

Mid Cap Dividend Value

First Quarter 2020 Commentary

Past performance does not guarantee future results. The performance data quoted represents past performance and current returns may be lower or higher. The investment return and principal will fluctuate so that an investor's portfolio, when liquidated, may be worth less than the original cost/balance. As with any investment, there is a potential risk of loss. Smaller and medium-sized company stocks are more volatile and less liquid than larger, more established company securities.

Performance

For the quarter ended March 31, 2020, the Mid Cap Dividend Value Strategy fell -33.12% gross (-33.22% net of fees) compared with a -31.71% decline for the Russell Mid Cap Value Index.

Macroeconomic Review

The year started out promisingly with the S&P 500 making new all-time highs in the first quarter. That changed quickly. In fact, the S&P went from a new all-time high to a bear market (down 20%) in a record sixteen days. This is faster than the thirty days it took to enter a bear market in 1929 and the thirty-eight

days in 1987. The bear markets that started in 1973, 2000, and 2008 took more than two hundred days to "qualify" as bear markets.

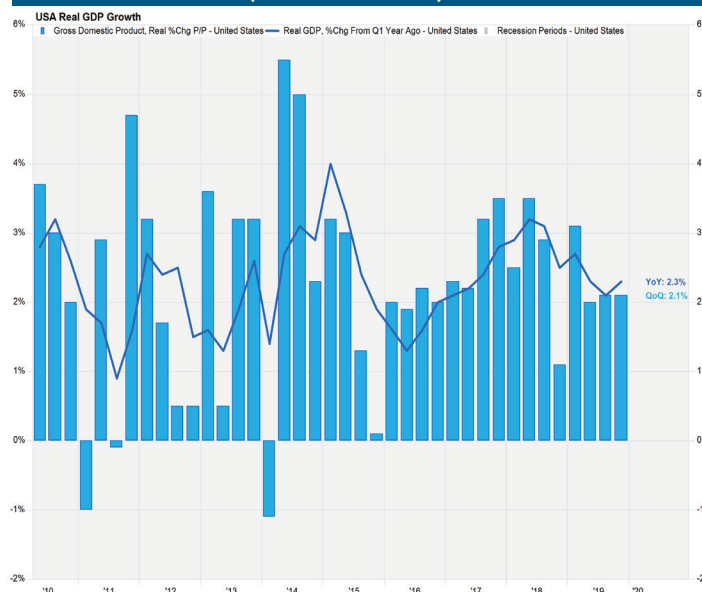
Unlike some times when we see rapid changes in stock prices, the move largely reflected an equally quick change in the fundamental outlook. Fueling investor panic was the rapid spread in the U.S. of the coronavirus (COVID-19) pandemic, forcing hospital emergency rooms to the brink of capacity. President Trump declared a U.S. National Emergency as the contagion forced a virtual shutdown of the U.S. economy, forcing closure of factories, schools, restaurants, sporting events, hotels, entertainment, and air travel. California and New York, among other states, ordered residents to stay at home except for essential services. The impact has rippled broadly throughout the U.S. economy, disrupting supply chains, shuttering thousands of businesses and leading to a

Market Performance

As of March 31, 2020	3 Months	1-Year	3-Year
S&P 500 Index	-19.6%	-7.0%	5.1%
Russell 3000 Value Index	-27.3%	-18.0%	-2.7%
Russell 3000 Index	-20.9%	-9.1%	4.0%
Russell 2500 Value Index	-34.6%	-28.6%	-8.4%
Russell Midcap Value Index	-31.7%	-24.1%	-6.0%
Russell 2000 Index	-30.6%	-24.0%	-4.6%
Russell 2000 Value Index	-35.7%	-29.6%	-9.5%
Bloomberg Barclays Agg. Bond Index	3.1%	8.9%	4.8%

Source: eVestment.

USA Real GDP Growth (Q1 2010 - Q4 2019)



Source: U.S. Bureau of Economic Analysis, Factset.

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surge in jobless claims.

The most visible consequence has been the nearly 16 million jobs lost in the US in just three weeks, more are likely. For companies in the travel, hospitality, and services industries, business has slowed to a crawl or stopped altogether. Many formerly healthy companies now face serious financial distress. This is reflected in lower stock prices and higher corporate bond yield spreads.

