PENN CAPITAL

Small Cap Equity and the Deleveraging Catalyst

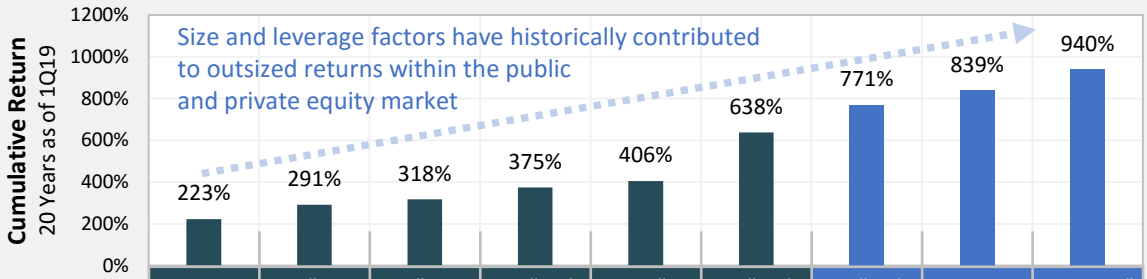
Capturing Alpha from the Debt Paydown of Leveraged Equities

Eric Green, CFA and Matthew Bogdan

Introduction: Private Equity Returns in the Public Market

Leveraged small cap equities ("LSCE"), defined here as public companies with high debt to capital and smaller market capitalizations, have historically generated outsized returns (Exhibit 1). As we'll discuss in this paper, this is derived from successful balance sheet deleveraging, which LSCE has a higher probability of doing and with greater effect on returns. Deleveraging can be achieved through debt paydown, refinancing, acquisitions, and divestitures as well as equity issuance and appreciation. Leveraged companies that pay down debt, and are thereby no longer considered leveraged, are rewarded with improved market perception, credit ratings, borrowing costs, and equity appreciation, which we consider a "Conversion to Quality" premium. Likewise, private equity funds' LBO structures have long demonstrated that buying small companies, loading them up with debt, and deleveraging can generate outsized returns. Our research indicates that LSCE has been an effective factor, albeit widely misunderstood, with significant opportunity for improvement by active management via credit analysis typically not performed by equity managers. Penn Capital's Small Cap Equity strategy, managed alongside our credit strategies, has developed and utilized this approach over the last 25 years.

Equity Performance: 20 Year Small, Leverage, and Active Factors — Exhibit 1



Equity Factor	Large Cap	Small Low Leverage	Small Low-Mid Leverage	Small Mid Leverage	Small Cap	Small Mid-High Leverage	Small High Leverage	Private Equity	Active Small High Leverage
Cum. Return	223.14%	291.33%	317.73%	374.80%	405.58%	637.96%	771.05%	839.12%	939.61%
Ann. Return	6.04%	7.06%	7.41%	8.10%	8.44%	10.51%	11.43%	11.85%	12.42%
Std. Deviation	14.52%	22.73%	19.08%	18.61%	19.49%	20.98%	23.18%	33.58%	24.56%
Sharpe Ratio	0.29	0.23	0.29	0.34	0.34	0.41	0.41	0.30	0.43
Security Count	501	328	329	329	1968	329	329	781	73
*Leverage (D/C)	34.91%	0.21%	5.78%	26.20%	30.73%	45.94%	75.53%	63.25%	52.38%
Factor Proxy	S&P 500 Index	Russell 2000 Leverage Quintile 5	Russell 2000 Leverage Quintile 4	Russell 2000 Leverage Quintile 3	Russell 2000 Index	Russell 2000 Leverage Quintile 2	Russell 2000 Leverage Quintile 1	Cambridge Private Equity Index**	Penn Capital Small Cap Equity

Source: Bloomberg, S&P Global Market Intelligence, Cambridge Associates, National Bureau of Economic Research. As of March 31, 2019.

Past performance is no guarantee of future results. The performance results presented above for Penn Capital's Small Cap Equity composite are prior to the deduction of actual investment advisory fees ("gross of fees") which includes reinvestment of income. Full composite and "gross of fees" disclosure can be found at the back of this presentation. Index comparisons have limitations as volatility and other characteristics may differ from a particular investment. *Leverage Quintile Calculation Methodology: Total debt to total capital, ex financial sector. **Private Equity Calculation Methodology: Standard Deviation: Volatility methodology of NBER paper "Private Equity Indices Based on Secondary Market Transactions." Security Count: Cambridge average number of companies receiving initial investments per year. Leverage: S&P Global Market Intelligence average LBO equity contribution. Cambridge index 4Q2018 and 1Q2019 returns not available at time of analysis, proxied with Reuters Private Equity Index. PC-EQTYWP-1Q19_05242019

Methodology and Analysis: Measuring Size, Leverage, and the Deleveraging Factor

For this analysis, we consider LSCE to be the top leverage quintile of the Russell 2000 Index, as measured by the debt to capital ratio (Total Debt / [Total Equity + Total Debt]). An equal number of companies were sorted into each quintile, rebalanced annually, with returns weighted by market capitalization. *Successful deleveraging* is defined as the movement to a lower leverage quintile, e.g. from a 1 to a 2 or lower, between rebalancing periods. *Deleveraging predictability* is calculated as the leverage quintile's percentage of successful deleveraging plus improvements to that percentage through a free cash flow screen**. The analysis excludes financials, whose balance sheet and operational treatment of debt fundamentally differs from non-financials. We consider the debt to capital ratio preferable to other leverage ratios (Debt/EBITDA, Debt/EV, EV/EBITDA, Debt/Assets, Debt/Equity, Assets/Equity) for this analysis due to its explanatory power as a regression variable and consistent range of outcomes over time. Exhibits 2 and 3 summarize the Russell 2000 Index by leverage quintile over the last 20 years. The complete breakdown can be found in the appendices.

Penn Capital's Key Findings Over the Last 20 Years (Exhibits 2 and 3)

- Deleveraging improved, and leveraging reduced, returns across quintiles to varying degrees.
- Quintile 1 [5] displayed lowest [highest] risk of increasing leverage, highest [lowest] deleveraging benefit.
- Quintiles 2, 3, and 4 exhibited deleveraging benefit, but higher leveraging risk and lower predictability.
- Quintile 1 generated highest return, deleveraging rate, and deleveraging predictability.
- An average of 187 companies (43 in quintile 1) deleveraged each year, while 222 increased leverage.
- Successful deleveraging from quintile 1 to 2 led to outperformance in the following year.

Russell 2000 Statistics by Leverage Quintile (Annual Rebalance) — Exhibit 2

Last 20 Calendar Year Average	Russell 2000	Russell 2000 by Leverage (1=Highest)				
Portfolio Characteristics	Total	Quintile 1	Quintile 2	Quintile 3	Quintile 4	Quintile 5
Leverage (Debt/Capital) %	30.70	**75.53**	45.94	26.20	5.78	0.03
Successful Deleveraging Return %	38.73	**54.41**	49.16	36.11	15.23	—
Unsuccessful Deleveraging Return %	7.20	**6.43**	5.19	5.91	8.99	10.94
Total Return %	11.53	**14.90**	12.39	9.66	9.77	10.94
% of Companies Successfully Deleveraging	13.23	**18.37**	17.61	14.66	14.71	—
FCF Screen Improvement to Deleveraging Rate %	1.25	**5.47**	1.12	-0.95	0.61	—
**Total Deleveraging Predictability %	14.48	**23.84**	18.73	13.71	15.32	—

Source: Bloomberg. As of December 31, 2018.

Russell 2000 Return Matrix by Leveraging and Deleveraging Equity (Annual Rebalance) — Exhibit 3

Average Annual Return %
By Start and End Quintile Last 20 Yrs

Starting Quintile \ Ending Leverage Quintile	Q1	Q2	Q3	Q4	Q5
Q1	6.43	48.07	*	*	*
Q2	-21.70	9.46	48.64	*	*
Q3	*	-14.65	12.01	39.01	*
Q4	*	*	-7.32	10.00	15.23
Q5	*	*	*	5.88	8.78

Average 1 Yr Forward Return %
By Prior Year Start and End Quintile Last 20 Yrs

Starting Quintile \ Ending Leverage Quintile	Q1	Q2	Q3	Q4	Q5
Q1	12.14	14.28	*	*	*
Q2	13.31	10.93	6.68	*	*
Q3	*	11.64	10.72	7.15	*
Q4	*	*	8.88	7.70	9.17
Q5	*	*	*	10.15	6.30

Average # of Companies
By Start and End Quintile Last 20 Yrs

Starting Quintile \ Ending Leverage Quintile	Q1	Q2	Q3	Q4	Q5
Q1	198.7	41.1	1.5	0.3	0.3
Q2	48.3	167.1	48.9	1.8	1.1
Q3	9.7	50.5	160.2	37.1	8.0
Q4	2.6	9.5	40.0	157.8	47.2
Q5	1.9	5.7	13.8	40.5	196.1

*Data omitted as multiple quintile moves (e.g. 2 to a 4) occurred infrequently. Full breakdown in appendix.

Leverage Status Legend: Leveraging | No Change | Deleveraging

Source: Bloomberg. As of December 31, 2018.

Past performance is no guarantee of future results. Leverage Quintile Calculation Methodology: Total debt to total capital, ex financial sector. **Deleveraging Predictability: Proxied as the percentage of companies with successful deleveraging plus improvements to that percentage through a FCF/Debt ratio >5% company screen.

