Where Every Stock Counts®

SECOND QUARTER 2018

PERFORMANCE COMMENTARY

SMID-CAP COMPOSITE

2ND QTR PERFORMANCE

	Contribution (%)
Best	2.36%
Worst	-1.44%
Best Minus Worst	0.92%
Rest of Portfolio	3.83%
Total Daruma	4.75%
Russell 2500	5.71%
Return Difference	-0.96%

Dear Clients and Friends,

For the second quarter of 2018, the Daruma SMid-Cap composite was up +4.75%, trailing the Russell 2500's +5.71% by 96 bps. Year to date Daruma is up +6.67% vs. +5.46% for the Benchmark, ahead by 121 bps.

The quarter's results were largely driven by June's 79 bps of underperformance caused in part by our Energy holdings, which cost us a relative 92 bps and our Consumer Discretionary stocks, which nicked another 49 bps. Relative underexposure to the Benchmark cost us a great deal. Specifically, our lack of exposure to REITs hurt the most (+98 bps contribution to the Index) and under or lack of exposure to Biotechs, Utilities and Consumer Staples stocks cost us as well (+21 bps, +29 bps, and +20 bps respectively). Overall, the price of not mirroring the Benchmark in the second quarter was a 168 bps headwind.

We take some small consolidation from the fact that this was a tough quarter all around. Only 34.1% of smid-cap managers beat the Index in the quarter[1]; we are pleased that we are ahead YTD as only 31.7% beat for the year.

Energy (+16.9%) was the only Russell sector that was up double digits in the quarter and this reversal is particularly significant. Since the second half of 2017 there has been a notable divergence between the price of crude and the performance of energy stocks, and this quarter's sharp move started to bridge that gap. Year to date, Energy has been

[1]DeSanctis, Steven G., CFA "U.S. Equity Strategy JEF's SMID-Cap Manager Scorecard Q2 was not pretty for active managers", Jefferies, July 1, 2018

less dominant but Health Care (+15.2%) and Technology (+11.1%) have been the movers and shakers. In short, growth is still in the catbird's seat.

The influx of capital into small-cap ETFs also drove the outperformance of low-priced stocks (+9.5% vs. +7.1%) while the desire to avoid international currency and tariff woes drove stocks with low foreign sales (<20%) to outperform those with high foreign sales exposure (+8.5% vs. +6.3%). Additionally, continued tightening by the Fed caused investors to avoid stocks with levered balance sheets and stocks with the lowest leverage are beating those with high leverage for the quarter (+9.1% vs. +6.7%) and year to date (+11.1% vs.+4.9%)[2].

The influx of ETF dollars into the small-cap space also affected performance of the lower capitalization stocks within the Russell 2500, with the smallest three quintiles significantly outperforming the largest in both the second quarter and year to date. Growth, no matter the price, was in vogue: those companies with the best sales growth trounced the slow growers (+9.7% for top quintile vs. +1.6% for the bottom quintile) and the most expensive stocks on a P/E basis beat the lowest P/E stocks by a wide margin (+13.6% for the highest P/E quintile vs. -0.53% for the lowest P/E quintile). Investors also favored companies with low (<20%) foreign sales, especially in the 2nd quarter (+7.4% vs. +3.3% for those with >20% foreign sales), though that also held true for year to date (+6.1% vs. +4.4% respectively). With rising Fed Fund rates investors also favored those companies with less leverage year to date (+8.9% lowest leverage vs. +2.9% highest leverage).

This is not a healthy market — it feels thin and stretched, and it's hard to make a case for either multiple or margin ex-

This should not be considered a recommendation to buy or sell any security. Please also see General Disclosures at the end of this presentation.

[2]DeSanctis, Steven G., CFA, "U.S. Equity Strategy JEF's SMID-Cap Q2 Recap Slides & 2H Outlook - Tough Sledding for Active Mgrs", Jefferies, July 6, 2018

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SMID-CAP COMPOSITE

pansion. Big price moves are happening on low volume. We continue to scan the investment landscape, and are looking for attractive new ideas. We are determined to stay patient and not chase stocks. Rather, in this fickle and punishing market, we are following a number of potential opportunities closely and stand ready to add compelling long term investments when we see attractive entry points.

