SMid-Cap Portfolio Commentary

Mariko O. Gordon, CFA
Founder, CEO & CIO

Daruma lagged the benchmark in the quarter, down 1.34% vs. down 0.34% for the Russell 2500. The bulk of the underperformance occurred early in April when the market sold off. While we outperformed the benchmark in May's rally, it was not enough for a positive quarter, and we trailed slightly in June.

Looking at the scorecard of our outliers vs. the rest of the portfolio, the net of our best and worst three stocks was a slight negative at 14 basis points. This is not unusual in flat to down markets, but we strive to maximize our big winners and minimize our losers. This quarter, it was a wash.

The rest of the portfolio sagged, trailing the benchmark, and detracting a total of 120 bps. Biotechs were up 30% and pharmaceuticals were up 25% for the Russell 2500. We have no exposure to biotechs and our one pharma stock struggled with company specific issues both of which contributed to our underperformance.

Our Best 3 Stocks

Ticker	*Company*	*Description*	*Contribution (%)*
PLL	**Pall Corporation**	filtration and purification	0.7
ALGN	**Align Technology, Inc.**	clear dental aligners (braces)	0.5
AVY	**Avery Dennison Co.**	labeling & packaging materials supplier	0.5
		Best	**1.7%**

Our best stocks were filtration & purification company Pall Corporation (PLL) up, 70 bps; clear dental aligner company Align Technology (ALGN), up 54 bps; and labeling & packaging materials supplier Avery Dennison (AVY), up 53 bps. PLL saw nice gains on the announcement that it was being purchased by Danaher. ALGN had a solid first quarter report and AVY reported positive results and continued to aggressively return capital to shareholders. We trimmed both Pall and Align in the quarter, locking in some gains.

Our Worst 3 Stocks

Ticker	*Company*	*Description*	*Contribution (%)*
DGI	**DigitalGlobe**	satellite & equipment provider	-0.7
FRAN	**Francesca's Holdings**	apparel & accessories retailer	-0.7
BDC	**Belden Inc**	signal transmission provider	-0.5
		Worst	**-1.9%**

By contrast, satellite imagery provider DigitalGlobe (DGI) cost us 72 bps; apparel & accessories retailer Francesca's Holdings (FRAN), was down 69 bps; and signal transmission supplier Belden (BDC), down 50 bps. In DGI's case investors fret about growth in the commercial sector and the impact of small satellites, while ignoring cash flow growth. FRAN has new leadership and has shown glimmers of better trends but still suffers from sluggish same store sales. BDC lowered guidance due to f/x and faces some tough comparisons in its broadcast business. We continue to hold all three positions.

Rest of portfolio and sector performance

Not surprisingly, given that the rest of the portfolio was down 120 bps, 51% of our holdings were down in the quarter, and only 44% were positive and beating the index. Similarly, we outperformed the index in four out of nine sectors on both a returns and contribution basis. Producer Durables was our best performer, driven by good performance across a number of stocks, in addition to Pall and Avery. Petroleum products shipper Scorpio Tankers (STNG) was up 8.5%; water treatment company Xylem (XYL) was up 6.2%; inkjet printer & software supplier Electronics for Imaging (EFII) was up 4.3%.

The following disclosure language applies to this entire commentary. Past performance is not a guarantee of future results. This information supplements the SMid-Cap Composite Presentation available on our website at http://www.darumanyc.com/disclosures/equity-composite-presentation-smid-cap/. The holdings identified do not represent all of the securities purchased, sold or recommended for clients. Please also see the General Disclosures at the end of this commentary.

We also benefited from our zero weight in Utilities, which detracted 7% from the benchmark (the worst performing sector in the Russell 2500), and our underweight in Financial Services which was down slightly for the Index. Our sole financial stock, payment processor WEX, was up 6% in the quarter.