Misconceptions of Leveraged Equities: High Alpha Diversifier

LSCE outperformance comes as a surprise to most, eliciting skepticism and running counterintuitively to the "Quality at a Reasonable Price" mindset of the current era. Per the ethos, high leverage indicates low quality, which underperforms and should be avoided. This qualitative skepticism is further confirmed by the quantitative success of lower risk factors such as quality, low volatility, dividend growth, and momentum. Each of these factors are published by major index providers, are targeted by smart beta ETFs and by active managers, and have in fact generated significant alpha. Accordingly, such factors are seen as the antithesis to leveraged equities. However, as shown in Exhibits 4 and 5, LSCE has outperformed *alongside* these factors, generating *uncorrelated* alpha that make it a complementary diversifier, not a zero-sum offset factor (e.g. value vs growth). We attribute this low correlation to the deleveraging factor, which is far less present in other factors. It should be noted that *lower risk factors and active managers* have exhibited high correlation, indicating significant holdings or factor overlap.

5 Year Correlation Matrix: Excess Returns vs Russell 2000 by Small Cap Factor — Exhibit 4

Top leverage quintile exhibits low alpha correlation to quality factors and active management, which exhibit high alpha intercorrelation

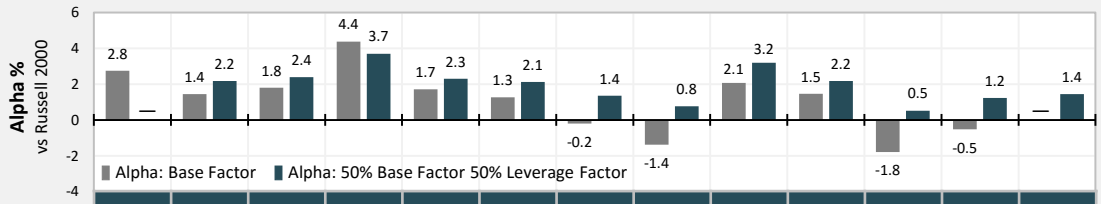
1	Russell 2000 Top Leverage Quintile	1.00											
2	Russell 2000 Comprehensive Index	-0.01	1.00										
3	Russell 2000 Defensive Index	-0.13	0.83	1.00									
4	Russell 2000 Dividend Growth Index	-0.07	0.73	0.85	1.00								
5	Russell 2000 Quality Index	-0.15	0.77	0.90	0.69	1.00							
6	Russell 2000 Low Volatility Index	-0.11	0.77	0.98	0.85	0.87	1.00						
7	Russell 2000 Dividend Yield Index	0.18	0.66	0.72	0.75	0.60	0.73	1.00					
8	Russell 2000 Value Index	0.23	0.72	0.58	0.55	0.48	0.54	0.73	1.00				
9	Morningstar Active Small Cap Managers	0.19	0.56	0.63	0.52	0.58	0.62	0.63	0.55	1.00			
10	Russell 2000 Growth Index	-0.23	-0.73	-0.57	-0.54	-0.48	-0.54	-0.72	-1.00	-0.54	1.00		
11	Russell 2000 Dynamic Index	0.15	-0.83	-1.00	-0.85	-0.90	-0.98	-0.72	-0.57	-0.64	0.57	1.00	
12	Russell 2000 Momentum Index	-0.28	-0.08	0.08	-0.02	0.15	0.09	-0.23	-0.43	-0.09	0.42	-0.09	1.00
13	**Russell 2000 Index (Benchmark)**	—	—	—	—	—	—	—	—	—	—	—	—

1.0 to 0.4 High Positive Correlation
-1.0 to -0.4 High Negative Correlation
-0.4 to 0.4 **Low Correlation**

Source: Bloomberg, Morningstar Direct. As of December 31, 2018.

10 Year Modern Portfolio Statistics: Alpha Improvement by Leverage Factor Pairing — Exhibit 5

Almost every factor saw alpha improvement when paired 50-50 with leverage factor, rebalanced annually



Russ 2000 Factors*	Leverage	Compreh	Defense	Div Grow	Quality	Low Vol	High Div	Value	Active	Growth	Dynamic	Momntm	Total
Leverage (D/C) %	78.35	27.24	25.58	28.32	25.85	29.58	37.03	29.74	25.04	31.82	36.27	29.25	30.73
Alpha %	2.75	1.44	1.80	4.38	1.72	1.27	-0.19	-1.38	2.07	1.46	-1.78	-0.52	—
Beta %	1.11	0.94	0.85	0.80	0.93	0.87	0.91	1.00	0.93	1.00	1.16	0.97	1.00
Info Ratio %	0.51	0.22	0.07	0.27	0.44	0.00	-0.22	-0.45	0.61	0.44	-0.09	-0.32	—
Tracking Error %	6.91	3.56	4.10	7.95	2.27	3.72	5.32	3.14	2.23	3.15	4.26	2.50	—
R Squared %	88.51	96.36	96.51	81.49	98.89	96.97	91.72	97.19	98.94	97.15	97.97	98.17	100.00
50/50 Alpha %	—	2.18	2.39	3.71	2.30	2.12	1.35	0.77	3.16	2.18	0.52	1.24	1.44
50/50 Beta %	—	1.02	0.98	0.95	1.02	0.99	1.01	1.06	1.01	1.05	1.13	1.04	1.06
Improved Alpha %	—	**0.74**	**0.59**	**-0.67**	**0.58**	**0.85**	**1.54**	**2.14**	**1.09**	**0.72**	**2.30**	**1.76**	**1.44**

Source: Bloomberg, Morningstar Direct. As of December 31, 2018.

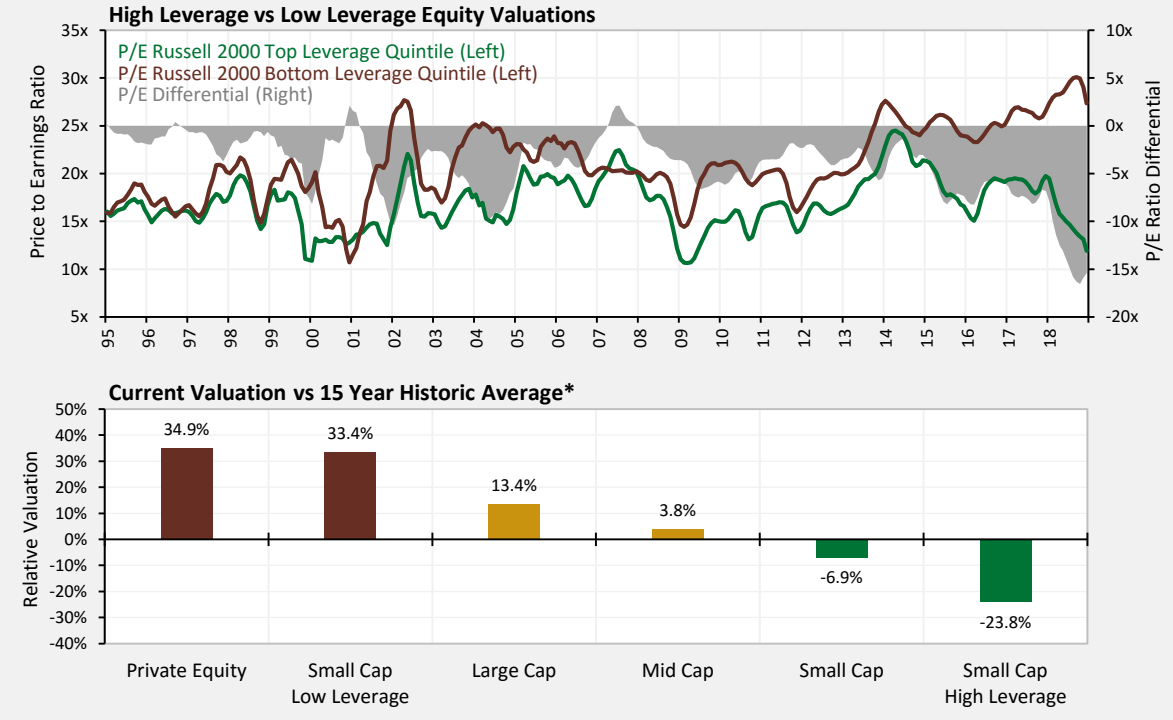
Past performance is no guarantee of future results. Index comparisons have limitations as volatility and other characteristics may differ from a particular investment. Leverage Quintile Calculation Methodology: Total debt to total capital, ex financial sector. *All factors are published Russell 2000 factor indices with the exception of leverage and active factors. Active factor: Morningstar Active Small Cap Blend SMA Category.

Quantitative backtesting tends to identify leveraged equity underperformance unless properly specified to target smaller, non-financial companies with a rebalancing period of at least 1 year. Large cap equity, financials, and monthly rebalancing does not adequately capture the deleveraging factor, leading to suboptimal risk-return conclusions as shown in Exhibits 9 and 10. Generally, factor research will utilize monthly/quarterly rebalancing, which tends to benefit lower risk factors and misconstrue leverage.

