Skyline Asset Management, L.P.

Executive Summary

Skyline Small Cap Value Composite

September 30, 2016

Overview

The composite generated a 6.0% return for the third quarter, compared to a 9.1% return for the Russell 2000 Index and an 8.9% return for the Russell 2000 Value Index. For the first nine months of 2016, the composite generated a 6.6% return, compared to an 11.5% return for the Russell 2000 Index and a 15.5% return for the Russell 2000 Value Index. Small cap stock prices posted strong gains for both the third quarter and first nine months of the year, responding to a benign environment for equities. The U.S. economy is expanding at a level conducive to corporate earnings growth but muted enough to keep interest rates low, which helps maintain relatively high valuations.

The composite underperformed its benchmarks during the third quarter and first nine months of the year due primarily to disadvantageous stock selection. The underperformance was due to severe stock price declines in several holdings due to factors we believe are temporary or overstated. In our opinion, the long-term earnings prospects of the companies in our client's portfolios remains quite strong.

If the economy maintains its current trajectory, and both a recession and a sharp rise in interest rates are avoided, the opportunity for further stock price appreciation remains. In addition, our clients' portfolios are well positioned given the significant P/E multiple contraction several of the holdings in our clients' portfolios have experienced.

Market Review

Stocks rose in the third quarter, as indicated by the Russell 2000 Index's 9.1% increase, the 8.9% return generated by the Russell 2000 Value Index, and the S&P 500 Index's 3.9% increase. For the first nine months of 2016, the Russell 2000 Index rose 11.5%, the Russell 2000 Value Index increased 15.5%, and the S&P 500 Index rose 7.8%.

Conditions remain benign for stock prices. Typically, the biggest threats to stock prices are a recession, which causes earnings to decline, or a rapid rise in interest rates, which tends to cause valuations to contract as alternative investments such as bonds become more attractive. The economy continues to grow at a moderate pace, fast enough to allow resumption of earnings growth yet not so fast as to cause interest rates to spike along with an increase in inflation expectations.

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After stalling out for the past year or so, earnings have begun to resume their growth. During the third quarter, small cap companies reported year-over-year earnings growth of 2.1% for the second quarter, the first positive comparison in five reporting seasons. Estimates for all of 2016 currently call for 3.6% EPS growth for small cap stocks and 7.9% if energy is excluded.

At the same time, interest rates remain at low levels, which supports higher P/E multiples for stocks. The U.S. 10-year Treasury note fell to an all-time low early in the third quarter and was not far above that level as the quarter ended. Low interest rates have a positive impact on equity valuations for two main reasons. First, low rates make the returns on alternatives to stocks such as bonds less attractive. In addition, stock prices tend to reflect the discounted value of their future cash flows, and all else being equal, lower interest rates tend to increase the present value of those future cash flows.

Stock gains were broad based for both the third quarter and first nine months of the year. Each economic sector within the small cap market posted gains for either the third quarter or year-to-date, with most posting gains for both periods. The best performing sectors for the third quarter included both economically sensitive sectors as information technology, industrials, and materials, and the less-economically sensitive healthcare sector. Similar trends were evident for the first nine months of the year, with the economically sensitive materials, information technology, and industrials sectors and less-economically sensitive consumer staples and utilities sectors posting strong gains.

Small cap stocks outperformed large cap stocks in both the third quarter and year to date. Valuations between large cap and small cap stocks are similar and small cap stocks are posting better earnings growth.

Portfolio Review

The composite generated a 6.0% return for the third quarter, compared to a 9.1% return for the Russell 2000 Index and an 8.9% return for the Russell 2000 Value Index. For the first nine months of 2016, the composite generated a 6.6% return, compared to an 11.5% return for the Russell 2000 Index and a 15.5% return for the Russell 2000 Value Index.

Sector allocation was a slight positive for the composite for the third quarter and first nine months of the year. Overweights in the strong performing materials and industrials sectors benefitted the composite during both periods. Underweights in the utilities and real estate sectors also benefitted performance during the third quarter. However, underweights in utilities and real estate, which were among the strongest performers in the first half of the year, detracted from performance for the first nine months of the year. In addition, although our clients' portfolios were overweight in the strong performing materials sector during both periods, positioning within that sector negatively impacted results. Our clients' portfolios were invested in specialty materials and chemicals companies and lacked exposure to commodity-oriented companies, which were the main drivers of performance in the materials sector.

