U.S. Small/SMID Cap | First Quarter 2020

Market Overview–Managing Downside Risk

"You make most of your money in a bear market; you just don't realize it at the time."

– Shelby Davis, famed value investor

Executive Summary

» The decade-long bull market ended when markets fell into bear territory in March

» With volatility reaching highs not seen since the Great Financial Crisis, investors should have a heightened concern for risk-adjusted performance

» It is important now to understand the value of downside protection

» Since inception, our Small and SMID Cap strategies have consistently protected capital in down markets

Introduction

From a personal perspective, times of crisis like these provide opportunities to evaluate priorities and focus on loved ones. From a portfolio perspective, times like these are a true test of our risk controls and a reminder of why we invest in quality companies. Given the impossibility of timing markets or knowing the market impact of unpredictable events, we feel a great responsibility to structure our portfolios in a manner that provides our investors downside protection relative to the market during times of turmoil. As volatility has spiked in recent weeks, we have been given a great opportunity to strengthen the quality of our portfolios by adding to our higher conviction holdings and investing, at what we believe are great prices, in new companies that we believe will manage their businesses well, regardless of the length or effects of the coronavirus.

Our portfolios have a quality bias that, at times, has caused us to underperform some of markets' upside. However, this quality bias has consistently allowed us to outperform in down markets, as our portfolios are doing now. This approach has allowed us to outperform in both the short and long term for our investors.

Good vs. Bad Volatility

In volatile markets, investors should have a heightened concern for the risk-adjusted performance of their trusted money manager. Because most volatility metrics for a portfolio (standard deviation, beta, etc.) do not differentiate between upside volatility (good risk) and downside volatility (bad risk), they often do not provide the insight needed to fully appreciate the downside risk of an investment. We believe two of the better measurements to understand downside risk are the Sortino Ratio and Downside Capture. »

SORTINO RATIO (ABSOLUTE DOWNSIDE RISK)

As of 3/31/2020	3 Year	5 Year	10 Year	15 Year	ITD
RMB Small Cap Core	-0.12	0.07	0.64	0.48	0.63
Morningstar US Fund Small Blend	-0.33	-0.06	0.53	0.39	0.47
Russell 2000 Index	-0.36	-0.09	0.48	0.31	0.31
RMB SMID Cap Core	-0.01	0.19	0.73	0.49	0.52
Morningstar US Fund Mid Blend	-0.22	0.00	0.63	0.44	0.45
Russell 2500 Index	-0.28	-0.04	0.58	0.38	0.40

Sources: RMB Capital, Zephyr StyleADVISOR, Morningstar Direct

Sortino Ratio (Absolute Downside Risk)

The Sortino Ratio only considers the standard deviation of the negative returns (downside deviation) of an investment. In comparing a portfolio to its benchmark, you want to see a higher ratio for the portfolio, as a higher relative ratio implies less downside volatility than the benchmark. As shown in the table below, our Small and SMID Cap portfolios historically have experienced less downside variability than their benchmarks and peer universes, as defined by these Morningstar categories.

Downside Protection (Relative Downside Risk)

Having just experienced the fastest market drop into bear market territory in U.S. history, the Downside Capture of investment strategies has become a critical component of investors' ability to recover their losses.

DOWNSIDE PROTECTION

As of 3/31/2020	Downside Capture	Upside Capture	Beta	Tracking Error
RMB Small Cap Core	86%	96%	0.91%	5.01%
RMB SMID Cap Core	88%	89%	0.89%	3.93%

Sources: RMB Capital, Zephyr StyleADVISOR

Minimizing drawdown is critical due to the simple fact that you need a much stronger upmarket to recapture downside losses. For example, consider a market that drops -42% (as the Russell 2000 Index did from its high to low during the first quarter of 2020), then recovers with a +60% return. Assume an index and strategy begin that period with $100 each and apply the RMB Small Cap Core ITD upside capture of 96% and downside capture of 86% to the strategy's returns. We know that an upside capture of 96% hurts on the upside—implying the strategy will underperform by 200 basis points (bps) in this example's rebound. What we find is, on the downside, the index value drops -42% to $58.00 while the strategy returns -36%, resulting in a $63.88 market value. At this point, investors don't feel great about the market value loss, but they do like seeing that their strategy outperformed the index by +6%. When the index rebounds +60%, its market value increases from $58.00 to $92.80. Assuming the strategy's 96% upside capture (remember 100% upside capture is the breakeven point), we would see a +58% return for the strategy, with the market value increasing to $100.67. While investors are likely unhappy with underperforming the upside by 2%, they have now recaptured 100% of their losses while the index has not. When geometrically linking the two performance periods together, the strategy in this example outperforms the index by 8%.

