Barrons: The Best Small-Cap Funds*

Trailing Performance (%)

As of Date: 9/30/2023	Inception	20 Years	15 Years	10 Years	5 Years	3 Years	1 Year	QTD
FPA Queens Road Small Cap Value	8.89	8.52	8.21	7.23	7.44	12.71	15.36	-2.25
Russell 2000 Value Index	7.57	7.73	7.16	6.19	2.59	13.32	7.84	-2.96

Past performance is no guarantee of future results and current performance may be higher or lower than the performance shown. This data represents past performance and investors should understand that investment returns and principal values fluctuate, so that when you redeem your investment it may be worth more or less than its original cost. Current month-end performance data, which may be lower or higher than the performance data quoted, may be obtained at www.fpa.com or by calling toll-free, 1-800-982-4372.

The FPA Queens Road Small Cap Value Fund ("Fund") commenced operations on June 13, 2002 (Inception date). Fund performance shown is for the Investor Class shares (QRSVX). Periods greater than one year are annualized. Fund performance is shown net of all fees and expenses and includes reinvestment of all distributions. Fund performance does not reflect the deduction of taxes that a shareholder would pay on Fund distributions or the redemption of Fund shares, which would lower these figures. An investor cannot invest directly in an index.

Prior to November 1, 2020, the performance shown reflects the historical performance of the Fund when Bragg Financial Advisors, Inc. ("BFA") served as investment adviser of the Fund. Effective November 1, 2020, FPA became the investment adviser of the Fund and BFA transitioned to serving as the sub-adviser. BFA continues to be responsible for the day-to-day management of the Fund, subject to FPA's oversight. No changes to the Fund's principal investment strategies were made in connection with these changes in management of the Fund, and Steve Scruggs, CFA, Director of Research and Senior Portfolio Manager for BFA, continues to serve as the portfolio manager for the Fund.

From inception of the Fund to December 31, 2004, BFA and its affiliates voluntarily absorbed certain expenses of the Fund and voluntarily waived its management fee. Had BFA not done this, returns would have been lower during that period. Effective January 1, 2005 through October 31, 2020, BFA charged a single unitary management fee and contractually agreed to pay all operating expenses of the Fund except for brokerage, taxes, interest, litigation expenses, and other extraordinary expenses.

The Fund's Total Annual Operating Expenses before reimbursement is 0.96% (Investor Class), 0.90% (Advisor Class), and 0.79% (Institutional Class) as of the most recent prospectus. As of the most recent prospectus, First Pacific Advisors, LP, the Fund's Adviser, has contractually agreed to waive its management fees and to make payments to limit Fund expenses, until February 1, 2024, so that the total annual operating expenses (excluding interest, taxes, brokerage fees and commissions payable by the Fund in connection with the purchase or sale of portfolio securities, fees and expenses of other funds in which the Fund invests, and extraordinary expenses, including litigation expenses not incurred in the Fund's ordinary course of business) of the Fund do not exceed 1.04%, 0.99% and 0.89%, for Investor Class, Advisor Class, and Institutional Class shares, respectively. These fee waivers and expense reimbursements are subject to possible recoupment by the adviser from the Fund in future years (within the three years from the date when the amount is waived or reimbursed) if such recoupment can be achieved within the lesser of the foregoing expense limits or the then-current expense limits. The expense limit agreement may be terminated only by the Fund's Board of Trustees, upon written notice to the adviser. Prior to November 1, 2020, the Fund had a utilized fee structure that limited annual operating expenses to 1.18%.

* BARRON'S Q3 2023 *Funds Quarterly* dated October 9, 2023, *The Best Small-Cap Funds*. Performance and other statistics shown in the article is for the Investor Class shares.

Important Disclosures

You should consider the Fund's investment objectives, risks, and charges and expenses carefully before you invest. The Prospectus for the Fund details the Fund's objective and policies and other matters of interest to a prospective investor. Please read the Prospectus carefully before investing. The Prospectus may be obtained by visiting the website at www.fpa.com, by calling toll-free, 1-800-982-4372, or by contacting the Fund in writing.

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The author used both quantitative and qualitative metrics to come up with his top small cap funds list. Some quantitative metrics considered in the analysis were downside capture ratio; 2022 and YTD through 9/29/2023 returns; fees; manager tenure and stability; and for larger firms, the depth of the research team. Qualitative factors considered included the manager's reputation for focusing on risk mitigation, especially in more concentrated funds. *(Source: author of the article, Lewis Braham).*
Investments, including mutual fund investments, carry risks and investors may lose principal value. Capital markets are volatile and can decline significantly in response to adverse issuer, political, regulatory, market, or economic developments. Small and mid-cap stocks involve greater risks and they can fluctuate in price more than larger company stocks. Short-selling involves increased risks and transaction costs. You risk paying more for a security than you received from its sale. Groups of stocks, such as value and growth, go in and out of favor which may cause certain funds to underperform other equity funds. The value of an individual security can be more volatile than the market as a whole and can perform differently than the value of the market as a whole.

