CORBYN INVESTMENT MANAGEMENT, INC.

April 2018

Dear Advisors and Clients:

In a marked contrast to recent quarters, the equity markets experienced significant volatility during the first quarter of 2018. For example, the S&P 500 had six separate one-day moves of 2% or more during the quarter, after going through all of 2017 without any moves of such magnitude. After posting strong gains during January, equity prices fell sharply in early February with the Dow Jones Industrial Average and the S&P 500 both experiencing their first correction (a decline of 10% or more) in almost 2 years. Although the stock market staged a brief rally in early March, it could not hold the advance and most of the major equity market indices suffered losses for the quarter, with the S&P 500 posting its first decline in 10 quarters. Fixed income markets also had a difficult quarter as both short and long-term interest rates moved higher, causing most corporate and government bond market indices to suffer negative returns.

The increased level of volatility and the correction in the equity markets resulted from a combination of factors. Interest rates moved higher as the Federal Reserve continued to reverse its very accommodative monetary policy and inflation expectations rose given continued strong economic indicators as well as anticipated growth acceleration spurred by tax reform and increased deficit spending. Midway through the quarter, protectionist trade policies took center stage, and investors struggled to determine what effect proposed tariffs might have on global economic growth, as well as specific industries and individual companies. As investors looked out into a more uncertain world, increased sensitivity to underlying business fundamentals resulted in more volatile equity valuations.

Although increased volatility is unsettling to some, we welcome a shift in market dynamics back to a more thoughtful, valuation-sensitive framework, as it plays into Corbyn's strength as a "bottom-up" active manager. These factors should serve our clients well during such volatile market environments.

Equities

Corbyn equity-oriented accounts had strong positive performances in January but ultimately finished the quarter with returns that were flat to slightly down. This compares favorably to the -2.8% decline in the Russell 3000 Value Index, a broad representation of value stocks of all market capitalizations that is most characteristic of the portfolio holdings. Overall, we believe that our focus on company-specific fundamentals and valuations helped to insulate the portfolios from some of the market turmoil during February and March.

The recent market turbulence is reminding investors about the importance of the relationship between business fundamentals and valuations. We have always been committed to searching for stocks that we believe are undervalued and have strong balance sheets, substantial free cash flows and management teams that are focused on growing shareholder value. Through conversations with management teams, industry analysts and others, we work to identify drivers of fundamental improvement likely to be realized through either individual company actions or broader industry or economic trends. In this way, we invest the portfolios in securities that we believe are attractively valued with strong franchises and improving fundamentals.

Many of the equity securities held in the portfolios should benefit, directly or indirectly, from lower corporate tax rates, higher capital spending driven by incentives included within the tax reform legislation, a broad base of various infrastructure investments, improving employment, wage growth and a strong domestic economy. Beyond these macroeconomic drivers, many securities in the portfolios have company-specific initiatives to further drive value, including cash flow deployment, product repositioning, cost savings plans, and acquisitions and/or divestitures. As the year progresses, we expect these company-specific tailwinds to drive healthy levels of growth in earnings per share, cash flow and dividends for the equity holdings within the portfolios.

Fixed Income

The Corbyn fixed income portfolios turned in yet another quarter of steady positive performance despite a challenging environment in which interest rates generally increased, saddling many fixed income investors, in both government and corporate bonds, with losses. Although the absolute increase in interest rates was not large, as the 10-year and 30-year U.S. Treasury securities increased by only 34 and 23 basis points, respectively, the relative increase was meaningful given the low interest rate environment. Additionally, investor psychology continued to shift towards expectations of further increases in interest rates going forward.

In a rising interest rate environment, our focus on short-duration fixed income securities should benefit the portfolios due partially to “bond math.” Fundamentally, bond prices move inversely with yields (if yields go up, prices go down) with the maturity date of a bond significantly affecting the magnitude of a price change. Consequently, when yields rise, a short-term bond will see a much smaller price change than a longer-term bond because the short-term bond holder receives the cash flows (principal and interest) over a relatively short period of time. On the other hand, a relatively small increase in interest rates has a large negative impact on the price of a long-term bond, particularly a low coupon bond, since many future years of cash flows are discounted back at the higher rate. We saw evidence of this dynamic during the quarter, as many long-term bond funds suffered losses in excess of 3%. If interest rates continue to move higher, even at a measured pace, it could be a painful experience for long-term bond investors.

Fortunately, unlike many fixed income investors, due to the short duration of our bond holdings, we see a benefit to higher interest rates. Many of our recent bond purchases have been at higher expected yields to maturity/call than in recent months and years, which should help to drive greater future total returns for the portfolios.

Bond math is only part of the equation for a successful total return with short-duration fixed income securities. As with all fixed income investors, we must also continue to employ careful credit analysis to assure that the companies in which we invest will be in a position to comfortably service their debt even in a more tumultuous business environment.

At Corbyn, our definition of value has evolved over our long history and continues to be refined as the financial world changes around us. We remain committed to our distinctive long-practiced value style of investing for both equity and fixed income securities. Our approach is intended to generate attractive returns over the long term and, just as importantly, reduce the potential for substantial capital losses.

We look forward to reporting our updated thoughts and comments to you at the end of the second quarter.

Respectfully,

Charles vK. Carlson, CFA
President
Co-Chief Investment Officer

Michael J. Fusting, CFA
Senior Vice President
Co-Chief Investment Officer

Michael J. Pulcinella
Head Trader & Investment Analyst

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