Tributary Capital Management (Gross of Fees) | 1.7% | 14.9% | -1.6% | 10.6% | 8.2% | 14.9%
Tributary Capital Management (Net of Fees) | 1.4% | 14.4% | -2.4% | 9.6% | 7.3% | 13.9%
Russell 2000 Index | 2.1% | 17.0% | -3.3% | 12.3% | 7.1% | 13.5%
Russell 2000 Value Index | 1.4% | 13.5% | -6.2% | 9.8% | 5.4% | 12.4%

**Market Review**

The Tributary Small Cap Equity strategy returned +1.7% in the second quarter of 2019, trailing the Russell 2000 benchmark’s return of +2.1%.¹

It was a bumpy ride when looking at monthly Russell 2000 returns for the quarter. April and June witnessed strong returns of +3.4% and +7.1%, respectively. This was offset by a decline of -7.8% in May, likely influenced by tariff talk. Drivers of small cap market performance were mixed this quarter. However, growth did outperform value by approximately 140 basis points with the Russell 2000 Growth Index returning +2.8% and the Russell 2000 Value Index returning +1.4%. Companies with higher valuations (P/E, P/S and P/B), higher market capitalizations and higher ROE/ROA tended to outperform. According to FactSet Research, small cap stocks in the Russell 2000 with negative projected earnings in the next 12 months were down -1% while stocks with positive projected earnings were up +3%. The best performing sectors in the small cap market were industrials (+8%), utilities (+5%) and financials (+5%). The worst performing sectors in the small cap market were energy (-8%), communication services (-6%) and consumer staples (-3%).¹

The portfolio’s two best performing economic sectors relative to the Russell 2000 were financials and healthcare. In financials, the portfolio’s +8% return bested the +5% return for the Russell 2000 financial sector. Selective Insurance Group was a top performer in the portfolio this quarter. In addition, the portfolio’s overweight position and better stock returns in the banking industry were also a positive. The portfolio’s banks returned +6% vs. +5% for the Russell 2000. In healthcare, the portfolio’s sector return of +4% compared favorably to the Russell 2000 sector’s flat return. AMN Healthcare was the primary contributor to the portfolio outperforming the benchmark sector return.¹

The portfolio’s two worst performing sectors vs. the Russell 2000 were consumer discretionary and real estate. In consumer discretionary, the portfolio’s -11% sector return compared unfavorably to the Russell 2000 sector’s return of -1%. Higher growth consumer discretionary stocks performed better than value-oriented companies. Also contributing to relative underperformance was Big Lots and G-III Apparel. In the real estate sector, the portfolio’s -8% sector return was below the Russell 2000 sector’s return of +1%. Marcus & Millichap was the primary driver of underperformance for the portfolio in the real estate sector.¹

**Portfolio Changes**

There were three additions to the portfolio in the second quarter. G-III Apparel is a manufacturer and marketer of over 30 brands of proprietary and licensed upscale accessories and apparel. This historically well-managed company is expected to drive revenue growth by expanding international distribution, developing new products, growing proprietary license fees and capturing market share. In addition, earnings growth should be enhanced by margin expansion through increased sales of higher margin proprietary products and a leveraging of fixed costs.

Movado Group is a designer and marketer of proprietary and licensed luxury and upscale fashion watches with great brand recognition, global distribution, a high quality balance sheet and paying over a 2% dividend yield. The recent acquisition of the MVMT brand of watches gives Movado exposure to the millennial generation with an online sales model.

MedPace Holdings is a contract research organization that provides fully-outsourced phase I-IV development services to small- and mid-sized biopharmaceutical and medical device companies. This is a good way to gain exposure to growing pharmaceutical development activity without the concentrated product risk of an individual biotech company. Several years of robust funding growth provides a backdrop for solid revenue growth at MedPace for the next few years.

There were four eliminations during the quarter. Massimo was sold due to the market cap exceeding $5 billion and valuation. Emergent BioSolutions was eliminated due to increased expectations that the company’s opioid treatment, NARCAN, will face increasing competition from generic pharmaceuticals and a greater likelihood that the FDA grants over-the-counter status to a “NARCAN-like” product. Lydall exited the portfolio following multiple revisions of earnings expectations related to the acquisition of Interface Performance Materials and management’s minimal debt reduction projections. Dave & Buster’s Entertainment was sold due to margin erosion from increased competition, broad weakness in the sit-down restaurant industry and higher wage costs.

**Top Contributors**

Tetra Tech, a water engineering company, has raised profit guidance twice this year after robust state and local government spending trends continue and federal government exposure has good visibility.

Selective Insurance Group, a property and casualty insurer, is benefiting from improved pricing in the commercial insurance space along with a generally bullish outlook from the industry. In addition, Selective has now posted three consecutive quarters of profitability out of its historically challenging excess and surplus segment.

AMN Healthcare, a healthcare workforce solutions provider, reported results that witnessed improvement in the IT issues that had negatively impacted the physician placement segment and the company experienced its highest travel nursing demand in two years. AMN also closed an acquisition in June that will be EPS accretive, on an annualized basis, in 2019.

CACI International, an information technology and network services provider, reported a strong quarter driven by acquisitions, record quarterly awards, and on-contract growth. Guidance for the year was also raised.

Navigant, a business consulting firm, recovered from an overdone February selloff as its healthcare consulting business showed signs of life after disappointing trends, bolstering management’s confidence in its guidance for the year.

