisis. The inflection was messy but for the next decade large growth's outperformance continued unabated. We contend that the pandemic is as significant of an economic and public psyche event as these previous events and that a change of leadership is upon us.



Source: Chart courtesy of The Leuthold Group

Putting this all together one begins to see why we are so excited about the future. There are indications that quality and fundamentals are starting to mean more to investors again. We see signs that the economic backdrop, be it GDP, inflation or interest rates, are coming together in a way that has historically been quite favorable to the small cap value investing style. Current earnings growth estimates favor our small and micro cap companies. These are all important attributes of an investment environment that can be quite favorable to us. It looks like we are back to a fair fight.

Performance

During the quarter, the Small Cap Value Fund generated returns well above the Fund's Russell 2000 Value Index benchmark. We were pleased to see that over three quarters of the outperformance was due to stock selection. Our selections in Consumer Discretionary, Industrials, Materials, and Information Technology were additive to performance. Our absence of exposure to Utilities was the largest laggard.

Performance in Consumer Discretionary is largely explained by our exposure to Manufactured Housing ("MH") companies Legacy Housing Corp (LEGH) and Skyline Champion (SKY). We have followed the MH industry closely for over a decade. While there have been many articles written about lumber pricing and rising cost of median home transactions, we felt that investors were missing the work that many MH companies were doing to improve their operations and provide truly affordable housing to US home buyers. As sales performance of LEGH and SKY has improved, the market is starting to take notice. With both company's average home price well below the US median home price, the MH industry is taking share from stick built competition while increasing margins. We believe that MH sales will remain elevated for at least the next few years.

Industrial performance came from a variety of names. Our largest contributors were Ameresco (AMRC), an engineering and construction firm; VSE Corp (VSEC), an aerospace parts distributor; Titan Machinery (TITN), an agricultural equipment distributor; and Comfort Systems (FIX), an HVAC contractor. Ameresco benefited from market recognition of the earnings growth outlook driven by new business wins. VSEC benefited from a rebound in 3Q21 sales and an improving demand outlook. Titan Machinery benefited from strong 3Q21 sales performance and margin expansion, with the 2022 agriculture equipment demand outlook very strong. Comfort Systems benefited from improving 3Q21 revenues and a sizable improvement in organic backlog.

Top Contributors

Top contributors in the quarter were Axcelis Technologies (ACLS), a manufacturer of ion implantation technology used in chip manufacturing. The company is benefitting from increasing sales and backlog tied to the global build out of increased semiconductor fabrication. Ameresco (AMRC), discussed below, Skyline Champion (SKY), already discussed, and Materion (MTRN), a manufacturer of specialty metals and alloys. The company has been benefiting from a demand recovery and improved margin performance.

Top Detractors

Green Dot (GDOT), a service provider to the banking industry, was negatively impacted in the quarter by falling valuations among fintech names. We continue to like GDOT as it has a bank holding company and generates positive free cash flow which compares favorably to many of its competitors. Gulfport Energy (GPOR), an exploration and production company, was negatively impacted by falling natural gas prices during the quarter.

Jack in the Box (JACK), discussed below, was negatively impacted as it missed 3Q21 earning per share numbers compared to street expectations, and what we believe is an inappropriate acquisition.

Portfolio Contributors – Q4 2021

Security	Average Weight (%)	Contribution
Axcelis Technologies, Inc.	1.42	0.65
Ameresco, Inc. Class A	0.95	0.58
Skyline Champion Corp.	1.97	0.49
Materion Corp.	1.69	0.48
VSE Corp.	1.91	0.44

Portfolio Detractors – Q4 2021

Security	Average Weight (%)	Contribution
Green Dot Corp. Class A	1.60	-0.58
Gulfport Energy Corp.	1.66	-0.25
Jack in the Box, Inc.	0.79	-0.21
ProPetro Holding Corp.	1.18	-0.20
NuVasive, Inc.	1.25	-0.19

Names Added

During the quarter we added six names. Alamo Group (ALG), a commercial equipment and agriculture implement manufacturer, has navigated COVID well, resulting in a much improved leverage profile. We believe the company is well positioned to benefit from elevated farm incomes for the next few years, while benefiting from consistent demand from government and commercial in vegetation management focused product lines. Backlogs are at record levels. Historically the company has made very accretive acquisitions, and the balance sheet is well positioned for deal activity.

ANI Pharmaceuticals (ANIP), a generic drug manufacturer, is a name we have been monitoring for some time. The company had been trying to bring a generic version of Acthar Gel, called Cortrophin Gel, to the market for some time. The drug was approved by the FDA in November 2021. Cortrophin is currently targeted for arthritis indications, but may have additional market vertical exposure going forward. Acthar Gel was owned by Mallinckrodt and made headlines in the past for its elevated price and lack of generic competition. ANIP has an opportunity to take share through more attractive pricing of Cortrophin. We also note that Mallinckrodt is currently in bankruptcy, which can present a market share opportunity for the company.

