Cove Street Capital Small Cap Value Fund Letter to Shareholders

DEAR FELLOW SHAREHOLDER — Spoiler alert—we did not own Bitcoin, Cannabis-related stocks, large cap tech stocks, and we weren't up 20% in 2017. You are forgiven for moving onto another Twitter feed.

As opposed to yet another outlook piece cluttering your inbox—and life—in 2018, we would prefer to spend some time on more of an inward look. As such, we will discuss our views on what is happening in our portfolio as well as on some of the more conceptually seismic issues that could really mean something to a client rather than the annual coin flipping or pontificating about our rhetorical other hand. Our annual forecast, for whatever it's worth, remains unchanged. The broader market's historical long-term average return has been about 10% on a nominal basis and about 7% real. We think the market will have a hard time continuing down this path unabated, and as most consumer products warn, results may vary, because invariably they do. You can temper that view based on a personal gauge of where we are in an economic cycle and the relative state of valuation. We think late and high.

"The market has never done better" was a quote from the Financial Times recently and the reference was in regard to the 2018 production of a 20% return in the S&P 500 with exceptionally low volatility. That is the classic financial free lunch that we apparently were educated, through practical and historical experience, not to expect. The stock market behaved as if the results were scripted by the Board of Federal Reserve academics…hmmm.

We have done a mediocre job in the past 18 months on a relative basis. While there were a few specific errors of commission, more so there were more instances of omission. Large Cap outperformed Small Cap, and Growth (i.e. shiny and new) outperformed Value (i.e. solid and dull). The second half of the year in particular felt dully reminiscent of 1999, when we were buying fast food restaurants and insurance companies while all the other "cool" kids were having the time of their lives.

Total Return (CSCAX) — % as of December 31, 2017

	3 MONTH	1 YEAR	3 YEAR	5 YEAR	10 YEAR	INCEPTION (09/30/98)
Cove Street Capital Small Cap Value Fund	1.71	5.74	5.83	10.06	8.05	10.66
Russell 2000® Index	3.34	14.65	9.96	14.12	8.71	9.21
Russell 2000® Value Index	2.05	7.84	9.55	13.01	8.17	9.84

Performance shown for the period through January 20, 2012 reflects performance for CSC Small Cap Value Fund, a series of CNI Charter Funds, the predecessor to Cove Street Capital Small Cap Value Fund ("The Fund"). The Fund has the same portfolio manager and substantially similar investment strategies to the predecessor fund. The Institutional Class commenced operations on October 3, 2001. The performance results for the Institutional Class reflect the performance of the Investor Class shares from September 30, 1998 through October 2, 2001. The Investor Class subsequently closed, effective November 25, 2015.

The performance data quoted represents past performance. Past performance does not guarantee future results. The investment return and 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. Current performance may be lower or higher than the performance quoted. For performance data current to the most recent month end, please call 1-866-497-0097.

The gross expense ratio is 1.40%. Net expense ratio, as of the most recent prospectus, is 1.24% and was applicable to investors. Cove Street Capital, LLC (the "Adviser" or "Cove Street") has contractually agreed through at least January 27, 2018 to reduce its management fees, and may reimburse the Fund for its operating expenses, in order to ensure that Total Annual Fund Operating Expenses (excluding acquired fund fees and expenses, leverage, interest, taxes, brokerage commissions, and extraordinary expenses) do not exceed 1.25% of the Fund's average daily net assets.

The Fund imposes a 2.00% redemption fee on shares sold within 60 days of purchase. Performance data does not reflect the redemption fee. If it had, return would be reduced.

