# FPA Queens Road Small Cap Value Fund

## Fourth Quarter 2021 Commentary

**You should consider the Fund's investment objectives, risks, and charges and expenses carefully before you invest. The Prospectus 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.**

**Average Annual Total Returns (%)***

| Trailing Performance (%)<br>As of Date: 12/31/2021 | S.I. | 15 Years | 10 Years | 5 Years | 3 Years | 1 Year | QTD | Current Market Cycle Performance<br>06/05/07-09/30/2021 |
|---|---|---|---|---|---|---|---|---|
| **FPA Queens Road Small Cap Value** | 10.11 | 8.43 | 10.79 | 10.90 | 18.86 | 23.19 | 8.80 | 7.76 |
| **Russell 2000 Value TR USD** | 9.17 | 7.19 | 12.03 | 9.07 | 17.99 | 28.27 | 4.36 | 6.88 |

The FPA Queens Road Small Cap Value Fund ("Fund") commenced operations on June 13, 2002. 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. S.I. = since inception.

* 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 1.07% (Investor Class), 0.96 % (Advisor Class), and 0.91% (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.

*Market Cycle* reflects the most recent market cycle (peak to peak) defined as a period that contains a decline of at least 20% from the previous market peak over at least a two-month period and a rebound to establish a new peak above the previous one by Russell 2000 Value Index. The current cycle is ongoing and thus is presented through the most recent quarter-end. Once the cycle closes, the results presented may differ materially.

**Past performance is no guarantee, nor is it indicative, of future results. 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.**

***Please see important disclosures at the end of the commentary.***

Dear Fellow Shareholders:

FPA Queens Road Small Cap Value Fund ("Fund") returned 23.2% in 2021. This compares to a 28.3% return for the Russell 2000 Value Index during the year. During the fourth quarter, the Russell 2000 Value Index rallied sharply early, fell off sharply from early November through mid-December, and then rallied during the last two weeks of the year to finish up 4.4%. The Fund was up 8.8% over that time. For the quarter, small value stocks continued to outperform relative to the shares of small growth companies, which finished the quarter flat, marking the fifth consecutive quarter small cap value outperformed small cap growth. The 28.3% return for the Russell 2000 Value Index during 2021 outpaced the Russell 2000 Growth Index, which was up 2.83%, the second-largest outperformance of the value index over the growth index since the indices were created in 1979.[1] Despite the recent outperformance of small value over small growth, we believe the valuation differential between value and growth still favors small value and that small value is poised to continue its relative outperformance.

## 2021 Contributors and Detractors[2]

### Contributors

- **Synaptics**, a developer of human interface (HMI) hardware and software, has continued its strategic shift to higher margin business, primarily Internet of Things (IoT) products. As we've followed management's strategic shift towards higher-margin markets, we note that the company's return on invested capital (ROIC) has steadily risen from around 8.5% in 2019 to the mid teens for the 12 months ending 12/31/2021.[3] While we believe the recent and expected performance of the company are positives, valuation has become a concern and we are trimming our position.

- **ServisFirst Bancshares**, a full-service commercial bank, continued to increase its deposits and loans during the quarter. In spite of growing assets from $10 billion to $15 billion over the last 18 months, we believe the company is poised for more growth – it has a record-high loan pipeline and continues to hold $4.5 billion in cash at the Federal Reserve as of 12/31/2021.[4] As one of the largest holdings in the portfolio, we remain confident in the company's long-term prospects.

- **American Equity Investment Life Holding Company**, a leading writer of fixed index annuities, continued expanding its channel distribution to increase sales and made progress on expanding its interest spread. Several strategic relationships were announced during the year which benefited the company in 2021 and we expect the benefits to expand over the next several years.

- **Fabrinet**, a manufacturer of optical communications sensors and equipment, announced better-than-expected results[5] on increased demand for its telecom and datacom products, despite continuing supply chain disruptions. While supply chain issues had a significant impact on the company's automotive business, it was less than expected (automotive is a small but growing market for the company). We are impressed by the company's execution and held a 3.4% position at quarter end.

