



MAIRS & POWER

# SMALL CAP *fund*

## First Quarter Results

March 31, 2018

The Mairs & Power Small Cap Fund is closed to new investors.

FOCUSED INVESTING FOR THE LONG-TERM

# SMALL CAP *fund* (MSCFX)

## First Quarter Market Overview - March 31, 2018

With the bull market entering its 9th year, the first quarter exhibited some recurring themes as both the economy and market fundamentals continued strong. Consumer confidence is at a 17-year high while unemployment is at a 17-year low, business confidence remains high and small business confidence is at an all-time high. Corporate earnings growth remains strong and revenue growth has been accelerating for seven quarters. We expect this momentum to continue, helped by lower tax rates, strong job growth and accelerating wage growth.

Countering those positive trends, Q1 also saw the return of volatility to the stock market. The S&P 500 finished the quarter 8% below its January 26th all-time high.\* After eight sequential quarters of gains, the broad market fell in the first quarter of 2018. The S&P 500 Total Return (TR) finished down 0.76 percent, the Dow Jones Industrial Average TR Index was down 1.96% and our other key benchmark, the Bloomberg Barclays U.S. Government/Credit Bond Index Return was down 1.58% for the period.

The Trump administration's recently announced steel and aluminum tariffs raised concerns over rising costs for industrial companies and the potential for a trade war that could cause meaningful damage to the economy and corporate profits if China and other countries retaliate. The first quarter also saw the new Federal Reserve (Fed) chairman, Jerome Powell,

implement a widely anticipated rate hike in his first meeting as Chair. The market sold off sharply following the Fed signaling at least three rate hikes this year and further rate increases in 2019 and 2020. While most equities bounced back from the sell-off, rising rates have already had a negative impact on fixed income securities and fixed income substitutes such as Real Estate Investment Trusts (REITs) and Utilities.

In addition to those macro worries, sector-specific news headlines added volatility to stock prices as well. Many healthcare stocks fell on news of an effort by Amazon (AMZN), J.P. Morgan (JPM) and Berkshire Hathaway (BRK.A) to create a private health insurance association for their employees. While a handful of Information Technology (Tech) names continued to drive market returns in Q1, the sector lost momentum late in the quarter driven by negative comments from the President about Amazon and revelations about Facebook's activities during the 2016 election, fueling concerns over increased government scrutiny and regulation in the sector. Despite those worries, the sector finished the quarter up 3.5%. The only other sector with gains for the quarter was Consumer Discretionary, up 3.1%, largely due to strength in Amazon. Nine of the eleven market sectors posted negative returns for the quarter with Telecom and Consumer Staples bringing up the rear, falling 7.5% and 7.1%, respectively - volatility is back.

\*The closing price of the S&P 500 Index on January 26, 2018 was 2,872.87.

Dow Jones Industrial Average TR Index is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the NASDAQ. It is not possible to invest directly in an index.

Bloomberg Barclays U.S. Government/Credit Bond Index is a broad-based flagship benchmark that measures the non-securitized component of the U.S. Aggregate Index. It includes investment-grade, U.S. dollar-denominated, fixed-rate treasuries, government-related and corporate securities. It is not possible to invest directly in an index.

The S&P 500 TR Index is an unmanaged index of 500 common stocks that is generally considered representative of the U.S. stock market. It tracks both the capital gains of a group of stocks over time and assumes that any cash distributions, such as dividends, are reinvested back into the index. It is not possible to invest directly in an index.

Corporate Earnings Growth is the percentage change in a firm's earnings per share in a period, as compared with the same period from the previous year.

## Future Outlook

We remain cautious in our outlook for 2018. Per FactSet Market Aggregate, earnings for the S&P 500 may grow in the range of 15 – 20% this year, helped significantly by lower tax rates, but this expectation appears to be largely factored into current stock prices. The weaker dollar, strong job and wage growth, lower tax rates and high levels of confidence all provide a tailwind for revenue and earnings growth. However, margins are likely to come under pressure from increased labor and transportation costs, a cautionary note we've heard from several companies. In addition, a rising rate environment puts downward pressure on equity valuations, which are currently at the high-end of their historic ranges.