As always, we are happy to discuss our second quarter results with you.

All the best,

Mariko O. Gordon, CFA
Founder & CEO

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WINNERS AND LOSERS

SMID-CAP COMPOSITE COMMENTARY

Top Contributors

Company	Quarter End Position Size	Contribution
WEX Inc.	4.6%	0.87%
Align Technology, Inc.	2.9%	0.76%
Encompass Health Corporation	4.5%	0.73%
Total		**2.36%**

WEX
Payment processor
+87 bps

ALIGN TECHNOLOGY
Orthodontic appliance maker
+76 bps

ENCOMPASS HEALTH
Hospice services provider
+73 bps

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Our best three stocks (payment processor WEX Inc. (WEX) +87 bps; orthodontic appliance maker Align Technology (ALGN) + 76 bps and rehabilitation and hospice services provider Encompass Health (EHC) +73 bps) contributed a total of 236 bps.

Payment processor WEX Inc. (WEX) rose 21.6% and contributed 87 bps. WEX has three business lines — payment processing for car and truck fleets; one time MasterCard payment processing (used by on-line travel agencies like Expedia to settle hotel bookings); and software and services used by providers of Health Savings Accounts (HSAs) in the U.S. WEX is benefiting from multiple rising tides: higher fuel prices mean more revenues on some contracts, miles driven is rising as is demand for HSAs, and travel spending continues to be robust. WEX also has enjoyed some stock specific good news including a new large contract with Shell and better loss and fraud prevention (preventing the use of credit card skimmers at gas pumps).

After treading water for six months on rumors that a competitive offering would soon hit the market, putting pressure on its priced for perfection P/E multiple, Align's stock finally broke out, up 36.2%. Competitive product unveiled at the American Association of Orthodontists conference proved to be underwhelming, and a subsequent analyst day publicly confirmed the long-term financial targets the Street had long been using, giving investors the confidence to revalue Align back to prior peaks.

In-patient rehabilitation, home health care, and hospice service provider Encompass Health Corp. (EHC) was up 18.9% and contributed 73 bps. Encompass was well positioned to benefit from investors' desire to hold U.S. only exposure as the company is a domestic operator and is unlikely to become collateral damage from a trade war. Demographic shifts also are pointing to increased use of the company's services as more of the population ages and gets sicker (e.g. post-stroke rehabilitation services), and dies (e.g. hospice services). Rising health care costs will continue to encourage the shift of care to the home which also benefits the home health services business.

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WINNERS AND LOSERS

SMID-CAP COMPOSITE COMMENTARY

Top Detractors

Company	Quarter End Position Size	Contribution
National Instruments Corporation	3.4%	-0.55%
First American Financial Corp	3.6%	-0.48%
Xylem Inc.	3.1%	-0.41%
Total		**-1.44%**

NATIONAL INSTRUMENTS
Test & measurement company
-55 bps

FIRST AMERICAN FINANCIAL
Title insurer
-48 bps

XYLEM
Water management equipment and services
-41 bps

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Our worst three detractors (test & measurement company National Instruments (NATI) -55 bps; title insurer First American Financial (FAF) -48 bps and water management equipment and services Xylem (XYL) -41 bps) cost us a total of 144 bps.

National Instruments was down 16.8% on a 3.5% revenue miss in the quarter and a lower second quarter guide caused by weaker than expected orders from the smartphone supply chain. This was unpalatable to the Street, given a valuation that is at historical highs (both absolute and relative to peers). We trimmed the position twice in 1Q due to valuation ahead of earnings, not anticipating a degradation in reported results.

First American Financial was down 11.2% on fears that rising rates would put a damper on housing sales and mortgage refinancing volume. Despite rising rates and constrained supply, housing transactions have held up, as millennials seem to finally be moving into houses and baby boomers downsize or die. Additionally, many who fear rising rates fail to realize that FAF's investment portfolio benefits from rising rates which can offset potential slowdowns.