- **Concentrix**, a customer experience solutions provider, spun off from one of our other portfolio holdings (Synnex) in December of 2020, continued to validate its value proposition by adding over 24 new clients in the fourth quarter, continuing a trend. The company, which expects to achieve above-average

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[1] Source: FTSE Russell

[2] Reflects top five contributors and top five detractors to the Fund's performance based on contribution-to-return on a gross basis. This is not a recommendation for a specific security and these securities may not be in the Fund at the time you receive this Commentary. The information provided does not reflect all positions purchased, sold or recommended by the Fund during the quarter. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities listed. For a full list of holdings, please view the holdings report at the end of this Commentary. The portfolio holdings as of the most recent quarter-end may also be obtained at www.fpa.com.

[3] Source: Zacks Investment Research

[4] Source: SEC Filings, ServisFirst

[5] Source: Fabrinet Form 8k, announced 11/1/2021

**Past performance is no guarantee, nor is it indicative, of future results.**

market growth and improved margins,[6] initiated a dividend during the year. Given the company's growth expectations and what we believe to be a very reasonable valuation, we like the investment opportunity the company offers.

**Detractors**

- **Schweitzer-Mauduit** International, a product engineering and manufacturing company, fell during the year because of supply chain issues and input cost inflation. The company's margins suffered, but the company expects a normalization by mid-2022. The company made a significant acquisition during the second quarter of 2021 (Scapa Group) at what we think was a bargain price, however scarcity problems and inflation negatively impacted Scapa's initial performance. The company has aggressively raised prices and worked through a significant amount of its supply issues. Demand hasn't been a problem for the company, and as its results normalize relative to the supply/inflation issues, we think the company remains a very attractive opportunity.

- **Science Applications International Corp.**, a federal information technology contractor, declined during the year. The company which derives 98% of its revenue from the federal government,[7] is a slow-growing, consistently profitable IT provider that supplements organic growth with add-on acquisitions. It operates in a competitive, low-margin business, but given the company's visibility, entrenched position, and low valuation, we remain positive on the company's outlook.

- **TreeHouse Foods, Inc.**, a manufacturer and distributor of private label food, announced in November 2021 a plan to explore strategic alternatives. We think this is a wise decision as we think there is unrecognized value in the company. While the company has made progress in its strategic transition begun in 2018, the rationale the company gave for exploring strategic options by either selling the entire business, or major parts of it, makes sense. We continue to follow developments closely.

- **Horace Mann**, an insurance provider to teachers and educators, 2021 earnings were negatively impacted by above-average catastrophic losses. The insurer targets K-12 educators and administrators and holds a strong position in that niche. In 2021, the company acquired Madison National Life, which provides group life and disability products. We think the acquisition will create value as the company expands its product offering to its key market.

- **Equity Commonwealth** declined modestly during the year as its attempted $3.4 billion acquisition of industrial REIT, Monmouth, was rebuffed (Monmouth was acquired later for $4 billion by Industrial Logistics Properties Trust). Equity Commonwealth, headed by Sam Zell, is a REIT that has sold off substantially all its properties over the last eight years and now boasts a balance sheet with $3 billion in cash and around $120 million in debt.[8] Zell has shown himself to be very patient with deploying this capital, and we believe this investment will require a lot of patience. Given his track record, we are confident he will make a shrewd acquisition when the time is right.

## Additions & Subtractions

During the quarter we trimmed several positions. We will identify those when we are no longer trading in those positions.

We continued to add to mortgage insurer MGIC Investment Corp. The much-maligned private mortgage insurance market is not without its risks, most notably regulatory risk. The risks are real, but we think they are overblown and not existential. The company trades at close to our estimate of adjusted net tangible assets, which protects our downside. The company has $2.5 billion in excess capital, some of which will be

[6] Source: Concentrix, Fourth Quarter and Full Year 2021 Financial Results Conference Call January 19, 2022

[7] Source: Science Applications International Corp., Form 10k, FYE January 29, 2022

[8] Source: Equity Commonwealth SEC Filings 10-Q, September 30, 2021

used to accelerate its share buybacks.[9] We generally aren't supportive of large buyback programs, but we believe it's a smart move in this situation. The company's tangible net value and attractive valuation more than offset our concerns of increased competition and regulatory risk.