To summarize the misconception, we believe the market's aversion to public leveraged equity stems from qualitative skepticism, underspecified quantitative research, and complex balance sheets requiring credit analysis for which most equity managers do not have the skillset. This helps explain why, despite the abundance of smart beta vehicles, it is unheard of for ETFs or indices to target leveraged equity. It also explains why the Morningstar Active Small Cap Management universe has historically held less than 5% portfolio exposure to leveraged equities (Exhibit 13). Increased targeting of lower leverage factors has significantly expanded their valuation multiples to *historic highs*, while leveraged equities trade at a discount (Exhibit 6). The aversion to public leverage does not extend to private equity, where volatility can be veiled through the lack of a market pricing mechanism. The successful utilization of leverage and subsequent outperformance has led to massive inflows to private equity funds, which are likewise seeing *historically high* valuation multiples.

Valuation Multiples of High Leverage, Low Leverage, and Private Equity — Exhibit 6

Public leveraged equities trading at discount, exhibit opportunistic entry point vs highly valued low leverage and private equity



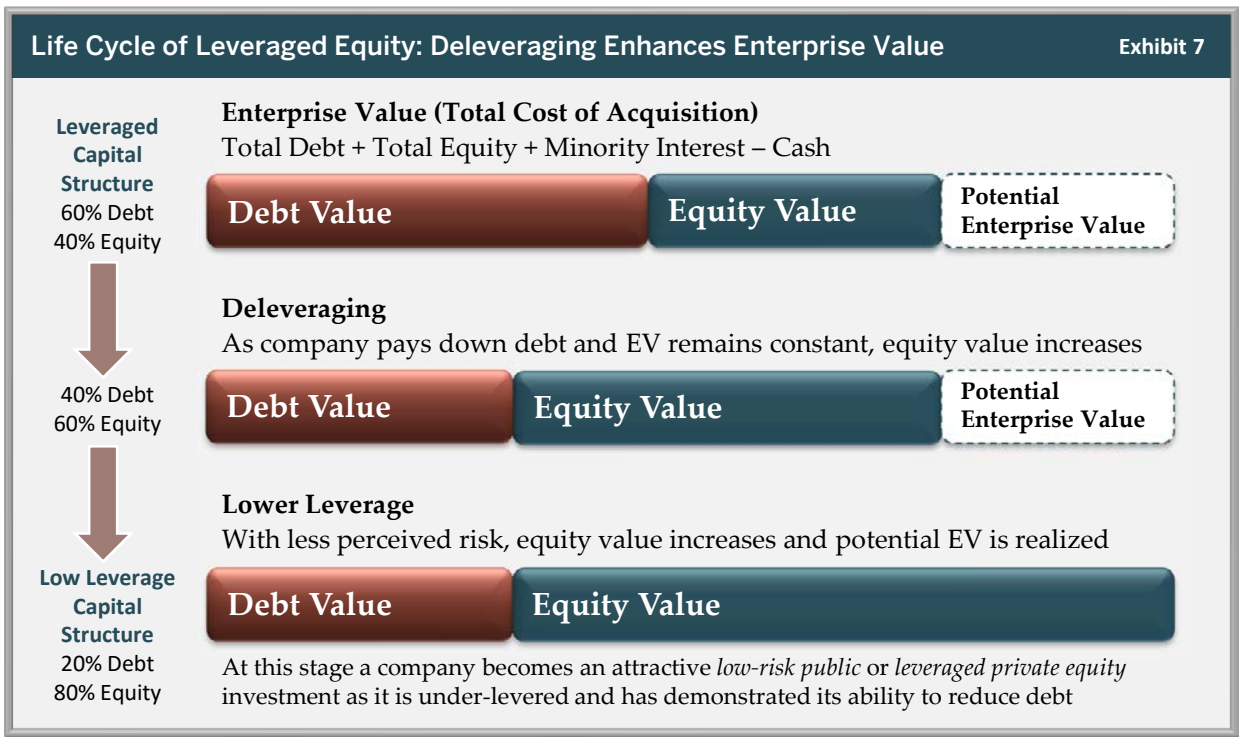
Source: Bloomberg, S&P Global Market Intelligence. As of December 31, 2018.

Past performance is no guarantee of future results. Indices: Russell 1000, Russell Mid Cap, Russell 2000. Leverage Quintile Calculation Methodology: Total debt to total capital, ex financial sector. *Public P/E valuations calculated as price by trailing 12M earnings. Private valuation calculated by average purchase price multiple of leveraged buyout transactions. **All factors are published Russell 2000 indices with the exception of leverage factor.

Lifecycle of Leveraged Equity: Conversion to Quality

Companies with leveraged capital structures seek to transfer value from debt to equity through deleveraging. As leveraged equities are questionably deemed low quality by the market, successful deleveraging induces a *conversion to market-perceived quality*. Over its lifecycle, this relationship is best captured with an enterprise value analysis, commonly utilized by private equity. High debt levels are not a direct indication of weakness. Leverage can act as a growth catalyst, tax shield, and indicator of credit worthiness. Leveraged companies tend to exhibit financial discipline, with an explicit goal of paying down debt instead of less accretive buyback, dividend, acquisition, or capex transactions.

A company typically accrues leverage through debt issuance, refinancing, acquisitions, and/or equity depreciation. Since leverage tends to act as catalyst for success or failure, the leveraged firm is now perceived as risky by the market and receives a low valuation. As the company utilizes its free cash flow to pay down debt, value is transferred from debt to equity, resulting in equity appreciation. Initially, enterprise value remains unchanged, as the leveraged company retains its risky status and relative multiples. Upon further deleveraging and normalization of debt levels, favorable perception is achieved through credit rating upgrades, sell-side recommendations, and improved fundamentals. Equity appreciates to the relative valuation of high quality companies, concluding the lifecycle. With low leverage and risk characteristics, the stock now passes quantitative screens, and is targeted by low risk active and smart beta managers. It also becomes an attractive private equity target given its low leverage and proven ability to reduce debt. This is exemplified by the performance of the Penn Capital Small Cap strategy (Exhibit 1), which has experienced 50% greater M&A exposure than the Russell 2000*.



*As of December 31, 2018. Source: Bloomberg and Penn Capital.

Active Enhancement of Leveraged Equity

Per our 20 year analysis, only 18.4% (Exhibit 8) of companies within the top leverage quintile of the Russell 2000 successfully deleveraged per year, returning an average of 54.4%. Outsized returns from those companies offset lower average returns of 6.4% per year from the remaining 81.6% of companies, for an aggregate return of 14.9% per year. While effective as a passive factor, this leaves significant room for improvement by active management. Our research highlights 3 key areas to actively enhance LSCE alpha: (1) fundamental credit research, (2) selective attribute targeting, and (3) holding period discipline.

(1) Fundamental credit research can provide positive or negative signals for leveraged equities. Active targeting of companies with improving credit fundamentals, such as higher levels of free cash flow to debt, may enhance the probability of successfully paying down debt. Per Exhibit 8, targeting a subset of the Russell 2000 top leverage quintile with a FCF to Debt ratio of at least 5.0%, representing a third of the quintile, has historically improved the rate of successful deleveraging by 5.5% per year. The resulting portfolio saw a return increase of 18 bps per year with significantly reduced volatility and downside.

Screening for Free Cash Flow — Exhibit 8

Targeting 5% FCF/Debt companies within Russell 2000 Leverage Quintile 1

Last 20 Years	Russell 2000 Leverage Quintile 1 Total		Quintile 1 Subset FCF/Debt > 5%	
Year	% of Firms Deleveraging	Total Return %	% of Firms Deleveraging	Total Return %
12/31/2018	19.36	-20.37	22.53	-15.22
12/31/2017	15.64	15.07	15.13	13.28
12/31/2016	19.76	35.46	25.34	20.71
12/31/2015	21.30	-14.55	34.87	-5.69
12/31/2014	17.87	2.03	23.07	6.72
12/31/2013	16.76	49.94	24.59	50.27
12/31/2012	17.47	31.14	21.87	31.19
12/31/2011	15.25	-4.87	22.72	-1.30
12/31/2010	24.70	35.86	27.57	28.11
12/31/2009	11.58	72.60	11.65	71.70
12/31/2008	12.91	-40.80	10.41	-35.85
12/31/2007	17.16	-18.98	25.05	-10.14
12/31/2006	22.81	22.28	30.81	9.83
12/31/2005	16.10	1.24	23.56	5.16
12/31/2004	12.41	25.49	12.30	23.67
12/31/2003	13.27	57.81	17.97	31.97
12/31/2002	23.97	-7.13	32.56	-3.96
12/31/2001	21.56	19.29	40.83	29.94
12/31/2000	22.64	17.41	27.23	17.61
12/31/1999	24.83	19.10	26.75	12.06
Deleverage Rate %	18.37		23.84	
Calendar Yr Return %	11.39 (Avg 14.90)		11.57 (Avg 14.00)	
Calendar Yr Std Dev %	27.68		23.33	
Calendar Yr Sharpe	0.34		0.42	

Source: Bloomberg. As of December 31, 2018.

(2) Selective attribute targeting seeks to target equity within areas that benefit the most from higher leverage utilization. As shown in Exhibit 9, larger companies and certain sectors tend to underperform with higher leverage and should be avoided. As leverage acts as a catalyst for success or failure, we correlate larger company underperformance to their *suboptimal upside-downside relationship* with higher debt, e.g. large caps have less room to grow and more room to shrink.