The apparent suspension of the Herbert Stein's "if it can't go on forever, it won't" rule—which we would postulate as still being as inviolable as are the basic rules of thermodynamics—simply makes life on a relative basis more difficult for us. As a firm that seeks to buy a legitimate dollar of future cash flow, we require some combination of obfuscation, confusion, and price volatility

that comes about due to issues ranging from short-term fundamental disappointment to sheer panic-selling. It is within this murky fog that we can formulate a differentiated viewpoint with a large enough margin of safety to be convinced to commit someone else's money in sufficient size to make a difference. There was not a lot of that over the last year, as the S&P 500 put up 12 months of consecutive gains—the longest streak since 1958/1959. So, thorn in our side number one in 2017 was erring on the side of caution in any number of security-specific instances when, in retrospect, we should have stepped up and been rewarded by the short-term direction of the tide. This has been a perennial mistake of this portfolio manager in his career, a fact that his colleagues regularly point out with disdain. In fact, the post-Trump election period has mostly been a fantastic time to just shut up and buy stocks and stick with them. And if you had been willing to "pay up a little" in 2017, you would have been rewarded.

There is a major difference—as we have become painfully aware over the last 33 years—between the investment management "business" and the act of investing. The latter values patience and understands the unpredictability of the timing of return realization, a result that has a very low R-squared to the calendar year. The former wants to know "what have you done for me lately," and the answer is simply not as much as we would have liked. Being competitive in up markets and outperforming in down markets pencils out marvelously on paper. It's just less fun in practice in a very strong upcycle.

But as we will get into more below, being annoyed with the short-term is quite different from a number of behaviors we typically see during times such as these: quitting outright, throwing in the towel on longer-term value-based investing, changing stripes to play catch-up with the prior year, or believing that the game is now "rigged" against careful, concentrated, fundamental, value investing. 2017 was not the first year when things "seemed" very different than they have in the past. **"This time is different"** is a very important statement to consider before full implementation. We are always re-underwriting what we own at marked-to-market prices, just as we regularly reconsider ideas and values that we don't own.

But, our continuing bet is that people don't change nearly as much as markets normally vacillate. To suggest that one should simply extrapolate recent trends as the proper expectation for the future has a material non-zero probability of being very wrong, and therein lies our own mean reversion. In the meantime, we have lots of interesting things going on in the portfolio that have their own engine of growth or change and don't require much help from the overall state of the equity market to produce very satisfactory returns.

What Happened (CSCAX) — % for the Quarter Ending December 31, 2017

TOP 5 DETRACTORS	AVERAGE WEIGHT	RETURN	CONTRIBUTION
G.P. Strategies Corp	4.0	-24.7	-1.1
E.W. Scripps Company	5.1	-18.3	-0.9
American Vanguard Corp	3.3	-14.1	-0.5
Eastman Kodak Company	0.7	-59.8	-0.5
Cherokee Inc	0.8	-30.9	-0.3
TOP 5 CONTRIBUTORS	AVERAGE WEIGHT	RETURN	CONTRIBUTION
GTT Communications Inc	3.1	48.0	1.2
ViaSat Inc	6.1	16.7	1.1
Avid Technology Inc	4.1	18.7	0.7
USG Corp	2.8	18.1	0.5
TEGNA Inc	5.2	6.1	0.4

The 5 Detractors measure the five bottom contributors to the portfolio's return and the 5 Contributors measure the top five contributors to the portfolio's total return. Average Weight shown is a calculation of the average percentage held of each included company over the course of the listed period. Return is the total return for each included company over the course of the listed period. Contribution is a ranked measure of how each included company contributed to the Fund over the course of the listed period.

Looking specifically at the portfolio, we start with our detractors as is our tradition. GP Strategies (Ticker: GPX), a provider of training and e-Learning solutions to corporations around the world, gave back its gains from the prior quarter as it announced the termination of an oil and gas contract, which to our knowledge (that extends back to a first purchase in the stock in the mid-single digits) is the first "termination" of its kind. There was a single digit million-dollar write-off and a very serious reconsideration of what it takes to succeed legally in this business in the Middle East. We consider GPX a classic Buffett value and, as such, we have been adding to the position during this period of weakness.

