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Q2 2024 FPA Queens Road Small Cap Value Fund (QRSIX) Webcast
July 30, 2024

Note: Items in brackets [ ] are meant to be clarifying statements but are not part of the actual audio recording of the webcast.

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You should consider the FPA Queens Road Small Cap Value Fund (the "Fund") 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 the prospective investor. Please read the Prospectus carefully before investing.

The prospectus for the Fund dated September 30, 2023 and corresponding supplements, can be accessed at: https://fpa.com/request-funds-literature. The most current prospectus can always be obtained by visiting the website at fpa.com, by calling toll-free, 1-800-982-4372, or by contacting the Fund in writing.

(00:00:00)

Moderator: Hello and welcome to today's webcast. Please note that today's webcast is being recorded.

During the presentation, we will have a question and answer session. You can ask text questions at any time. Submit your question in the questions and answers panel, and click New Question to submit. If you would like to view the presentation in a full-screen view, click the corner of the slides panel to drag and resize to best fit your view. To restore the panels to their original view, click the Restore icon from the icons on the right side of the screen. And finally, should you need technical assistance, as a best practice, we suggest you first refresh your browser. If that does not resolve the issue, please submit your issue in our question and answer panel, and someone will assist you.

It is now my pleasure to turn today's program over to Courtney Reardon. Courtney, the floor is yours.

Courtney: Hello, everyone, and thank you for joining us today. Welcome to the FPA Queens Road Small Cap Value Fund First Half 2024 Webcast. My name is Courtney Reardon and I've been the relationship manager for the Fund.

[Please see slide 2] In just a moment, you will hear from Steve Scruggs, portfolio manager for the strategy. Steve has managed the Fund since its inception over 20 years ago, in 2002. Over that period, the Fund has delivered benchmark-beating returns with less risk over the long term, and protected capital during every large drawdown. Steve's disciplined value approach is predicated on investing in attractively priced small cap companies that are in sound financial condition, led by strong management teams, and operating in growing industries.[1]

As of June 30, [2024] the AUM for the Fund was about $700 million.

[1] Large drawdown is defined as a 20% or larger decline in the Russell 2000 Value Index. See page 7 of the presentation for details. "Less risk" is as measured by the Fund's annualized standard deviation of returns since inception versus the Russell 2000 Value Index. Since inception through June 30, 2024, the annualized standard deviation was 15.10% for the Fund versus 20.16% for the Russell 2000 Value Index (Source: Morningstar Direct). **Past performance is no guarantee, nor is it indicative, of future results.**

In terms of our agenda today, there are a few items we'll cover. First, we often get questions regarding availability of our Small Cap Fund on various platforms and we wanted to update you on our progress. The Fund is currently available on most major platforms. If you have any trouble transacting in the Fund, please feel free to reach out to crm@fpa.com, and we'll be happy to assist.

(00:02:12)

And finally, Steve and his analyst Ben Mellman will review the Fund's performance, provide an update on the portfolio, and walk through recent addition[s] to the portfolio, and share their views on the small cap space. Then we'll open it up to additional Q&A.

If at any time during this webcast, you have a question, please submit those through the device on your screen, and we'll get to them at the end of the presentation.

An audio replay, transcript, visual replay, and slides of today's webcast will be made available on our website FPA.com.

And with that, Steve, I'll hand it over to you.

Steve: [Please see slide 3] Thank you, Courtney, and thank you all for joining us today for the mid-year recap of the FPA Queens Road Small Cap Value Fund.

The Fund, the first six months of the year, the strategy performed well. We were pleased with it. We were up a little less than 1% versus the Russell 2000 Value, our primary benchmark, was down about 1%. So we outperformed by maybe a couple of percent but really, we both were pretty flat.

Looking over the last 12 months, we've returned about 11.25% versus just under 11% for our index. So we're pleased with those returns and they're very much in line with our expectations.