Leverage Performance by Sector, Size, and Style Attributes* — Exhibit 9

Last 10 Years	Russell 2000 Index by Sector and Style**											Russell Size Indices				
Return	Mats	Cons Disc	Energy	Health	Indust	Utility	Cons Stap	Info Tech	Fin Serv	Growth	Value	Micro	Small	Mid	Large	Giant
Top Leverage Quintile Return %	21.88	21.98	2.68	21.35	12.88	13.60	13.09	18.42	9.43	15.30	15.86	15.97	16.85	15.46	11.45	5.80
Total Factor Index Return %	10.89	14.79	-5.81	14.75	9.99	11.10	11.57	17.44	9.69	13.52	10.40	11.71	11.97	14.03	13.28	13.00
Excess Return %	**10.99**	**7.19**	**8.49**	**6.60**	**2.89**	**2.50**	**1.52**	**0.99**	**-0.25**	**1.78**	**5.46**	**4.26**	**4.88**	**1.44**	**-1.83**	**-7.20**

Source: Bloomberg. As of December 31, 2018.

Past performance is no guarantee of future results. Indices: Russell Micro Cap, Russell 2000, Russell 2000 Growth, Russell 2000 Value, Russell Mid Cap, Russell 1000, Russell Top 200. Index comparisons have limitations as volatility and other characteristics may differ from a particular investment. *Leverage Quintile Calculation Methodology: Total debt to total capital, ex financial sector, except for financial specific indices. **Sector allocations can be found in appendix.

(3) Holding periods have a significant impact on LSCE returns. Our research shows that leveraged small firms generate outsized returns when given at least 1 year to deleverage, with successful deleveraging companies continuing to outperform 1 year later (Exhibit 10). The LSCE factor exhibits a higher outperformance probability when held for over 5 years, with a 100% success rate vs the Russell 2000 for 10 year periods in the last 25 years (Exhibit 11). Due to short term volatility, a long term holding period requires discipline as LSCE assets are not locked up for 7+ years, unlike most private equity assets.

Rebalancing Frequency: Russell 2000 Top Leverage Quintile Performance — Exhibit 10

Last 20 Years	Rebalancing Frequency of Top Leverage Quintile				Successful Deleveraging
Russell 2000 Top Leverage Quintile	Monthly	Quarterly	Semi-Annually	Annually	Successful Deleveraging 1 Year Forward Return*
Annualized Return %	8.81	9.12	9.79	**11.39**	**11.91**
Cumulative Return %	441.22	472.91	547.52	**764.82**	**849.24**
Standard Deviation %	24.12	23.8	23.45	**23.05**	**22.82**
Sharpe Ratio	0.29	0.31	0.34	**0.41**	**0.44**
Annual Turnover	134.96	85.79	62.43	**45.8**	**18.37**
Security Count	330	331	332	**329**	**60**

Source: Bloomberg. As of December 31, 2018.

Investment Horizon: Rolling Performance and Risk-Return Scatterplot — Exhibit 11

1 Year Rolling Return, 1 Year Shift

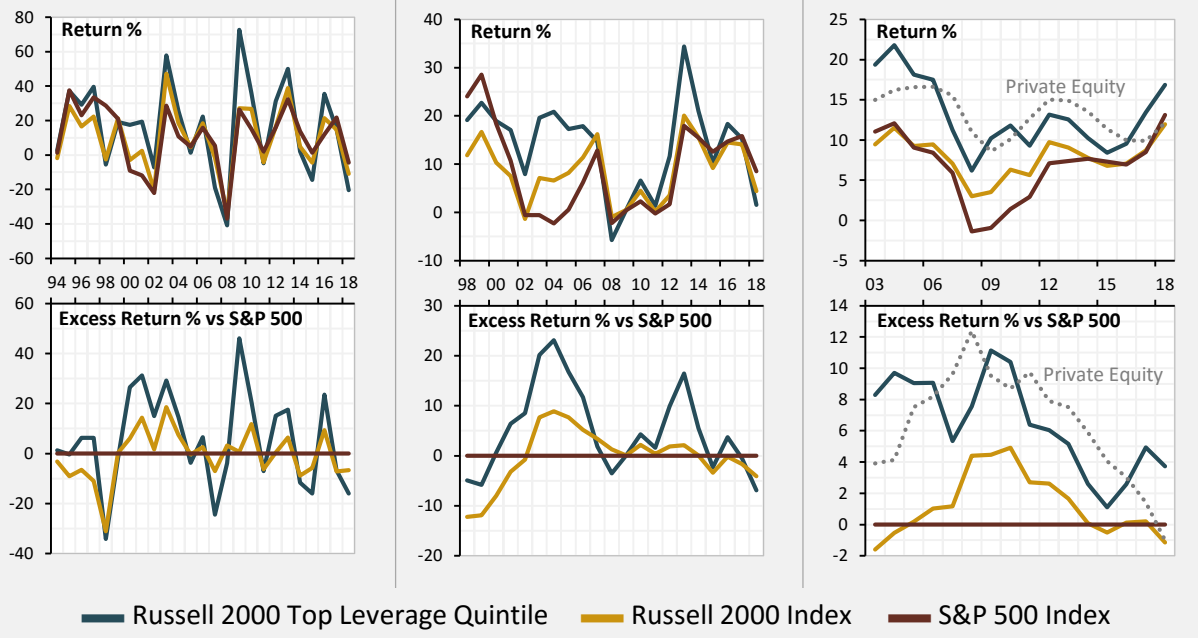
Russell 2000 Leverage Excess Return Rate
Versus Russell 2000: 64%
Versus S&P 500: 56%

5 Year Rolling Return, 1 Year Shift

Russell 2000 Leverage Excess Return Rate
Versus Russell 2000: 77%
Versus S&P 500: 68%

10 Year Rolling Return, 1 Year Shift

Russell 2000 Leverage Excess Return Rate
Versus Russell 2000: 100%
Versus S&P 500: 100%



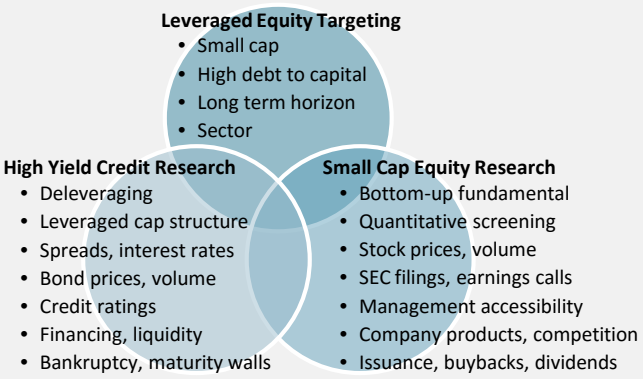
Source: Bloomberg. As of December 31, 2018.

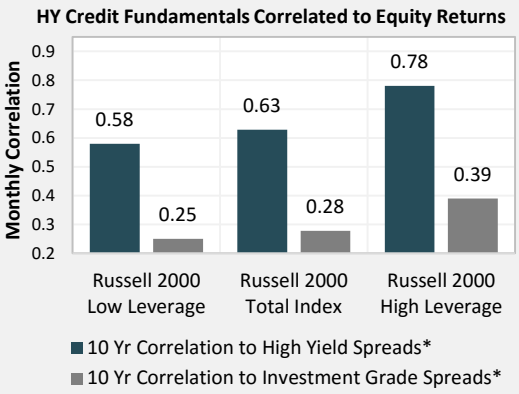
Past performance is no guarantee of future results. Private Equity: Cambridge Private Equity Index. Index comparisons have limitations as volatility and other characteristics may differ from a particular investment. **Leverage Quintile Calculation Methodology:** Total debt to total capital, ex financial sector. *Calculated as the forward 1 year return after a company has moved from leverage quintile 1 to leverage quintile 2.

We believe that *active management* of leveraged equities requires a unique and synergistic consolidation of high yield credit and small cap equity research (Exhibit 12). We call this process a Complete Capital Structure Analysis®. High yield credit research specializes in the leveraged and complex debt structures typically found within LSCE balance sheets. Additionally, 78.6% of companies with speculative grade debt also have smaller equity capitalizations below $5 billion. Research integration of the two, though rare, is actually quite natural, which is why Penn Capital has managed its small cap equity and high yield credit strategies together over the last 25 years. As shown in Exhibit 13, this approach (and resulting return characteristics) significantly differs from most managers, who tend to focus on traditional equity research and lower-risk factors that LSCE exposure complements quite well.

High Yield Credit and Small Cap Stock Research Consolidation — Exhibit 12

High yield credit analysis can identify debt catalysts to equity performance, with fundamentals highly correlated to LSCE returns

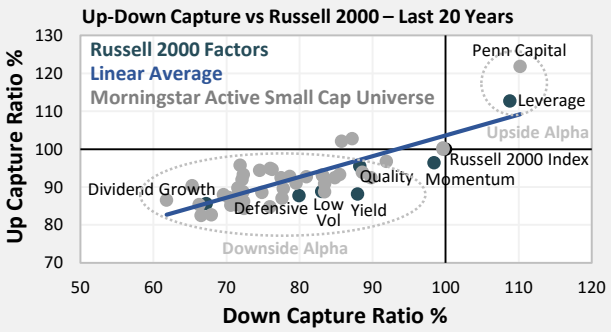


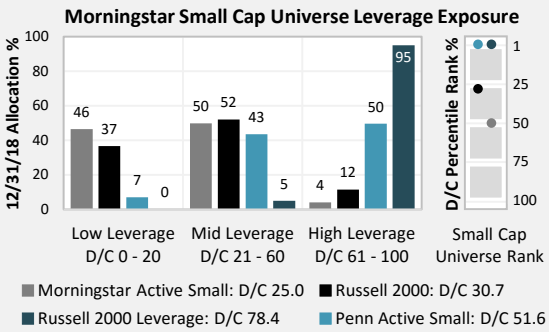


Source: Bloomberg. As of December 31, 2018.

