

Investing in Small/Mid Cap Value

A Conversation with GAMCO



What is GAMCO's investment philosophy?

Our value-oriented stock selection process is based on the fundamental investment principles articulated in 1934 by Columbia University professors Benjamin Graham and David Dodd, the forefathers of modern security analysis. In 1977, their ideas were augmented by Mario Gabelli, who founded GAMCO. The academic community credits GAMCO with advancing these ideas and turning them into a discipline called Private Market Value (PMV) with a Catalyst™. At its core is an analytical process that identifies companies selling below PMV, a theoretical price an informed buyer would pay for the entire company.

What is meant by the term catalyst?

The process also focuses on catalysts, potential events that could trigger a narrowing of the spread between the current market price and PMV, either instantly (as in an announced takeover) or more gradually over time. A variety of catalysts can drive changes, including company-specific and industry or regulatory events. GAMCO constantly examines the investment universe to determine which companies are trading with a “margin of safety” or discount to what the entire business could be worth.

How does your research add value to this strategy?

GAMCO's research team does not cover all industries. Rather, it focuses on areas of **core competency** on a global basis and across all capitalizations. Each GAMCO equity analyst is an expert in his/her respective industry, and the firm has accumulated compounded knowledge in the specific industries it has covered over many decades. The research process can best be described as “GAPIC” – Gather, Array, Project, Interpret and Communicate.

Do individual research analysts drive GAPIC?

Yes, and they follow a consistent methodology. First, each analyst **examines** all publicly available filings (10Ks, 10Qs, 8Ks) as well as industry publications to evaluate each company's financial strength. Data then is **arrayed** using a proprietary spreadsheet model that highlights earnings, cash flow and PMV, all **projected** over a five-year period. Finally, analysts develop an in-depth **interpretation** of the company by meeting with corporate management, asking questions focusing on financial results, and understanding management's vision for the company's future. They also frequently meet with the company's suppliers, customers and vendors.

GAMCO is known for expertise in small-cap companies. How do you leverage this expertise in managing investments?

GAMCO's research intensive investment process is a natural fit for coverage of small- and mid-cap companies. GAMCO analysts cover companies globally and are agnostic to market cap. However, since the firm's inception in 1977, it has maintained a strong focus on small-cap companies uncovered by intensive, fundamental research. Small- and mid-cap companies, which are less well followed by Wall Street analysts, have a potentially greater possibility of price inefficiency, which creates value-based opportunities. Within the small- and mid-cap value universe, GAMCO is known for certain themes, sectors and industries in which the firm has accumulated deep knowledge over decades.

What are a few of those themes, sectors and industries?

GAMCO prefers cash-generating “franchise businesses” that can command pricing power over time. We have a core competency in the consumer staples, consumer discretionary and industrial sectors. GAMCO is also known for its ability to identify catalysts, particularly mergers and acquisitions.

What specific types of catalysts have you identified lately?

Recent catalysts include company repurchases of shares, sale or spin-off of divisions, changes in management, regulatory changes, industry consolidations, and company takeovers. Also, companies are using financial engineering as a tax-efficient way of surfacing value. Global merger and acquisition activity has been strong and gained momentum recently with the lowering of the corporate tax rate. High cash levels on corporate balance sheets, low interest rates, and high stock prices provide an attractive backdrop for deal activity. The smaller and mid-size companies GAMCO covers are natural beneficiaries of a robust merger and acquisition environment.

What specific global macro trends do you believe will drive profitable investment opportunities in the years to come?

While focusing on bottom-up fundamental research of individual companies, GAMCO also takes a step back to identify themes that may provide fertile ground for investment over the long term. One recent example has been a focus on health and wellness in the food and beverage industry. GAMCO has also maintained a strong focus on media investments since the firm's inception in 1977, and more recently a focus on live entertainment and experiences and companies focused in the companion pet market.

What big-picture themes do you see in the future?

We are focusing on a unique theme that we call The Aging of Cars, Trucks, Aircraft and People. Infrastructure investing, which includes investment in bridges, toll roads, airports, pipelines, utility towers, and educational and healthcare facilities, has been a core competency of the research team for three decades. Now, investments in new infrastructure assets are becoming a more popular investment choice because of the imminent need and increased focus on shoring up the country's roads, bridges and airports. At GAMCO, the research team works to identify companies that will benefit from this trend of rebuilding the country's infrastructure.

GAMCO also believes that the issue of sustainability will be the greatest global challenge facing companies in coming years. The firm's analysts are evaluating the issues, changes and implications that companies will face as the world's population grows beyond 10 billion people by 2050 who will need 50% more food, 45% more energy, and 30% more water. Companies that successfully address these challenges and adapt to conserve resources may sustain greater long-term profitability and deliver superior returns.

Morningstar categorizes the 1290 GAMCO Small/Mid Value Fund as Small Cap BLEND though the name says VALUE. Can you explain the difference?

Morningstar uses their own definition of what comprises value and what comprises growth.

In small cap value, for example, value is defined based on low valuations (low price ratios and higher dividend yields) and slow growth (low growth rates for earnings, sales, book value and cash flow). Screening for any of these metrics is not part of our investment process.

Our valuation methodology focuses on earnings, private market value, and free cash flow over time (operating cash flow minus capital expenditures), not just in a current snapshot. We invest in companies trading at a discount to what we think an expert would pay to own the entire company (PMV), and then identify a catalyst that will help narrow the discount.

We are long term holders of stocks, resulting in very low turnover for the portfolios. As such, Morningstar periodically re-evaluates the portfolios based on their definition of value. At time of purchase, value portfolio holdings have certain characteristics that might change over time. As the stock price, earnings, and other metrics change, the same holding might gravitate from "value" to "blend" or "growth" in the Morningstar characterization.

As a firm, we have accumulated compounded research knowledge of certain industries over long periods of time. That focus and intensity results in the portfolio looking quite different from the index.

Q&A with Regina M. Pitaro, Managing Director, GAMCO Investors, Inc.

Regina M. Pitaro joined GAMCO Investors, Inc. in 1984 and has served in senior level positions in Marketing and Client Relations. Ms. Pitaro made significant contributions to the development and success of the firm's Merger Arbitrage strategy including authoring one of only three books on the subject entitled *"Deals...Deals...and more Deals."* Prior to joining GAMCO, she worked as an analyst for Lehman Brothers. Ms. Pitaro holds an MBA in Finance from Columbia Graduate School of Business and an MA in Anthropology from Loyola University of Chicago.

Risks

An investor should consider the investment objectives, risks, charges and expenses of the Fund carefully before investing. To obtain a prospectus containing this and other information, please call 1-888-310-0416 or download the file from www.1290funds.com. Read the prospectus carefully before you invest.

Investing involves risks, including loss of principal. The funds are new with limited operating history.

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Funds that emphasize investments in small cap companies generally experience greater price volatility.

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