Small Capitalization Companies. The QRSCV Fund primarily invests in equity securities (common stocks, preferred stocks and convertible securities) of small-capitalization U.S. companies, defined as those with market capitalization, at the time of purchase, that is no greater than the largest market capitalization of any company included in the Russell 2000 Index. Investing in small companies involves special risks including, but not limited to, the following: smaller companies typically have more risk and their company stock prices are more volatile than that of large companies; their securities may be less liquid and may be thinly traded which makes it more difficult to dispose of them at prevailing market prices; these companies may be more adversely affected by poor economic or market conditions; they may have limited product lines, limited access to financial resources, and may be dependent on a limited management group; and small cap stocks may fluctuate independently of large cap stocks.

The prices of securities held by the Fund may decline in response to certain events taking place around the world, including those directly involving the companies whose securities are owned by the Fund. Securities in the Fund's portfolio may underperform due to inflation (or expectations for inflation), interest rates, global demand for particular products or resources, natural disasters, pandemics, epidemics, terrorism, regulatory events and governmental or quasi-governmental actions. There is a risk that you may lose money by investing in the Funds.

Value style investing presents the risk that the holdings or securities may never reach their full market value because the market fails to recognize what the portfolio management team considers the true business value or because the portfolio management team has misjudged those values. In addition, value style investing may fall out of favor and underperform growth or other styles of investing during given periods.

Please refer to the relevant Fund's Prospectus for a complete overview of the primary risks associated with each Fund.

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BARRON'S
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The Best Small-Cap Funds

The opportunities in small-cap stocks haven't been this good in many years, yet they continue to be overlooked. Here are the best ways to play the rebound.

By Lewis Braham

If the stock market were rational, the **Avantis U.S. Small-Cap Value** exchange-traded fund would be beating the S&P 500 and the Nasdaq 100 this year. As its investment strategy, Avantis employs two of the key stock selection factors—small-cap and value—that financial academics have long identified as leading to market outperformance. And pricey growth stocks, like the Magnificent Seven tech names leading those two benchmarks, normally fall when interest rates are high, as they are now.

Yet the market can stay irrational longer than you can stay solvent. Despite recent setbacks, the S&P 500 and the Nasdaq 100 indexes are still up 13.1% and 35.4%, respectively, for the year, while the small-cap Russell 2000 and Russell 2000 Value indexes have returned 2.5% and minus 0.5%. The Avantis U.S. Small-Cap Value ETF is up just 6.1%.

That's despite the fact that, by many measures, small-cap stocks are historically cheap relative to large-growth ones. The average price/earnings ratio of both the Russell 2000 and the S&P SmallCap 600 indexes is less than 13. Meanwhile, the S&P 500's P/E ratio is 21, and the tech-heavy Nasdaq 100 and Russell 1000 Growth P/Es are 29 and 31, respectively. In the cheaper Russell 2000 Value, the P/E is only 9.1.

The average P/E ratio of the Russell 1000 Growth index since the beginning of January 2010 was a little less than 24, says Phil McInnis, chief investment strategist at Avantis Investors. Depending on the small-cap benchmark, since 2010 those P/E averages are 18 or 19. About the only time McInnis has seen the small versus large valuation gap wider was during the dot-com bubble's peak in January 2000, when Russell 1000 Growth was trading at 38 times earnings.

Thanks to renewed inflation and interest-rate worries, there are signs that we are finally reaching a selloff inflection point. In the third quarter, energy and financial stocks held up, and they are usually found in the value camp, and in the case of regional banks, the small-value camp. The average fund in Morningstar's Equity Energy category gained 10.2%, and the average Financial fund was up 0.6%. Meanwhile, the S&P 500, Nasdaq 100, Russell 1000 Growth, and the Russell 2000 Value were all down about 3%. Russell 2000 Growth lost 7.3%.

Recession Outlook

Cheapness itself has rarely been the reason that stocks outperform. There needs to be another catalyst for small-caps to win.

The upside case for small-caps, valuations aside, is a mild recession—or, better yet, none—in which inflation and interest rates remain flat or decline gradually. The downside risk is a significant recession. Smaller companies tend to have weaker businesses that get hurt more in recessions than blue chips. They're also more dependent on external bank or bond market financing that can dry up or become too expensive when times are tough.