Another detractor this quarter was E.W. Scripps (Ticker: SSP), which owns television broadcasters and a collection of digital assets. The U.S. broadcast television industry is currently in a state of flux. People are concerned about cable subscribers "cutting the cord" and about advertising dollars migrating to, ostensibly, greener digital pastures. While these are legitimate industry dynamics, our research suggests that the aforementioned industry trends are unlikely to undo the business models of companies such as E.W. Scripps. It remains a fact that 23 out of 25 of the top prime time shows on television are shown on the big four broadcast networks. As such, broadcast remains a very relevant advertising medium for companies who want to reach millions of people, all at once. Furthermore, recent Federal Communications Commission rule changes are likely to open up very accretive station swaps and station acquisitions for SSP. Our valuation analyses indicate that the market is ascribing minimal value to the SSP's growing digital businesses and is underestimating the strength of the Company's political ad footprint. We also own a large position in TEGNA (Ticker: TGNA), a broadcaster with the same theme.

American Vanguard (Ticker: AVD), the last detractor for discussion this quarter, is an agricultural chemical company that continues to expand into new product categories and into new geographies around the world. The Company has recently participated in a number of regulator-mandated business line and product divestments that are a result of the merger activity in the agriculture world. AVD's acquisition spree has coincided with consistent organic growth within a number of its major product categories. We remain holders of the stock.

We will briefly note our continuing struggle in Cherokee (Ticker: CHKE) which is navigating a tough retail environment and a well thought out but poorly executed acquisition. We expect clarity on the trajectory of the business in 2018, and if it's not positive, we will exit.

Also briefly, Eastman Kodak (Ticker: KODK) is a classic "sum of the parts" Graham stock. There is a specialty printing and packaging business that we value at multiples of the current price of the stock, but there are also cash drain anchors that are resisting restructuring efforts to date. We have it "risk-weighted" as a portfolio position and it remains on a tight leash.

Our largest contributor this quarter was GTT Communications (Ticker: GTT), a provider of cloud networking services and broadband connectivity to multinational enterprises and government customers. We increased our position after doing a thorough deep dive into the Company following additional acquisitions of unique networking service assets, which brought a significant missing ability concentrated on SD-WAN into GTT's asset base. Put simply, there is an enormous gap between newer and more nimble competitors versus the incumbent Telcos, and the messy combination of Level 3 Communications (Ticker: LVLT) and CenturyLink (Ticker: CTL) versus an organization like GTT in a world of ever-growing international interconnectedness. With management continuing to execute their acquisition and integration strategy, the Company's performance continued to outpace expectations, driving the stock higher. We see significant upside potential and feel that insiders' about 20% ownership of the Company properly aligns management's incentives with our own.

ViaSat (Ticker: VSAT) performed well for the quarter as the market has turned its attention to the looming monetization of the Company's new second-generation satellite (ViaSat-2) for terrestrial broadband and commercial airlines, which was successfully launched and provisioned several months ago. Continued penetration by the Company into airborne services for the military and government are providing excellent high margin growth to the government segment and generating additional RFP ("Request For Proposal") wins for future deployments. Even though this year was supposed to be a stasis year and VSAT's growth would be constrained until the launch of ViaSat-2, the Company has executed well while ramping up its investment in the building and design of the two third-generation satellites slated for launch in the 2019-2020 time frame. We continue to see this as a potential long-term compounder driven by technological moats that its competitors cannot surmount in the short- or medium-term.

Our final contributor this quarter, Avid Technologies (Ticker: AVID), is the leading provider of professional software for video and audio production through its Media Composer and Pro Tools product lines. The Company has struggled in recent years to show any pickup in demand for its core products and has had a history of disappointing people's expectations. Consequently, by stringing together two consecutive, disappointment-free quarters with moderate revenue growth, the stock rebounded from its historic lows. The mission critical nature of AVID's products to the creative types of the world continues to support our view that several strategic buyers would be interested in owning the installed software base at a higher equity value than is currently prevailing in the market.