As we begin our 87th year, our investment philosophy remains unchanged. While market volatility has increased recently we know that, regardless of the economic and market environment, what's most important is to maintain a disciplined long-term investment approach that has served our investors well over the long-term. We intend to do just that.

## Small Cap Fund Performance Review

The Mairs & Power Small Cap Fund started the year in negative territory. The Fund was down 3.28% in the first quarter of 2018 while the S&P 600 Total Return Index was up 0.57%. The peer group as measured by the Morningstar Small Blend category was down 0.93%.

*Performance data quoted represents past performance and 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 lower or higher than the performance quoted. For the most recent month-end performance figures visit [www.mairsandpower.com](http://www.mairsandpower.com) or call Shareholder Services at (800)304-7404. Expense Ratio 1.05%.*

Sector allocation played an insignificant roll in the relative underperformance of the Fund with stock selection being the primary driver. Top contributors to performance in the quarter included Bio-Techne (TECH) and Cullen/Frost Bankers (CFR). Bio-Techne, a manufacturer of proteins and antibodies used by academic and commercial research laboratories, has seen a strong resurgence in organic growth as the management team's vision for the company has been performing admirably. The company has always had a strong portfolio of products of interest to clinical investigators, but management's strategy of acquiring better platform technology to leverage these raw products has fueled strong demand from customers looking to utilize their time more effectively. While the strategy has shown strong initial success recently recognized by investors, we believe there is a long runway ahead for the company to continue to leverage its acquisitions. As a result of strong stock price appreciation, Bio-Techne common stock was the largest holding in the portfolio at the end of the quarter.

Cullen Frost Bankers, based in San Antonio, Texas has benefited from rising interest rates like other banks, but also enjoys the added tailwind of an extremely strong local market. Cullen, the largest independent bank in Texas, enjoys very strong brand and reputation. As both the local population and economic growth in its market have accelerated, Cullen has not only participated, but has been successful in capturing additional share. Future growth and competitive position also appear very attractive, and the Fund maintained a large weight in Cullen at the end of the quarter.

### Mairs & Power Small Cap Fund Performers

#### TOP PERFORMERS

FIRST QUARTER (12/31/17 - 3/31/18)

Bio-Techne Corp.	64.03%
Cullen/Frost Bankers, Inc.	36.49%
Marcus Corporation	23.23%
Proto Labs, Inc.	21.71%
CyberOptics Corp.	18.64%

#### WEAK PERFORMERS

FIRST QUARTER (12/31/17 - 3/31/18)

Tile Shop Holdings, Inc.	-55.27%
Oshkosh Corp.	-52.00%
CoreSite Realty Corp.	-36.98%
Snap-on Inc.	-35.37%
Physicians Realty Trust	-34.73%

Performance shown is relative to the S&P 600 TR Index as of March 31, 2018. Relative return is the difference between the absolute return and the performance of the market, in which the position is held. Relative contribution is used for ranking, which considers average daily weightings for each holding. Past performance does not guarantee future results.

Top detractors from relative performance included The Tile Shop (TTS) and Oshkosh Corporation (OSK). As we have highlighted in past shareholder letters, The Tile Shop has been one of our worst performing recent additions to the portfolio. The company appeared to have a strong position in retail that should be insulated from potential online competitors. However, The Tile Shop has mis-executed in a number of operational areas including management of store inventory, pricing, promotions and new product introductions. While the Fund continues to hold a position in the stock, we are waiting for signs of better execution and a strengthening competitive position before getting more aggressive with the name.

During the first quarter, the Fund added one new stock to the portfolio; Littelfuse (LFUS), and exited one stock; Bank Mutual (BKMU). Littelfuse is a Chicago-based company that manufactures circuit protection equipment for a broad range of electronics in automobiles, telecommunications, industrial robotics, and consumer electronics. We believe the company appears very well positioned to benefit from several big trends going forward; for example, the increased technology content of automobiles such as electrification and additional sensing that accompanies autonomous technology. The company also appears poised to benefit from the ramp up of “the internet of things” as technology is added to everything from appliances to water meters. Bank Mutual was removed as its acquisition by Associated Bank (ASB) was completed in the quarter.

