WESTWOOD FUNDS®

# Westwood Income Opportunity Fund (WWIAX)

A Share Class 2Q17 Commentary

## Investment Objective

The primary investment objective of the Westwood Income Opportunity Fund is to provide current income. A secondary objective of the Fund is to provide the opportunity for long-term capital appreciation.

## Strategy Description

The Westwood Income Opportunity Fund seeks to provide a competitive level of income, along with the opportunity for long-term appreciation by investing in a diversified variety of higher-quality securities. The goal is to find the best relative value and solid dividend or interest paying securities including common and preferred stocks, corporate and government bonds, MLPs (Master Limited Partnership) and REITs (Real Estate Investment Trust).

## Key Highlights

- Volatility remained subdued across most asset classes as markets cheered pro-European Union Emmanuel Macron's victory in the French presidential election. In June, the CBOE's Volatility (VIX) Index had its lowest close since 1993
- Oil prices declined roughly 11% and natural gas prices declined roughly 5%
- The 10-year U.S. Treasury yield declined 0.08% to 2.30%

## Market Overview

Looking back, the stock market produced another solid gain for the second quarter. Large-cap stocks continued beating small-cap stocks and growth stocks outperformed value, which has been the case for both since the beginning of the year. The Federal Reserve (the Fed) raised the benchmark rate in June by 25 basis points as expected, but, also indicated their intent to reduce the size of their balance sheet later this year by not fully reinvesting the proceeds as their bond holdings mature. Taken together, these actions to unwind the Fed's asset purchases, shrinking their balance sheet, and raising extremely low rates put in place after the 2008-2009 financial crisis will continue to shift monetary policy back to more "normalized" levels. Global markets moved higher as economic conditions appeared stable to improving in many areas of the world. Political noise remained high and investors continued to discount meaningful legislative impacts on businesses given the discourse so far this year. Noteworthy, most companies' outlooks were positive as their fundamentals came through strongly during the most recent quarterly earnings season.

## By the Numbers

Several Common Stock holdings saw strong gains during the quarter. For the second consecutive quarter, Oracle featured as one of the top contributors with its shares again reacting positively to further incremental evidence of an inflection point in the company's transition to a cloud-focused strategy. Alexandria Real Estate Equities rose steadily throughout the quarter, aided by lower interest rates together with continued solid operational performance that highlighted the currently favorable environment for the company's niche focus on laboratory space. Shares of Honeywell rose sharply after the company's new CEO - formerly its COO - signaled a better outlook for 2017 after announcing first-quarter results that showed strength across all of the company's segments, including better sales of energy-related products.

Boston Properties declined after reporting underwhelming leasing results that seemed especially lackluster when compared to the record leasing volume the company achieved in the prior quarter. Additionally, concerns over New York City office rent growth, which has ebbed and flowed over the last year, rose again. The pressure exerted on General Mills' shares toward the end of the first quarter carried through to the second quarter on the same reasoning: a combination of weak organic revenue trends, part of which was self-inflicted as a result of lower advertising and marketing spend, together with reduced merger & acquisition speculation. The company continued to achieve good operating margin expansion through cost cuts, which is driving earnings growth. Energy and energy-related names such as Magellan Midstream Partners, Western Gas Partners and General Electric - which recently agreed to merge its oil and gas business with Baker Hughes, thereby creating one of the world's largest oilfield services and equipment companies - saw weakness as both oil and natural gas prices fell meaningfully.

## Summary and Positioning

Looking forward, companies both domestically and abroad are seeing improvements in their fundamental prospects even as political uncertainty remains elevated. While Washington headline noise appears unlikely to abate in the near-term, the more important regime change continues to be progressing as monetary policy becomes less accommodative in conjunction with improving economic indicators. Fundamentally, investors continue to forecast strong earnings growth; the upcoming 2Q17 earnings season for the S&P 500 is expected to be the fourth consecutive quarter of year-over-year improvement after a streak of four declines prior. Given the changes underway from both fiscal and monetary policies, dispersion remains a key watch item as different companies are better situated to cope with the changing landscape. Higher levels of inflation and interest rates should further help to reduce correlations within the equity markets. This should also raise the cost of capital, with high-quality business models being better able to offset the rising costs vs. their lesser peers. We continue to focus on identifying high-quality businesses with undervalued growth prospects and attempt to limit downside

**Summary and Positioning** *(continued)*

risk in order to protect client capital should volatility increase from the low levels seen so far this year.

Our research process continues to find opportunities both across asset classes and within each asset class. As an illustration, we are currently finding the most attractive investment opportunities in high-quality dividend-paying Common Stock, and within that asset class we continue to like exposure to U.S. banks, which we expect should benefit from several tailwinds including easing regulatory burdens and higher interest rates. The flexibility we have to invest across a company's capital structure allows us to target different expected risk-adjusted returns; at times we focus on just a single security, and at other times we supplement exposure to one part of a company's capital structure with another part. As an example, our Common Stock holding in Becton Dickinson - a medical device company that we believe will benefit greatly from its upcoming acquisition of rival C.R. Bard - was recently supplemented with exposure to the company's newly issued Convertible, which offers a substantial yield pickup over the Common Stock together with a high degree of participation in the underlying Common Stock's return.

