AMG GW&K Small Cap Core Fund

COMMENTARY | ASSET CLASS | SMALL CAP

Class N | GWETX | Class I | GWEIX | Class Z | GWEZX

GW&K INVESTMENT MANAGEMENT

Average Annual Returns (%)[1] (as of 09/30/21)

	Q3	YTD	1 yr	3 yr	5 yr	10 yr	Since Incpt.
GWETX (Class N)	-0.23	16.38	46.21	12.85	14.16	14.90	9.13[2]
GWEIX (Class I)	-0.14	16.66	46.69	13.25	14.56	15.34	14.95[3]
GWEZX (Class Z)	-0.11	16.73	46.77	13.30	—	—	13.54[4]
Russell 2000® Index	-4.36	12.41	47.68	10.54	13.45	14.63	8.99[2]

GWETX (Class N) Expense Ratio (Gross/Net): 1.30%/1.30%
GWEIX (Class I) Expense Ratio (Gross/Net): 0.95%/0.95%
GWEZX (Class Z) Expense Ratio (Gross/Net): 0.90%/0.90%

The performance data shown represents past performance. Past performance is no guarantee of future results. Current performance may be lower or higher than the performance data quoted. The investment return and the principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. For performance information through the most recent month end, please call 800.835.3879 or visit our website at amgfunds.com.

The **AMG GW&K Small Cap Core Fund** (Class N) returned -0.23% for the third quarter of 2021, compared with -4.36% for its benchmark, the Russell 2000® Index. For the 12 months ending September 30, 2021 the Fund returned 46.21%, while the benchmark returned 47.68%. Please note that this Fund has multiple share classes.

The harder they come, the harder they fall. While AMC Entertainment (AMC) and other meme stocks would have seemingly little connection to the 1972 Jimmy Cliff song and movie of the same title, the third-quarter stock market action provides an unlikely and unexpected link. Struggling to build something out of nothing, the meme stock group came at markets hard with outsized moves in January and May/June of this year. A few traders made a huge payday and many more joined the game seeking easy wins, not realizing the structure of an investment bubble meant the odds were stacked against them. Ultimately, these stocks must fall, as the weight of their inflated size becomes too great to maintain or expand. AMC experienced that hard fall in the third quarter, dropping -33%, with many other meme stocks following in direction if not in magnitude. Most traders involved in the space will come away with nothing, and some may lose their shirts. Like the hero early in the film, these traders are operating in a system they don't fully understand, and this system seems stacked against them. Investment success is much more likely when one takes a long view. Investors fall hard when they attempt strategies looking for quick and easy success.

For the small cap universe overall, the third quarter was similarly negative. While AMC lost a third of its value, the Russell 2000® Index merely declined -4.4% and lagged large caps. Small cap growth underperformed small cap value in the quarter by almost 270 basis points as cyclicals and financials generally performed better than areas of stable or speculative growth. The high for the Russell 2000® during the quarter was on July 1 and the Index has made no progress since early February. Investors of all types might be asking what exactly the problem is with U.S. small caps. We will attempt to offer a more complete answer, but in some ways the meme stock influence has been a weight on the benchmark. U.S. small caps were bid up as a marker for domestic cyclical growth coming off the pandemic lows, and speculative furor made its greatest impact down market cap. Some of these gains needed to be digested or wrung out. AMC itself was responsible for over 6% of the decline in the Russell 2000® in the third quarter, with many other smaller memes pitching in as well. Meanwhile, outside of this meme world, a lot of strong businesses are seeing robust demand and delivering excellent earnings results. Earnings revisions remain very strong in the Fund, with the upward to downward revision ratio at 2.35x. So while the Index appears to make no progress, its quality and valuation support is improving.

Digging more into the benchmark components for the quarter, we observe the inverse relationship between the meme stocks and higher-quality companies. For the third quarter, quality as defined by stocks with positive earnings, a history of earnings, higher ROE, and dividend payers all outperformed the Index. In fact, taking non-earners out of the benchmark would have reduced the decline of the Russell 2000® to only -90 basis points. On the sector side, higher oil and natural gas prices pushed the energy sector to the top position. Financials also ended the quarter positively, helped by earnings support and a hope for higher spreads between short and long interest rates. Real estate, industrials, and information technology were all outperformers although slightly negative on the quarter. Communication services was the worst performing sector, dragged

[1] Returns for periods less than one year are not annualized.
[2] Since the inception of the Fund's Class N shares on December 10, 1996.
[3] Since the inception of the Fund's Class I shares on July 27, 2009.
[4] Since the inception of the Fund's Class Z shares on February 24, 2017.

lower by AMC and other stocks with limited earnings or cash flow support. Health care was hurt by its exposure to high secular growth stocks with a similar lack of earnings support. Consumer discretionary, materials, and consumer staples were also lackluster performers.

The Fund outperformed amid this environment. Stock selection broadly was excellent, with particular strength in information technology, consumer discretionary, and health care. Strength in the information technology sector was primarily from the software industry. While the benchmark return there was essentially zero, Paylocity Holding, Paycor HCM, Rapid7, Inc., and Descartes Systems Group all meaningfully outperformed. Endava Plc and Novanta also saw strong demand trends and benefited from expanding valuations. Within consumer discretionary the fund had three holdings up double-digit percentages: these included Churchill Downs, Patrick Industries, and Skyline Champion, with Patrick and Skyline in particular benefiting from rising earnings estimates after reporting strong quarters. Boot Barn also outperformed its retail peers. In the health care sector, the largest contributor came from our underweight in biotechnology. This industry within the Index lost nearly -11% in the quarter, echoing the weakness for non-earners in the benchmark. Outside of this allocation benefit, Veracyte Inc., ICU Medical, CryoPort Inc., and Phreesia also generated positive returns. Other outperforming sectors included materials, energy, and financials. The only modest underperformance came from industrials, where three stocks declined double digits (Primoris Services Corp, US Ecology, and SPX Corp.) and two others lost about -8% (UFP Industries Inc. and Alamo Group, Inc.). Nevertheless, the negative impact was only 11 basis points of relative performance. Looking at relative performance through a factor lens, the allocation in the Fund toward higher quality stocks helped results by about 90 basis points as an average across six factors, with earnings being the most predominant factor.