During the quarter, there were no significant changes in the portfolio. We did make some trades. The trades we made were primarily portfolio management trades, risk management trades.[2]

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We did add one new position in the first quarter, John Bean Technologies. They're industrial, operating in the food and beverage industry. We wrote about that in our first quarter letter.[3] We've got about a 2% position size in that. It has sold off pretty significantly over the last couple of years, and we have, as I said, a 2%—it started out at a 2% position, which we would consider an equal weight holding. So we think

[2] Portfolio composition will change due to ongoing management of the Fund. The holdings mentioned should not be considered a recommendation to purchase or sell a particular security.
[3] Please see the FPA Queens Road Small Cap Value Fund Commentary Archive; https://fpa.com/funds/fpa-queens-road-small-cap-value-fund-quarterly-commentary-archive. As of June 30, 2024, John Bean Technologies was 2.0% of the Fund's total net assets.

it's a high-quality company and the price came back down to a level that we found attractive.

Additionally, we made some additions. We added to six holdings of companies that had fallen; we bought some more on weakness.

We unloaded United Natural Foods. We have spoken about United Natural Foods over the last 18 months. They stumbled during COVID. They had some significant warehousing and pricing issues. And management announced a turnaround plan to right the ship and we gave them some patience, but they're not making the material progress that we'd like to see. So we sold out completely, moved it to the watchlist, and we'll keep an eye on management over the next few quarters and if we can start to see some progress, maybe we'll go back into it. But for now, we're on the sidelines.

We did trim a few positions, some of the holdings that had performed really well, really on a matter of valuation, for three of our higher-quality companies that are getting kind of at the higher end of our comfort level with valuations. So we took some profits there and trimmed those.

And then cash has remained right around 10%, which is our [typical] cap. So there's been no real change there.

But that's a brief update on the first six months of the year. That's where we are.

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Courtney: [Please see slide 4] Thanks, Steve. I think we'd be remiss if we didn't talk a little bit about what's been happening in the small cap space, especially small cap relative to large cap, and what's been going on in July, specifically July 10th through the 16th, the Russell 2000 Value was up over 12%. Can you talk a little bit about what the drivers were for that and how the portfolio fared?

Steve: Yes. Those five days were—that was the best performance for the Russell 2000 Value in decades, up over 12% in five days was quite something. Very frothy, what we would call an exuberant rally. As you would expect, we would expect, we were up but not as much as the index, which is how we typically perform. We have a very disciplined and conservative process that leads us to kind of a performance profile where, when markets perform like that, we [typically] participate and we participate meaningfully, but we tend to trail. And historically we've done that, and we make up for that by holding up really well on the downside.[4] The performance was in line with our expectations.[5]

[4] Please see slide 6 of the presentation materials for how the Fund has held up during down markets on a rolling 5-year basis since its inception.

[5] Note: The Fund's Net Asset Value (NAV) increased from $37.05 on July 10, 2024 to $39.57 on July 16, 2024, (Source: Yahoo Finance). **Past performance is no guarantee, nor is it indicative, of future results.**

And we get asked a lot what caused this, is this a long-term shift, or was that just a fluke? And there's no way to know for sure but [we believe] part of it was a technical shift. The trade out of the big Nasdaq stocks which have performed so well over the last few years, into the more reasonably valued small cap stocks was a big part of that.

And I wish we could say that this is going to last for—this is the beginning of a trend. I can't say that but I can say that when we look at overall valuations, you know, you can look at it in the small cap, S&P 500, and especially in the Nasdaq, the valuation differential is very significant. We think small caps are in a good spot relative to the larger companies, and especially the growth companies. So we'll see about that.

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[Please see slide 5] And also, when we looked into that rally to try to see what really drove the performance, and Société Générale put out a chart that really is a really good explanation. This shows, each of those bars represents 60 companies really—this is the Russell 3000 and they divided it into 50 buckets of companies. And you can see the performance over that period for the S&P 500, which is roughly the first 9 bars, 8 or 9 bars, versus the Russell 2000. And so you can see that small cap really outperformed large cap. And even when you look a little closer within small cap, it was the smaller small caps that really outperformed the best.

And we tend to be, if you look on that chart, between kind of the 20th and 30th bar is kind of our sweet spot. It's a little bit larger small caps. We find there's generally going to be higher quality there. We go down into the smaller companies but generally speaking, that's the range that we're going to be in. And that rally was, as I say, it was the smallest of the small [cap], and it was a lower-quality rally, which is really not, you know, what we're trying to put into the portfolio.