Active Management Sources of Alpha: Upside-Downside Capture Factors — Exhibit 13

Vast majority of active are managers defensive, targeting low risk factors which are complemented by leveraged equities





Source: Bloomberg, Morningstar Direct. As of December 31, 2018.

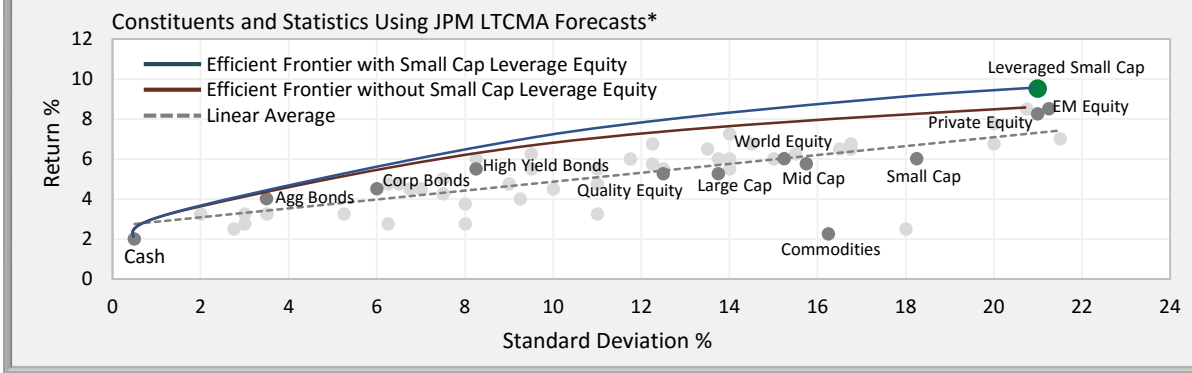
Past performance is no guarantee of future results. The performance results presented above are prior to the deduction of actual investment advisory fees ("gross of fees") which includes reinvestment of income. Full composite and "gross of fees" disclosure can be found at the back of this presentation. Index comparisons have limitations as volatility and other characteristics may differ from a particular investment. Leverage Quintile Calculation Methodology: Total debt to total capital, ex financial sector. *Monthly return correlation to monthly change in credit spreads, High Yield Spreads: ICE BofAML High Yield Index, Investment Grade Spreads: ICE BofAML Corporate Index.

Conclusion: Expanding the Efficient Frontier with LSCE Exposure

Leveraged small cap equity exposure has historically acted as a high alpha, low correlation diversifier to a traditional portfolio. When added to a portfolio, LSCE can enhance risk-return characteristics and extend the efficient frontier (Exhibit 14). LSCE alpha is derived from the deleveraging catalyst, which leveraged companies have the highest probably of achieving, and with the greatest effect to returns. Likewise, private equity has long utilized small size and high leverage factors, resulting in similar performance and leverage levels as public leveraged equity. The market has embraced the use of leverage in the private space, where a lack of a daily market pricing mechanism tends to veil true investment risk. In the public sector, the market has clearly favored low leverage. We believe these dynamics are behind the historically high valuations of private equity and public low risk equity factors, which provides an opportunistic entry point for LSCE exposure.

Active management can further enhance the risk-return characteristics of LSCE through various techniques, such as fundamental credit research, selective attribute targeting, and holding period discipline. Credit research of complex, leveraged balance sheets is a skillset most utilized within the high yield credit space, where analysis of free cashflow, deleveraging, credit ratings, yield spreads, liquidity, defaults, and other debt catalysts are commonplace. The identification of debt catalysts to leveraged equity performance, a "credit leads equity" approach, is why Penn Capital has managed its small cap equity strategies alongside our high yield credit strategies, representing 40% and 60% of firm AUM respectively, for the last 25 years.

Efficient Frontier Enhancement with Leveraged Small Cap Equity Exposure Exhibit 14



Source: Bloomberg, JP Morgan. As of December 31, 2018.

Eric Green, CFA *Senior Portfolio Manager and Partner*

Eric Green serves as the portfolio manager for Penn Capital's Small Cap Equity strategy. Mr. Green began his career with Penn Capital in 1997. Prior to joining, he gained experience with the Federal National Mortgage Association, the Royal Bank of Scotland, and the US Securities and Exchange Commission where he served as a financial analyst in the Division of Investment Management. Mr. Green is also Vice Chairman of the Board of Directors for the Anti-Defamation League (ADL), Mid-Atlantic Region. He received a BSBA, cum laude, from American University and received an MBA from the Yale School of Management.

Past performance is no guarantee of future results. Leverage Quintile Calculation Methodology: Total debt to total capital, ex financial sector. *JPM 2019 Long-Term Capital Market Assumptions, with exception of leveraged equity factor, calculated using historic volatility and Penn Capital forecast using LTCMA economic assumptions.

Appendix A

Analysis of the Russell 2000 Index by leverage quintile over the last 20 calendar years

Last 20 Years	Calendar Year Return %						Leverage (Debt/Capital) %						% of Companies Successful Deleveraging					
Year	Total	Q5	Q4	Q3	Q2	Q1	Total	Q5	Q4	Q3	Q2	Q1	Total	Q5	Q4	Q3	Q2	Q1
12/31/2018	-9.48	0.17	1.33	-12.90	-15.60	-20.37	33.23	0.01	8.70	30.63	48.45	78.35	12.30	—	11.56	10.93	19.62	19.36
12/31/2017	19.90	33.02	22.23	15.19	14.00	15.07	33.01	0.02	8.98	30.23	47.93	77.87	13.00	—	15.79	12.57	20.99	15.64
12/31/2016	16.95	4.19	2.45	17.19	25.47	35.46	32.90	0.01	7.86	28.55	48.08	79.98	13.61	—	10.83	16.05	21.41	19.76
12/31/2015	-5.31	0.34	-1.05	-2.35	-8.93	-14.55	30.76	0.01	4.49	25.33	46.88	77.10	13.71	—	10.29	18.71	18.24	21.30
12/31/2014	4.57	7.81	0.43	7.48	5.11	2.03	29.78	0.01	3.87	24.07	45.21	75.73	13.68	—	15.92	17.67	16.94	17.87
12/31/2013	44.87	47.72	38.65	43.24	44.82	49.94	28.17	0.01	2.86	21.32	41.89	74.75	11.03	—	13.98	10.10	14.32	16.76
12/31/2012	15.89	8.37	10.41	15.67	13.87	31.14	26.57	0.01	2.42	19.54	39.74	71.16	14.49	—	17.04	20.14	17.78	17.47
12/31/2011	-3.01	-7.12	1.98	-3.25	-1.80	-4.87	26.19	0.02	2.17	18.96	39.10	70.71	16.23	—	22.21	21.63	22.06	15.25
12/31/2010	30.60	37.78	23.86	23.92	31.56	35.86	25.82	0.01	1.67	17.60	37.30	72.51	17.30	—	24.70	20.14	16.96	24.70
12/31/2009	42.60	42.80	29.95	33.48	34.19	72.60	26.08	0.01	1.92	17.96	38.09	72.43	9.70	—	11.92	13.46	11.53	11.58
12/31/2008	-36.98	-34.75	-40.28	-35.00	-34.09	-40.80	29.06	0.01	4.05	23.58	43.98	73.66	7.21	—	10.57	5.73	6.82	12.91
12/31/2007	-0.65	4.11	16.72	1.52	-6.60	-18.98	32.20	0.01	6.77	28.45	48.74	77.03	11.89	—	11.47	14.65	16.19	17.16
12/31/2006	15.87	8.28	11.52	16.26	21.04	22.28	32.37	0.01	8.04	28.91	48.82	76.07	15.65	—	16.68	16.11	22.64	22.81
12/31/2005	5.14	0.38	3.25	12.25	8.58	1.24	31.93	0.02	7.57	28.65	47.65	75.75	15.90	—	21.03	17.06	25.30	16.10
12/31/2004	18.81	11.08	14.00	20.25	23.25	25.49	31.41	0.01	6.08	28.17	47.61	75.21	10.22	—	13.89	12.94	11.86	12.41
12/31/2003	50.10	56.52	50.07	40.29	45.80	57.81	32.77	0.04	7.06	29.76	49.44	77.56	11.43	—	16.18	11.79	15.92	13.27
12/31/2002	-18.83	-37.19	-31.60	-15.29	-2.94	-7.13	31.85	0.04	6.46	28.29	48.27	76.18	18.78	—	18.18	25.48	26.29	23.97
12/31/2001	4.74	-12.75	-1.69	5.54	13.29	19.29	32.06	0.04	6.27	28.86	50.14	74.99	12.30	—	12.66	14.49	12.77	21.56
12/31/2000	1.37	-28.63	-4.92	2.13	20.89	17.41	31.63	0.05	6.26	29.39	49.18	73.26	10.27	—	10.42	2.85	15.46	22.64
12/31/1999	33.46	76.61	48.11	7.67	15.81	19.10	36.14	0.24	12.19	35.74	52.27	80.27	15.86	—	8.94	10.63	19.04	24.83
Average	11.53	10.94	9.77	9.66	12.39	14.90	30.70	0.03	5.78	26.20	45.94	75.53	13.23	—	14.71	14.66	17.61	18.37
Note	Q1 generated highest returns						Small cap leverage relatively consistent over time						Q1 exhibited highest rate of deleveraging					