Xylem was down 12.2% on in-line results with cost reductions offsetting inflation. Although the company will pass along price increases, this is the second quarter in a row of merely meeting rather than beating expectations as they have in the previous seven quarters. Other concerns include a delay in promised infrastructure spend, mix impacting margins (more large projects ramping up in emerging markets) and further inflation pressures from tariffs. With solid bookings, guidance reiterated for the year, and a dominant position in critical water infrastructure, we continue to hold the stock.

The net contribution of our best and worst three stocks was 92 bps. The rest of the portfolio contributed 383 bps.

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SECTORS OF NOTE

SMID-CAP COMPOSITE COMMENTARY

For Daruma, our double digit absolute gainers were Health Care +18.1% and Energy +12.8%. Our best relative performers were Health Care (with the Index sector up +8.8%) and Materials and Processing (+9.1% vs. +1.6%). On a contribution basis, Health Care was also our biggest gainer relative to the Index sector, contributing an excess of 52 bps. Performance was driven in large part by orthodontic appliance maker Align Technology (ALGN) (+36.2% and generating 76 bps) and physical rehab and hospice provider Encompass Health Corp. (EHC) (+18.9% and contributing 73 bps).

In contrast, our Technology stocks chipped away 51 bps in relative performance and our Consumer Discretionary stocks lopped off another 90 bps. We lagged in Tech largely due to our lack of exposure in some of the "hot" industries (computer technology +16.7% and electronic entertainment +11.3%). Semi-conductor equipment stocks were down 8.9% in the Index, whereas semi-conductor filtration equipment maker Entegris, Inc. (ENTG) was down only 2.5%, a validation of our hypothesis that investors would credit its consumables business for buoying results in a downturn. Technology and intelligence contractor Leidos Holdings (LDOS) was also down 9.4% on a light 1Q sales report due to a timing shift. Bookings were strong, margins and EPS were on target and revenue guidance for the year was unchanged.

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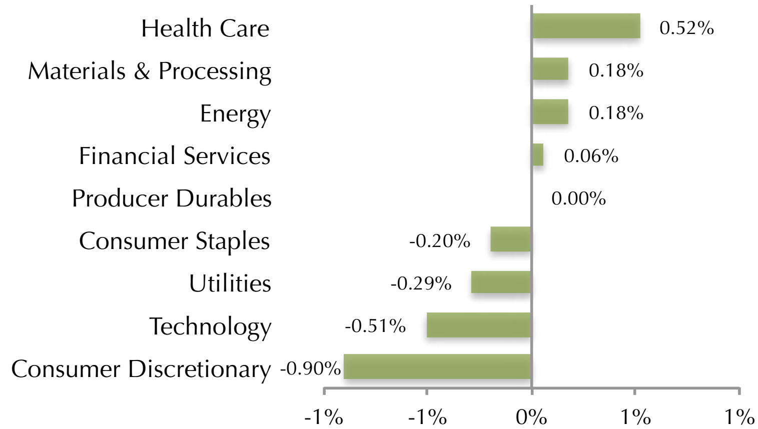
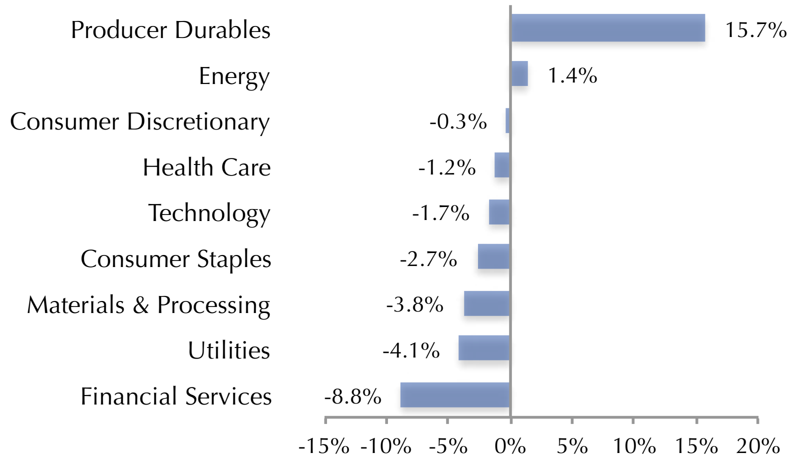
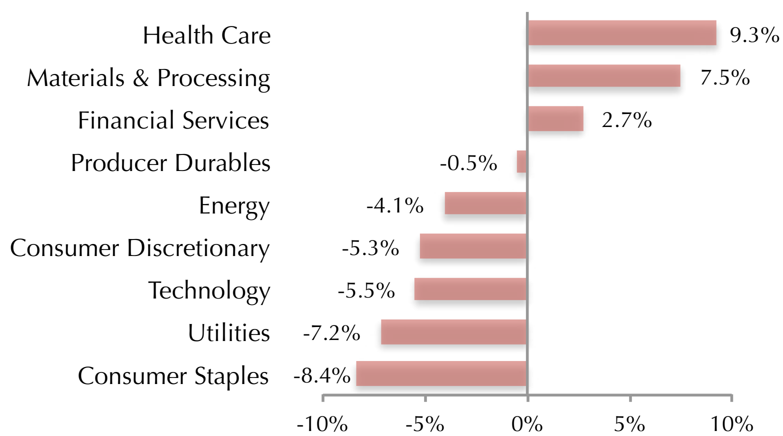
CONTRIBUTION DIFFERENCE DARUMA VS. R2500