We maintain modest exposure to government and corporate bonds; we will look for an increase in interest rates, combined with a widening in credit spreads, to create additional opportunities within the fixed income and fixed income-like markets. Our higher-than-normal cash position has continued to help serve as a cushion against market volatility and will give us the ability to acquire assets at more attractive levels as volatility and interest rates normalize.

During the quarter, the team made several changes to the portfolio in an attempt to improve our expected risk-adjusted return. Positions were initiated in a Fannie Mae bond due 2018, in the short-dated Corporate Debt of Aetna, AT&T, Citigroup, Pfizer and PNC Bank, and in the Mandatory Convertible Preferred Stock of Becton Dickinson. Positions were exited in the Common Stock of Time Warner and General Electric, in the Convertible Debt of Microchip Technology, and in the Corporate Debt of Occidental Petroleum. A U.S. Treasury, Fannie Mae, Toyota and United Technologies bond holding each matured.

## 2Q17 Largest Contributors and Detractors

| Five Largest Contributors | Five Largest Detractors |
|---|---|
| Oracle Corp. | Boston Properties Inc. |
| Alexandria Real Estate Equities Inc. | General Mills Inc. |
| Honeywell International Inc. | General Electric Co. |
| Boeing Co. | Magellan Midstream Partners L.P. |
| Abbott Laboratories | Kinder Morgan Inc. Preferred |

## Westwood Income Opportunity Fund – A Share Performance as of 6/30/17

| | | | Annualized | | |
|---|---|---|---|---|---|
| | 2nd Quarter | 1 Year | 3 Years | 5 Years | Since Inception* |
| Westwood Income Opportunity Fund – A Share | 2.01% | 7.02% | 3.56% | 6.92% | 6.94% |
| with 5.00% sales charge | -3.08% | 1.70% | 1.79% | 5.83% | 6.36% |

**Inception date is 12/31/07. The performance data quoted represents past performance. Past performance is not indicative of future results. The investment return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost and current performance may be lower or higher than the performance quoted. Total expense ratio for the Fund is 1.11%. The expense ratio does not reflect the ability of the Adviser to recover all or a portion of prior waivers, which would result in higher expenses for the investor. This option is available contractually to the Adviser until three years after the year in which the Adviser incurred the expense if the recoupment does not exceed the existing expense limitation. The maximum sales charge for the Fund is 5.00%. For performance data current to the most recent month end, please call 1-877-FUND-WHG or visit our website at westwoodfunds.com.*

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## Top 10 Holdings as of 6/30/17*

| | |
|---|---|
| Bank of America Corp. | Comcast Corp. Class A |
| U.S. Bancorp | Home Depot Inc. |
| Oracle Corp. | JPMorgan Chase & Co. Preferred |
| PepsiCo Inc. | Enterprise Products Partners L.P. |
| Honeywell International Inc. | Alexandria Real Estate Equities Inc. |

**Top 10 holdings represent 23.27% of the total portfolio. Holdings are subject to change. Current and future holdings are subject to risk.*

Large cap (sometimes "big cap") refers to a company with a market capitalization value of more than $5 billion. Large cap is a shortened version of the term "large market capitalization." Market capitalization is calculated by multiplying the number of a company's shares outstanding by its stock price per share.

Small cap is a term used to classify companies with a relatively small market capitalization. A company's market capitalization is the market value of its outstanding shares. The definition of small cap can vary among brokerages, but it is generally a company with a market capitalization of between $300 million and $2 billion.

S&P 500 is the Standard & Poor's 500 Index 500 stocks seen as a leading indicator of U.S. equities and a reflection of the performance of the large cap universe, made up of companies selected by economists.

Growth stocks - a growth stock is a share in a company whose earnings are expected to grow at an above-average rate relative to the market. A growth stock usually does not pay a dividend, as the company would prefer to reinvest retained earnings in capital projects. Growth investors choose stocks based on the potential for capital gains, not dividend income, so they can be risky.

*Mutual fund investing involves risk, including possible loss of principal. In addition to the normal risks associated with investing, bonds and bond funds are subject to interest rate risk and will decline in value as interest rates rise. Investments in securities of MLPs involves risk that differ from investments in common stock including risks related to limited control and limited rights to vote on matters affecting the MLP. MLP common units and other equity securities can be affected by economic and other factors affecting the stock market in general, expectations of interest rates, investor sentiment towards MLPs or the energy sector, changes in a particular issuer's financial condition, or unfavorable or unanticipated poor performance of a particular issuer. In addition to the normal risks associated with investing, REIT investments are subject to changes in economic conditions, credit risk and interest rate fluctuations. There is no guarantee that the Fund will achieve its stated objective, which can be found in the prospectus, or that of the strategy.*

***To determine if this Fund is an appropriate investment for you, carefully consider the Fund's investment objectives, risk factors, charges and expenses before investing. This and other information can be found in the Fund's summary or full prospectus, which may be obtained by calling 1.877.FUND.WHG (877-386-3944), or by visiting our website at westwoodfunds.com. Read the prospectus carefully before investing or sending money.***

*This material represents the manager's assessment of the market environment and should not be relied upon by the reader as research or investment advice regarding any security, nor is it intended to be a forecast of future events or a guarantee of future results.*

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