Last 20 Years	Successful Deleveraging Return %						Unsuccessful Deleveraging Return %						*FCF Screen Deleveraging Rate Improvement %					
Year	Total	Q5	Q4	Q3	Q2	Q1	Total	Q5	Q4	Q3	Q2	Q1	Total	Q5	Q4	Q3	Q2	Q1
12/31/2018	8.50	—	-4.60	28.90	9.43	0.26	-12.48	0.17	2.10	-18.04	-21.71	-25.32	1.09	—	-0.19	0.72	1.73	3.17
12/31/2017	42.32	—	36.21	52.44	43.09	37.53	14.92	33.02	19.60	9.83	6.27	10.90	0.09	—	2.14	-2.45	1.27	-0.51
12/31/2016	40.85	—	-8.82	40.14	48.20	83.86	11.95	4.19	3.82	12.80	19.28	23.55	1.39	—	0.12	0.54	0.69	5.59
12/31/2015	9.05	—	-14.39	12.00	16.64	21.96	-8.35	0.34	0.48	-5.65	-14.64	-24.42	3.13	—	0.32	-0.20	1.98	13.57
12/31/2014	23.50	—	10.51	39.89	21.63	21.99	1.28	7.81	-1.48	0.52	1.75	-2.31	2.10	—	-1.23	0.73	5.80	5.20
12/31/2013	72.18	—	34.27	81.88	88.86	83.70	40.45	47.72	39.36	38.90	37.47	43.14	0.95	—	1.27	-2.01	-2.32	7.83
12/31/2012	26.48	—	8.88	15.63	25.73	55.69	13.53	8.37	10.72	15.68	11.30	25.95	1.25	—	2.69	-1.16	0.33	4.40
12/31/2011	8.16	—	-2.30	-3.17	17.57	20.54	-5.30	-7.12	3.20	-3.27	-7.28	-9.44	1.62	—	1.04	-1.90	1.46	7.48
12/31/2010	46.85	—	21.60	35.53	62.26	67.99	27.05	37.78	24.60	20.99	25.29	25.32	1.36	—	1.17	1.33	1.45	2.87
12/31/2009	94.70	—	34.01	30.09	108.48	206.23	31.93	42.80	29.40	34.01	24.50	55.09	0.37	—	0.44	1.02	0.33	0.07
12/31/2008	-14.75	—	-44.10	-34.69	18.97	0.81	-38.54	-34.75	-39.83	-35.02	-37.98	-46.97	-1.00	—	0.40	-2.60	-0.27	-2.50
12/31/2007	24.05	—	24.12	26.06	38.24	7.80	-4.12	4.11	15.76	-2.69	-15.27	-24.52	1.79	—	0.28	1.28	-0.51	7.89
12/31/2006	35.38	—	11.83	31.28	54.43	43.98	13.12	8.28	11.45	13.37	11.27	15.87	2.25	—	-1.29	4.72	-0.19	8.00
12/31/2005	25.54	—	16.56	29.67	26.64	29.29	1.55	0.38	-0.29	8.67	2.47	-4.14	-0.92	—	2.73	-14.77	0.00	7.47
12/31/2004	41.29	—	12.93	40.53	50.99	60.70	16.23	11.08	14.17	17.23	19.52	20.50	-0.76	—	1.04	-4.52	-0.23	-0.11
12/31/2003	85.25	—	46.24	71.20	89.17	134.39	45.07	56.52	50.81	36.16	37.58	46.09	1.98	—	3.67	-0.28	1.81	4.70
12/31/2002	0.06	—	-30.97	6.07	11.06	14.08	-22.03	-37.19	-31.75	-22.59	-7.93	-13.82	3.23	—	2.27	-5.41	10.69	8.59
12/31/2001	45.69	—	39.23	32.18	58.88	52.46	-0.64	-12.75	-7.62	1.03	6.62	10.18	4.79	—	-2.86	2.85	4.70	19.27
12/31/2000	82.83	—	47.03	85.68	122.90	75.72	-10.96	-28.63	-10.96	-0.32	2.23	0.35	-1.58	—	-3.85	-0.55	-8.12	4.60
12/31/1999	76.63	—	66.31	100.91	70.11	69.17	29.37	76.61	46.32	-3.42	3.04	2.56	1.85	—	1.84	3.78	1.71	1.92
Average	38.73	—	15.23	36.11	49.16	54.41	7.20	10.94	8.99	5.91	5.19	6.43	1.25	—	0.60	-0.95	1.12	5.47
Note	Q1 saw highest benefit from successful deleveraging						Q5 and Q4 least impacted by unsuccessful deleveraging						Q1 exhibited highest improvement from FCF screen					

12/31/18	Russell 2000 Market Cap Weighted Sector Exposure % by Leverage Quintile										Trailing Returns % by Leverage Quintile				
	Com Serv	Cons Disc	Cons Stap	Energy	Health	Indust	Info Tech	Mats	Utilities	Fin Serv	1 Year	3 Years	5 Years	10 Years	20 Years
Q1	12.50	21.02	4.35	13.08	7.02	21.52	6.36	6.91	7.22	—	-20.37	7.47	1.59	16.85	11.39
Q2	4.97	14.29	5.67	8.15	8.37	21.25	14.68	8.01	14.61	—	-15.6	6.48	2.94	12.69	10.52
Q3	1.91	16.55	1.49	3.30	19.41	28.91	21.18	5.70	1.56	—	-12.9	5.54	4.29	12.58	8.01
Q4	4.33	15.72	4.95	1.51	37.41	10.59	23.15	2.28	0.05	—	1.33	7.81	4.42	11.99	7.22
Q5	4.11	14.29	6.84	2.12	35.80	9.16	26.98	0.61	0.08	—	0.17	11.55	8.47	15.95	7.04
Total	5.56	16.38	4.66	5.63	21.60	18.28	18.47	4.70	4.70	—	-9.76	7.67	4.34	13.73	9.02

Source: Bloomberg. As of December 31, 2018.

Past performance is no guarantee of future results. Leverage Calculation Methodology: Total debt to total capital, ex financial sector. *Deleveraging Improvement: Improvement to "% of companies successful deleveraging" with a FCF/Debt ratio >5% company screen.

Appendix B

Leveraging and deleveraging impacts to Russell 2000 Index, as measured by quintile movements

