Wells Capital Management

Strategy spotlight

Stageline Value Equity

November 2016

Celebrating five years with five reasons to invest in Stageline Small Cap Value Equity

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The Stageline Small Cap Value Equity strategy has one of the most extensive small-cap value histories dating back to 1988. This translates to an extraordinary 28 years of industry knowledge that is built upon rigorous fundamental research on small-cap companies, their management team, competitors, and industry dynamics. The team celebrated another significant milestone this past quarter. The strategy reached a five-year performance history with Lead Portfolio Manager Garth Nisbet, who took the helm in September 2011. Since joining the team, Garth has stayed true to the 28-year-old philosophy of buying underfollowed and unloved small-cap companies. The team focuses on bottom-up fundamentals and layering on risk management both of which lead to strong long-term performance results for investors. In this strategy spotlight, we will provide a brief overview of why investors should have a meaningful allocation towards small-cap companies and more specifically, five reasons to consider Stageline Small Cap Value for the job.

Small companies, big impact

The companies around the world that receive the biggest headlines and largest analyst coverage are typically large-cap listed stocks. In the U.S., the S&P 500 represents a basket of large-cap equities that has a market capitalization range between $2 billion and $600 billion. U.S. large-cap stocks are also more heavily followed by Wall Street analysts, are more liquid, and are often household names well known by investors. From this perspective, it is understandable why U.S. large cap is a popular asset class and serves as the ballast for many U.S. equity portfolios. However, it is worthwhile to note that almost 70% of companies listed in the U.S. are actually small-cap companies, typically in the market capitalization range of $350 million to $5 billion. Investors with no or minimal allocations towards small-caps equities are essentially missing out on more than half of the growth opportunities within the U.S. equity space. Another attractive feature of this asset class is that small companies tend to have substantial inside ownership, which means management teams of these companies have a vested interest in growing the company. Unlike larger companies, the revenues of a small-cap company are more dependent on local drivers and are less susceptible to macro global events and currency risks. Lastly, a significant portion of small-cap companies are significantly underfollowed by Wall Street analysts, some with only three or less analyst coverage. Companies that are neglected provide more room for investors to uncover mispriced opportunities. Investing in those underfollowed and unloved companies is a key hallmark of the Stageline Small Cap Value strategy.

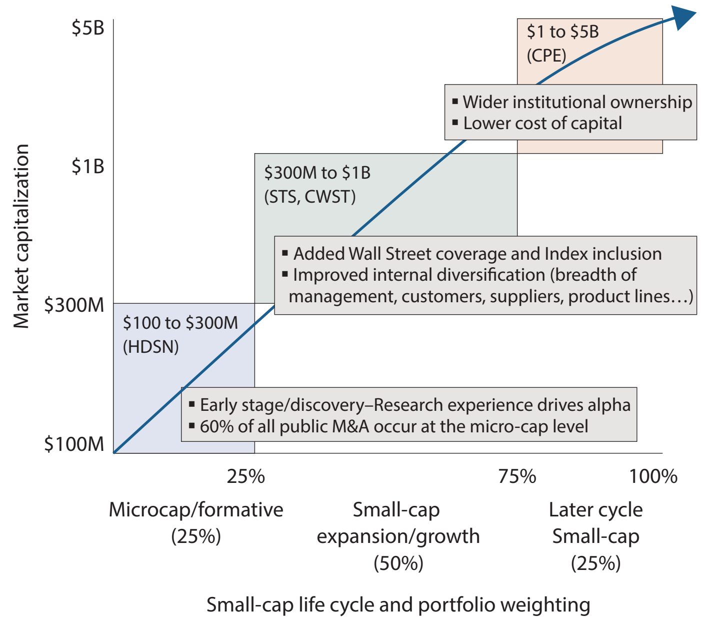
Five reasons to invest in Stageline Small Cap Value Equity

1. Unique stock picks in underfollowed and unloved names

One of the key beliefs for the Stageline team is that neglected companies can provide a unique investment opportunity. These types of companies are typically still in the early stage or formative years, have very low institutional ownership, and low analyst coverage of typically only three to four analysts. The market capitalization of these companies is also usually around $250 million or less, and is considered micro-cap stocks by many. The team believes it has the expertise to find value in this space, as well as across the entire small-cap spectrum. In Figure 1 below, we highlight the different small-cap life cycle stages (i.e., microcap/formative, expansion/growth, and later-cycle phase) that the strategy has exposure to.