## Economic Outlook

2021 was a great year for U.S. equities, with most broad-market indices ending the year near all-time highs. Stocks rose on strong earnings growth, continued monetary and fiscal stimulus from Washington, and optimism in controlling the COVID virus. The bounce back in profits expected for 2021 occurred as predicted, with profits for the companies in the S&P 500 growing approximately 45% for the year compared to the COVID-related easy comparisons in 2020. When compared to 2019 S&P 500 earnings, the 2021 S&P 500 earnings are approximately 27% higher.[10]

As we compare the outlook today to our outlook at the beginning of 2021, we see a mixed bag of news. As we enter 2022, the Federal Reserve (Fed) has shifted from an accommodative position to a more hawkish one. The Fed is poised to raise the federal funds rate, to taper its monthly purchase of bonds, and to allow maturing bonds to roll off its balance sheet. The Fed will have to tread carefully because the economy and markets have been gorging on Fed liquidity for over a decade. As usual, the Fed has stated that these actions are data dependent, contingent on economic growth, inflation, and the employment situation. As of January 25, 2022, the International Monetary Fund forecasts GDP growth for 2022 to be 4.5%, unemployment sits at 3.9%, and the inflation rate hit 7% during December 2021. As these numbers change, so will the Fed's plan.

Developments that could change the economic outlook for 2022 resulting in the Fed to change its course:

- **Supply Chain Disruptions:** From what we're hearing from company executives, supply chain and logistical problems experienced throughout 2021 seem to be lessening to a degree. Most of our portfolio companies have navigated these issues admirably, but challenges remain. Various developments could set back the supply chain recovery, such as local and regional COVID outbreaks (as recently experienced in Xi'an, China), geopolitical issues (Taiwan, Ukraine, et. al.), increasing labor shortage problems, or imprudent political actions. While these risks are real, if they occur, we think they will be managed more effectively than in 2021.

- **Resurgence of COVID-19:** The bounce back in aggregate demand we expected coming out of the initial shutdowns has occurred and GDP growth was robust, reported at an annualized growth rate of 6.9% in the fourth quarter. This quarterly growth, the best since 1984,[11] occurred despite the resurgence of COVID infections attributed to the new COVID variant, Omicron. While the recent spike in COVID cases due to Omicron is concerning, the less severe nature of this variant is good news. What's concerning though, is the way in which Omicron has evolved. This variant has changed through adaptive evolution and is genetically distinct from previous variants. This is perhaps why current vaccines appear to have lower efficacy against transmitting Omicron. This rapid adaptive evolution has scientists concerned and may very well necessitate additional boosters. On the positive side, each flare up of COVID seems to have less of an impact as the previous one.

A much-asked question remains: If the economic news remains strong, the Fed tapers, and asset prices fall precipitously -- as happened during previous 'taper tantrums' -- will the Fed have the resolve to stay the course and continue to extract liquidity from the economy? Only time will tell.

## Investment Outlook

U.S. equity returns have been strong for over a decade. We've had modest economic growth over most of that period, but earnings growth has been above average with operating margins of the S&P 500 at all-time

[9] Source: MGIC Investment Corp. management presentation, November 4, 2021.

[10] Source: Factset, Yardini Research. As of December 31, 2021

[11] Source: US Bureau of Economics. As of December 31, 2021

highs. Stock prices have risen faster than earnings. This has resulted in elevated valuations. And while we believe valuations have been elevated for some time, the valuations of the broad markets today are generally higher than they were when the pandemic began. If the Fed tightens as it has telegraphed, equity valuations will likely be impacted. In that environment, owning companies whose valuations we estimate at being below their intrinsic value will be extremely important. We think the growth stocks trading at mind-blowing valuations will be impacted most, but valuation is going to be critical even within more reasonably priced asset classes. We are confident that if this re-risking occurs, the reasonably valued investments in the portfolio will benefit. We continue to look at companies from a bottom-up perspective and we continue to see companies with compelling valuations and prospects.

We've gone through an unprecedented global crisis at a time when central banks around the world were providing an unprecedented amount of liquidity. Although the pandemic exacted a horrific toll on the world, we have progressed this far. And while we don't presume to predict the future, we expect 2022 will be as turbulent as the last two years. As such, we remain focused on finding the best investment opportunities given the host of uncertainties we face. Our focus is on making sure we are invested in well-capitalized companies with strong management teams focused on creating long-term shareholder value, and that also compete in attractive industries. Despite all the things we can't predict or control, we are confident companies that meet these criteria provide us with the best opportunity for long-term investment success.

