AMG Managers Fairpointe Mid Cap Fund

COMMENTARY

ASSET CLASS | MID CAP

Class N | CHTTX | Class I | ABMIX | Class Z | ABIZX

FAIRPOINTE CAPITAL

Average Annual Returns (%)[1] (as of 12/31/18)

	QTD	YTD	1 yr	3 yr	5 yr	10 yr	Since Incpt.
CHTTX (Class N)	-16.48	-18.58	-18.58	4.05	2.07	13.54	10.96[2]
ABMIX (Class I)	-16.41	-18.37	-18.37	4.31	2.33	13.83	8.17[3]
ABIZX (Class Z)	-16.42	-18.31	-18.31	—	—	—	-11.25[4]
S&P MidCap 400® Index	-17.28	-11.08	-11.08	7.66	6.03	13.68	11.20[2]
Russell MidCap® Index	-15.37	-9.06	-9.06	7.04	6.26	14.03	10.36[2]

CHTTX (Class N) Expense Ratio (Net/Gross): 1.14%/1.14%
ABMIX (Class I) Expense Ratio (Net/Gross): 0.89%/0.89%
ABIZX (Class Z) Expense Ratio (Net/Gross): 0.81%/0.81%

The performance data shown represents past performance. Past performance is not a 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. From time to time the advisor has waived fees or reimbursed expenses, which may have resulted in higher returns.

The **AMG Managers Fairpointe Mid Cap Fund** (Class N) returned -16.48% for the fourth quarter of 2018, compared with the -17.28% return for its primary benchmark, the S&P MidCap 400® Index. For the 12 months ending December 31, 2018, the Fund returned -18.58%, trailing the -11.08% return for its benchmark.

Overview

The past year was marked by a return of market volatility, as well as increased concerns about the global economy. Although we acknowledge the concerns over a broader downturn, we believe that falling stock prices have offered new buying opportunities—the likes of which have not been available in the U.S. markets for several years. Additionally, investors appear to favor fundamental, value-oriented stocks, which should benefit stock-picking approaches such as ours.

Uncertainty Continues, but Fundamental Value-Based Investing Is Gaining Favor

Since we started this strategy in 1999, we have endured several periods of underperformance. The most recent period, however, has lasted longer than we expected. This has been partly due to the broad shift toward passive investing, which started a number of years ago and may have peaked in 2017. In this environment, stocks that performed well ended up performing exceptionally well, as more and more money moved into passive funds, which buy regardless of fundamentals. As a result, highly valued stocks enjoyed even higher prices—a trend that greatly favored growth and momentum stocks.

Recently this trend has started to revert. Several months ago, value began outperforming growth. Investors are seeking fundamentally sound companies that offer attractive valuations. These might be traditional growth companies that are attractively priced versus their peers, or stocks that are attractive relative to their own pricing history.

Although we are encouraged by the turn toward fundamentals-based investing, the overall outlook is muted. This is partly due to recent economic news, especially inflation risk and the U.S Federal Reserve (the Fed) tightening activity, but most of the concern, in our view, is due to tariffs and unresolved trade policy.

As the U.S. struggles with economic and political concerns, Europe does not seem to offer a viable investment alternative. Germany has been the growth engine of Europe for the past several years, and its economic figures appear to be flagging. The country exports a significant amount of goods to China, including production and automation equipment for factories, all of which have slowed. This is because the growth outlook for China has become more subdued and has in turn affected the world economy. Italy's economy is still struggling, Brexit is creating considerable uncertainty, and a combination of austerity measures and political turmoil are weighing on continental Europe. Although the U.S. market may show signs of softening, it could be in a better position than Europe.

In times like these, when volatility and uncertainty are the only constants, we believe a return to fundamental, value-based investing becomes more relevant. Stock picking becomes more important. We have a long history of engaging with company management, including frequent and in-depth conversations. Recent talks revealed considerable worries about tariffs on steel and aluminum driving up raw material prices. Many companies thought they would be able to pass on higher raw materials costs to their customers, but that appears less viable. The slowing economy may mean that companies will need to absorb more of these costs than previously expected.

No one can definitively say whether we have reached the bottom of the market downturn. We are currently doing the same thing we have always done. This is a difficult period, but we have been through difficult periods before. Ten years ago, we experienced a most difficult period. In 2008 the global financial crisis was in full swing, and markets suffered

[1] Returns for periods less than one year are not annualized.
[2] Since the inception of the Fund's Class N shares on September 19, 1994.
[3] Since the inception of the Fund's Class I shares on July 6, 2004.
[4] Since the inception of the Fund's Class Z on September 29, 2017.
[5] Reuters

tremendously. But from December 2008 through the end of 2018 the mutual fund has generated returns that place it in the top 10th percentile of its peer groups (Morningstar Mid-Cap Blend/Value), and generated average annual returns of 13.54%. Looking back even further, over the past 15 years our returns put us in the top 20th percentile, relative to our peers.

It is important to remember that what we did during the last market downturn paid off. We added selectively to existing holdings. Those purchases ultimately turned into significant gains for our investors, and we are taking advantage of what we believe are similar opportunities right now. We believe that the current market volatility is a good environment for our investment approach.