Figure 1: Small cap manager with the flexibility to dip down into micro-cap names[1]

Stageline discovery and small-cap life cycle



2. High active share portfolio and low correlation to peers
Since the team believes that neglected companies offer attractive investment opportunities, the strategy invests in companies with an average market capitalization of $500 million, which is significantly lower than the average small-cap value manager at $1.5 billion. The team also targets non-benchmark (or low-benchmark weight) investments. These factors have likely contributed to the strategy's high active share of 96% and also very low excess return correlation of only 0.09 over the past five years with its small-cap value peer group.

3. Consistent alpha driven by stock selection
The team believes that rigorous bottom-up fundamental research should be the foundation of all investment selection decisions. As seen in Figure 3, there are three core alpha drivers that the team looks for when evaluating a company. First and foremost, the company needs to have attractive valuations by selling at a discount but also have strong cash flows. The team also looks for companies that are a quality partner to shareholders which means that the company will have the management, business model, products, and resources to be able to drive organic growth. Lastly, the company should be in a unique position for value creation that might be overlooked by the investment community—in other words a contrarian buy. At purchase, if the company possesses all of the above traits then the investment will generally fall into one of the following investment categories—neglected, oversold, thematic, or earnings turnaround.

Figure 3: Fundamental analysis is a key driver for investment selection

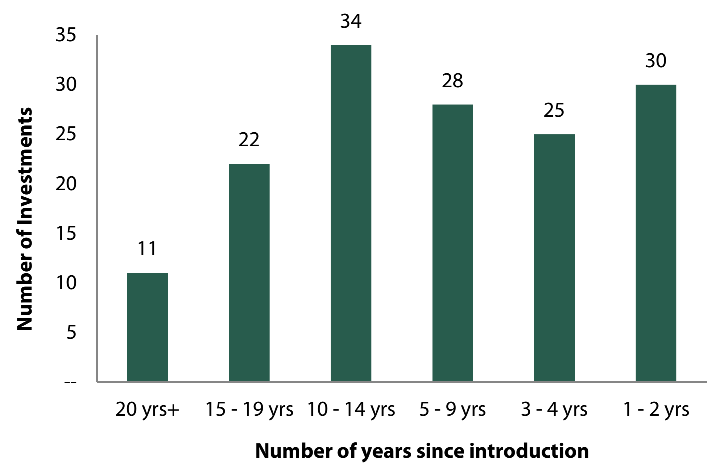
Purchase candidates incorporate three core alpha drivers

Value	Quality partner	Contrarian
Focus is on relative and absolute valuation to identify companies selling at a discount with strong cash flows. Our investment horizon is 3-5 years.	Identify companies that have the management, business model, products and resources that can drive organic growth.	Companies in a unique position for value creation but are not highly valued by the investment community
▪ Low price multiples – forward P/E, P/B ▪ Low enterprise valuations – EV/EBITDA, EV/Sales ▪ Strong cash flow – DCF, FCF yield ▪ Discount to sum-of-parts	▪ Ability to generate revenue and cash flow to reduce debt ▪ High margins or expansion opportunities ▪ Focus with niche expertise or specialization ▪ Strong management with a plan ▪ ESG awareness	▪ Low institutional ownership or recent selling ▪ Bottoming relative strength and valuation ▪ Low expectations ▪ Longer time horizon ▪ Underfollowed and unloved

