Q2 | 2020 AMG River Road Long-Short Fund

COMMENTARY | ASSET CLASS | ALTERNATIVE

Class N | ARLSX Class I | ALSIX Class Z | ARLZX

Average Annual Returns (%)[1] (as of 06/30/20)

	Q2	YTD	1 yr	3 yr	5 yr	Since Incpt.
ARLSX (Class N)	1.77	-8.82	-1.65	3.09	3.84	4.68[2]
ALSIX (Class I)	1.83	-8.65	-1.37	3.35	4.09	4.08[3]
ARLZX (Class Z)	1.82	-8.63	-1.29	—	—	2.87[4]
Russell 3000® Index	22.03	-3.48	6.53	10.04	10.03	11.33[2]
50% Russell 3000®/50% ICE BofAML 0-3 Month US Treasury Bill Index[5]	10.86	-0.16	5.51	6.47	6.00	6.28[2]

ARLSX (Class N) Expense Ratio (Gross/Net)[6]: 2.85%/2.44%
ALSIX (Class I) Expense Ratio (Gross/Net)[6]: 2.60%/2.19%
ARLZX (Class Z) Expense Ratio (Gross/Net)[6]: 2.52%/2.11%

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. 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. From time to time the advisor has waived fees or reimbursed expenses, which may have resulted in higher returns.

The **AMG River Road Long-Short Fund** (Class N) returned 1.77% for the second quarter of 2020, compared with the Russell 3000® Index, which returned 22.03%, and the blended 50% Russell 3000/50% BofA Merrill Lynch U.S. T-Bill (0–3 month) Index, which returned 10.86%. For the 12-month period ending June 30, 2020, the Fund returned -1.65%, trailing the two indices, which returned 6.53% and 5.51%, respectively.

Performance Review

The Fund underperformed the blended index in Q2, while averaging 24% net market exposure (NME). Individual short performance and low NME during the Drawdown Plan were the primary contributors to Q2 underperformance. While the Drawdown Plan served its purpose in Q1 by protecting the Fund during the market's historic decline, it prevented the Fund from participating in the market's historic advance in Q2. The Fund's long portfolio outperformed the Russell 3000® and Russell 3000® Value, returning 22.61% versus 22.03% and 14.55%, respectively. The Fund's short portfolio underperformed the Russell 3000® and Russell 3000® Value, returning 24.93%. Year to date, the Fund underperformed its blended index by -866 basis points (bps) with average NME of 35%.

What worked...

The top contributing holding in the Fund during the quarter was Sandstorm Gold Ltd. (SAND) (long), a gold royalty company with a portfolio of nearly 200 royalties. Gold royalty companies are underrated in our opinion and produce significant free cash flows with very little overhead or capital requirements. For instance, both Franco Nevada (a Dividend Aristocrat) and Royal Gold have increased their dividends at double-digit rates for more than a decade (during falling gold prices). We believe SAND is an off-the-beaten-path idea (only one U.S.-based sell-side analyst follows the company) run by proven operators with a rock-solid balance sheet and significant production growth potential.

Unprecedented fiscal and monetary reactions to the COVID-19 crisis drove gold prices and SAND shares higher during the quarter. We suspect there may be more upside for gold prices as real interest rates (treasury yields less inflation rate) remain below 0%, lowering demand for cash and bonds and supporting gold prices as they have a proven history of keeping up with inflation. Ned Davis Research reports that when real interest rates (defined as the 10-year Treasury yield less the one-year percent change in CPI) have been negative since 1968 (~14% of the time and currently), gold has returned 16.64% per annum. With the downside protected with a debt-free balance sheet, ~$70 million in annual cash flow, and a ~$350 million untapped credit line, we believe SAND is particularly

[1] Returns for periods less than one year are not annualized.
[2] Since the inception of the Fund's Class N shares on May 4, 2011.
[3] Since the inception of the Fund's Class I shares on March 4, 2013.
[4] Since the inception of the Fund's Class Z shares on September 29, 2017.
[5] Effective October 20, 2017, the BofA Merrill Lynch indices were renamed ICE BofAML Indices.
[6] The Fund's Investment Manager has contractually agreed, through March 1, 2021, to limit fund operating expenses. The net expense ratio reflects this limitation, while the gross expense ratio does not. Please refer to the Fund's Prospectus for additional information on the Fund's expenses.

well positioned if gold prices continue to rise, as it enjoys more leverage to gold prices than its larger peers like Franco Nevada and Royal Gold.

Another top contributor during the quarter was Alphabet Inc. (Cl C) (GOOG) (long), which owns the largest search engine in the world. Google.com dominates global search with ~90% market share. Search should continue to grow as more individuals access the internet (roughly half the world has access to the internet) and digital advertising continues to steal market share from traditional advertising markets. The search business generates significant free cash flow, which is added to the firm's Fort Knox-like balance sheet (~11% of the market cap is in cash). Management has proven to be excellent at capital allocation with eye-popping returns in businesses such as Android, YouTube, and Waymo and the potential to increase shareholder returns through more significant buybacks.

