TRIBUTARY
CAPITAL MANAGEMENT

SMALL/MID CAP EQUITY MARKET COMMENTARY

PORTFOLIO MANAGERS: DON RADTKE & MARK WYNEGAR | **FIRST QUARTER 2019**

	Quarter	Year to Date	1 Year	3 Years	Since Inception*
Tributary Capital Management (Gross of Fees)	14.1%	14.1%	6.9%	N/A	10.3%
Tributary Capital Management (Net of Fees)	13.9%	13.9%	6.2%	N/A	9.7%
Russell 2500 Index	15.8%	15.8%	4.5%	N/A	9.2%
Russell 2500 Value Index	13.1%	13.1%	1.8%	N/A	4.1%

Inception: 12/31/2016

PORTFOLIO REVIEW

The Russell 2500 benchmark increased +15.8% in the first quarter of 2019. Value underperformed growth in the quarter, with the Russell 2500 Value Index +13.1% versus an increase of +19.0% for the Russell 2500 Growth Index.[1]

The top performing sectors in the Russell 2500 this quarter were information technology (+25%), healthcare (+19%), energy (+18%) and real estate (+17%). The weakest sectors included consumer staples (+7%), financials (+10%), utilities (+10%) and consumer discretionary (+12%).[1]

The Small/Mid Cap Equity Portfolio rose +14.1% in the quarter but fell short of the Russell 2500 benchmark's return of +15.8%. The portfolio's strongest relative performance was in the industrials, communication services, consumer staples and energy sectors. In industrials, the portfolio had a +18% return versus a +15% return for the Russell 2500 industrials sector. In communication services, the portfolio's sector return of +39% exceeded the Russell 2500 return of +14%. The portfolio's consumer staples sector increased +18%, compared to +7% for the respective market sector. The energy holdings of the strategy rose +21%, surpassing the +18% return from the Russell 2500 energy sector.[1]

The portfolio's most significant sector detractors versus the Russell 2500 were information technology and healthcare. The portfolio's information technology holdings rose +15% but fell short of the +25% return realized by the Russell 2500 information technology sector. Key drivers were the disparity between growth and value stocks in the sector, as well as the performance of the software industry group. During the quarter, the Russell 2500 Growth tech sector rose +27%, outperforming the Russell 2500 Value tech sector's return of +21%. The software industry group, which constitutes over a third of the tech sector, rose +28%. Because this industry group is populated by companies with some of the highest valuations in the sector, the portfolio is underweighted software. The portfolio's healthcare holdings rose +14% compared to the Russell 2500 healthcare sector's +19% return. Favorable performance by portfolio holdings Omnicell and PerkinElmer was offset by weaker performance from AMN Healthcare. Additionally, the portfolio was underweight in the Biotech industry, which rose +27%. The portfolio's average cash position was 4.2% in the quarter, resulting in a minor cash drag during the strong market move.[1]

On a trailing twelve month basis, the Small/Mid Portfolio outperformed the Russell 2500 benchmark by 2.4%, with a total return of +6.9% versus +4.5% for the index. Favorable performance from the portfolio's consumer discretionary, industrials, materials and healthcare holdings was offset by underperformance in the information technology, energy and real estate sectors. At the market level, the growth versus value disparity was a driving force for the market for much of the past twelve months, with the Russell 2500 Growth +7.5% and the Russell 2500 Value +1.8%.[1]

PORTFOLIO CHANGES

During the first quarter, no new positions were added to the portfolio and two were removed. *Snap-on*, a manufacturer of tools and shop equipment, was eliminated due to the lack of recovery in its core Tools Group segment and difficult upcoming comparisons for other segments. Additionally, in contrast to the last recession, the company's finance unit is now in-house, which may be a source of investor concern during the next economic downturn. *Multi-Color Corporation* was removed from the portfolio in February. Following some recent operational struggles and a sizable acquisition, the producer of labels for consumer products received an all cash bid to be acquired by Platinum Equity Partners.