Our worst sector performance was in Technology, Materials Processing and Health Care. Technology was largely weighed down by the DGI's results -- semiconductor manufacturer NXP Semiconductor (NXPI), which saw a -6 bps impact and direct marketing services Acxiom (ACXM), which had a -19 bps impact, were down 2% and 5% respectively. By contrast electronic design automation software Cadence Design Systems was up 6.5% and generated 20 bps in contribution.

Health Care was also driven largely by one stock: specialty pharmaceutical company Pacira Pharmaceuticals (PCRX) (-49 bps impact) on a 20% decline. PCRX was a great contributor last year, and we had taken the position down to 2.2% on both valuation and a push out on approvals to sell into a broader set of procedures. We continue to believe that in the long-term PCRX's Exparel can be a $750 million drug, with $7.00+ in EPS power. In the short run, the stock will continue to be volatile until the company can reaccelerate sales growth, necessary to propel the stock higher.

By contrast, the underperformance in Materials and Processing was much more broad based. We hold four stocks in that sector, across a wide range of industries, from food ingredients (Sensient Technologies -- SXT) to adhesives (HB Fuller -- FUL), building materials (Owens Corning -- OC) and cabling (Belden -- BDC). All were down 2% to 5%, save for BDC which was down 13%. All four have significant global businesses and therefore f/x exposure, which given the dollar's strength, has been a headwind.

We expect FUL to show progress on its European operational consolidation over the course of the rest of the year. The integration, once complete, will make a huge impact not only on current profitability but will also set the scene for significant operating leverage on future growth. The integration should be a big boost to free cash flow when spending returns to normal.

SXT will continue to benefit from both a trend towards natural vs. artificial colors and flavors in the market place, as it continues on its quest to boost returns and profitability in its Flavors segment, something it has already accomplished in Colors.

Belden's weakness is much more macro related and tied to a slowdown in demand for its industrial cables as well as a pause in demand from international broadcasting clients where budgets are impacted by lower energy prices.

Return by Sector for the Second Quarter (%)

Sector	*Daruma SMid-Cap*	*R2500*	*Variation*
Producer Durables	5.60	-1.89	7.49
Utilities	0.00	-6.99	6.99
Financial Services	6.07	-0.51	6.58
Consumer Staples	0.00	-0.60	0.60
Consumer Discretionary	-3.82	-0.59	-3.23
Energy	-7.75	-3.77	-3.98
Health Care	0.05	4.99	-4.94
Materials & Processing	-7.48	-2.43	-5.05
Technology	-5.48	1.87	-7.35

Source: Factset

Contribution by Sector for the Second Quarter (%)

Sector	*Daruma SMid-Cap*	*R2500*	*Variation*
Producer Durables	1.25	-0.27	1.52
Utilities	0.00	-0.36	0.36
Financial Services	0.19	-0.12	0.31
Consumer Staples	0.00	-0.02	0.02
Energy	-0.36	-0.16	-0.20
Consumer Discretionary	-0.72	-0.12	-0.60
Health Care	-0.02	0.64	-0.66
Materials & Processing	-0.90	-0.18	-0.72
Technology	-0.78	0.25	-1.03
Total	**-1.34**	**-0.34**	**-1.00**

Source: Factset

This should not be considered a recommendation to buy or sell any security.

Puchases and Sales

We bought two stocks in the quarter: Sensient and life sciences equipment company Bruker (BRKR). We sold one, hospital management company Universal Health Services (UHS).

Year to Date Performance

With the second quarter results in, we are up 32 basis points for the year, in contrast to 4.81% for the Russell 2500. We lag by 449 basis points. There are two big culprits for this underperformance -- DIY flooring company Lumber Liquidators (LL) and as previously mentioned, our zero exposure to biotech stocks. The former cost us 228 bps; the latter 101 bps. Early stage biotech stocks are not typical Daruma fare as outcomes tend to be binary, and they must constantly raise capital.

Our top three stocks generated 225 basis points of performance, while our worst three stocks detracted 338 basis points. The net contribution of our outliers was a negative 113 basis points. While the rest of the portfolio contributed 145 basis points, it was clearly not enough.