The Federal Reserve acted very quickly in cutting rates to zero and has been aggressively supplying liquidity and confidence to sectors of the credit markets as they flared up. One of the problems in the 2008-2009 downturn was that some important credit markets stopped working. While the last several weeks have been bumpy, the markets have mostly functioned.

Though catastrophic, this public health crisis will eventually peak and the U.S. economy and financial markets should rebound sharply given the extraordinary liquidity measures undertaken by the U.S. Federal Reserve and global central banks, along with two trillion in fiscal stimulus appropriated by Congress. The powerful combination of monetary and fiscal accommodation should ensure access to bank lines and credit markets by companies requiring bridge financing, while increasing jobless benefits for unemployed workers. We would expect a sharp contraction in U.S. GDP for the first half of 2020, along with commensurate profit declines for U.S. companies. Assuming a peak in the infection rate in the months ahead, the economy should post a strong recovery in the second half of 2020, discounted in advance by equity markets.

Portfolio Results

First quarter results for the Mid Cap Dividend Value Strategy fell short of our expectations. One of the attractions of investing in dividend-paying stocks is that they tend to hold up better in turbulent market conditions. That was not the case in the first quarter either for the Strategy or for dividend-paying mid-cap stocks in general. The decline in dividend-paying mid-cap value stocks was only slightly less than that for non-dividend-paying mid-cap value stocks at negative 31.4% vs. negative 32.5%, respectively. In addition, our holdings in a couple sectors detracted materially from results.

If we break down the relative performance of the portfolio into the impact from Sector Allocation decisions and Stock Selection choices, we find that Sector Allocation added to performance, while Stock Selection detracted. The positive impact from Sector Allocation was mostly due to cash. We do not allocate to cash, but in a period when the market moves a great deal in one direction even a small cash holding can help or hurt performance.

Three factors drove the underperformance in Stock Selection. Although the impact was spread among several sectors, most of it was in the Real Estate, Communications Services, and Consumer Discretionary sectors. The three broad issues that hurt performance were exposure to travel, investments in companies that depend on advertising, and a tilt toward financials stocks that would benefit from stability in interest rates after last year's declines.

Stocks that were impacted by the decline in travel-related stocks included hotel stocks and timeshare companies as well as an aircraft leasing company. Coming into the year, the consumer looked healthy

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because of low unemployment, low gas prices, and low interest rates. The spread of the coronavirus not only caused the travel industry to grind to a halt, it also has hurt employment and the outlook for a rebound has not yet developed.

The same root cause undermined conditions in the advertising business. While viewership has jumped for companies like Nexstar Media, an owner of broadcast television stations, advertisers have pulled back on spending as their own business outlooks have deteriorated. This trend not only hurt performance in the Consumer Discretionary sector, it contributed to the underperformance in the Real Estate sector because outdoor advertising company Lamar Advertising fell as the prospects for all advertising have dimmed.

The tilt in the Financials sector was the least impactful of these three factors. Coming into the year, we thought the Fed would be on hold and that the valuations were attractive. As the magnitude of the risk to the economy from the measures needed to contain the pandemic emerged, the Fed acted very quickly by cutting interest rates to zero in a matter of weeks. This creates clear headwinds for banks and life insurance companies. In addition, as the credit markets became disjointed, investors worried about the investment portfolios at insurance companies. The shutdown of businesses across the United States and the steep drop into recession has caused concerns to emerge about the credit quality of bank loan portfolios. As we write this, the Government's intervention appears to be creating some stability in credit markets, albeit at much wider credit spreads. We will get some early indications of how banks are faring in this environment as they report earnings over the next several weeks. Earnings expectations have declined dramatically, but it will still be difficult for investors to gauge the impact of the decline in the economy because of new accounting rules and the impact of the Government's response to the economic slowdown.

The Strategy was more active than usual during the quarter as it bought ten new positions and exited eleven holdings in addition to a number of adds and trims. The general theme of the activity was to further upgrade the quality of the portfolio by buying some stocks that we had historically viewed as either too large or too expensive. The sales were a combination of completing the sale of companies being acquired or that had grown larger than our market cap ranges (early in the quarter) and selling down or out of stocks that we felt might not have the balance sheet staying power to weather the recession we are entering. In a couple of cases stocks were sold because we believed had found similar, but better ideas and we used the sale of an existing holding to fund the purchase of the new one.