The underperformance of the composite relative to its benchmarks for both the third quarter and first nine months of the year was due to unfavorable stock selection. However, we believe that, for the most part, the stocks that performed poorest overreacted to temporary factors and not a significant deterioration in fundamentals. In addition, the factors that contributed to price declines for many of our clients' portfolio holdings were varied, and in our opinion, unrelated.

For example, during the third quarter, the healthcare sector detracted most from the composite's performance on both an absolute basis and relative to its benchmarks. Our clients' portfolios' two hospital staffing companies, Cross Country Healthcare, Inc. and AMN Healthcare Services Inc., declined sharply during the quarter. The declines resulted from fears that the beneficial impact of the Affordable Care Act on hospital admissions was waning and would slow demand for hospital staffing services. Our positive view on these stocks is based on more durable demographic trends that remain in place, namely the large number of nurses approaching retirement age and the fewer number of nursing school graduates entering the workforce to replace them. We believe this trend will overwhelm any short-term fluctuations in hospital admissions over the long term, leading to solid earnings growth and stock price appreciation for our hospital staffing companies.

The industrials sector detracted most from the composite's performance relative to its benchmarks for the first nine months of the year. Korn/Ferry International (KFY), an executive search and leadership consulting firm, now trades at less than 10 times its current fiscal year EPS estimate after declining over 35% in the first nine months of the year. KFY experienced a roughly 10% reduction in earnings estimates related to more difficult end-market conditions. However, we believe the stock declined significantly more than warranted by the change in fundamentals. A recent acquisition increased KFY's exposure to Europe and investors focused on the potential for short-term weakness related to Brexit rather than the long-term value created by the deal.

Several of our clients' portfolio holdings generated strong price gains during the third quarter and first nine months of the year. Greenhill & Co., Inc., an independent investment bank was the largest contributor to the composite's third quarter performance after rising nearly 50%. Greenhill rebounded strongly from extremely depressed levels due to results that indicated that the company's disappointing 2015 earnings were due more to timing issues than a deterioration in the company's long-term business prospects.

The two largest contributors to the composite's performance for the first nine months of the year were consumer discretionary stocks: The Children's Place Retail Stores, Inc., a retailer of children's clothing, and Drew Industries Incorporated, a provider of parts for recreational vehicles. The strong performance of these stocks during a period when consumer discretionary was one of the worst performing sectors in the benchmarks highlights our ability to find stocks that have company-specific factors that allow them to perform well despite operating in sectors facing stiff headwinds.

We believe that the underlying fundamentals of the companies in our clients' portfolios are much stronger than their stock prices would imply. In fact, the companies in our clients' portfolios posted median year over year EPS growth of 13% in the second quarter, and are expected to grow EPS 11% over the next twelve months, figures that compare favorably with the average small cap stock.

Outlook

A key component of our investment process is identifying stocks that have been driven to very low valuations when investors overreact to temporary factors or overestimate the risks from macro factors such as exposure to certain industries or geographies. Ideally, these factors arise prior to our investment. However, they can also occur subsequent to our purchase. Either way, if we are correct in our assessment, our clients' portfolios companies will deliver the earnings growth we expect causing investors to reassess the risks and reward the stocks with higher valuations.

On the whole, the fundamentals of the companies in our clients' portfolios remain solid. In addition, many stocks in our clients' portfolios have seen their valuations drop to extremely attractive levels due to factors we believe are either temporary or overstated. We have experienced similar periods of underperformance over the twenty-plus years we have invested in small cap value stocks. In prior instances, we have maintained our investment disciplines and our investors have been rewarded for their patience. We see no reason to believe that the current situation is any different.

William F. Fiedler Partner, Portfolio Manager	Michael Maloney Partner, Portfolio Manager	Mark N. Odegard Partner, Portfolio Manager

Note: Portfolio holdings are subject to change and are not a recommendation to buy individual securities. The views expressed are those of Skyline Asset Management, L.P. and are subject to change. The composite's performance is gross of fees. Gross returns do not reflect the deduction of investment advisory fees or expenses and therefore the client's return will be reduced by the advisory fees and any other expenses it may incur. For example, a separately managed client portfolio, which earned 15% per annum for ten years, would result in a cumulative return of 304.6% before the investment advisory fee of 1% and expenses and 270.7% net of such fees and expenses. The investment advisory fees are described in Part 2 of Skyline's Form ADV.

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Sources: Bloomberg L.P.; C.L. King & Associates; Jefferies LLC; npr; Piper Jaffray Companies; Sandler O'Neill + Partners, L.P.; The Wall Street Journal; William Blair & Company, L.L.C.; Yardeni Research, Inc.; S&P Capital IQ; Morningstar, Inc.; and Skyline Asset Management, L.P.