Neglected, Oversold, Thematic, and Earnings Turnaround

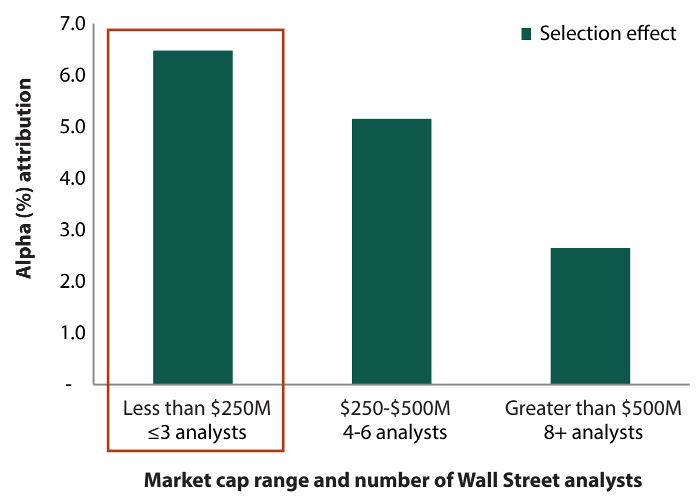
The team is one of the most seasoned teams in the small-cap value space, with an average of 25 years of industry experience among the team's research analysts and portfolio managers. The extensive experience makes the team uniquely positioned to cover a larger universe of investment opportunities without sacrificing research depth. On average, each analyst on the team covers about 30 names at any given point. The majority of these names will not be new to the team since most members have had multiple decades of experience and familiarity with small-cap companies and their management teams (please see Figure 4). On average, the team has covered their current 150 names in their portfolio for an average of nine years. The breadth and depth of research experience combined with the team's disciplined focus on fundamentals have resulted in consistently producing alpha. As seen in Figure 5, the team has been able to produce positive stock selection alpha during all phases of the small-cap life cycle, especially in companies that have been neglected by the investment community (i.e., under $250 million in market cap).

Figure 4: Extensive depth and breadth of research expertise in small-cap companies



Source: Wells Capital Management.

Figure 5: Strong stock selection alpha across all market cap ranges over the past 3-year period



Source: FactSet Research Systems Inc.

4. Choosing to minimize risk in a risky asset class
The team believes diversification is particularly important when investing in small- and micro-cap companies due to the inherent increased volatility of the asset class. The team employs a variety of risk management techniques to build a portfolio that exhibits lower

Figure 6: eVestment universe: Small cap value managers

As 9/30/16	# of managers	3-yr return	5-yr return	3-yr standard deviation	5-yr standard deviation	3-yr Sharpe ratio	5-yr Sharpe ratio
Under 125 names	153	6.97	16.29	13.87	14.67	.52	1.12
Over 125 names	53	8.19	17.23	13.41	14.35	.61	1.20
Stageline Small Cap Value		9.69	18.85	12.51	14.18	.77	1.32
Russell 2000 Value		6.77	15.45	13.77	14.24	.49	1.08

Source: eVestment Alliance. Data shown is gross of fees. Note: The GIPS® compliant presentation can be found at the end of this presentation.

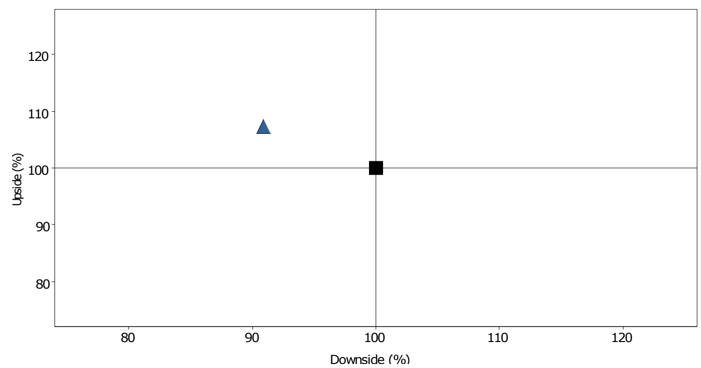
volatility than its benchmark and peers. For example, the team pays careful attention to setting risk budgets, understanding their active risk by limiting unintended risks, and maintaining a beta close to 1.0. In addition, when new positions are initiated in the portfolio, the team prefers to start small and gradually increase the position as their thesis matures and materializes instead of taking outsized positions right away. The result is a well-diversified portfolio of 140-150 holdings which successfully reduces the downside risk of a volatile asset class without sacrificing the upside potential. The data in Figure 6 confirms the strategy has outperformed its small-cap value peers with less risk since the start of the tenure of the lead portfolio manager. It is worthwhile to note that the Stageline Value Equity team has significantly outperformed concentrated managers (i.e., managers with fewer than 125 names in their portfolio). For example, over the three- and five-year periods, the team has outperformed more concentrated managers by more than 250 basis points with substantially less risk. Moreover, by focusing primarily on stock selection, having a diversified approach increases the likelihood of generating repeatable alpha.