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One other thing I'll say. We talk a lot about the valuation differential between large and small, and small growth and small value, but Bank of America put something out that I just came across today, and it says that they're looking at small value versus large growth, which has been the darling as of late. The differential in valuations between those two asset classes has not been as great as it is today since 2000, right before the internet bubble popped.[6] So we're not predicting anything like that. But when we look at the broad valuations, history's pretty clear that, you know, if you start from a lower valuation, generally speaking, you're going to have better long-term performance than if you start with an elevated valuation. So that's where we are today.

[6] Source: Wall Street Journal Live Updates on July 18, 2024; *The Puzzle of the Small-Stock Rally;* https://www.wsj.com/livecoverage/stock-market-today-dow-sp500-nasdaq-live-07-18-2024/card/the-puzzle-of-the-small-stock-rally-uBLo3eK2c08LiOiggFtM?mod=lctimeline_finance

[Please see slide 6] This chart we use frequently. I’m not going to go through it in too much detail. But what it shows is our performance in different types of markets. These are rolling 5-year returns. Each dot represents a rolling 5-year return.

And on the far right side, you’ll see when markets are robust, when they're greater than 10% on a rolling 5-year basis, we typically underperform. But when we underperform, the return of the indexes in those periods is an average of 14% versus 12%, about 12% for us. So we meaningfully participate but we tend to trail.

And if you look at the center section, at 0% to 10% on a rolling 5-year basis, 77% of the time in those markets, we’ve outperformed by about 1.5%, 2%.

And then on the left side, down markets, rolling 5-year return that's negative [for the index], we've outperformed 100% of the time. And during those periods, our average return is actually a positive little over 2% and outperformed by about 4%.

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[Please see slide 7] So we say that we make our money in down markets. Making a lot of money in a bull market really doesn't matter if you're going to give it all back in the next down market. So we really, [we think our investment] process does a good job of protecting on the downside.

And this slide shows that very well. Since inception, there have been five bear markets in the Russell 2000 Value and we've outperformed in each of those. And we've outperformed by anywhere between 11% and just over 19%. So protecting the money that we made in the bull markets during bear markets is how we get to our ultimate goal.[7]

[Please see slide 8] And the ultimate goal is to end up with the most money in the long run for our investors. We do that by steadily compounding our returns over long periods.

And this is a very simple graph but I think it's a great illustration of how we've been able to accomplish that. The green line is the Russell 2000 Value and the blue line is the FPA Queens Road Small Cap Value Fund, and you can see how we have slowly and steadily increased our lead over the index over the long term. And that's what this philosophy is designed to do, by losing less money in down markets, giving up a little bit of the upside, and continuously compounding over long periods, and it's resulted in a great long-term absolute performance.[7]

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

[Please see slide 9] So these are the winners and the losers over the last 12 months. You'll notice that both winners and losers are broadly diversified. We don't make calls or tactical bets. Everything we do is bottom-up. So we're not going to end up in a situation where we made a tactical bet that turned out wrong and wherever that area is going to really hurt our performance.

The best performers over the year are some of the highest-quality companies in the portfolio, and we're going to talk a little bit more about quality, and we've been talking about that a lot lately. But those companies have continued to perform really well. They have a higher valuation, we have to pay up for that quality, but they continue to perform well. We trimmed some during the period as those valuations have gotten up higher on the spectrum of what we think is a reasonable range of valuation.

And as far as detractors, they're also very idiosyncratic. Specific things happened to those individual companies. And one in particular, Darling Ingredients, is one that is down very sharply and we've been adding to that one on weakness. It's a long-term holding that we really continue to feel good about the long-term prospects for.[8]

[8] The information provided does not reflect all positions purchased, sold or recommended by FPA during the TTM. A copy of the methodology used and a list of every holding's contribution to the overall Fund's performance during the TTM is available by contacting FPA Client Service at crm@fpa.com. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities listed. **Past performance is no guarantee, nor is it indicative, of future results.**

[Please see slide 10] So the five biggest companies, the five biggest holdings, you'll notice a lot of those were some of our best contributors to performance. You also may notice that this chart really hasn't changed much since the last quarter, with one exception: the order has changed.