DARUMA SECTOR OVER/UNDERWEIGHT VS. R2500



RETURNS DIFFERENCE DARUMA VS. R2500



Sources: FactSet, Russell Investments & Daruma Capital Management

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DECILE ANALYSIS

SMID-CAP COMPOSITE COMMENTARY

Given the recent rebalance of the Russell 2500, the decile returns for the second quarter do not foot to the actual Benchmark returns (as historical decile data are now based on current Russell constituents).

Having said that, there are some observations worthy of note in the patterns in this quarter's decile chart. Sales growth was clearly rewarded and the impact of ETF inflows can be seen in the outperformance of multiple decile categories.

Record flows lifted all boats but disproportionally rewarded lower quality market decile segments (e.g. lowest institutional ownership, highest betas, highest short interest and lowest dividend yielding stocks).

The trend is even more pronounced in the year to date performance decile breakdown for the Russell 2500: Once again growth was rewarded and the lower quality deciles caught an even bigger lift from fund flows.

2Q 2018

Deciles	1	2	3	4	5	6	7	8	9	10
Market Cap (Largest to Smallest)	6.9%	8.3%	8.6%	12.2%	9.3%	15.5%	15.1%	12.3%	14.5%	0.3%
P/E Ratio (Lowest to Highest)*	7.9%	5.6%	7.8%	10.1%	10.5%	14.8%	12.4%	13.7%	16.6%	9.2%
Dividend Yield (Highest to Lowest)**	9.3%	6.8%	5.4%	6.5%	6.8%	-	-	-	-	13.1%
Short Interest (Lowest to Highest)	7.7%	9.1%	6.7%	8.5%	10.7%	9.9%	9.8%	9.1%	13.6%	17.8%
Beta (Lowest to Highest)	7.4%	11.6%	7.9%	7.8%	7.2%	8.5%	7.7%	7.9%	12.1%	24.8%
Sales Growth (Best to Worst)	16.1%	15.3%	9.3%	8.5%	7.8%	9.0%	7.4%	8.9%	7.7%	6.7%
Analyst Ratings (Best to Worst)	13.0%	11.6%	10.4%	8.7%	10.0%	12.8%	8.2%	8.9%	28.6%	9.7%
Institutional Ownership (Most to Least)***(*)	10.1%	7.8%	7.3%	9.2%	6.6%	8.8%	12.8%	13.4%	10.3%	16.8%
% Chg Q1 2018 (Best to Worst)^	14.5%	9.7%	8.8%	6.8%	7.6%	7.6%	8.8%	10.6%	9.4%	17.0%
% Chg in 2017 (Best to Worst)^^	13.7%	9.4%	5.7%	8.1%	6.7%	6.9%	9.3%	8.6%	9.6%	22.2%