5. Consistent, repeatable performance

The strategy's focus on bottom-up fundamentals combined with a meticulous approach to managing risks has delivered tremendous value in both up and down markets. This is evident by looking at the strategy's performance scorecard across a variety of metrics, as seen in Figure 7 and 8.

Figure 7: Strong up/down market capture ratios

5 years ending September 30, 2016

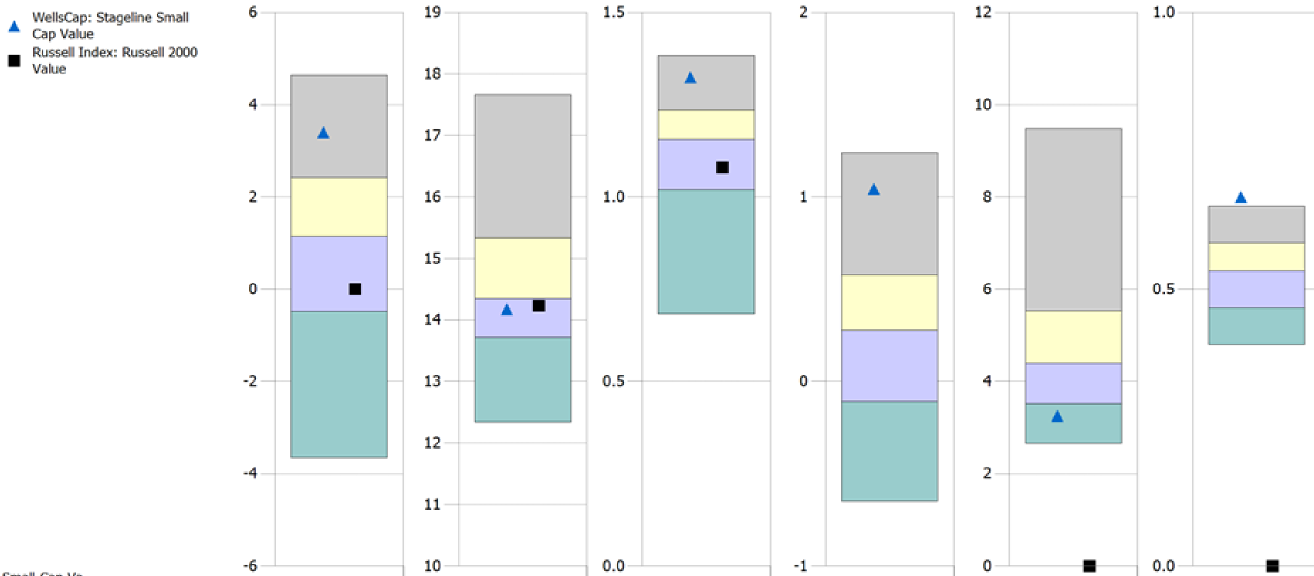


	Up capture vs. market	Down capture vs. market	R-squared vs. market
▲ Stageline Small Cap Value	106.8	90.9	95.4
■ Russell 2000 Value	100.0	100.0	100.0

Source: eVestment Alliance Database via MPI. Data shown is gross of fees. Note: The GIPS® compliant presentation can be found at the end of this presentation.