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But Sprouts Farmers Market, it's a company we started buying about three years ago. They were going through some change in their marketing strategy, distribution strategy, and we entered the stock in 2021 and we've watched management do an excellent job of really executing on exactly what they said they were going to do and doing it successfully. So Sprouts came into the top 5 on its own through appreciation. We have not changed our weight, didn't add to it. It wasn't a change in conviction, but it has been a really strong performer for us.[9]

[Please see slide 11] So we often get asked, you know, when you look at the allocations of our portfolio versus the Russell 2000 Value, they differ significantly, and we often get asked how do you come up with your sector weights. And we don't think about things in those terms. We are pure bottom-up investors, looking at each company one at a time, and wherever we're finding the best value is where our sector weights shake

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

out. We're thoughtful about making sure that we have broad exposure. Again, we're not going to load up on any sector or any industry. But we do have a very high active share,[10] and a lot of it is due to our willingness to not hang to the target sector weights of the index, or it's going where we see value.

So if you look at our allocations today, for instance technology, we have right at 26%—I'm sorry, we have right at 21%, a little over 21% in technology versus 6% for the benchmark.[11] And again, it's not a bet on technology per se. But when we go through our process of finding companies with strong balance sheets, at good valuations, with great managements, in good industries, this leads us to a lot of value in technology.

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And I'd also like to point out that within technology, if you look at our holdings, they're not the disruptors or the high-flying small cap tech stocks that make headlines. These are companies that are consistently profitable, they've been around for a long time, they're generally going to be distributors or components manufacturers or process-oriented companies, not ones that have to launch a new product on a product cycle

[10] Active Share is a measure of the difference between a portfolio's holdings and its benchmark index.

[11] Please see slide 19 of the presentation materials for the Fund's sector allocations at 6/30/2024, and slide 21 for the Fund's holdings split out by sector at 6/30/2024.

basis to maintain relevance. So they're the [most boring] of the technology companies.

When you looked at financials, you'd see we have about a 20% allocation there versus 26% for our benchmark. So you might say we’re underweight financials. But when you look a little closer there, you'll see too that we own two banks, and so most of our financial exposure is in a very diversified basket of insurers, and it’s just a matter of where we’re seeing value today.[11]

And lastly, oil and gas. As we've discussed before, we have no direct exposure to oil and gas. And the reasoning behind that is if you look over long periods of time, the small gas energy companies have not generally done a good job of capital allocation. They do not have the things that we look for in a business: pricing power being one, consistent operating margins, strong returns on invested capital. They're very cyclical businesses and I think a lot of people will trade in and out of them with the hopes of trying to predict a near-term move in commodity prices, but that's just not a game that we play.

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Courtney: [Please see slide 12] Steve, in terms of quality, we often think of quality and valuation on a spectrum. Can you talk a little bit about what you mean by quality and maybe walk us through some examples of companies that fall across different areas of the spectrum between quality and valuation?

Steve: Yes, we've been talking about quality a lot over the last several quarters in our letters and in our presentations, and I'll add a little context. We think that price is what you pay and value is what you get, and so our job is constantly weighing the tradeoff between quality and valuation.

And we talk about our four-pillar process a lot, and it's extremely rare to find a company that sits atop the four pillars and is at a bargain basement valuation. There's almost always a quality premium. And there are a few times where I can think during COVID, during the financial crisis, and here and there where you can find a really high-quality company at a really good valuation. But generally, we have to pay up to a certain extent for quality. And then the question is how much are you willing to pay up for quality. So we're weighing on that spectrum of quality and valuation. And so that's how we're looking at quality.

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And when we look today, we see quality, the quality premium is quite high. We're having trouble finding new companies that meet our disciplined philosophy and process. And as a matter of fact, during the first half of the year, we sold down some of our highest-quality holdings. These are companies that have performed really well but they're getting to a valuation that's on the higher end of what we're comfortable with.

So, in answer—and I'll go back, as an aside, when we look at this small cap/large cap conversation and when we look at quality, generally speaking, larger cap companies are going to—they tend to be a little bit higher-quality, generally speaking. But if you look at the highest-quality large cap companies versus the highest-quality small cap companies, the quality premium right now in large caps is by far the farthest, the largest I've ever seen.