This should not be considered a recommendation to buy or sell any security.

Year to Date Performers

NXP Semiconductors (+90 bps), Pall Corporation (+70 bps) and inpatient rehabilitation services Healthsouth Corporation (HLS), up 65 bps hail from three very different industries and have been favored by investors for very different reasons.

NXPI sits squarely in the fastest growing areas of semiconductors, security and near field communications. Its acquisition of Freescale Semiconductors will result in tremendous synergies and rapid deleveraging.

Pall Corp., as we've already discussed previously, is being acquired by Danaher.

Healthsouth's stock continues to politely compound as it is one of the best run companies in its industry and well-positioned in the health care ecosystem. Now that the industry upheaval caused by health care reform is ending, HLS is starting to expand into home health rehabilitation services, a natural business extension and another avenue for growth.

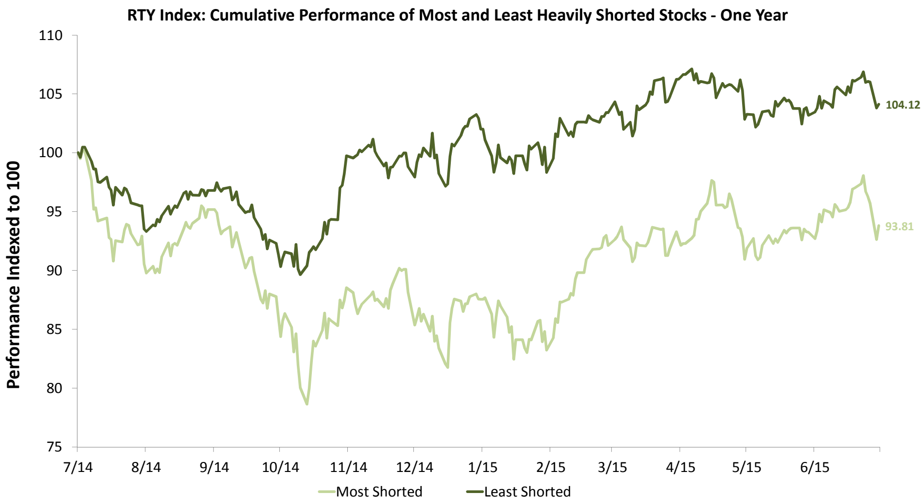
Year to Date Detractors

Lumber Liquidators (-228 bps), Acxiom (-58 bps) and Francesca's Holdings (-52 bps) were our three biggest detractors, all for company specific reasons.

We sold Lumber Liquidators in the first quarter. In hindsight, a quicker trigger finger would have softened the blow somewhat (though the decline was so sudden from the inflammatory 60 Minutes segment that we might have avoided only half the hit), but selling when we did saved us from another 65 bps of damage.

Acxiom needs to rebuild credibility with investors by showing that its legacy business begins to grow anew, and that the hiccups are indeed self-inflicted and not a sign of market share loss. Until then, Acxiom will not get any credit for all that it has done to create additional revenue streams, divest capital intensive and low returns businesses, and ensure its rightful place at the center of the data ecosystem between companies and their customers and prospects.

Francesca's sold off when the company provided second quarter guidance below consensus. The company is showing glimmers of improvement in merchandising but is still suffering from weak store traffic. The new CEO has taken quick steps to improve inventory management, redirect the ecommerce strategy and focus on store level sales training.



Market Observations

As can be seen in the graph above, there has been rotation in the market between stocks that are heavily and not heavily shorted. Starting last year, stocks with the highest short interest started to underperform dramatically. This makes sense, if rates are expected to rise, that those companies that are either levered, or whose valuations are very affected by changes in discount rates, would fall out of favor.

Our portfolio has a bigger component of stocks that are shorted (more for being turnarounds than for being levered or early stage companies) relative to the Russell 2500. These circumstances have proved to be an unexpected headwind to performance. As you know, we don't overhaul the portfolio chasing short-lived trends, and we do assess short interest carefully in our positions.