The firm's first quarter was well received as advertising revenues appeared to bottom (-15%) in March and customers returned to more normal behavior in early April. As usual, the businesses continue to grow rapidly with YouTube (+33%) and Cloud (+52%) leading the way, but core search posted a solid 8.6% during the bleakest period of the COVID-19 shutdowns. There was a noticeable uptick in repurchases as GOOG bought back $8.5 billion in stock (up nearly 3x year over year). We continue to hold the position.

Rounding out the top contributors was CorVel Corp. (CRVL) (long), a national provider of managed care services in the workers' compensation industry. Workers' compensation is federally mandated and CRVL assists employers and others with software solutions such as claims management, bill review, etc. CRVL checks all River Road boxes: a growing, capital light business (~30% ROICs) gushing free cash flow (positive every year on record, since 1994) that is run by an owner/operator (insiders own 51% of the company) that has repurchased 26% of its shares over the last decade and is backed by a superb balance sheet (no debt since 1994). The icing on the CRVL cake is that the Street completely ignores it with no sell-side coverage or ratings since 2007.

The company has a proven track record during tough times, as the top line grew throughout the financial crisis. CRVL shares performed well this time around as it showcased the resilient nature of its business. Revenues were down just -2.7%, and EBITDA (earnings before interest, taxes, depreciation, and amortization) -2.8% during the quarter. Lower revenue and modest gross margin pressure were largely offset by reduced SG&A expenses thanks to management's fast response to the COVID-19 pandemic, making required adjustments to reduced healthcare spending created by lockdowns across the country.

What didn't work...

The largest negative contributing holding during the quarter was Janus Henderson Group PLC (JHG) (short), an investment manager with AUM of $294 billion as of Q1 20. We target melting ice cubes, or businesses that shrink over time, as we search for new short ideas, and we believe JHG fits the bill. Along with most active money managers, the company has lost assets to passive, cheaper alternatives. In JHG's case, the outflows have escalated in recent years: 2017 (-3.2%), 2018 (-4.9%), and 2019 (-8.3%). With falling managed assets and compressing fees, we think the future for JHG will not look like the past and margins will decline as costs rise to produce better results and enhance distribution.

Given that nearly two-thirds of JHG's revenue is earned from equities, it is no surprise that JHG shares roared during one of the best quarters in the stock market. First quarter results supported our thesis and conviction in the short. Over $12 billion in outflows equated to an organic, annualized outflow rate of -13%. Aside from multi-asset products ($1 billion in inflows, ~11% of AUM), every segment recorded net redemptions during the period. The stock hit our stop loss so we exited the position, and we look forward to revisiting the idea in late August, when it emerges from our three-month "cooling off" list.

Another poor performer was Quaker Chemical Corp. (KWR) (short), a global supplier of industrial process fluids and chemical management services to global metalworking, metals, and industrial end markets. We do not short melting ice cubes exclusively; we also short average companies with too much leverage and little share price momentum. In our view, KWR is particularly ill suited for a COVID-19 economy. After buying Houghton at a cyclical peak in August 2019 for ~$1.7 billion (12x EBITDA), the company's leverage ticked up to an all-time high of 3.5x. Volumes had been shrinking before the crisis (-9% year over year in Q4 19), and the pandemic has targeted approximately one-third of KWR's key end markets, including transportation, aerospace, and offshore energy.

Investors may have been relieved with the first quarter earnings results ($1.38/share) that blew away consensus expectations ($1.00/share), but that is only if almost $3.00 of negative adjustments are excluded. We think the stock is ahead of itself given that adjusted EBITDA is expected to be down ~50% and leverage will almost certainly tick higher by year end. There is no assurance that the virus will subside throughout the rest of 2020 and KWR's end markets will bounce back. However, we were stopped out of the position and will consider the stock in several months.

Another bottom contributor during the quarter was Gap Inc. (GPS) (short), a diversified retailer with ~75% of sales from its 3,345 brick-and-mortar stores and ~80% of its operating profit attributable to its Old Navy segment (Gap and

Banana Republic are also well known). The business does not grow, as sales were flat for the six years before the pandemic, which will likely reduce 2020 revenue by up to 20% or more. Old Navy has been Gap's biggest success story, but same-store sales have foundered at less than 3% during five of the past seven years and a -2% drop in 2019. The company dropped its potentially value-enhancing plans to spin off Old Navy in January due to the "cost and complexity of splitting...combined with softer business performance." Discount apparel at e-commerce firms like Amazon and outlet stores like TJ Maxx will likely lead to more sales pressure in the years ahead.