20 Yrs	Russell 2000 Annual Return % by Start and End Leverage Quintile, Calendar Year Rebalance																				Summary		
Start / End	2018	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999	Year Count	Avg Return	CAGR
1 / 1	-25.32	10.90	23.55	-24.42	-2.31	43.14	25.95	-9.44	25.32	55.09	-46.97	-24.52	15.87	-4.14	20.50	46.09	-13.82	10.18	0.35	2.56	20	6.43	3.08
1 / 2	0.51	35.77	83.86	22.46	21.45	82.55	57.40	24.50	67.99	146.80	0.81	8.07	40.51	26.08	58.01	119.88	12.39	50.22	75.72	26.33	20	48.07	43.60
1 / 3	2.90	101.90	—	-4.31	272.62	125.11	—	-45.32	—	1167.86	—	—	129.18	—	89.29	247.49	32.02	242.26	—	443.46	13	215.73	127.12
1 / 4	—	—	—	—	—	—	—	—	—	—	—	—	—	92.88	—	454.58	7.66	—	—	—	3	185.04	125.82
1 / 5	-25.08	—	—	—	—	—	-69.38	—	—	—	—	-15.51	—	21.26	—	469.50	—	—	—	—	5	76.16	6.00
2 / 1	-47.76	-33.32	-0.65	-36.14	-32.15	11.77	-12.95	-40.55	-6.43	0.91	-68.74	-42.88	-3.17	-17.19	1.88	24.04	-45.66	-18.97	-36.68	-29.39	20	-21.70	-25.31
2 / 2	-17.25	11.64	21.94	-8.31	2.78	40.28	16.34	-3.27	29.13	34.47	-28.17	-8.26	12.29	1.84	21.94	35.76	-2.87	9.80	26.80	-7.79	20	9.46	7.84
2 / 3	9.43	38.60	48.20	16.87	22.63	90.70	25.73	18.01	65.02	113.41	19.29	40.71	53.44	28.73	51.18	91.59	9.65	57.43	129.11	43.12	20	48.64	45.24
2 / 4	—	174.90	—	—	9.22	—	—	-2.54	7.19	62.58	—	-1.69	62.33	41.58	—	67.83	60.51	94.35	45.25	283.08	13	69.58	56.42
2 / 5	—	—	—	2.86	3.56	47.18	—	—	3.15	—	7.39	-16.39	65.89	-19.59	27.10	48.03	—	—	-13.31	—	11	14.17	11.02
3 / 1	-56.97	-64.22	-30.63	-41.64	-56.47	-7.30	19.86	-37.55	-2.20	-34.06	-74.85	-55.61	-43.59	-25.81	-30.03	12.03	-79.94	-38.22	-71.27	-48.66	20	-38.36	-44.35
3 / 2	-37.33	-4.62	-16.54	-27.35	-18.51	23.19	-2.04	-15.89	-6.26	5.17	-52.76	-22.87	-0.74	-6.24	-11.24	15.81	-46.76	-15.74	-25.11	-27.11	20	-14.65	-16.81
3 / 3	-7.38	10.88	21.79	-0.63	7.78	42.51	16.37	-3.65	28.03	41.20	-24.45	5.25	17.33	9.81	23.28	34.81	-13.39	8.11	20.36	2.23	20	12.01	10.67
3 / 4	31.17	55.06	42.95	8.90	36.70	88.40	16.98	-1.32	43.45	31.78	-31.98	33.34	32.66	34.07	43.98	69.67	7.64	36.10	93.85	106.82	20	39.01	35.12
3 / 5	3.25	33.64	-3.65	26.40	78.50	50.53	10.38	-6.66	16.34	26.39	-46.64	-15.55	17.21	13.78	11.10	90.57	-5.78	-8.76	-27.17	-30.29	20	11.68	6.90
4 / 1	-70.24	-50.72	-60.19	-33.26	-35.57	-40.27	53.58	-56.36	-58.96	19.42	-83.92	-82.94	—	46.57	39.01	19.10	-72.75	-51.19	-74.44	-47.35	19	-33.71	-46.95
4 / 2	-45.51	-15.51	-16.32	-23.06	-37.37	34.66	-9.21	-14.92	-37.84	5.01	-60.01	-21.67	-9.26	-13.04	-4.71	17.39	-64.51	-45.55	-61.50	-45.74	20	-23.43	-27.99
4 / 3	-26.06	4.36	-3.10	-12.10	-10.54	19.46	9.37	-13.47	1.18	5.75	-44.06	-7.03	-9.11	-6.92	20.53	27.97	-42.25	-18.26	-26.83	-15.28	20	-7.32	-9.32
4 / 4	5.79	26.15	6.43	-0.46	3.18	45.49	8.59	0.07	28.57	32.39	-34.30	13.58	10.25	2.22	10.82	49.98	-29.21	-1.94	2.63	19.72	20	10.00	8.02
4 / 5	-4.60	36.21	-8.82	-14.39	10.51	34.27	8.88	-2.30	21.60	34.01	-44.10	24.12	11.83	16.56	12.93	46.24	-30.97	39.23	47.03	66.31	20	15.23	11.71
5 / 1	-80.64	5.74	-30.95	-65.21	-60.19	—	13.95	-9.91	—	62.03	-76.38	-61.22	—	-39.33	-36.74	105.22	-79.98	—	-97.45	-21.75	16	-29.55	-51.50
5 / 2	-38.15	14.72	-38.87	-20.21	9.92	20.95	-3.20	-27.91	25.22	28.76	-69.55	-15.92	-24.73	-45.38	-27.45	32.13	-45.95	-25.99	-76.08	-42.29	20	-18.50	-25.35
5 / 3	-25.58	16.49	-0.45	-0.70	4.27	52.73	7.53	-22.69	21.27	70.89	-12.49	3.32	0.22	-0.76	31.49	40.75	-37.68	-6.99	-41.69	-23.48	20	3.82	0.06
5 / 4	-6.69	62.65	22.63	-0.49	8.54	54.21	2.87	-11.38	32.16	46.12	-47.19	5.17	3.78	9.31	4.46	65.52	-36.94	-30.54	-67.11	0.51	20	5.88	-0.75
5 / 5	-0.24	26.07	0.31	4.24	5.09	42.29	9.39	-3.61	36.68	36.64	-35.12	-2.72	9.40	-1.41	9.44	47.68	-36.33	-10.67	-23.94	62.47	20	8.78	5.64

20 Yrs	Russell 2000 # of Companies by Start and End Leverage Quintile, Calendar Year Rebalance																				Summary	
Start / End	2018	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999	Company Count	Company Average
1 / 1	197	201	191	187	207	213	198	201	195	171	120	232	216	218	237	222	211	207	174	176	3974	198.70
1 / 2	32	35	43	42	40	37	41	45	54	27	16	49	55	38	29	40	56	55	44	44	822	41.10
1 / 3	1	2	—	1	1	1	—	2	—	2	—	—	3	—	3	4	3	1	—	6	30	1.50
1 / 4	—	—	—	—	—	—	—	—	—	—	—	—	—	2	—	1	3	0	—	—	6	0.30
1 / 5	1	—	—	—	—	—	1	—	—	—	—	1	—	1	—	1	—	—	—	—	5	0.25
2 / 1	45	28	33	46	42	31	44	42	27	67	84	60	40	45	49	54	50	36	73	70	966	48.30
2 / 2	160	176	165	168	173	178	168	168	172	144	122	184	171	170	202	187	173	178	131	152	3342	167.10
2 / 3	59	46	59	57	45	48	55	59	55	36	16	45	59	57	38	57	66	39	33	49	978	48.90
2 / 4	—	4	—	—	1	—	—	3	1	2	—	2	4	3	—	2	4	3	1	6	36	1.80
2 / 5	—	—	—	1	4	2	—	—	2	—	1	1	2	4	1	2	—	—	1	—	21	1.05
3 / 1	6	7	11	15	6	7	4	9	4	5	21	14	6	6	5	4	11	6	25	22	194	9.70
3 / 2	60	37	35	42	41	44	35	39	31	70	80	58	51	46	55	56	38	35	85	72	1010	50.50
3 / 3	163	167	164	155	153	167	156	146	162	143	130	177	170	174	196	187	163	169	125	137	3204	160.20
3 / 4	29	42	45	42	46	33	50	39	36	22	15	37	48	45	36	37	64	40	7	29	742	37.10
3 / 5	3	7	6	11	8	11	14	19	15	10	4	7	4	14	5	4	11	4	1	2	160	8.00
4 / 1	5	2	2	3	2	4	1	1	2	2	7	1	—	4	1	3	2	1	4	5	52	2.60
4 / 2	13	4	12	11	10	6	9	9	2	9	12	12	10	9	9	2	9	4	15	22	189	9.45
4 / 3	33	33	32	34	41	31	29	37	25	47	71	55	31	30	44	34	38	27	66	62	800	40.00
4 / 4	166	164	149	146	139	159	132	155	156	164	151	189	179	159	192	213	150	150	98	144	3155	157.75
4 / 5	32	50	62	61	71	57	76	62	64	36	30	42	41	57	37	44	52	30	21	19	944	47.20
5 / 1	4	1	3	4	2	—	3	2	—	3	4	1	—	3	1	1	1	—	1	3	37	1.85
5 / 2	3	5	6	9	7	7	8	7	3	5	8	6	4	5	7	3	3	4	6	7	113	5.65
5 / 3	9	19	13	11	17	19	22	11	6	16	18	15	6	14	12	12	11	15	18	11	275	13.75
5 / 4	26	28	44	42	41	44	49	54	54	42	58	41	28	40	38	24	36	37	43	40	809	40.45
5 / 5	197	187	187	182	180	186	176	191	177	187	192	224	218	199	232	250	222	204	149	182	3922	196.10

Source: Bloomberg. As of December 31, 2018.

Past performance is no guarantee of future results. Index comparisons have limitations as volatility and other characteristics may differ from a particular investment.
Leverage Calculation Methodology: Total debt to total capital, ex financial sector.

Specialists in capital structure investing

At Penn Capital, we believe that understanding a company's entire capital structure is the best way to identify investment opportunities with the most value. In fact, we've found that managing bond portfolios makes us better equity managers, and vice versa. Employing a fully integrated credit and equity research process, we focus on non-investment grade companies in the micro to mid-capitalization range, where we can take advantage of inefficient security pricing. We are an independent, employee-owned boutique investment management firm based in Philadelphia. We forge our own ideas, we respect hard work, and we are committed to our clients, our staff, and our community.

Contact information:
215-302-1500
info@penncapital.com
www.penncapital.com

Disclosure

As of March 31, 2019, Penn Capital Small Cap Equity strategy inception: 1/1/1994, Source: Bloomberg, FactSet, Morningstar Direct, FTSE Russell, S&P Global Market Intelligence, Cambridge Associates, National Bureau of Economic Research.

Risk Disclosure: Penn Capital Small Cap Equity strategy is subject to the following risks, among others: ETF risk, which is the risk that the strategy is subject to the same risks as the underlying securities in which the ETF invests as well as entails higher expenses than if invested into the underlying ETF directly; foreign securities and ADRs, which involve certain risks such as currency volatility, political and social instability and reduced market liquidity. Investments in REITs may be more susceptible to adverse developments affecting a single project or market segment than more broadly diversified investments. The strategy may invest in convertible securities, which tend to decline as interest rates rise and, because of the conversion feature, tend to vary with fluctuations in the market value of the underlying securities. Small- and mid-capitalization companies may be subject to greater market risks and fluctuations in value than large capitalization companies. Leveraged companies tend to be more sensitive to issuer, political, market and economic developments than the market as a whole. Investing in the stock market involves gains and losses and may not be suitable for all investors. Different types of investments and/or investment strategies involve varying levels of risk, including loss of principal, and there can be no assurance that any specific investment or investment strategy will be suitable or profitable for a client's or prospective client's portfolio.