In addition our portfolio has more exposure to international sales than the benchmark, which hasn't helped when investors fret more about global macro issues.

Encouraging Signs

Year to date we have sold four stocks and bought three, for an annualized turnover of 28%. Our annualized turnover average since inception is 42% so our turnover is running lower than normal. I am pleased to note that going into earnings season we finally have some good new idea momentum. We are putting the finishing touches on some promising new ideas and have a handful that we have vetted and are waiting for better prices. Our pipeline is much, much healthier, which as you know is critical to our success.

In a concentrated portfolio new ideas are crucial to the health of the sell discipline, as they force out both expensive stocks (avoiding round tripping) and mistakes (capping further losses). Historically our alpha has been generated by our sell discipline, something I credit our 35 stock limit -- concentration makes discipline a lot easier to come by.

Nothing makes me happier than observing and generating new idea flow except working with talented colleagues who allow me to focus on the investment process. Martha Everett in client service and Dan Sendrowitz in compliance have been superb additions to the Daruma team. An introduction from each follows.

We are not unfamiliar with the magnitude of an extended duration of underperformance, which has happened at least three times in Daruma's history. Each time we bounced back with a vengeance, stock by stock, the meaningful lessons learned enabling us to make better mistakes tomorrow.

Notable Performers

Our Best Three

Company	Quarter End Position Size	Contribution
Pall Corp.	2.1%	0.7%
Align Technolgy Inc	3.9%	0.5%
Avery Dennison	3.8%	0.5%
Best		**1.7%**

Pall Corp. (PLL) – filtration & purification
Pall Corporation stock was up 25% in the quarter, driven largely by the news that it was being acquired by Danaher. Pall has been a steady performer for us during the nearly four years we have owned the stock -- the filtration business is a very good business, and Pall CEO Larry Kingsley proved to be the solid operator -- with the takeout being nice icing on the cake.

Align Technolgy Inc (ALGN) – clear dental aligner (braces) company
Align was up 17% in the quarter, driven by solid first quarter results (reported in April) as well as an improvement in sentiment. In late March, Align announced that its long time CEO Tom Prescott was retiring. Tom was well regarded by the street and his seemingly sudden retirement made for nervous investors. The stock ended first quarter on a weak note. However, investors' fears were assuaged when Align reported solid first quarter results and gave a favorable second quarter outlook as well. Importantly, Align's strong results were driven in part by a nice acceleration in North American case volumes – a part of the business that has been lagging. Management attributed the strength in North America to an improving macro backdrop as well as to traction in the company's go-to-market strategy. We continue to hold the stock, as we believe there is a long runway for clear aligners to take share from traditional braces.

Avery Dennison (AVY) – labeling & packaging materials supplier
Strong profit improvement in Avery's largest segment, Pressure Sensitive Materials (PSM), helped lift its shares. A heightened focus on margins and returns instead of market share gains in PSM was well received by investors. Recent management changes in AVY's other segment, Retail Branding & Information Solutions (RBIS), have made us more enthusiastic that AVY will achieve its long-term margin targets for this unit, as aggressive cost actions are implemented. RBIS' global scale and product leadership advantage make it an important supplier to retailers and brand owners around the globe. AVY's disciplined use of capital and consistent return of free cash flow to investors remains a key part of our investment thesis.

Our Worst Three

Company	Quarter End Position Size	Contribution
DigitalGlobe	3.3%	-0.7%
Francesca's Holdings	2.2%	-0.7%
Belden	3.3%	-0.5%
Worst		**-1.9%**

DigitalGlobe (DGI) – satelite equipment provider
Shares of DGI performed poorly in 2Q as investors continue to wait for DGI to prove that it can accelerate growth in its commercial (non-US government) business. While management's outlook for the year was unchanged after their 1Q15 earnings report, their expectation for strong growth in the commercial segment became more back-half weighted. This resulted in more concern around making 2015 numbers, which was made worse by a rehashing of concerns surrounding government budget pressures and small satellite/drone imagery competition by short sellers. We continue to have confidence in DGI's ability to monetize new satellite capacity/capability from its new satellite WorldView-3 and the mid 2016 launch of WV-4. These new satellites should support our view of sustainable double digit growth in its commercial business and a significant increase in free cash flow as capital expenditures normalize.