"Let's say **Apple** and [a small business] go to the same bank and ask for loans," says Joe Hohn, a senior portfolio manager at Dimensional Fund Advisors, which manages the $5.7 billion **Dimensional U.S. Small Cap** ETF. "Who's going to get the lower interest rates? Of course, Apple is."

While inflation seems to be moderating, and Federal Reserve Chairman Jerome Powell paused rate increases in September for the second time this year, he indicated that the central bank could increase rates again later this year. Moreover, a faction of the Republican Party has proved willing to shut down the government. Such shut-downs, although not as economically severe as failing to raise the federal debt ceiling—which, after much debate, was approved earlier this year—could lead to credit downgrades of U.S. Treasuries and trigger a recession if not resolved quickly. The current federal funding bill expires in mid-November.

Index vs. Active

Although small-caps look appealing now, you should probably favor funds that minimize the downside risks. "If we have a hard landing, I think portions of the small-cap universe will do poorly," says Fred Stanske, manager of **Fuller & Thaler Behavioral Small-Cap Growth**. "If you're going to buy a small-cap portfolio right now, you'd want to lean toward more-profitable companies. Those companies will probably still make money in more difficult times."

Stanske points out that 41% of companies in the Russell 2000 small-cap index are unprofitable, versus only 17% in the large-cap Russell 1000. That makes Russell 2000 index funds a poor choice for today's fragile economic environment. A better option for the pure index investor is the **SPDR Portfolio S&P 600 Small Cap** ETF. It has a low, 0.03% expense ratio, and its benchmark requires companies to be profitable before they're included. It also has beaten the **iShares Russell 2000** ETF in the past three, five, and 10 years, and it fell less in 2022's decline, losing 16.1% while the Russell 2000 ETF fell 20.5%.

Small-cap stocks are a less efficient market than large-caps, which are covered widely by financial analysts, providing opportunities for active managers to add value. For a low fee, quantitative managers like Dimensional Fund Advisors and Avantis can improve returns just by making small but often important shifts away from the benchmark.

Dimensional U.S. Small Cap has beaten the SPDR small-cap ETF in the past 10 years and has shown a moderate risk profile, falling less—13.8%—than the SPDR in 2022. It also eliminates the least profitable companies, companies with the highest price/book ratios, initial public offerings, and those that have grown their assets too much by dilutive share offerings—all of which Dimensional has found lead to subpar future performance.

Perhaps most important, Dimensional actively trades the fund's stocks daily to find the best pricing, while index funds add and remove stocks in their benchmark quarterly or annually. That's especially important with illiquid small-caps. Index funds with trades scheduled in advance can suffer from bad pricing and even "front running," in which hedge funds and other players bid up or push down small-stock prices before indexers can make their purchases or sales.

Hohn says that Dimensional tries to offer the best of both worlds: the low costs of index funds and an active quantitative edge. Dimensional U.S. Small Cap has a modest, 0.26% expense ratio. Ideally, it should outperform the indexes by a small margin over time, as it holds about 2,000 stocks.

That said, a truly astute active manager can trounce small-cap benchmarks with less risk by holding a smaller portfolio of carefully researched stocks. Yet you'll pay more for that manager. **Reinhart Genesis PMV** has a 1.20% expense ratio but has bested Dimensional's ETF and 94% of its Small Blend category fund peers in the past five years with an 6.8% annualized return.

Two important stats for analyzing funds' risks are upside and downside capture ratios. The Reinhart Genesis fund has had a 65% downside capture ratio in the past three years, indicating that for every 1% the small-cap stock market fell, it lost only 0.65%. It has a 96% upside ratio, so it captures most of the market's upside.

Reinhart typically holds only 35 to 45 stocks, says manager Matthew Martinek: "When you're investing in durable companies, you can be a lot more concentrated if you're doing your research and still not have [too much] portfolio volatility."

One example that illustrates the quality of the companies in Martinek's portfolio is **First Citizens BancShares**, which the fund has held since 2018. "Banking is very competitive, largely commoditized," he says. "But there are a handful of banks that have carved out a nice competitive advantage." He points to First Citizens' strong branch network and its history of savvy acquisitions of distressed or bankrupt banks by working with the Federal Deposit Insurance Corp. and buying their assets at a discount.

First Citizens' latest acquisition is a familiar one—the now-defunct Silicon Valley Bank—which it bought cheaply with the FDIC's blessing in March.