A new addition to the portfolio, Esterline Technologies (Ticker: ESL), is a diversified manufacturer of products for the aerospace and defense industries. We acquired the position following a significantly disappointing quarterly result and a third consecutive year of subpar performance on both revenue growth and profitability metrics. Analysts and investors dumped the stock. The commentary on the call from analysts suggested to us that all previous optimism about the management team's ability to deliver the "model" result has disappeared. Our own work indicates that ESL could have a clear path to their "model" profitability and organic growth through some self-help via strategic divestitures, as well as relief from regulatory overhang. Possessing several key business units that are worth a majority of the stock price, our research indicates that if you apply a reasonable multiple to their two largest businesses, you get the balance at a significant discount and that excludes the potential embedded in the management plan. Raise your hand if you like margin of safety plus optionality.

We sold our position in Novanta (Ticker: NOVT), which is a diversified medical and industrial components supplier. The market has rewarded the Company's recent success at driving high single digit organic sales growth, improving margins, and intelligent acquisitions with a tripling in the Company's valuation over the last two years. At some point, goodness is more than reflected in valuation, and we exited our position, which we had held for many years.

We also exited our successful involvement with Sleep Number (Ticker: SNBR), formerly Select Comfort (Ticker: SCSS). After following the mattress industry for a number of years, we finally dipped our toe into the water in the 4th quarter of 2016. Since our initial purchases, the stock has risen substantially and the market has remedied much of the extreme undervaluation. We continue to have a positive view of SNBR's prospects, but the margin of safety is no longer present. As such, we sold the shares during the quarter but remain very open to investing in the Company again at if we ever see another attractive opportunity.

Looking forward, our first big thought surrounds mean reversion. As we observed in historical periods, such as 2008/2009 and 2010/2011, often times near-term underperformance has led to "spring compression" within the portfolio, as what we own that had minimal market reaction in the recent past mysteriously becomes more recognized by someone not on our payroll. We believe a big chunk of our portfolio is in this category with company-specific catalysts that will work, or not, independent of the broader market. The second thought is that while most asset classes remain elevated, small cap—and value in general—have lagged so badly that we should benefit on a relative basis from any hiccup in the club of what has been recently working.

There remains the big fat hurdle of starting from what are, by any standards, historically high equity valuations, but of course those have to be judged relative to interest rates. Just how much is valuation supported by unprecedented suppression (using any variety of techniques) of global interest rates, and how much innate caution has been thrown into the wind by yet another year with so little consequence for those actions? Dunno, but the statistical history of starting at high valuations has been impressively robust in suggesting the broader market is in for lower returns going forward. As noted many times here, investing is fiendishly simple: be greedy when others are fearful and vice versa. Based on our relentlessly bottom-up basis, we continue to see a lot that looks expensive to us.

That brings us to the real bubble in the world worth watching—fixed income. It remains a great mystery of the world how ten trillion dollars of sovereign debt has a negative yield, and that number is a lot bigger than the greater fool theory ongoing in crypto-currency. Thus, it matters much more if things change in the interest rate or credit extension world. Who cares if the shoeshine guy or the digital millionaire camping out at WeWork gets digitally marked back to whatever some think constitutes a true market? Being marked down suddenly—and hard—on trillions of assets held everywhere is a special unknown, and is worth some sort of embedded risk premium which does not seem priced into markets. Specifically, any scan of past historical unpleasantness often starts with unusualness in interest rate change and subsequent changes in the availability of credit. But, to set a record for scientific references in a financial piece despite having zero background in the physical sciences, Newton's law of inertia is in effect here—equities have continued to move higher because things have not changed. The music plays and people dance until they don't. Timing remains uncertain.

While this tax bill violates almost any common sense test of simplicity, fairness—as defined as rational economic thinking versus what can be bought and sold at the last minute—and some defined sense of strategic direction, it does have "lower" going for

it, and that is an important improvement over prior years. Combined with the promise of less regulatory silliness, you have a pretty decent backdrop for economic growth and improved corporate cash flow. Is that effectively priced into equity markets as of this writing?