First quarter results were ugly with sales down -43% and an operating loss of more than $1.2 billion, but the market was relieved that it sourced enough liquidity to operate through 2021. We are less impressed. The company had only opened 55% of its store base by early June, and of those stores that did open, same-store sales were down -30%. Longer term, we do not think the road will get much easier given that mall traffic may remain at depressed levels due to consumer fears, $1.3 billion of annual rent expenses, and uncertain one-time costs to exit store leases. We exited the position as it reached our stop loss.

Positioning

The largest new long and short positions added during the quarter were Huntington Ingalls Industries Inc. (HII) and Union Pacific Corp. (UNP), respectively. During the quarter, the long gross exposure declined from 87% to 79% while the individual short portfolio exposure more than doubled from 13% to 27%. The index hedge was eliminated as we exited the Drawdown Plan after the 50-day moving average for the S&P 500® Index increased for 10 consecutive days. NME averaged just 24%, increasing from 10% at the beginning of the quarter to 53% by quarter end. We believe we ended the quarter with the Fund better positioned to participate in future market upside.

The views expressed represent the opinions of River Road Asset Management as of June 30, 2020, are not intended as a forecast or guarantee of future results, and are subject to change without notice.

Top Ten Long Positions (%)[7, 8] (as of 06/30/20)

Holding	% of Net Assets
Berkshire Hathaway Inc, Class B	4.74
Progressive Corp	3.29
Huntington Ingalls Industries Inc	2.84
NextEra Energy Inc	2.78
Cie Financiere Richemont SA ADR	2.45
Comcast Corp, Class A	2.22
Nintendo Co Ltd ADR	2.22
American Express Co	2.20
AptarGroup Inc	2.14
UniFirst Corp	2.08
TOTAL %	26.96

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.

The Fund may suffer significant losses on assets that it sells short. Unlike the possible loss on a security that is purchased, there is no limit on the amount of loss on an appreciating security that is sold short.

Active and frequent trading of a fund may result in higher transaction costs and increased tax liability.

The Fund may invest in derivatives such as options and futures; the complexity and rapidly changing structure of derivatives markets may increase the possibility of market losses.

A greater percentage of the Fund's holdings may be focused in a smaller number of securities, which may place the Fund at greater risk than a more diversified fund.

Investments in international securities are subject to certain risks of overseas investing including currency fluctuations and changes in political and economic

[7] 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.

[8] Top ten holdings for long portfolio only.

conditions, which could result in significant market fluctuations. These risks are magnified in emerging markets.

The Fund is subject to special risk considerations similar to those associated with the direct ownership of real estate.

Real estate valuations may be subject to factors such as changing general and local economic, financial, competitive, and environmental conditions.

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 of time.

Investing in PTPs (including master limited partnerships) involves risks in addition to those typically associated with publicly traded companies. PTPs are exposed to the risks of their underlying assets, which in many cases includes the same types of risks as energy and natural resources companies. PTPs are also subject to capital markets risk. PTPs may lose their partnership status for tax purposes. The status as a regulated investment company may be jeopardized if it does not appropriately limit such investments in PTPs or if such investments are recharacterized for tax purposes.

Companies that are in similar businesses may be similarly affected by particular economic or market events; to the extent the Fund has substantial holdings within a particular sector, the risks associated with that sector increase.

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 Russell 3000® Index is composed of the 3,000 largest U.S. companies as measured by market capitalization, and represents about 98% of the U.S. stock market.

The secondary benchmark is composed of 50% Russell 3000® Index and 50% ICE BofAML 0–3 Month U.S. Treasury Bill Index. The Russell 3000® Index is composed of the 3,000 largest U.S. companies as measured by market capitalization, and represents about 98% of the U.S. stock market. The ICE BofAML 0–3 Month U.S. Treasury Bill Index is a subset of The Bank of America Merrill Lynch 0–1 Year U.S. Treasury Index including all securities with a remaining term to final maturity less than 3 months.

The Russell 1000® Index measures the performance of approximately 1,000 of the largest securities based on a combination of their market cap and current index membership. The Russell 1000® represents approximately 92% of the U.S. market.

The Russell 1000® Growth Index is a market capitalization weighted index that measures the performance of those Russell 1000® companies with higher price-to-book ratios and higher forecasted growth values.

The Russell 1000® Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000® companies with lower price-to-book ratios and lower expected growth values.

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 3000® Growth Index measures the performance of those Russell 3000® Index companies with higher price-to-book ratios and higher forecasted growth values.

The Russell 3000® Value Index measures the performance of the broad value segment of the U.S. equity universe. It includes those Russell 3000® companies with lower price-to-book ratios and lower forecasted growth values.

The S&P 500® Index is a capitalization-weighted index of 500 stocks. The S&P 500 Index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The CBOE Volatility Index®, known by its ticker symbol VIX®, is a popular measure of the stock market's expectation of volatility implied by S&P 500 Index options, calculated and published by the Chicago Board Options Exchange (CBOE).

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

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