Attractive Fundamentals

Currently, the Fund's Price-earnings ratio (P/E) for calendar year 2019 is 11x. In comparison, the P/E for the S&P MidCap 400 is 13.3x, the Russell MidCap® Index's P/E is 13.6x, the S&P 500® Index's P/E is 14.4x, and the Russell 2000® Index's P/E is 12.6x, according to FactSet. Further, the Fund's P/E for the calendar year 2018 is 12x, whereas major midcap benchmarks are at about 14x, the S&P 500's P/E is 15.4x and the Russell 2000® Index's P/E on current calendar year is 13.6x. Using another measure, the Fund's price-to-sales ratio is at 0.6x, compared to the S&P MidCap 400's price-to-sales ratio of 1.1x, the Russell Midcap® Index's price-to-sales ratio of 1.5x and the S&P 500's price-to-sales ratio of 1.9x.[5] This is the lowest the portfolio's price-to-sales ratio has been since mid-2009 and may indicate that some of our holdings could benefit from merger and acquisition (M&A) activity, since they trade at such compelling valuations. Even if the market as a whole does not turn around, we believe the Fund's holdings can still be boosted in the interim based on the attractive valuation and company fundamentals.

For the year, the best performers were Hormel Foods Corporation, Cree, New York Times Company, Unisys Corporation, and Adtalem Global Education. We eliminated Adtalem and reduced the other positions based on valuation. Hormel Foods' shares rose on higher earnings and solid execution in 2018. Cree shares were driven higher by strong semiconductor demand. The company is expanding capacity based on long-term electric vehicle production forecasts. New York Times was driven by growth in digital subscribers. The company's content remains in high demand due in part to the news cycle in Washington.

Detractors for the year were McDermott International, Lions Gate Entertainment, Stericycle, LKQ Corporation, and Mattel. McDermott International announced additional charges to three legacy Chicago Bridge & Iron contracts that are losing money. The projects are over 80% complete and will be completed in 2019 and 2020. The company has substantial revenue and cost synergies from the Chicago Bridge & Iron merger. Insider buying was pervasive. Lionsgate's 2018 movie lineup was weaker than expected, and investors overreacted to that, in our view. The specter of "cord cutting" has also scared investors, and Lionsgate has been punished along with other content providers. Despite these short-term concerns, we believe that Lionsgate is significantly undervalued. That is why executives are adding to their personal holdings of the stock. Stericycle had a disappointing 2018 as earnings were impacted by price cuts in its medical waste business. While the valuation is compelling, we are analyzing the company for signs of an inflection in pricing trends.

Perspective and Outlook

Looking ahead, we are encouraged by the strong fundamentals of the Fund's holdings and believe we are well positioned for upside potential. We expect that volatility and economic uncertainty will continue to affect the stock markets. The next important statement will be fourth quarter earnings announcements, which should establish expectations for 2019. We will be paying close attention to those announcements, and we look forward to the touch of reality they will bring.

Environmental, social, and governance (ESG) investing topics have received a lot of press coverage recently. These are not new topics for Fairpointe. We have considered many ESG issues in our investment analysis and actively engaged in governance discussions for many years. Due to this focus, we believe the Fund has strong ESG characteristics.

Active investing requires patience and a long-term view. According to a study published by Morningstar,[6] it is routine for a good manager to trail a benchmark for multiple years. We fully expect that we will underperform our benchmarks and peers from time to time. But we also expect that over the longer term, we will outperform as we have in the past. Our confidence comes from looking back to the last market downturn 10 years ago. We are approaching the market and company valuations as we always do, by identifying solid companies with strong balance sheets that are trading at discounted valuations. For these reasons, we believe it is a good time to add money to U.S. equities and to the Fund.

Thank you for your continued interest and support.

Thyra E. Zerhusen, Chief Investment Officer

Marie L. Lorden, Portfolio Manager

Mary L. Pierson, Portfolio Manager

Brian M. Washkowiak, CFA, Portfolio Manager

The views expressed represent the opinions of Fairpointe Capital LLC as of December 31, 2018, are not intended as a forecast or guarantee of future results, and are subject to change without notice.

[5] FactSet

[6] Morningstar Manager Research, *How Long Can a Good Fund Underperform Its Benchmark?* (March 20, 2018)

Top Ten Holdings (%)[6] (as of 12/31/18)

Holding	% of Net Assets
TEGNA Inc	4.26
Teradata Corp	3.41
Juniper Networks Inc	3.40
Meredith Corp	3.32
Molson Coors Brewing Co, Class B	3.20
New York Times Co, Class A	2.93
Northern Trust Corp	2.89
Jabil Inc	2.86
Mattel Inc	2.84
Bunge Ltd	2.76
TOTAL %	31.87

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 is subject to risks associated with investments in mid-capitalization companies such as greater price volatility, lower trading volume, and less liquidity than the stocks of larger, more established companies.

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 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.

Investments in international securities are subject to certain risks of overseas investing including currency fluctuations and changes in political and economic conditions, which could result in significant market fluctuations. These risks are magnified in emerging markets.

The S&P MidCap 400 Index, more commonly known as the S&P 400, is a stock market index from S&P Dow Jones Indices. The index serves as a barometer for the U.S. mid-cap equities sector and is the most widely followed mid-cap index in existence.

The Russell Midcap® Index measures performance of the 800 smallest companies (31% of total capitalization) in the Russell 1000® Index, with weighted average market capitalization of approximately $6.7 billion, median capitalization of $3.6 billion, and market capitalization of the largest company $13.7 billion.

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 and higher 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.

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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[6] 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.