On a much minor note, and this will be addressed in only one paragraph—the current fascination with Crypto-currency is as dumb and crooked as nearly anything I have seen or studied in 37 years of my career and schooling. The Long Island Iced Tea Company (Ticker: LTEA—really?) changes its name to Long Blockchain (Ticker: LBCC) and goes up 5x in one day? This lunacy will end the same way combining stupid and money always does—stupid loses. This statement has nothing to do with the technological innovations now possible in many industries due to the advent of blockchain as a service. And we are not commenting on the likelihood of Bitcoin itself retaining some value as a niche form of payment or cult form of value that exists for zillions of more years. Our concerns have to do with all the crap and outright fraud. To close this paragraph with a fantastic quote from Ethereum creator Vitalik Buterin, whom we would call "Mr. Just Close the Door Behind Me," via *Bloomberg*:

> "I'm concerned a lot of these token models aren't going to be sustainable," Buterin said in a rare interview last week at the Ethereum Developers Conference in Cancun, Mexico.
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> So what's the problem? There's a hard limit -- 21 million coins -- on the supply of bitcoin, the first successful cryptocurrency, that helps underpin its value. Buterin isn't mulling a cap like that, but he's intrigued by the idea of imposing fees on applications built atop ethereum.
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> Those fees would destroy -- or burn, in Buterin's parlance -- ether tokens over time. "If the token is being burned, then you have an economic model that says the value of the token is the net present value of basically all future burnings," he said. Otherwise, "it's just a currency that goes up and down. It feels kind of like voodoo economics and the price of the token isn't really backed by anything," Buterin added.
>
> "That's a very spooky thing."

There is a lot of yack about "Artificial Intelligence and Big Data" and how that might affect the management of assets. To paraphrase *Bloomberg*'s breathless summary of the issue: the ability to process large amounts of data efficiently and rapidly through artificial intelligence and machine learning is changing the nature of financial research and making it harder to "surprise" markets and thus dampening volatility, even around known events like economic releases. Hmmm…

We would note we have great technology internally, and we have our own in-house computer scientist, Eugene Robin, CFA, who can evaluate raw technology in conjunction with possessing a terrific BS radar. But it's not clear to me that a lack of data is the problem for any investor today who has a Yahoo Finance account. The issue remains interpretation. The history shows that huge amounts of dollars being thrown at quantitative strategies in a large institutional rush has rarely led to a permanent advantage or sustained value-add. I have evaluated a dozen "cool" Fintech toys oriented toward research in the past year and each one is primarily focused on predicting the next quarter. Paraphrasing Jeff Bezos: that's what everyone is doing and it's a hard game to play that is getting harder with more tech advancement. In the meantime, less attention is paid to "the next 7 years," and getting that right seems like the place to spend time.

To throw out some recent thoughts by Yale's David Swensen:

> "I have never been a big fan of quantitative approaches to investment. And the fundamental reason is that I can't understand what's in the black box. And if I don't know what's in the black box, and there's underperformance, I don't know if the black box is broken or if it's out of favor. And if it's broken, you want to stop. And if it's out of favor, you want to increase your exposure."

Our firm has never been in better shape and we remain substantial seven-figure investors in the fund partnered alongside you. This is not the first time we have looked less than genius in the short-run, a fact that through the math of compounding eats at our reported returns, and annoyingly is somewhat inevitable. We cannot deliver superior performance in the long-run if we are trying to be the big man every quarter. It has never worked.

Best Regards,

Jeffrey Bronchick, CFA | Principal, Portfolio Manager
Shareholder, Cove Street Capital Small Cap Value Fund

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The fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The statutory prospectus and summary prospectus contain this and other important information about the investment company, and they may be obtained by calling 1-866-497-0097 or visiting www.covestreetfunds.com. Read it carefully before investing.

Top 10 Holdings (CSCAX) — % for the Period Ending December 31, 2017		
ViaSat Inc	7.1	%
TEGNA Inc	5.8	%
E.W. Scripps Company	5.3	%
Heritage-Crystal Clean Inc	5.2	%
Wesco Aircraft Holdings Inc	4.8	%
Millicom International Cellular S.A.	4.6	%
GP Strategies Corp	4.5	%
Avid Technology Inc	4.1	%
GTT Communications Inc	4.0	%
American Vanguard Corp	3.1	%

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