Trimas (TRS), an industrial conglomerate, is a name we have owned in the past and have continued to monitor after the appointment of Thomas Amato as CEO in 2017. The company had made some progression in simplifying its business through the spin-off of Cequent (renamed Horizon Global), but the remaining Trimas found itself with four disparate businesses: Packaging, Aerospace, Engineered Products, Bolts & Gaskets. We appreciated Amato's strategy of focusing capital towards growth of the packaging business. The company sold the Bolts & Gaskets business line in the 4Q18, and used proceeds to acquire additional packaging businesses in 2020. We had anticipated the 2021 packaging results would be materially lower as a result of a surge in 2020 demand. This did not occur and packaging results were fairly resilient. We anticipate a return to packaging organic growth in 2022, and a return to more predictable airplane build rates for TRS's aerospace segment which will tailwind for segment revenues and profits in 2022.

Federal Agricultural Mortgage Corp (AGM) is also known as Farmer Mac. The company is primarily known for loan guarantees for agricultural loans, but the appointment of Brad Nordholm as CEO in October 2018, has resulted in a clear change in business results. The company has become proactive with banking partners, revamped internal systems, and hired employees to better service customers. Given the company's backing by the US government, AGM finds itself in an advantageous borrowing position; able to borrow slightly above the treasury yield curve. From a lending perspective the company can provide attractive loan rates to agriculture borrowers and has proactively looked to increase the farm & ranch loan portfolio. From an underwriting perspective, historic loan losses have been very low due to disciplined underwriting standards. With a positive outlook for farm income, we see a good loan demand outlook heading into 2022.

ProPetro (PUMP), a pressure pumping company, was added due to the net cash balance sheet and favorable exposure to US oil & gas fracking activity which should improve rig day rates and utilization.

Patrick Industries (PATK), a manufacturer of components sold into the RV, Marine, and MH markets was added due to strong demand outlook of the company's primary end markets. We see 2022 demand in those markets as strong relative to 2021 due to low distributor inventories and solid retail demand. We feel the company's valuation is attractive given the impressive operating margin improvement over the last few years.

Names Sold

During the 4Q21 we exited four names. Ameresco (AMRC) performed well in 2021 and exceeded our price targets, and we moved on. We liked the company's strategy and the market picked up on the earnings growth story driven by increasing backlog and the annuity like earnings that would come from managing completed energy projects.

Jack in the Box (JACK), owner of quick service restaurants, was a company we recently purchased based on our expectation for EBITDA growth driven by franchise development. The company had spent a large amount of time at an investor day explaining their strategy of improving franchisee relations and improving franchise economics. These initiatives were keys to getting franchisees to commit to open new units over the next few years. We felt the company was on the cusp of a fundamental change in its organic growth outlook. In December 2021, JACK announced that the company would purchase Del Taco for $575M. We did not feel that this was an appropriate investment given the previous desire to grow the Jack in the Box brand organically. We moved on after the acquisition was announced.

Perdoceo (PRDO), a provider of online education, was a company that we felt was well positioned to benefit from increased demand for post-secondary education. The valuation was very attractive from a historic perspective, and the balance sheet should have allowed for meaningful share repurchases. We exited the position after it became clear management was unwilling to repurchase shares in a meaningfully way and was focusing on non-accretive acquisitions.

UFP Technologies (UFPT), a foam products manufacturer, the 3Q21 sales and margin performance benefited from a rebound from 2020 COVID weakness. We felt that the valuation was too far above historic levels and exited the position.

Conclusion

In our last commentary, we spoke about looking forward to 3Q21 earnings releases as we believed that held names would start to differentiate themselves from the index. We have the same feeling heading into the 4Q21 reporting period. An ability to compound 2022 results on top of 2021 results will be a clear differentiating factor in the market going forward. We believe the portfolio is positioned well.