"This was probably the most attractive acquisition I've seen in my career," says Martinek. "It doubled [First Citizens'] tangible book value per share overnight, and there are a lot of protections and guarantees built in that were granted by the FDIC."

Wall Street agrees. The stock is up 76% this year, while the regional banking sector has declined.

Concentration Risks

Still, concentrated portfolios, even those in high-quality stocks, dramatically increase the risk of missteps. Any individual company blowup can tank a fund's returns. Boutique fund shops like

Small Wonders

The best small-cap funds offer defense as well as offense. We picked the most intrepid ones out there.

Active Small Value Funds	Total Return				Expense
Fund / Ticker	YTD	3-Yr	10-Yr	P/E Ratio	Ratio
Avantis U.S. Small Cap Value / AVUV	6.1%	24.2%	N/A	7.6	0.25%
FPA Queens Road Small Cap Value / QRSVX	2.6	12.9	7.3%	14.3	1.00
Royce Small-Cap Special Equity / RYSEX	3.6	11.5	5.7	9.1	1.21

Active Small Blend Funds	Total Return				Expense
Fund / Ticker	YTD	3-Yr	10-Yr	P/E Ratio	Ratio
Dimensional U.S. Small Cap / DFAS	3.4%	14.1%	7.6%	12.4	0.26%
Fidelity Stock Selector Small Cap / FDSCX	5.6	11.0	8.5	12.1	0.93
Reinhart Genesis PMV / RPMAX	7.2	18.4	N/A	11.0	1.20
Tributary Small Company / FOSCX	4.0	16.0	7.7	14.0	1.18

Active Small Growth Funds	Total Return				Expense
Fund / Ticker	YTD	3-Yr	10-Yr	P/E Ratio	Ratio
Fuller & Thaler Behavioral Small-Cap Growth / FTXNX	17.3%	10.7%	N/A	23.6	1.25%
Needham Aggressive Growth / NEAGX	24.8	14.7	12.3%	30.4	1.88

Active All Cap Funds	Total Return				Expense
Fund / Ticker	YTD	3-Yr	10-Yr	P/E Ratio	Ratio
Fidelity Low-Priced Stock / FLPSX	3.2%	12.9%	8.4%	10.8	0.82%

Active Foreign Small Cap Funds	Total Return				Expense
Fund / Ticker	YTD	3-Yr	10-Yr	P/E Ratio	Ratio
Driehaus International Small Cap Growth / DRIOX	1.9%	1.6%	6.4%	19.9	1.16%
Fidelity International Small Cap / FISMX	7.2	6.8	5.6	13.4	1.02
Moerus Worldwide Value / MOWNX	12.8	21.7	N/A	7.0	1.51

Index Funds	Total Return				Expense
Fund / Ticker	YTD	3-Yr	10-Yr	P/E Ratio	Ratio
iShares Russell 2000 / IWM	2.5%	7.0%	6.6%	12.4	0.19%
iShares Russell 2000 Growth / IWO	5.1	1.0	6.7	19.9	0.24
iShares Russell 2000 Value / IWN	-0.6	13.1	6.0	9.3	0.24
SPDR Portfolio S&P 600 Small Cap / SPSM	0.8	12.1	7.4	13.1	0.03
iShares Core S&P 500 / IVV	13.1	10.2	11.9	22.2	0.03

Note: Returns through Sept. 29; three- and 10-year returns are annualized. N/A=not applicable

Source: Morningstar Direct

Reinhart tend to have more-concentrated portfolios than big fund shops, which can afford the deep analyst teams necessary to research thousands of small stocks worldwide and find attractive ones.

Fidelity Investments has a series of active small-cap and mid-cap funds that have done exceptionally well while holding more stocks. **Fidelity Stock Selector Small Cap**, for instance, holds 210 stocks but has managed to beat 93% of its Small Blend category peers in the past 10 years, generally with less downside risk.

The granddaddy of Fidelity's small-cap funds is **Fidelity Low-Priced Stock**. Because of its $26 billion size, it is now more of an all-cap than small-cap fund that holds over 700 stocks. Still, co-manager Sam Chamovitz credits Fidelity's 12-member dedicated global small-cap analyst team with being able to uncover high-quality but low-valued undiscovered gems.

One example the team scooped up in last year's selloff is energy-efficient swimming-pool equipment company **Hayward Holdings**, which has a strong market position despite recession concerns. Such a balance of quality and value has given the fund a low, 70% downside capture ratio in the past three years.

Small-Cap Value

While academics favor small-cap value over growth, the research proving their outperformance is for them as a whole, not for concentrated portfolios. Individually, small-value stocks tend to be the weakest companies that can be cheap for good reasons.