Figure 8: Delivering top-quartile or top-decile return rankings with below average risk

5 years ending September 30, 2016



Universe:
eVestment US Small Cap Va

	DS	VT	RM	Excess Rtn [1]	Rk	Std Dev	Rk	Sharpe [2]	Rk	IR [1]	Rk	TE [1]	Rk	Bat. Avg. [1]	Rk
5th percentile				4.6		17.7		1.4		1.2		9.5		0.7	
25th percentile				2.4		15.3		1.2		0.6		5.5		0.6	
Median				1.1		14.3		1.2		0.3		4.4		0.5	
75th percentile				-0.5		13.7		1.0		-0.1		3.5		0.5	
95th percentile				-3.7		12.3		0.7		-0.6		2.7		0.4	
# of Observations				237		237		237		237		237		237	
Stageline Small Cap Value	IM	SA	GF	3.4	15	14.2	56	1.3	12	1.0	8	3.3	81	0.7	2
Russell 2000 Value	IM	IX	IX	0.0	68	14.2	55	1.1	67	---	---	0.0	100	0.0	100

Results displayed in US Dollar (USD)

1 Russell 2000 Value; 2 Citigroup 3-Month T-Bill

Source: eVestment Alliance. Data shown is gross of fees. Note: The GIPS® compliant presentation can be found at the end of this presentation.

Stageline Small Cap Value Equity GIPS® compliant presentation

Period	Gross Annual Return (%)	Net Annual Return (%)	Primary Index Return (%)	Composite 3 Yr Std Dev (%)	Primary Index 3 Yr Std Dev (%)	Internal Dispersion (%)	Number of Accounts	Composite Assets ($-mm)	Total Firm Assets ($-mm)
2015	-3.3	-4.3	-7.5	13.03	13.46	0.23	10	103.2	349,342
2014	9.1	8.0	4.2	12.64	12.79	N.A.	9	77.9	351,065
2013	42.4	41.1	34.5	17.36	15.82	0.32	8	62.1	357,113
2012	20.2	19.0	18.1	20.65	19.89	N.A.	8	48.2	332,154
2011	-5.7	-6.7	-5.5	26.84	26.05	0.41	7	121.3	330,855
2010	26.2	24.9	24.5	29.80	28.37	0.25	10	169.2	365,552
2009	39.8	38.4	20.6	27.40	25.62	0.37	23	640.7	363,451
2008	-37.3	-38.0	-28.9	20.25	19.14	0.76	34	572.3	252,048
2007	-8.8	-9.7	-9.8	12.07	12.59	0.36	54	1,270.7	219,912
2006	18.4	17.2	23.5	11.90	12.33	0.64	71	1,763.5	189,100

Primary Index = Russell 2000 Value

1. Wells Capital Management ("WellsCap") claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. WellsCap has been independently verified for the periods from January 1, 1997 through December 31, 2015. 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 Stageline Small Cap Value Equity Composite has been examined for the periods from January 1, 2003 through December 31, 2015. The verification and performance examination reports are available upon request.

2. WellsCap is a registered investment adviser and a wholly owned subsidiary of Wells Fargo Bank, N.A. Since the firm's creation in 1996, the firm has acquired a number of investment teams and/or assets through mergers and acquisitions. These include assets and/or investment teams from Norwest Investment Management Inc., Sutter Advisors, LLC, Montgomery Asset Management, Benson Associates, Strong Financial Corporation, Evergreen Investments, First International Advisors, LLC, Metropolitan West Capital Management, LLC, EverKey Global Partners and ECM Asset Management Limited. In all cases, the investment teams involved in each acquisition and merger remain autonomous teams within WellsCap.