Francesca's Holdings (FRAN) – apparel & accessories retailer
Francesca's shares sold off when the company provided below consensus second quarter guidance. While near term trends could be volatile, new CEO Michael Barnes has quickly taken steps to improve inventory management, redirect the e-commerce strategy and focus on store level sales training. Certain merchandising categories have shown signs of improvement (jewelry, gifts and dresses), and Barnes will lead a strategic review over the summer to set a course for better results. Barnes is known on the Street for his turnaround of Signet Jewelry where he did an excellent job creating a brand.

Belden (BDC) – signal transmission supplier
After a strong start to the year, the stock of slumped 13% in Q2. Heightened foreign currency volatility added a new worry for investors for global businesses like Belden's. BDC's EPS outlook for 2015 remains strong despite a minor adjustment to account for the stronger dollar. A multi-year journey from commodity cable supplier to a higher value-added transmission solutions provider remains intact and underpins our investment thesis. Belden's entry into the information technology security market via its Tripwire acquisition is well timed and will be another source of margin improvement. With a well-diversified product offering, and good geographical diversity, we expect BDC to manage through the global macro uncertainty and achieve its long-term financial targets.

Snapshot of the SMid-Cap Landscape

Ron Viener
Director of Trading

In these charts the Russell 2500 is sorted into deciles of performance according to different characteristics, some fundamental and some sentiment-based. The percentage in each box is the performance of that attribute (e.g. beta) for that decile.

That the second quarter was choppy can be seen in the mixed decile results. In contrast, what's worked vs. not worked in the market year to date follows a more linear progression.

In our monitoring of the Russell 2500 we've spotted a new trend: the outperformance of high p/e stocks as well as low (or no) dividend yielding companies. These characteristics are directly linked to the M&A fueled rally in biotechnology companies, an industry that has led the market higher. The outperformance of stocks that are least owned by institutional investors is also a new phenomenon, one caused by the second quarter rally in banks, an industry sensitive to the rise in interest rates and widely under owned by investors.

Furthermore, the top performing stocks are those that continue to trend higher, both first quarter winners and the best stocks of 2014, as well as the best-in-class sales growth companies. These metrics have been on our radar for a while now and continue to gain importance. Clearly the trend is still your friend and investors crave growth no matter the price.

Russell 2500 Performance (%) of Attributes by Decile as of June 30, 2015

Second Quarter

	Deciles									
	1	2	3	4	5	6	7	8	9	10
Market Cap Largest to smallest	2.2	-0.2	1.0	1.0	4.3	1.2	4.5	0.6	5.7	-1.7
P/E Ratio Lowest to highest[1]	-3.1	-0.3	0.8	0.5	2.0	4.3	2.3	1.6	-	4.3
Dividend Yield Highest to lowest[2]	-6.0	-0.7	1.5	2.0	2.6	-	-	-	-	3.8
Short Interest Lowest to highest	3.2	0.9	1.5	0.5	1.8	2.8	2.5	3.5	0.8	1.1
Beta Lowest to highest	3.1	0.5	-0.1	1.7	1.1	2.2	3.0	2.3	1.2	3.6
Sales Growth Best to worst	6.3	6.0	2.0	2.7	0.7	-0.4	-0.4	-1.4	-1.7	0.4
Analyst Ratings Best to worst	4.8	4.2	3.2	3.2	2.6	1.8	0.2	-2.2	-0.6	0.6
Institutional Ownership Most to least[3]	0.1	-1.3	2.0	0.7	0.8	2.8	0.7	3.0	4.5	5.6
% Change Q1 2015 Best to worst	7.4	0.5	1.4	1.7	-1.4	1.9	1.0	1.6	1.9	2.6
% Change in 2014 Best to worst[4]	3.4	-2.6	-0.9	0.7	1.6	3.3	0.2	1.0	5.8	-