This illustration shows that it is more beneficial to outperform on the downside than the upside. For that market drop of -42%, the index would need approximately a +73% return to get back to its initial investment value. »

Quality Bias

With increased uncertainty in the future, quality factors start to manifest their value. When we think of quality, we think of management teams capable of leading their firms through both the good times and bad. We have found these management teams typically operate with less leverage on their balance sheets, which better enables them to adapt to changing market conditions and maintain their long-term strategic goals. As of the week ending March 6, 2020, there wasn't a significant trend in how leverage was impacting a stock's performance from late February, when the recent sell-off began. Everything was down, which is expected when markets panic. Although caution still abounds, panic selling seems to have dissipated, as some investors are capitalizing on lower valuations. Since that second week of March, we have seen companies with lower debt ratios outperforming more highly levered companies; this trend is especially evident in the small cap space.

In the table below, you see the performance by leverage bands for the Russell 2000 and 2500 Indexes for the month of March. Our Small & SMID Cap strategies are overweight quality (less levered) companies, which has provided a significant benefit.

TOTAL DEBT AS % TOTAL CAP

March 2020	Russell 2000	Russell 2500
Total	-21.73	-21.70
80%-100%	-36.13	-31.22
60%-80%	-30.70	-28.71
40%-60%	-22.32	-21.59
20%-40%	-20.11	-20.73
0%-20%	-12.74	-13.01

Sources: RMB Capital, FactSet

As markets continue to deal with uncertainty, we would expect this trend to continue, with capital flowing toward companies with strong balance sheets, lower leverage, and stable earnings.

Summary

Since inception, our Small and SMID Cap strategies have consistently protected capital in down markets, outperforming their benchmarks 82% and 80% of quarters when the index had a negative return, respectively. These numbers include the most recent quarter, in which both strategies outperformed by over 400bps gross of fees. Detailed below is a collection of charts showing how our RMB Small Cap Fund (RMBBX) has performed through previous viral outbreaks.

As we eagerly await new information about our collective ability to defeat COVID-19 and the economic impacts of its disruption, we are relentlessly looking for opportunities to strengthen our portfolios. We believe our current environment provides an incredible opportunity for active managers to add value. Bear markets are a painful, yet necessary, part of the capital allocation process, which punishes poor stewards of capital while rewarding good stewards, ultimately strengthening the financial markets.

We will continue to strive to actively position our investors for an eventual recovery while maintaining the integrity of our quality bias. We are grateful to be part of the capital allocation process and are excited about the continued opportunities to add value for our clients. »

HOW THE RMB SMALL CAP FUND BEHAVED IN PAST SIGNIFICANT VIRUS OUTBREAKS

SARS: January 2003–March 2003

Time Period: 1/1/2003 to 3/31/2003

RMB Small Cap I

Time Period: 1/1/2003 to 3/31/2003 Calculation Benchmark: Russell 2000 TR USD

	Return	Std Dev	Excess Return
RMB Small Cap I	-1.60	19.12	2.89
Russell 2000 TR USD	-4.49	23.32	0.00

Avian Influenza: January 2004–August 2004

Time Period: 1/1/2004 to 8/31/2004

RMB Small Cap I

Time Period: 1/1/2004 to 8/31/2004 Calculation Benchmark: Russell 2000 TR USD

	Return	Std Dev	Excess Return
RMB Small Cap I	0.80	22.12	1.74
Russell 2000 TR USD	-0.94	23.38	0.00

MERS: September 2012–November 2012

Time Period: 9/1/2012 to 11/30/2012

RMB Small Cap I

Time Period: 9/1/2012 to 11/30/2012 Calculation Benchmark: Russell 2000 TR USD

	Return	Std Dev	Excess Return
RMB Small Cap I	0.60	16.85	-0.98
Russell 2000 TR USD	1.58	17.82	0.00

Ebola: December 2013–February 2014

Time Period: 12/1/2013 to 2/28/2014

RMB Small Cap I

Time Period: 12/1/2013 to 2/28/2014 Calculation Benchmark: Russell 2000 TR USD

	Return	Std Dev	Excess Return
RMB Small Cap I	5.55	17.85	1.74
Russell 2000 TR USD	3.82	18.81	0.00

Zika: November 2015–February 2016

Time Period: 11/1/2015 to 2/29/2016

RMB Small Cap I

Time Period: 11/1/2015 to 2/29/2016 Calculation Benchmark: Russell 2000 TR USD

	Return	Std Dev	Excess Return
RMB Small Cap I	-10.20	23.17	0.36
Russell 2000 TR USD	-10.56	25.69	0.00

Coronavirus: February 2020–March 2020

Time Period: 2/20/2020 to 3/31/2020

RMB Small Cap I

Time Period: 2/20/2020 to 3/31/2020 Calculation Benchmark: Russell 2000 TR USD

	Return	Std Dev	Excess Return
RMB Small Cap I	-28.73	102.60	2.96
Russell 2000 TR USD	-31.69	110.25	0.00

Source: Morningstar Direct

RMB Asset Management