TOP CONTRIBUTORS

Nexstar Media Group, a television broadcaster, reported strong revenue growth driven by record mid-term election political advertising spending and continued strong growth in recurring retransmission fee revenue from pay TV providers. Margins were also up strongly on a leveraging of fixed costs.

Omnicell, a manufacturer of medication and supply dispensing systems to the healthcare industry, reported quarterly results and guidance above expectations. Organic revenue was +10% year-over-year. Management commentary suggested significant runway still exists for the rollout of their XT product. The XT upgrade cycle is only in the second inning and continues to accelerate. The company has also mentioned that they could exceed the margin target of 15% if momentum continues.

PerkinElmer, a provider of products and services to life sciences researchers and the diagnostics industry, announced positive quarterly results, including strong organic revenue growth from its diagnostics segment.

Stifel Financial, a provider of wealth management, investment banking and securities brokerage services, reported strong results from its asset management and bank divisions.

MTS Systems Corporation, a provider of testing systems and sensors used in the R&D process of its customers, recovered nicely during the market rally after underperforming slightly in 2018. The company is sitting on record total backlog, the sensors business is seeing record order levels and the company has said it sees minimal impact of any tariffs that may be put in place.

TOP DETRACTORS

AMN Healthcare Services, a healthcare workforce solutions provider, reported disappointing fourth quarter sales, paired with materially weak first quarter of 2019 sales guidance. Their physician placement business continued to be plagued by IT system problems and caused the company to miss sales opportunities in the fourth quarter. In addition, a large customer is temporarily dialing-back its first quarter utilization levels for temporary nursing positions.

Columbia Banking System, a bank holding company with locations in Washington, Oregon and Idaho, reported a weak quarter as both loans and deposits declined, fee income was lower and operating expenses were higher. Partially offsetting these negatives were a stable net interest margin, continued strong funding base and healthy credit quality.

RPM International, a manufacturer of coatings, sealants and building materials, is undergoing a restructuring plan which is expected to eventually generate solid margin improvement, but this will take time to work through. In the meantime, the company reported an all-around weak quarter in early January which weighed on the shares.

Dorman Products, a manufacturer of replacement parts and fasteners for cars, light trucks and heavy duty trucks, reported better-than-expected revenue and earnings, but 2019 guidance fell below expectations.

Burlington Stores, a discount retailer of apparel and home products, reported a deceleration in same-store sales growth, compared to the strong growth it has recently been delivering.

Portfolio Outlook

Following the late 2018 selloff, the market bounced back sharply in the first quarter. Investors' preference for risk and growth is very similar to what was driving the market for the majority of 2018. This reversal from the heightened risk aversion in the closing months of 2018 has been supported by accommodative Federal Reserve actions and policy statements. In early January, messaging from the Fed emphasized that it would be "data dependent". The dot plot issued in March indicated that they did not expect any changes to their current target federal funds rate of 2.25% to 2.5% during 2019. Additionally, they expect to complete their balance sheet runoff in September of this year, ending their quantitative tightening cycle.

Quantitative easing since the Great Recession has been pushing yields lower and possibly decreasing investors' perception of risk. This can be seen in the falling term premium, the additional yield investors demand for the risk of lending over long periods. Historically, inflation concerns have kept term premiums positive. However, the term premium on a 10-year zero coupon bond has been negative for most of the period from July of 2011 to present. This has likely contributed to the recent inversion of the 10-year and 3-month Treasury yield curves as well as the 10-year and 1-year Treasury yield curves. Yield curve inversions have historically been fairly accurate predictors of recessions, though a recession may not occur for 6 to 24 months. Forecasting the timing and/or the magnitude of a recession is not something we can accurately predict. However, we do pay attention to, and want to be aware of, historical economic and market relationships.