Leading Contributors

Hasbro, Inc. (HAS) a leading international toy and entertainment company that has iconic brands such as Nerf, Play-Doh, and Monopoly along with a diverse portfolio of licensed brands. We purchased shares this quarter at very attractive prices as the stock sold off on potential supply chain disruptions in China, the rapidly spreading coronavirus, and the lingering impacts of tariffs. We felt that Hasbro's board games and toys could benefit from consumers looking for alternatives during the "stay at home" orders that were enacted across the world to help slow the spread of this highly contagious virus. The stock has appreciated from where we bought it, making it one of the top contributors this quarter. We like Hasbro longer-term given its global reach and high-quality brand portfolio.

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Cypress Semiconductor (CY) designs, manufactures, and sells memory and logic semiconductors used in a wide array of industrial, automotive, and consumer applications. This turned out to be a good trade as the Strategy owned the stock for less than a week. We had previously owned Cypress but sold the stock after it agreed to be acquired by Infineon for \$23.85 in cash. The stock had been trending toward the buyout price until investors started to worry that the Committee on Foreign Investment in the United States (CFIUS) would not approve the deal. It fell below the price it traded at prior to the buyout announcement. At that point, we thought it was attractive whether the deal was approved or not. When the CFIUS approved the merger, the stock rebounded and was sold.

Pioneer Natural Resources (PXD) is one of the leading independent producers of oil in the prolific Permian Basin in Texas and New Mexico. The steep drop in oil prices during the quarter as a result of the COVID-related economic slowdown and the oil price war between Saudi Arabia and Russia drove stocks of oil companies lower. We did not own Pioneer before the fall as it had been above our market cap range. We took advantage of the fall in prices to add this well-operated, well-financed company to the portfolio. Our timing was good, so far.

Leading Detractors

Brixmor Property Group (BRX) shares declined significantly during Q1 as government-imposed measures in response to coronavirus caused the closure of numerous retail tenants whose businesses were deemed nonessential by local governments. While 70% of this retail REIT's shopping centers are anchored by grocers that remain open for business, just 14% of its rental income comes from grocers. That sparked investor worries about the health and status of Brixmor's other tenants. While some of Brixmor's non-essential, small-shop tenants are in jeopardy from continued closure, such tenants make up just 10% of Brixmor's tenant base and many of those may well be eligible for government assistance. There also is a misperception that Brixmor has greater exposure to coronavirus-hit New York City MSA (just 8% of rent) than it actually does. Brixmor's balance sheet is in great shape and should help the firm weather the storm. Also, Brixmor's tenant mix is more robust than popularly believed – some 60% of its space is leased to so-called “essential” retailers which still operate.

Discover Financial Services (DFS) is the financial services company that issues the Discover card. It also makes student loans and personal loans. Discover's shares fell sharply during the quarter as investors attempted to assess the impact of rising unemployment due to coronavirus-related business shutdowns on the company's credit card loan portfolio.

Air Lease Corporation (AL) is one of the leading commercial aircraft leasing companies in the world. Initially impacted by the continued grounding of Boeing's 737MAX, Air Lease was further hit with concerns over the health of its airline customers, future aircraft demand, and the ability of credit markets to fund its future aircraft purchases. In all prior downturns, air travel demand declined slightly for a short period before resuming its upward trend. Despite COVID-19, the long-term trends in globalization and the rising middle class worldwide will continue to drive aircraft demand. Most of the company's exposure is to foreign carriers whose governments have already implemented support measures and any delays/postponements of new deliveries due to customer request or aircraft supplier (Boeing cutting production schedules) alleviates the company's need for credit. Air Lease also has the youngest, most technologically-advanced fleet and the stock is quite attractive, selling at less than half of its book value.

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Outlook

As we look ahead, we see opportunity in stocks, particularly small- and mid-cap stocks. Given the high degree of near-term earnings uncertainty, it is a little difficult to know exactly where valuations are, but if we look out a year or two, stocks look attractive. Given the “shock” element to this downturn, we believe that earnings will recover at a faster pace than after the Global Financial Crisis. Given the indiscriminate sell off in equities, prices of so many excellent small and mid cap stocks have been sold down to decade low valuations. We view this market dislocation as an opportunity to reposition the portfolio for longer-term gains. We have selectively upgraded toward best of breed companies, selling at discounts to our calculation of intrinsic value based on underlying asset values, cash flow, and normalized earnings.