Year to Date

	Deciles									
	1	2	3	4	5	6	7	8	9	10
Market Cap Largest to smallest	10.7	6.1	8.1	7.4	12.0	5.2	9.8	2.2	7.4	2.0
P/E Ratio Lowest to highest[1]	-3.8	1.0	3.7	5.6	9.3	11.7	7.9	2.1	-	13.1
Dividend Yield Highest to lowest[2]	-5.6	1.3	4.6	6.7	9.8	-	-	-	-	10.9
Short Interest Lowest to highest	12.6	4.2	6.8	5.0	6.4	9.7	6.7	11.2	6.1	2.8
Beta Lowest to highest	11.8	3.3	6.4	6.3	8.1	6.3	6.2	7.3	6.0	10.0
Sales Growth Best to worst	16.8	13.9	8.3	8.7	7.2	2.4	1.9	-1.5	-1.5	0.7
Analyst Ratings Best to worst	11.1	13.1	11.9	10.5	5.6	5.6	7.3	-1.7	0.2	3.4
Institutional Ownership Most to least[3]	3.2	3.3	6.7	5.5	5.5	8.0	7.1	4.4	13.1	15.1
% Change Q1 2015 Best to worst	57.9	19.6	13.2	9.2	2.6	3.1	-0.8	-4.3	-10.1	-25.0
% Change in 2014 Best to worst[4]	13.9	2.3	3.0	7.1	5.3	6.4	4.8	4.2	9.6	-

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

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

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

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

3. Institutional Ownership may be over or under stated due to timing of filings.

4. Decile 10 of % Change in 2014 is made up of stocks with no complete 2014 performance.

Sources: CornerStone Macro & Daruma Capital Management

General Disclosures

It should be noted that this commentary should not be construed as an offer or a solicitation of an offer to buy interests/shares in any investment fund managed by Daruma. Any such offer will be made only to qualified investors by means of a confidential Private Offering Memorandum and other operative documents, and only in those jurisdictions where permitted by law. Neither the Securities and Exchange Commission nor any U.S. State or international securities administrator has passed on or endorsed the merits of any such offerings of these securities, nor is it intended that they will. Any representation to the contrary is a criminal offense. The firm does not offer or provide tax or legal advice. Individuals are urged to consult with their own tax or legal advisers before entering into any advisory contract.

Past performance is not a guarantee of future results. Many factors affect performance, including changes in market conditions and interest rates, as well as other economic, political and financial developments. Performance for 2015 is not yet audited and subject to change upon audit. You should not assume that investment decisions we make in the future will be profitable or will equal the investment performance of the past.

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 or of a particular allocation. You should not presume that any holding or allocation shown has been or will be profitable. A list of the Top Ten holdings as of 06/30/15 is available on our website at http://www.darumanyc.com/portfolio/smid-cap/.

The appropriate comparison benchmark for the Small-Cap Equity strategy is the Russell 2000. The Russell 2000 includes approximately 2000 of the smallest U.S. common stocks based on a combination of their market cap and current membership in the Russell 3000. The Russell 2000 Value Index includes those Russell 2000 Index companies with lower price-to-book ratios and lower forecasted growth values, while the Russell 2000 Growth Index includes those with higher price-to-value ratios and higher forecasted growth values.

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.

Several charts are included in the book to demonstrate certain information or conclusions. You should not make any investment decision relying only on these charts.

The information in this commentary is current as of the date of the commentary, unless otherwise noted, and may have changed by the time you read this. Daruma has obtained some of the information in this commentary from third-party sources we believe to be accurate. However, we cannot guarantee the accuracy of such information. Such third party information is footnoted.

Statements in this commentary that are not historical facts reflect our opinions, beliefs or expectations as of the date of this commentary. Subsequent events may impact whether those come to pass.