The final fourth quarter GDP measurement was 3% on an annualized basis. At the time of this writing, the Atlanta Federal Reserve's GDPNow model's estimate is for 2.1% real GDP growth in 2019. Corporate profit estimates for small and midcap companies in 2019 range from 2.8% to 7.3% and 4.3% to 9.1%, respectively, down considerably from 2018's estimated growth rates of more than 25%. Of course, 2018 experienced a sugar high from the 2017 Tax Cuts and Jobs Act. Regardless, these growth rates are down from the 2014 to 2017 averages of 14% and 11% earnings growth for small and mid-cap companies, respectively.

The economy is slowing but is underpinned by a number of positive fundamental factors. According to the Bureau of Labor Statistics, employment remains strong across all age groups. Recently, real wages have begun increasing and outpacing inflation. Nearly 70% of the U.S. economy is driven by personal consumption and a strong consumer can continue to drive growth. Additionally, mortgage rates are currently hovering near 4%, which should support the housing market that has yet to fully recover.

The most notable clouds on the horizon are the potential knock on effects from a slowdown in international growth and possible disruptions to international trade. The Organization for Economic Cooperation and Development estimate for 2019 global growth is 3.3%, down 20 basis points from November. Growth projections have been reduced for almost all G20 economies.

Commentary surrounding U.S. and China trade relations has been mostly positive at the start of 2019. The indefinitely delayed tariff increase on $200 billion of Chinese imports, from 10% to 25% has supported the market's rebound. However, negotiations appear to be fluid, with no certainty on when a deal may be reached. Additionally, there is the possibility that the U.S. places new tariffs on European auto imports. In mid-February the Commerce Department concluded its assessment of whether imported cars and parts pose a national-security threat. The results were not made public, but the administration has 90 days from delivery of the report to announce new tariffs or other barriers. Any developments that appear to limit trade between the Eurozone and the U.S. might spook the market.

Though growth is slowing domestically and internationally, we continue to find small and midcap companies to be attractive. On a forward P/E basis, the S&P 600 is trading at 16.7x, approximately fairly valued relative to its long-term average of 16.5x and, the S&P 400 is trading at 15.7x, slightly below its long-term average of 16.1x. Using the same valuation measure, both indexes are trading below their long-term averages relative to the S&P 500.

[1] *Factset Research Systems*

The performance numbers shown above are for the Tributary Small/Mid Cap Equity Composite and are expressed in U.S. dollars. The composite includes all discretionary accounts with an initial market value of $500,000 that are generally invested in the Small/Mid Cap Equity Strategy. The inception date of the Small/Mid Cap Equity Composite is December 31, 2016. The Russell 2500 is a market cap weighted index that includes the smallest 2,500 companies covered in the Russell 3000 Index. It consists of a blend of small and mid cap stocks "smid", and can describe any company up to the $10 billion market cap range. The Russell 2500 Value Index is a subset of the securities found in the Russell 2500 Index which includes companies that exhibit a value probability. The Russell 2500 Growth Index is designed to measure the performance of those Russell 2500 companies with higher price-to-book ratios and higher forecasted growth values.

Stocks of small companies are subject to market risk and may be more volatile and less liquid than stocks of large companies. Comments are provided as general market commentary and should not be considered investment advice or predictive of any future market performance. Sector performance in commentary is stated gross of fees.

Net of fees composite returns were calculated using the actual aggregate investment advisory fees applicable to portfolios within the composite. Net performance is reported net of investment advisory fees and transaction costs. Capital gains and dividends are reinvested for performance calculations.

It should not be assumed that an investment in securities identified was or will be profitable or that the investment decisions we make in the future will be profitable or will equal the performance of the securities discussed herein. Holdings are subject to change. The holdings identified do not represent all of the securities purchased, sold or recommended for the portfolio. The holdings listed should not be considered recommendations to purchase or sell a particular security. The "Top Contributors" and "Top Detractors" represented are based on contribution to portfolio return. To obtain the contribution calculation methodology and a complete list of every holding's contribution to the overall portfolio's performance during the quarter, please contact clientservices@tributarycapital.com.

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