**Top Detractors**

Marcus & Millichap, a commercial real estate broker, reported weak results. The company faced a difficult comparison from a year ago as the anticipation of rising interest rates provided motivation for many transactions to close in 2018. In addition, the change in interest rate expectations, trade war rhetoric and recession concerns left many buyers and sellers on the sidelines during the quarter.

Big Lots, a value retailer of discounted products in furniture, food, consumables, home products, electronics and toys, declined...
TRIBUTARY CAPITAL MANAGEMENT

PORTFOLIO MANAGERS: MARK WYNEGAR & MIKE JOHNSON

primarily on concerns about what impact U.S. tariffs will have on its Chinese-imported products.

G-III Apparel, a manufacturer and marketer of proprietary and licensed upscale accessories and apparel, was affected by U.S. tariffs on Chinese imports.

Carrizo Oil & Gas, an energy exploration and production company, was weak as global oil demand concerns negatively impacted small cap exploration and production companies.

Dave & Buster’s, a dining/sportsbar/arcade entertainment concept, reported a weak quarter with lower than expected same-store sales, revenue and EPS. Increased competition, industry saturation and new units appear to be cannibalizing existing units.

PORTFOLIO OUTLOOK

Market dynamics in the second quarter were interesting to say the least. The U.S. economy grew 3.1% in the first quarter, tied the longest economic expansion on record in June and began charting a new record in July. Unemployment is at a 50-year low, and job openings outnumber the unemployed by 1.6 million. Consumer spending continues to rise as do wages. However, large cap and small cap stocks have responded very differently to these fundamental economic drivers.

The S&P 500 ended the second quarter with a 4% gain. The Russell 2000 was up 2% during the quarter and has underperformed the S&P 500 by 7% since late February. This is surprising considering the more attractive valuation of small cap stocks relative to their larger peers and their greater domestic exposure. Comparing the S&P 600 small cap stock index and the S&P 500, smaller companies are more attractively valued relative to large cap stocks on a forward P/E basis and even more so on P/B, P/S or EV/EBITDA measures, as those metrics are far below their long-term averages and setting new 10-year lows. Companies in the S&P 600 generate approximately 20% of their revenue internationally, compared to 40% for the S&P 500, making them much less exposed to the volatile trade negotiations between the U.S. and its trading partners China, Mexico and Europe.

Irrespective of market cap, stocks have been influenced by changes in trade and monetary policy expectations. In early May, President Trump tweeted that tariffs would increase from 10% to 25% on $200 billion of Chinese goods, and eight days later it was announced that 25% tariffs would be imposed on an additional $300 billion of imports. These actions contributed to the drops in the S&P 500 and Russell 2000 in May by 6% and 8%, respectively. However, in the final days of the quarter, the U.S. and China reached a cease fire in their trade negotiations. The U.S. has agreed to indefinitely postpone the latest wave of tariffs, and China has agreed to buy more farm goods from the U.S. This news boosted markets and helped propel the S&P 500 to new record highs to start the third quarter. The Federal Reserve provided support for equity markets during the second quarter as well. Markets rebounded following comments from Federal Reserve members in early June that trade tensions were being closely monitored and that they would act appropriately to sustain the economic expansion. Investors’ expectations of a Fed rate cut started increasing at the end of May and these comments further supported those beliefs. According to the CME FedWatch Tool, the probability of a rate cut by the Fed’s December 2019 meeting have swung from 9% at the start of the year, to 64% at the end of the first quarter, and rose to 100% before the end of the second quarter. Furthermore, as of this writing, investors believe there is a 60% probability that the Fed will reduce rates by a total of 75 basis points by their meeting in December.

Though not as volatile as Fed rate cut predictions, earnings expectations for small cap stocks have changed dramatically in 2019 as well. At the beginning of the year, year-over-year earnings estimates for small cap stocks ranged from 15% to 20%. Today estimates range from flat to 7%. Estimates for large cap stocks have declined as well. They were projected to be between 7% and 14% at the beginning of the year but have been lowered to between 3% and 7%. Valuation multiples for the two indexes have taken opposite paths. The forward P/E multiple for the S&P 600 contracted slightly, from 16.7x at the beginning of the quarter to 16.4x at the end of the quarter; while the S&P 500 expanded from 16.4x to 16.7x. The S&P 600’s forward P/E relative to the S&P 500 ended the quarter at 0.98x, a low it hasn’t touched since March of 2002.

Our approach to investing will always focus on owning a fully invested and diversified portfolio of quality businesses at attractive prices. We believe the companies in our portfolio will continue to grow their intrinsic value for our shareholders and represent value that will be rewarded by the market over time.

Tributary, an SEC Registered Investment Adviser, is the combined entity of the prior Tributary (formed Jan. 1, 2005) and First Investment Group (formerly a department of First National Bank of Omaha) which merged in May 2010. This event constituted a change in ownership only, as the investment strategies and personnel remained the same for each prior firm. Tributary is a wholly owned subsidiary of First National Bank, a wholly owned subsidiary of First National of Nebraska, Inc. and manages mutual funds and equity and balanced portfolios. Tributary Capital Management, LLC (“Tributary”) claims compliance with the Global Investment Performance Standards (GIPS®). A fully compliant presentation can be requested by emailing clientservices@tributarycapital.com.

Past performance does not guarantee future results. Investments: Are Not FDIC Insured • May Go Down in Value • Are Not a Deposit

Tributary Capital Management, LLC
Omaha, Nebraska | 877.458.0021 | www.tributarycapital.com