So I say that again because I think if we can buy these companies at reasonable valuations, not dirt-cheap valuations but high-quality companies at reasonable valuations, we stand to, I think, have better future long-term performance than the alternative of starting at higher valuations.

[Please see slide 13] So I'm going to now go through a few companies, and they go across the spectrum of quality, companies within the portfolio—and I do this just to give some perspective on how we're thinking about this quality spectrum.[12]

[12] For illustrative purposes only, these investment examples were chosen to illustrate the tradeoffs between quality and valuation. We consider these companies to be a high quality companies, with one that trades at a full valuation (RLI Corp.) and one that trades at an attractive valuation (PVH Corp). Financial information/data sourced from Factset, Company reporting, and Bragg estimates. Please see footnotes and disclosures in presentation materials for further information.

This information should not be considered a recommendation to purchase or sell a particular security, and the security noted may not remain in the portfolio at the time of this presentation. **Past performance is not indicative, nor is it a guarantee, of future results.**

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The first company is RLI Corporation, and we've talked about it in the past some. One of the longest-term holdings in the portfolio. And it’s a nichey excess and surplus and specialty insurer, and all that means is they operate in more unregulated areas of the property and casualty insurance business. We know management really well; we’ve owned it for a long time. And it’s truly an amazingly well-run company with a unique business model.

When we look at the company through that four-pillar process of balance sheet, valuation, management, and industry, balance sheet, they're overcapitalized. They have excess capital, which means they could be writing more business but they're not because they're very conservative underwriters and they're not going to commit capital in a soft market. They have a very good track record of stepping away from business if they don’t think they can make good money on it. Also, their balance sheet, the investment side of their balance sheet, very conservative there. They focus on making money on the operations side and don’t try to juice returns on the investment side, which we like.

Valuation, as I say, there is a quality premium. This is one of the both highest-quality and most expensive companies in the portfolio, and it trades at roughly 24 times earnings, which is a lot. And historically, it has had a high quality premium. This is a little bit higher than typical. It's sized in the portfolio accordingly. You'll notice it's not in our in our top 5 holdings. But we're confident in management and their track record that it's worth paying up for this.

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When we look at management, as I said, [we believe] it's probably, it's one of the best-run property casualty insurers in the country, and it just happens that they do it in a niche and they're relatively small so you don't ever hear about them. But part of it is their entrepreneurial culture. When they go into these different niche markets, they'll pull together a team with expertise in whatever the specific risks they're covering, and they have unique compensation structures that focus on profitable growth. It's got to be profitable. They want to grow it. But it has to be profitable. So you're not penalized if you don't grow but you're more penalized if you're not profitable. And it allows the managers to make a lot of money if they manage their businesses well and they have, as I keep saying, a wonderful track record of doing that.

And as far as the industry, excess and surplus and special industry is a hard business but it's a really great business if you're great at it, and RLI is. So we feel good about the industry.

So that's an example of a high-quality company with a quality premium that we're willing to pay.

[Please see slide 14] The next company is PVH Corporation, and I would describe this as above-average quality for sure but I wouldn't call it a high-quality company. Part of that is the industry. But they own the Tommy Hilfiger and Calvin Klein brands, and their recent success has been more—they've had more success internationally, specifically in Europe, and the Tommy and Calvin brands domestically have struggled somewhat. They brought in a new CFO—CEO, former CEO of Ralph Lauren, and he has done a great job getting things back on track, committing to revamping the domestic business.

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And when we go through the four pillars, they do have some debt but they have—you know, their free cash flow, normalized free cash flow, is 7.5 times their interest expense. Their debt has an investment grade rating, which is somewhat unusual for a small cap company. So the balance sheet is strong.

They're trading, you know, 10 times trailing earnings and 9 times forward earnings, and they have really high free cash flow conversion from earnings so they throw off, consistently throw off, high levels of free cash flow.

Management, as I said, they've brought in Stefan Larsson and he's brought in a lot of new people, and we've watched them execute and they're doing a good job. They've made some very significant buybacks over the last few years at what we think are attractive multiples, so I think that's a good use of capital.