Sincerely,
Steve Scruggs, CFA
Portfolio Manager

## Important Disclosures

obligation to update or alter any forward-looking statements, whether as a result of new information, future events, or otherwise. Such statements may or may not be accurate over the long-term. Statistical data or references thereto were taken from sources which we deem to be reliable, but their accuracy cannot be guaranteed.

The reader is advised that the Fund's investment strategy includes active management with corresponding changes in allocations from one period of time to the next. Therefore, any data with respect to investment allocations as of a given date is of limited use and may not be reflective of the portfolio manager's more general views with respect to proper geographic, instrument and /or sector allocations. The data is presented for indicative purposes only and, as a result, may not be relied upon for any purposes whatsoever.

In making any investment decision, you must rely on your own examination of the Fund, including the risks involved in an investment. Investments mentioned herein may not be suitable for all recipients and in each case, potential investors are advised not to make any investment decision unless they have taken independent advice from an appropriately authorized advisor. An investment in any security mentioned herein does not guarantee a positive return as securities are subject to market risks, including the potential loss of principal. You should not construe the contents of this document as legal, tax, investment or other advice or recommendations.

Fund performance presented is calculated on a total return basis, which includes the reinvestment of all income, plus realized and unrealized gains/losses, if applicable. Unless otherwise indicated, performance results are presented on a net of fees basis and reflect the deduction of, among other things: management fees, brokerage commissions, operating and administrative expenses, and accrued performance fee/allocation, if applicable.

The information provided in this presentation is based upon data existing as of the date(s) of the report and has not been audited or reviewed. While we believe the information to be accurate, it is subject in all respects to adjustments that may be made after proper review and reconciliation.

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.

The 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 Value 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. All investment decisions are made at the discretion of the Portfolio Manager, in accordance with the then current Prospectus. Comparison to any index is for illustrative purposes only.

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 Fund.

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 **Fund's Prospectus** for a complete overview of the primary risks associated with the Fund.

*The FPA Funds are distributed by UMB Distribution Services, LLC, 235 W. Galena Street, Milwaukee, WI, 53212.*

**Index / Benchmark / Category Definitions**

Comparison to any index is for illustrative purposes only and should not be relied upon as a fully accurate measure of comparison. The Fund may be less diversified than the indices noted herein, and may hold non-index securities or securities that are not comparable to those contained in an index. Indices will hold positions that are not within the Fund's investment strategy. Indices are unmanaged and do not reflect any commissions, transaction costs, or fees and expenses which would be incurred by an investor purchasing the underlying securities and which would reduce the performance in an actual account. You cannot invest directly in an index.

The **Russell 2000 Value Index** is a subset of the Russell 2000 Index, and tracks the stocks of small domestic companies, based on total market capitalization. The Russell 2000 Value Index represents those stocks of the Russell 2000 with lower price-to-book ratios and lower relative forecasted growth rates. A total return index computes the index value based on capital gains plus cash payments such as dividends and interest.

**Russell 2000 Index** is a small-cap stock market index of the smallest 2,000 stocks in the Russell 3000 Index.

**Russell 2000 Growth Index** is an index that measures the performance of those Russell 2000 companies with higher price/book ratios and higher predicted and historical growth rates.

The **Global Industries Classification Standards**, or GICS®, is a common global classification standard developed by S&P Dow Jones Indices and MSCI. The GICS structure consists of 11 Sectors, 24 Industry groups, 69 Industries and 158 sub-industries.

**High Quality** companies, per the Fund's investment team, are typically those companies with balance sheet strength, attractive valuations with a margin of safety, quality of management, and in growing industries

**Intrinsic Value** a measure of what an asset is worth. This measure is arrived at by means of an objective calculation or complex financial model, rather than using the currently trading market price of that asset.

**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.

**Small Cap Value Companies:** The term small cap describes companies with a relatively small market capitalization. A company's market capitalization is the market value of its outstanding shares. The definition for small cap varies, but generally means a company with $300 million to $2 billion in market capitalization.

**Tangible Net Assets** is most commonly a calculation of the net worth of a company that excludes any value derived from intangible assets such as copyrights, patents, and intellectual property.

**Adjusted Net Tangible Assets** include tangible and intangible assets during the adjustment process. Also included are off-balance sheet (OBS) assets and unrecorded liabilities, such as leases or other notable commitments. The difference between the total fair market value of the adjusted assets and the total fair market value of the adjusted liabilities is the "adjusted book value" (what the business is considered to be worth).