The subject matter contained herein has been derived from several sources believed to be reliable and accurate at the time of compilation, but no representation or warranty (express or implied) is made as to the accuracy or completeness of any of this information. Under no circumstances should this information be construed as a recommendation or advice. The views expressed herein reflect the professional opinions of the portfolio managers, are as of the date referenced above and are subject to change. Penn Capital does not accept any liability for losses either direct or consequential caused by the use of, or reliance upon, this information.

This document has been prepared solely for informational purposes. The information presented herein is not to be used or considered as an offer or invitation to sell or issue or any solicitation of any offer or invitation to buy securities or other financial instruments, or any advice or recommendation with respect to such securities or other financial instruments. No information is warranted or guaranteed by Penn Capital or its affiliates as to its completeness, accuracy, or fitness for a particular purpose, express or implied. Information presented is subject to change at any time due to market, economic, regulatory or other changes. Any comments or statements made herein may reflect the opinions or commentary of the person(s) who prepared them, and therefore may not necessarily reflect those of Penn Capital. Penn Capital may have issued, and may in the future issue, other communications that are inconsistent with, and reach different conclusions from, the information presented herein. Those communications reflect the assumptions, views, and analytical methods of the person(s) that prepared them. These materials are not intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would subject Penn Capital to any registration or licensing requirement within such jurisdiction. To the extent permitted by applicable law, Penn Capital accepts no liability for any loss arising from the use of the material presented herein. Penn Capital may, to the extent permitted by law, act upon or use the information or opinions presented herein, or the research or analysis on which they are based.

Past performance is no guarantee of future results. Sharpe ratio is the average return earned in excess of the risk-free rate per unit of volatility or total risk. Standard deviation is a measure of the dispersion of a set of data from its mean. Alpha and beta gauges the performance of an investment against a market index or benchmark which is considered to represent the market's movement as a whole. The excess return, adjusted for risk using beta, of an investment relative to the return of a benchmark index is the investment's alpha. Upside and Downside capture indicates the strategy's historic performance when the market increases or declines, respectively. Tracking error is the standard deviation of the difference between the returns of the strategy and its benchmark. The information ratio measures the ratio between excess return and tracking error relative to the benchmark. R squared is a measurement of the correlation between a strategy and its benchmark. The data reported in this document reflects solely the views of Penn Capital as of March 2019. Unless otherwise indicated, any opinions or market observations made are strictly our own. The material presented herein is for informational purposes only and are not meant to provide investment advice and should not be considered a recommendation to buy or sell securities or employ any investment strategy by Penn Capital. You should not assume that any discussion or information provided here serves as the receipt of, or as a substitute for, personalized investment advice from Penn Capital or any other investment professional.

Disclosure

Small Cap Equity Composite January 1, 2009 - present

Year	Small Cap Gross of Fees Return	Small Cap Net of Fees Return	Russell 2000 Index	3 Year Standard Deviation Small Cap	3 Year Standard Deviation Russell 2000 Index	Number of Accounts in Composite	Composite Size (Millions)	Annual Standard Deviation	Firm Assets Under Management (Millions)	Percentage of Firm's Assets
2018	-15.07	-15.55	-11.01	N/A	N/A	5 or fewer	$543.56	N/A	$2,499.82	21.74%
2017	16.68	16.01	14.65	17.28	13.91	7	$726.54	0.06	$3,772.83	19.26%
2016	17.08	16.38	21.31	18.70	15.76	9	$688.86	0.09	$4,980.63	13.83%
2015	-6.62	-7.19	-4.41	16.47	13.96	13	$734.00	0.11	$5,661.47	12.96%
2014	-3.99	-4.63	4.89	14.88	13.12	15	$791.13	0.43	$7,143.46	11.07%
2013	50.00	48.92	38.82	20.69	16.45	13	$337.04	0.35	$6,751.27	4.99%
2012	23.37	22.44	16.35	25.80	20.20	17	$488.61	0.46	$6,353.59	7.69%
2011	-10.13	-10.83	-4.18	31.03	24.99	19	$415.08	1.23	$4,830.89	8.59%
2010	43.44	42.27	26.85	N/A	N/A	20	$424.53	0.37	$4,421.67	9.60%
2009	60.04	58.67	27.17	N/A	N/A	24	$352.89	0.87	$3,430.39	10.29%

Firm Information: Penn Capital Management Company, Inc. ("Penn Capital") is a Pennsylvania based investment advisor registered with the U.S. Securities and Exchange Commission under the Investment Advisers Act of 1940. Penn Capital is a 100% employee owned sub-chapter-S corporation. Penn Capital specializes in managing equity and fixed income portfolios for institutional and high net worth clients. Penn Capital's fully integrated process allows for strong crossover ideas between fixed income and equity, enabling Penn Capital's investment team to become experts in Complete Capital Structure Analysis® of a company. Penn Capital claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS® standards. Penn Capital has been independently verified for the periods January 1, 1994 through December 31, 2017. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The Small Cap Equity Composite has been examined for the periods January 1, 1994 through December 31, 2017. The verification and performance examination reports are available upon request by email to clientservice@penncapital.com. Penn Capital's fee schedule varies based upon the investment style. As disclosed in Penn Capital's Form ADV, Part 2A, the stated fee schedule for all separate Small Cap Equity accounts is 1.00% of assets under management.

Composite Characteristics: The Small Cap Equity Composite is defined to include separate accounts with assets over $1,000,000. These accounts solely invest in equities of U.S. companies with market capitalizations less than $2.5 billion at initial purchase or the maximum market capitalization of the Russell 2000 Index, whichever is greater. The Small Cap Equity strategy seeks positive investment returns that are attainable on a consistent basis by applying a disciplined value-driven investment approach, which capitalizes on fundamental and technical opportunities in the market. The Small Cap Equity Composite was created on December 31, 1992. Effective January 1, 2010, accounts which have a significant cash flow (20% or more on the transaction date) will be removed from their respective composite immediately. The account will be reevaluated monthly and if eligible, will enter their appropriate composite the next calendar quarter's opening. Effective November 1, 2012, accounts are eligible to re-enter the composite at the end of the following month. The Small Cap Equity Composite is comprised of all separate accounts that have been managed by Penn Capital for one full calendar quarter.

Calculation Methodology: The Small Cap Equity composite is shown as total returns, which assumes reinvestment of dividends and capital gains, with no reductions for taxes, presented before the deduction of actual investment advisory fees, calculated in U.S. dollars, and computed on a dollar-weighted-rate-of-return-basis. Performance results have been presented both prior to the deduction of investment advisory fees ("gross of fees") and after the deduction of actual investment advisory fees and all applicable performance fees ("net of fees"). For example, an account with a compounded annual total return of 10% would have increased by 159% over ten years. Assuming an annual advisory fee of 1.0%, this increase would be 137%. Internal dispersion is calculated using the asset-weighted standard deviation of all portfolio that were included in the composite for the entire year. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request. All returns are calculated net of transaction costs and gross of custodial fees and taxes on dividends and interest.

Other Disclosures: To receive a complete list and description of Penn Capital's composites and/or presentations that adhere to the GIPS® standards, contact Client Service by e-mail at clientservice@penncapital.com or write to Client Service at Penn Capital, Navy Yard Corporate Center, 1200 Intrepid Avenue, Suite 400, Philadelphia, PA 19112. The Russell 2000 Index (the "Index") is comprised of the 2,000 smallest companies in the Russell 3000 Index, representing approximately 11% of the Russell 3000 total market capitalization. For comparison purposes, the Index is a fully invested index, which includes reinvestment of income, and its performance has been linked in the same manner as the Small Cap Equity Composite. The returns for this unmanaged index do not include any transaction costs, management fees or other costs. Index returns are not covered by the report of independent verifiers. The 3-year ex-post standard deviation is not presented for either the Small Cap Equity Composite or the Index prior to 2011 because it was not a requirement. The Russell 3000 Index is a market-capitalization-weighted equity index maintained by the FTSE Russell that provides exposure to the entire U.S. stock market. The index tracks the performance of the 3,000 largest U.S.-traded stocks which represent about 98% of all U.S incorporated equity securities. The Russell 2000 Growth Index is comprised of the 2,000 smallest companies in the growth sector of the Russell 3000 Index. The Russell 2000 Value Index is comprised of the 2,000 smallest companies in the value sector of the Russell 3000 Index. The Russell 2000 Factor Index Series is a suite of benchmarks designed to represent the performance of specific factor characteristics. The factors represent common factor characteristics for which there is a broad academic and practitioner consensus, including Defensive, Dividend Growth, Quality, Low Volatility, High Dividend, Dynamic, Momentum, and Comprehensive factors. The Russell Microcap Index includes the smallest 1,000 securities in the small-cap Russell 2000 Index plus the next 1,000 securities. The Russell Midcap Index measures the performance of the 800 smallest companies in the Russell 1000 Index. The Russell 1000 Index is comprised of the 1,000 largest companies in the Russell 3000 Index. The Russell 200 Index is comprised of the 200 largest companies in the Russell 3000 Index. The S&P 500 Index is a capitalization-weighted index of 500 stocks intended to be a representative sample of leading companies in leading industries within the U.S. economy. The Cambridge Associates LLC US Private Equity Index® is a horizon calculation based on data compiled from 1,334 US private equity funds (buyout, growth equity, private equity energy and mezzanine funds), including fully liquidated partnerships, formed between 1986 and 2018.The information contained herein reflects historical performance; no assurances can be given and no inferences should be drawn with respect to any future results that may be achieved by clients of Penn Capital.