And then lastly, industry. They've got strong brands, they've got great distribution, but it's an industry where preferences change quickly and it can be somewhat cyclical but when we look back at their history, they've done a great job of managing that cyclicality and are consistently profitable.

So this is an example of a company that, as I say, is not the highest of quality but the price that we're getting for, getting it for, we think is very attractive and that's why it's positioned in the portfolio how it is, in the top 5 of our holdings [by weight].

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[Please see slide 15] And lastly, a new purchase—and we've made this purchase since the end of the second quarter—and I've talked a lot about quality and the spectrum, and we have a quality bias. We label each company in the portfolio as either a long-term compounder or an opportunistic position. And the long-term compounders will generally be between 80% and 90% of the invested portfolio, and opportunistic positions will be, will make up the rest of the invested portfolio.

And these are going to be companies that have had either something company-specific or industry-specific that they've got a little bit of hair on them, but when we look into them, we see that they have a level of quality that's acceptable, and are attractive opportunistic investments.

And Advance Auto Parts is a great example of that. The auto parts industry is an oligopoly of between Advance and O'Reilly and AutoZone. Advance made a big acquisition about ten years ago. The integration of that didn't go so well. They've been struggling as of late. A lot of it's related to that. And [we believe] they've identified the problems, they've brought in some new management and board members to address the problems, and we think, you know, if you can identify the problem and then bring in the right people to fix the problem, it's kind of a turnaround but it's a manageable turnaround, a higher-probability turnaround.

So I'll go through the four—you know, at first glance when you look at the balance sheet, it looks like it might be a bit over levered. But without getting in too terribly much detail, they have some hidden assets. They have a company that's outside of their primary business that they're going to put on the market and [based on our estimates] they're probably going to get $1.5 billion to $2 billion for it. So the balance sheet is not as levered as it appears.

(00:32:02)

From valuation, we normalize our free cash flow, and as I mentioned, in the middle of the turnaround their profits collapsed last year. But when we normalize the free cash flow, they don’t have—there's a lot of low-hanging fruit for them to get back to a position that could make this a very profitable investment.[13]

The management changes I just mentioned a second ago. They brought in a new CEO, Shane O’Kelly. He came from HD Supply. One thing I’ll say is a great deal of the issues, operational issues they're having, have to do with logistics and supply chain. And so they got, they brought in Shane O’Kelly. He was CEO at HP Supply—HD Supply, which was bought out by Home Depot. It’s a very similar business to this, and he has extensive experience doing the things that Advance needs done, the logistics and inventory management. And he’s brought in some other folks at the executive level with good experience too. But additionally, they’ve added three new board members with remarkable experience. Tom Seboldt, who came from O’Reilly, their big competitor, was in charge of logistics for them. Gregory Smith, he ran operations at Goodyear but he

[13] Investments involve risk, including risk of loss. There is no guarantee the company will be able to execute on its plan.

ran supply chain at Walmart. Just a wealth of depth there. And then Brent Windom, who was a former CEO of Pep Boys, which is kind of a medium-sized auto parts distributor—supplier. So they put together a team, they've identified their problem and they've put together a team that we think has the capabilities to do that. This is going to be—this is going to take some time to right the ship, but we think it's an attractive investment and we are going to, they've laid out the strategy and we're going to follow them over time and watch to see how they achieve their objectives.

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Then last, to talk about the industry, as I mentioned, it's an oligopoly and if you look at their competitors—O'Reilly and AutoZone—they earn fabulous returns on invested capital, consistent margins, the things—they are growers—the things that we like to see in a company. And Advance doesn't have to get to, say, the operating margins that their competitors are putting out. But if they can get to half of that operating margin, the company would be worth multiples of what it is today.[14]

So I go through three examples. One is a high-quality company, one is a higher-quality company but not as high, and then this opportunistic position that we have. And our job is weighing valuation and

[14] **Past performance is no guarantee, nor is it indicative, of future results.** Investments involve risks, including risk of loss.

quality, and I hope this shed a little bit of light on the lens that we're looking at that and the way we walk through that process.

Next, I'm going to hand it over to Ben, who's going to talk a little bit on, elaborate on the quality conversation about earnings consistency and what we see with earnings consistency. So I'll turn it over to Ben.