On the trading front, it was a quieter quarter with more active work on intra portfolio adds and trims vs. new buys or full sells. Two new holdings added this quarter were SPX Corp. and Paycor HCM. SPX is a manufacturing company with two main segments, and management has been transitioning the company toward higher growth, higher margin business lines. We believe these changes will allow for stronger out-year earnings power and a consistently higher stock multiple. Paycor HCM is a software business that recently went public. Its cloud-based human capital management products have high growth and retention rates and the company should be able to take share for many years in the <200-employee market segment. In addition to these two buys, we added to Halozyme Therapeutics twice to build out the position further after strong results but general stock malaise. We also added to smaller positions that were initiated last quarter, Open Lending and Matador Resources, and bumped up SPX Corp near September's end. In an unusual circumstance, we trimmed and then added back to two different stocks during the quarter. Endava was trimmed first due to position size and valuation and then a third time due to an announced delay in their filing. After talking with management post quarter, we added back a portion of what we had trimmed, as fundamentals remain solid and we had confidence the filing delay was not likely to repeat. Similarly, we trimmed RBC Bearings after it announced a great acquisition and the stock responded more favorably than expected. Later, as it issued equity to pay for the deal, the drop in price gave us a chance to rebuild the position. We also trimmed six other stocks during the quarter with a general goal of reducing overall portfolio market cap or repositioning after periods of relative stock outperformance. We also sold QTS Realty, as it was acquired.

As mentioned above, the U.S. small cap market hasn't made much notional progress since early February of this year. While the composition of the benchmark is improving in both quality and valuation with the hard fall of meme and other low quality stocks and continued earnings strength from many other components, there are still a great many uncertainties for investors to consider. Or as Jimmy Cliff would say, there are Many River to Cross (amazingly, the B-side for the single The Harder They Come). The metaphorical rivers here include some waning fiscal support for the domestic economy, the partisan and even intra-party roadblocks in Washington, potential for Federal Reserve tapering or a market tantrum off of Fed speak or policy, supply-chain shortages and challenges, and what appears to be an increasing acceptance of higher input prices, from commodities all the way up the value chain to labor. Will rising prices and interest rates result in a sudden change in the valuations investors are willing to pay for stocks? Could Delta or some other unknown variant change the calculus on our recovery from the pandemic? And we haven't even talked about China yet, which as the second largest economy in the world has domestic and foreign policy issues that could damage our best assumptions about future economic activity and corporate profits. Our conversations with small cap companies reveal demand that is still robust and creative thinking and innovation that can help circumvent many of these fundamental challenges. The risk of larger macro changes is always here. There are always rivers to cross. If we take the long view and avoid meme shortcuts, we believe our probability of investment success will increase meaningfully.

The views expressed represent the opinions of GW&K Investment Management as of September 30, 2021, are not intended as a forecast or guarantee of future results, and are subject to change without notice.

Top Ten Holdings (%)[5] (as of 09/30/21)

Holding	% of Net Assets
Skyline Champion Corp	2.24
Texas Roadhouse Inc, Class A	1.98
Medpace Holdings Inc	1.88
Brooks Automation Inc	1.87
Avient Corp	1.80
MACOM Technology Solutions Holdings Inc	1.75
Rapid7 Inc	1.75
STAG Industrial Inc	1.73
Globus Medical Inc, Class A	1.69
Phreesia Inc	1.68
TOTAL %	18.37

Disclosure

Investors should carefully consider the fund's investment objectives, risks, charges, and expenses before investing. For this and other information, please call 800.835.3879 or download a free prospectus. Read it carefully before investing or sending money.

Past performance is no guarantee of future results.

Market prices of investments held by the Fund may fall rapidly or unpredictably due to a variety of economic or political factors, market conditions, disasters or public health issues, or in response to events that affect particular industries or companies.

The Fund invests in growth stocks, which may be more sensitive to market movements because their prices tend to reflect future investor expectations rather than just current profits. Growth stocks may underperform value stocks during given periods.

The Fund is subject to risks associated with investments in small-capitalization companies, such as erratic earnings patterns, competitive conditions, limited earnings history, and a reliance on one or a limited number of products.

The Fund invests in value stocks, which may perform differently from the market as a whole and may be undervalued by the market for a long period.

The Russell 2000® Index is composed of the 2000 smallest stocks in the Russell 3000® Index and is widely regarded in the industry as the premier measure of small-cap stock performance.

The Russell 2000® Growth Index measures the performance of the Russell 2000® companies with higher price-to-book ratios and higher forecasted growth values.

The Russell 2000® Value Index is an unmanaged, market-value weighted, value-oriented index comprised of small stocks that have relatively low price-to-book ratios and lower forecasted growth values.

Unlike the Fund, the indices are unmanaged, are not available for investment, and do not incur expenses.

Any sectors, industries, or securities discussed should not be perceived as investment recommendations. Any securities discussed may no longer be held in the Fund's portfolio. It should not be assumed that any of the securities transactions discussed were or will prove to be profitable, or that the investment recommendations we make in the future will be profitable.

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[5] Mention of a specific security should not be considered a recommendation to buy or a solicitation to sell that security. Holdings are subject to change.