We feel the outlook for small cap stocks appears fairly positive as both revenue and earnings growth continues to accelerate. Valuations we monitor such as price-to-earnings ratios relative to larger firms appear quite attractive now as they have declined to levels not seen since the financial crisis in 2009. It is also possible that repatriation of cash by larger multinational companies will result in increased acquisition activity of smaller companies which could also support a positive outlook for small caps.

Andrew R. Adams            Allen D. Steinkopf  
Lead Manager              Co-Manager

***The Fund's investment objective, risks, charges and expenses must be considered carefully before investing. The summary prospectus or full prospectus contains this and other important information about the Fund and they may be obtained by calling Shareholder Services at (800) 304-7404 or by visiting [www.mairsandpower.com](http://www.mairsandpower.com). Read the summary prospectus or full prospectus carefully before investing.***

The stocks mentioned herein represent the following percentages of the total net assets of the Mairs & Power Small Cap Fund as of March 31, 2018: Amazon.com, Inc. 0.00%, Associated Banc-Corp. 2.76%, Bank Mutual 0.00%, Berkshire Hathaway 0.00%, Bio-Techne Corp. 4.34%, Cullen/Frost Bankers 3.33%, CoreSite Realty Corp. 3.49%, CyberOptics Corp. 1.17%, JP Morgan 0.00%, Littelfuse Inc. 1.02%, Marcus Corp. 2.47%, Oshkosh Corp. 3.02%, Physicians Realty Trust 2.78%, Proto Labs, Inc. 1.70%, Snap-on Corp. 2.14%, Tile Shop Holdings, Inc. 1.32%.

All holdings in the portfolio are subject to change without notice and may or may not represent current or future portfolio composition. The mention of specific securities is not intended as a recommendation or an offer of a particular security, nor is it intended to be a solicitation for the purchase or sale of any security.

Price-to-earnings ratio is the ratio of a company's share price to its per-share earnings.

## Average Annual Total Returns (%)

As of 3/31/18	QTR <sup>(1)</sup>	1 Year	3 Year	5 Year	Since Inception <sup>(2)</sup>
Mairs & Power Small Cap Fund <sup>(3)</sup>	-3.28	1.48	7.17	10.12	16.39
S&P 600 Index TR <sup>(4)</sup>	0.57	12.68	10.76	13.56	16.15
Morningstar Small Blend Category <sup>(5)</sup>	-0.93	9.68	7.21	10.29	N/A

Expense ratio: 1.05%

Inception: 8/11/2011

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<sup>(1)</sup> Periods less than one year are not annualized.

<sup>(2)</sup> Since inception performance is as of August 11, 2011, which was the offering date of the Small Cap Fund.

<sup>(3)</sup> Performance information shown includes the reinvestment of dividend and capital gain distributions, but does not reflect the deduction of taxes that a shareholder would pay on Fund distributions or the redemption of Fund shares.

<sup>(4)</sup> The S&P 600 Small Cap Total Return (TR) is an index of small-company stocks managed by Standard and Poor's that covers a broad range of small cap stocks in the U.S. The index is weighted according to market capitalization and covers about 3-4% of the total market for equities in the U.S. It tracks both the capital gains of a group of stocks over time and assumes that any cash distributions, such as dividends, are reinvested back into the index. It is not possible to invest directly in an index.

<sup>(5)</sup> Morningstar Small Blend Category, as defined by Morningstar are stocks in the bottom 10% of the capitalization of the U.S. equity market are defined as smallcap. The blend style is assigned to portfolios where neither growth nor value characteristics predominate. It is not possible to invest directly in Small Blend Category.

All investments have risks. Mairs & Power Small Cap Fund is designed for long-term investors.

The Fund's share price can fall because of weakness in the broad market, a particular industry or specific holdings. Investments in small and midcap companies generally are more volatile. International investing risks include among others political, social or economic instability, difficulty in predicting international trade patterns, taxation and foreign trading practices and greater fluctuations in price than U.S. corporations. The Fund may invest in initial public offerings by small cap companies, which can involve greater risks than investments in companies which are already publicly traded.

This commentary includes forward-looking statements such as economic predictions and portfolio manager opinions. The statements are subject to change at any time based on market and other conditions. No predictions, forecasts, outlooks, expectations or beliefs are guaranteed.

ALPS Distributors, Inc. is the Distributor for Mairs & Power Funds.

MAIRS &amp; POWER

MNP001071 7/31/2018

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