(00:35:49)

Ben: [Please see slide 16] Thank you, Steve. We've been writing about quality in our letters over the past year. I want to talk about a new essay that we wrote for our second quarter letter. The second quarter letter hasn't been released yet but keep your eyes on your inbox. It should be out shortly.[15]

We look at many financial metrics for our companies but when assessing quality, the two that we care about most are earnings consistency and returns on capital. And today we're going to talk about earnings consistency.

We believe that companies that are consistent earners in the past have a better shot of generating great returns in the future. Also, we know that the market is willing to capitalize companies with consistent earnings at higher multiples, the so-called bond proxy effect enjoyed by utilities and

[15] Please reference the 2024 Q2 FPA Queens Road Small Cap Value Fund Commentary here: https://fpa.com/docs/default-source/funds/fpa-queens-road-small-cap-value-fund/literature/fpa-qr-small-cap-value-fund-commentary-2024-06.pdf?sfvrsn=6f6c9e9d_3 , and after Q2 2024, you can find this commentary in the Commentary Archive (https://fpa.com/funds/fpa-queens-road-small-cap-value-fund-quarterly-commentary-archive).

consumer staples. And so, in our essay in the letter, we used earnings consistency as a lens to look at the relative quality between the small cap and the large cap indices.

So what did we find? That there are fewer quality companies in the small cap index than there are in the large cap indices, and this is what we mean when we call the Russell 2000 index (R2K) “junky,” The R2K has a large percentage of unprofitable companies, and in our data analysis we found that the R2K also has many fewer consistent earners than the S&P 500. On a bottom-up basis, small caps have more earnings volatility than large caps.

But, here is where it gets interesting. When we compare small companies to large companies of similar earnings consistency, the small companies are significantly cheaper. That is, the basket of small, low earnings volatility stocks has a much lower price-to-earnings ratio than the basket of large, lower earnings volatility stocks. And finally, we looked at our fund, the FPA Queens Road Small Cap Value Fund, where you get to have your cake at eat it too.

(00:38:08)

The Fund has a lot more consistent earners on a like-for-like basis than the small cap index, in this case the S&P 600; and, those consistent earners are significantly cheaper than comparable companies in the large cap index. So the Fund has higher quality and cheaper.[16]

And I think this really cuts to the chase of what we're doing at Queens Road. We build a portfolio of quality small companies that are available at significantly cheaper prices than those in large cap land. And, more generally, we think this supports the need for active management in small caps. [We believe] investors should avoid owning the entire small cap index, where you get some quality companies and a lot of junk.

Additional details, including the methodology for this analysis, will be provided in our Q2 2024 commentary, which should be out shortly. And with that, I'll turn it over to you, Courtney.

Courtney: [Please see slide 17] Great. Thank you, Steve and Ben. Thank you all for taking the time, and now we'd like to open it up to Q&A. We have a few pre-submitted questions, so please feel free to add any additional questions you have while we address the pre-submitted questions.

Steve, first question: are valuations overall for what you… **"How are valuations overall for what you own given the quality of the holdings?"**

[16] Source: Q2 2024 Commentary for details about the methodology and results. For example, when looking at the top 40% of the companies in the S&P 500 sorted based on earnings volatility (low to high) over the past 10 years, it has an earnings volatility of 20.1%. When comparing against companies in the S&P 600 and the Fund with similar earnings volatility, the weight in the Fund of those companies is 35.3% as of June 30, 2024 vs 16.3% for the small cap index (S&P 600), and the weighted average trailing price to earnings for the Fund is 15.83 versus 25.09 for the large cap index (S&P 500).

Steve: How are valuations overall. Yeah, I think—

Courtney: Portfolio valuations given the quality of your holdings.

(00:39:56)

Steve: I think we, I hope we addressed that in talking about that spectrum and we've paid up for quality in some instances, and we have a lot of companies that we think are above-average quality at attractive prices. But as I mentioned, the quality premium right now for companies that we're not invested in is higher than what we're comfortable with, which is why we say we're having trouble finding high-quality companies that we can justify the valuation of.