3. The Stageline Small Cap Value Equity Composite ("Composite") (formerly named the Benson Small Cap Value Equity Composite) includes all discretionary accounts over $1 million managed in this style. Prior to October 1, 2012, the Composite excluded taxable accounts. The redefinition reflects the similar management of taxable and non-taxable accounts. Prior to July 1, 2012, the minimum market value for this Composite was $3 million. The strategy seeks to provide capital appreciation by focusing primarily on equity securities of small companies with market capitalization of up to $1 billion. It pursues its objectives by investing in high-quality, small cap stocks with above average growth potential that are either out of favor, relatively undervalued, part of a broader market theme or are earnings turnaround candidates. The strategy is managed without regard to taxes. The objective is to outperform the Russell 2000® Value Index. On June 10, 2010, Mark Cooper, Senior Portfolio Manager (PM), left WellsCap. Dale Benson, Co-PM, transitioned to Senior Portfolio Advisor on February 1, 2009 and back to a Co-PM as of June 15, 2010. Garth Nisbet joined the Stageline Value Equity team as Senior PM on September 19, 2011. Dale Benson retired on December 31, 2012. The Composite creation date is August 1, 1997. The Composite inception date is April 1, 1988.

4. Composite returns are net of transaction costs and non-reclaimable withholding taxes, if any, are expressed in US dollars, and reflect the reinvestment of dividends and other earnings. Gross composite returns do not reflect the deduction of investment advisory fees. Net composite returns are calculated using a model investment advisory fee, which is the maximum annual advisory fee based upon the fee schedule in effect during each respective performance period. Any changes to the fee schedule are reflected in the calculation of the net composite returns beginning with the period in which the fee schedule is revised. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size. The Composite may contain accounts with performance-based fees. WellsCap's fee schedules are available upon request and may also be found in Part 2 of Form ADV. The published fee schedule for this strategy is 1.00% for the first $25mm, 0.90% for the next $25mm, 0.85% for the next $50mm and 0.80% over $100mm. Effective July 1, 2009, the Composite has a Significant Cash Flow (SCF) policy to temporarily remove accounts from the composite. A SCF is defined as a single or series of client initiated net cash flows within a fourteen business day window of either a contribution or withdrawal of cash and/or securities that exceeds 20% of the previous day's total market value of the account. Additional information regarding WellsCap's policies for valuing accounts, calculating performance and preparing compliant presentations are available upon request.

5. Internal dispersion is the equal weighted standard deviation of the annual gross returns of all accounts included in the composite for the entire year. For years where there are 5 or fewer accounts in the composite for the entire year, dispersion is not presented as it is not a meaningful statistical calculation. The 3-year annualized standard deviation measures the variability of the gross composite returns and the index returns over the preceding 36-month time period.

6. Index returns are provided to represent the investment environment existing during the time periods shown and are not covered by the report of independent verifiers. The Russell 2000® Value Index measures the performance of those Russell 2000 small cap companies with lower price-to-book ratios and lower forecasted growth values. The Index is fully invested, which includes the reinvestment of income. The returns for the Index do not include any transaction costs, management fees or other expenses.

7. Actual performance results may differ from composite returns, depending on the size of the account, investment guidelines and/or restrictions, inception date and other factors. Performance for some accounts in this composite may be calculated by third-parties that use different security pricing and performance methodologies. Past performance is not indicative of future results. As with any investment vehicle, there is always the potential for gains as well as the possibility of losses. Our registration as an Investment Adviser does not imply any level of skill or training. For a complete list of WellsCap composite descriptions, please see http://wellscap.com/wfweb/about-us/business-risk-compliance.jsp.

1 Stocks HDSN, CWST, STS and CPE are among Stageline's top ten holdings as of September 30, 2016. This example is a representative holding in our top ten equity holdings list. It is not necessarily owned or sold in all client portfolios. It is provided for illustration purposes only and is not intended nor should be construed to be a recommendation to buy or sell an individual security. It should not be assumed that the recommendations made in the future will be profitable or will equal the performance of the security shown here. Past performance is not indicative of future results. Differences due to restrictions, tax considerations, cash flows and other factors may have impacted the decision to buy and/or sell certain securities at specific times. A list of all recommendations made in the prior one-year period is available upon request.