This is why Avantis U.S. Small Cap Value is a good option, as it holds over 700 stocks while still making the necessary active tweaks to give it an edge, much like Dimensional Fund Advisors. In fact, Avantis was founded by former Dimensional alums who employ similar trading techniques. The fund's quant strategy not only screens for cheap stocks but also requires that they be profitable, adding a quality tilt. The fund's 24.2% three-year annualized return bests 93% of its peers, and it has a low, 0.25% expense ratio.

Still, there are more-concentrated active small-value funds that manage their downside risk well. **FPA Queens Road Small Cap Value** and **Royce Small-Cap Special Equity** hold 52 and 32 stocks, respectively, according to Morningstar. Yet both funds have managed to outperform their peers with significantly less downside capture and volatility.

Their secret: Both funds are run by managers who pay scrupulous attention to small-company balance sheets, so there is less potential for individual company blowups. Royce's fund is run by two managers with accounting backgrounds, a rarity among funds. The other risk-control measure is a strict unwillingness to overpay for stocks and a willingness to hold cash instead—both portfolios now hold over 10% cash—which dampens the downside.

Small-Cap Growth

The academic case for small-cap growth stocks is weaker than small-value, depending largely on variable definitions of growth, which produce different results. Profitability is good, but paying too much for it generally isn't. But with the right manager homing in on the best managed rapidly growing tiny companies, the returns can be exceptional.

Fuller & Thaler Behavioral Small-Cap Growth, **Needham Aggressive Growth**, and **Tributary Small Company** get small-growth investing right. The Fuller fund's strategy has an unusual behavioral spin in that Stanske, its manager, doesn't seek companies with long-term earnings growth but instead ones that have beaten their latest Wall Street earnings estimates. Investors underestimate the growth potential of such companies, which helps them outperform.

Stanske points to a recent portfolio addition, **Remitly Global**, as an example. "They're a transfer agent for money across [national] borders," he says. "They've just been grabbing market share and doing a lot better than [analyst] expectations." By picking up the stock near the beginning of 2023, Stanske has benefited from its almost 120% run this year.

Fuller's performance has been impressive, besting 89% of its peers in the past five years with a 7.0% annualized return, and 98% in 2023 with a 17.3% one. Still, most traditional small-growth funds get dinged on the downside when hot stocks suddenly cool. Fuller was down 27.7% in 2022, in line with the average Small Growth fund's 27.8%. Needham Aggressive Growth, which has more of a tech stock focus, also got dinged, down 27.5%.

If you want a more defensive small-growth fund, Tributary Small Company is a good choice. Although technically categorized as Small Blend, it employs a growth-at-a-reasonable-price strategy. Last year, it fell 12.9%. "We'll buy stocks that are exhibiting more growth, but we're going to be disciplined on what we pay for those," says co-manager Mark Wynegar.

One recent purchase was **Viavi Solutions**, a wireless network equipment company that has good long-term growth prospects but has suffered from recession concerns.

"Viavi is a high-quality company that is well positioned relative to the competition," says co-manager Michael Johnson. "It has a good balance sheet and cash flow, but in the short term, there's a spending slowdown."

International Small-Caps

Arguably the best opportunities for active small-cap managers are overseas, as foreign companies have the least analyst coverage. One of the most defensive international small-cap funds is **Fidelity International Small Cap**, which Chamovitz co-manages. It has an 87% three-year downside capture ratio.

Among the fund's recent stock additions is **Kansai Electric Power**, which should see a boost to its earnings as its nuclear power plants have recently reopened after closing because of the Fukushima accident in 2011. "That returns Kansai to a more normal-looking utility with a very low cost [power] generation structure," Chamovitz says.

Both value and growth stocks offer big opportunities overseas, but there are added currency and country risks with lesser-known foreign companies. **Driehaus International Small Cap Growth** has beaten its peers in Morningstar's Foreign Small/Mid Growth fund category in nine out of the past 10 calendar years.

Moerus Worldwide Value has done a terrific job in value-led markets like 2022's, when it gained 6.2% while markets dropped. But in growth-led markets like 2020's, it fell 10.3% while tech stocks soared. With an extremely low average P/E ratio of 7.0 for its stock portfolio, according to Morningstar, the fund could prove to be an excellent diversifier in a high-rate environment. Consider that in the midst of a U.S. banking downturn, two of manager Amit Wadhwaney's most successful stocks this year are **IDFC First Bank** and **UniCredit**, both of which have rallied from depressed levels.

It's precisely such diversification that makes small-cap stock investing worthwhile.