Our diversified portfolio holdings comprise companies with sustainable and recurring business models, strong balance sheets and dominant market positions run by top notch management teams driven to enhance shareholder value. As bottom up, fundamental stock pickers, we continue to search for mispriced business gems selling at substantial discounts to their future prospects.

Just as the virus induced market decline is unprecedented, we view the current investment environment with restrained optimism given the compelling valuations of so many excellent mid cap companies. We expect to generate attractive risk adjusted returns over the next market recovery cycle.

In conclusion, thank you for your investment in the Mid Cap Dividend Value Strategy. We will continue to work hard to justify your confidence and trust.

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First Quarter Contributors and Detractors

First Quarter Contributors

Top Contributors	Total Return (%)	Contribution to Return (%)
Hasbro, Inc.	47.83	0.34
Cypress Semiconductor Corporation	40.59	0.26
Pioneer Natural Resources Company	9.94	0.19
Virtu Financial, Inc. Class A	31.65	0.16
Chemed Corporation	14.67	0.14

First Quarter Detractors

Largest Detractors	Total Return (%)	Contribution to Return (%)
Brixmor Property Group, Inc.	-55.43	-1.25
Discover Financial Services	-57.78	-0.97
Air Lease Corporation Class A	-52.94	-0.90
Wyndham Destinations, Inc.	-66.32	-0.86
Diamondback Energy, Inc.	-71.62	-0.85

Source: Factset

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Past performance is no guarantee of future results. As with all investments, there is a risk of loss. Any performance and/or attribution information contained herein are based on a representative account of the specific strategy discussed.

Market Performance presented solely for informational purposes. The S&P 500 Index is designed to act as a barometer for the overall U.S. stock market and consists of 500 stocks that are chosen on the basis of market size, liquidity, and industry grouping. The S&P 500 is a market value weighted index with each stock's weight in the index proportionate to its market value.

The Russell 2000® Value Index is an unmanaged index that measures the performance of the small-cap value segment of the U.S. equity universe and includes those Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values.

The Russell 2000® Index is an unmanaged index that measures the performance of the smallest 2,000 companies by market capitalization of the Russell 3000® Index.

The S&P SmallCap 600® measures the small-cap segment of the U.S. equity market and is unmanaged. The index is designed to track companies that meet specific inclusion criteria to confirm that they are liquid and financially viable.

The S&P MidCap 400® provides investors with a benchmark for mid-sized companies. The index, which is distinct from the large-cap S&P 500®, measures the performance of mid-sized companies reflecting the distinctive risk and return characteristics of this market segment.

The Russell 2500® Value Index is an unmanaged index that measures the performance of the small to mid-cap value segment of the U.S. equity universe and includes those Russell 2500 companies with lower price-to-book ratios and lower forecasted growth values.

The Russell 2500® Index is an unmanaged index that measures the performance of the 2500 smallest companies by market capitalization of the Russell 3000® Index.

The Russell Midcap® Value Index is an unmanaged index that measures the performance of the mid-cap value segment of the U.S. equity universe and includes those Russell Midcap companies with lower price-to-book ratios and lower forecasted growth values.

The Russell Midcap® Index is an unmanaged index that measures the performance of the 800 smallest companies by market capitalization of the Russell 1000® Index.

The Russell 1000® Index is an unmanaged index that measures the performance of the 1,000 largest companies by market capitalization of the Russell 3000® Index.

The Russell 3000® Value Index is an unmanaged index that measures the performance of the broad value segment of the U.S. equity universe and includes those Russell 3000 companies with lower price-to-book ratios and lower forecasted growth values.

The Russell 3000® Index is an unmanaged index that measures the performance of the 3,000 largest U.S. companies by market capitalization.

The Barclays U.S. Aggregate Bond Index is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM passthroughs), ABS, and CMBS.

A direct investment into any of these indices is not possible.

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The net performance numbers shown are for informational purposes only. Management fees are negotiable and a table of standard fees is contained in the Firm's Form ADV Part 2A, which is available at no cost at www.keeleyteton.com.

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