2018 YTD

Decile	1	2	3	4	5	6	7	8	9	10
Market Cap (Largest to Smallest)	8.7%	10.8%	7.4%	10.3%	10.1%	19.2%	14.3%	11.5%	19.7%	1.9%
P/E Ratio (Lowest to Highest)*	5.9%	5.7%	14.3%	10.2%	11.8%	12.2%	13.5%	14.0%	24.4%	11.7%
Dividend Yield (Highest to Lowest)**	1.4%	3.5%	5.1%	6.7%	9.3%	-	-	-	-	17.0%
Short Interest (Lowest to Highest)	9.3%	13.1%	5.9%	10.8%	12.3%	13.6%	13.1%	10.1%	12.2%	13.3%
Beta (Lowest to Highest)	12.1%	11.1%	10.1%	11.3%	7.8%	9.6%	7.8%	7.3%	9.8%	27.6%
Sales Growth (Best to Worst)	21.7%	20.0%	11.7%	9.7%	8.6%	8.2%	6.7%	7.3%	3.8%	11.7%
Analyst Ratings (Best to Worst)	19.5%	17.8%	11.8%	9.0%	11.8%	7.7%	7.0%	6.9%	30.2%	1.8%
Institutional Ownership (Most to Least)***(*)	8.8%	7.2%	7.3%	7.0%	7.2%	9.0%	15.8%	18.6%	13.9%	19.6%
% Chg Q1 2018 (Best to Worst)^	70.3%	27.5%	18.0%	10.7%	7.6%	4.4%	1.9%	-0.7%	-7.5%	-18.1%
% Chg in 2017 (Best to Worst)^^	15.7%	12.7%	8.5%	12.8%	5.3%	6.4%	10.2%	5.5%	7.5%	29.3%

Sources: Bloomberg, Russell Investments & Daruma Capital Management

The green indicates the best-performing decile for the category.

The red indicates the worst-performing decile for the category.

*Decile 10 of P/E Ratio category is made up of all stocks that have no P/E

**Decile 10 of Dividend Yield category is made up of all stocks that pay no dividend

***Institutional Ownership may be over/under stated due to timing of filings

****Institutional Ownership is as of the end of last quarter (if report completed intra-quarter)

^% Change in Q1 2018 excludes stocks without complete performance

^^% Change in 2017 excludes stocks without complete performance

Note: Due to Russell Rebalance on 6/22/18 - actual benchmark returns may vary from decile results.

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A list of the Top Ten holdings by portfolio weight as of 06/30/18 is available on our website at http://www.darumanyc.com/portfolio/smid-cap. These holdings and certain other performance information contained in this presentation supplement the SMid-Cap Composite Presentation, which is available on our website at https://www.darumanyc.com/disclosures/equity-composite-presentation-smid-cap.

The portfolio is actively managed, so holdings, sector weightings and other portfolio characteristics may have changed since the dates shown. They should not be considered recommendations to buy or sell any security. You should not presume that any holding shown has been or will be profitable. The holdings referred to herein do not represent all of the securities purchased, sold or recommended for Daruma's clients.

The appropriate comparison benchmark for the SMid-Cap Equity strategy is the Russell 2500. The Russell 2500 includes approximately 2500 of the smallest U.S. common stocks based on a combination of their market cap and current membership in the Russell 3000. The Russell 2500 Value Index includes those Russell 2500 Index companies with lower price-to-book ratios and lower forecasted growth values, while the Russell 2500 Growth Index includes those with higher price-to-value ratios and higher forecasted growth values.

The SMid-Cap Equity strategy is a concentrated strategy that is not managed to a benchmark, so there are material differences in characteristics, such as the number of holdings and sector and industry weightings. In addition, benchmark performance does not include any fees or expenses. Because of these differences, benchmarks should not be considered a completely accurate comparison.

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