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

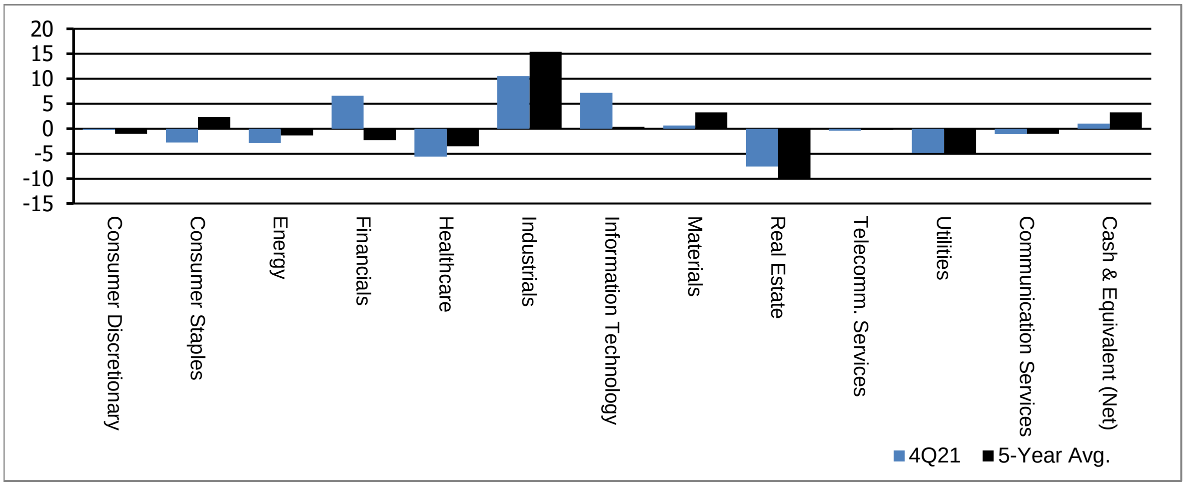


Exhibit 1 above highlights the fact that sector weight differentials between the Fund and the Russell 2000 Value Index benchmark have not changed greatly from today's levels versus the five year average.

Top Ten Holdings (%)

UMH Properties, Inc.	2.4
Textainer Group Holdings Ltd.	2.2
Skyline Corp.	2.2
Heritage-Crystal Clean, Inc.	2.1
Commercial Metals Co.	2.1
Seacoast Banking Corp. of FL	2.0
First Financial Corp.	2.0
Washington Trust Bancorp, Inc.	2.0
NBT Bancorp, Inc.	2.0
Heartland Financial USA, Inc.	2.0
Total % of Portfolio	21.0

Fund Characteristics

	Fund	Russell 2000 Value Index
Number of Holdings	63	1,451
Return on Equity[1]	8.4	0.1
Weighted Avg Market Cap (Millions)	1,703	2,954
Price/Book[2]	1.9	1.6
P/E using FY1 Estimate[3]	13.6	13.0
Long Term Debt/Total Capitalization[4]	28.3	41.2
Information Ratio (TTM)[5]	0.39	-
Active Share[6]	96.23	-

Source: FactSet Research

Portfolio Performance

	Q4 21	1 Year	3 Year	5 Year	10 Year	Since Inception	Inception Date
Walthausen Small Cap Value Fund: Investor Cl	7.91	36.99	18.21	8.14	12.11	11.83	2/01/08
Russell 2000 Value Index[7]	4.36	28.27	17.99	9.07	12.03	8.74	
Walthausen Small Cap Value Fund: Institutional Cl	7.96	37.28	18.46			18.46	12/31/18
Russell 2000 Value Index[7]	4.36	28.27	17.99			17.99	

Total Expense Ratio: 1.35% for Institutional Class, 1.35% for Investor Class. Net Expense Ratio: 0.98% for Institutional Class, 1.21% for Investor Class. Expense ratio per the June 1, 2021 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, 2022. The Advisor may not terminate the fee waiver before May 31, 2022. The Trustees may terminate the expense waiver upon notice to the Advisor. From the prospectus dated June 1, 2021.

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]*Return on Equity (ROE) is a measure of financial performance calculated by dividing net income by shareholders' equity. ROE is a measure of how effectively management is using a company's assets to create profits.*

[2]*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.*

[3]*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.*

[4]*Long Term Debt/Capitalization is a ratio that measures the proportion of long term debt used to finance assets, as a percentage of the firm's total capitalization.*

[5]*The Information Ratio is a measurement of portfolio returns beyond the returns of a benchmark, in this case the Russell 2000 Value Index, compared to the volatility of those returns.*

[6]*Active Share is a measure of the percentage of portfolio holdings that differs from the benchmark index.*

[7]*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.*

[8] *The Russell 2000® Index measures the performance of the small-cap segment of the US equity universe. The Russell 2000® Index is a subset of the Russell 3000® Index representing approximately 10% of the total market capitalization of that index*

[9] *Return on Invested Capital (ROIC) is a calculation used to assess a company's efficiency at allocating the capital under its control to profitable investments. The return on invested capital ratio gives a sense of how well a company is using its capital to generate profits.*

[10]*A special purpose acquisition company (SPAC) is a company with no commercial operations that is formed strictly to raise capital through an initial public offering (IPO) for the purpose of acquiring or merging with an existing company.*

<u>An investment in the Fund is subject to investment risks, including the possible loss of the principal amount invested.</u> 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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