Courtney: And the second question is**, "What will be the catalyst to light the small cap flame?"** I'm sure that's one that you love.

Steve: So we get asked that a lot and we've been waiting for a catalyst to light the small cap flame for the last decade and you know, maybe it happened in July, the middle of July. But we don't know. You never know which asset class is going to be the best-performing asset class over the next decade. And we know, looking back we know large growth is doing phenomenal. But back to a point I made earlier, one thing is clear is that if you start from a lower valuation, you're generally going to have better results than if you start from a higher valuation. And I think small cap, the valuation discount in small caps if you look at a small cap value versus small cap growth there's a discount there, if you look at small cap value versus large cap value, and the most notable example is small cap value versus large growth. So we don't make predictions but I think that the historical record is clear. There's a lot of great research out there that says when you start from a lower valuation, you're more likely to have better results than when you start from a higher valuation.

(00:42:07)

Courtney: Steve, one, also one that just came in. **"Can you remind us how you define small caps in terms of market cap?"**

Steve: Yes. I would say our sweet spot is in the $3-$5 billion range right now, and that's what the market's giving us, and that's moved up over the years. A lot of it's kind of from, I guess, just inflation over the last 20 years. A lot of it has to do with the market structure. When we go down into smaller companies, compared to 15-20 years ago, you don't see the quality that you used to see in the $500 million to $1 billion market cap. There are some out there and we have some in the portfolio, but I think it has a lot to do with the amount of private equity out there. Companies aren't coming public. And the good ones, there's so much money to take them private that if it's of high quality, they get taken out. So our sweet spot is in the $3-$5 billion right now, but that's just from doing our due diligence and seeing where we see value.

We do, when we're buying a company, we buy it as a small cap but we'll let them run. We think that's, you know, a success. And we have, over the years, we've somewhat changed our philosophy on that from as soon as it hits a market cap target, we're going to immediately sell out. And we've sold some great companies that we still love the investment but just because it hit a $6 billion market cap, we sold out of it. And the one I'm thinking of is now a $55 billion market cap company. And that's probably the most extreme example but there are others that have been, gone up 400 or 500 more percent after we sold out. And as I say, the only reason we sold out was because it hit an arbitrary market cap.[17]

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I say that, but we are a small cap value fund. We invest in small cap value. But we think it's a success when that company turns into a mid-cap. But we do have a policy in place that there is a cap, but it gives us a lot more flexibility on when we're required to sell. And we've been selling out of a position this year based on that, and I'll tell you that that cap right now is about, the way it's computed is around $24 billion and we have a company that we bought as a small cap that's done that well, and I'm glad we didn't sell it. But it's a judgment call and we understand. As I say, we're a small cap fund and we always will be. But we do want to make as much

[17] **Past results are no guarantee, nor are they indicative, of future results.**

money for our investors as we can, and ourselves as investors in the Fund.

Courtney: Thank you, Steve. That appears to be our final question for today. Thank you for those who listened to the webcast, and now I'll turn it over to the system moderator for closing comments and disclosures. Operator, over to you.

Moderator: Thank you for your participation in today's webcast. We invite you, your colleagues, and shareholders to listen to the playback of this recording and view the presentation slides that will be available on our website, typically within a few weeks, at fpa.com. We urge you to visit the website for additional information about the funds, such as complete portfolio holdings [and] historical returns.

(00:45:54)

Following today's webcast, you will have the opportunity to provide your feedback and submit any comments or suggestions. We encourage you to complete this portion of the webcast. We know your time is valuable, and we do appreciate and review all of your comments.

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We hope that our quarterly commentaries, webcasts, and special commentaries will continue to keep you appropriately informed on the strategies discussed today.

We do want to make sure you understand that the views expressed on this call are as of today and are subject to change without notice, based on market and other conditions. These views may differ from other portfolio managers and analysts at the firm as a whole, and are not intended to be a forecast of future events, a guarantee of future results, or investment advice.

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You should consider the Fund's investment objectives, risks, and charges and expenses carefully before you invest. The prospectus details the Fund's investment objective and policies, risks, charges, and other matters of interest to a prospective investor. Please read the prospectus carefully before investing.

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This concludes today's call. Thank you and enjoy the rest of your day.

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