Royce Small-Cap Value Fund Manager Commentary

By Jay Kaplan Last updated December 31, 2021

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Fund Performance

Royce Small-Cap Value Fundgained 28.2% in 2021, trailing the 28.3% gain for its primary benchmark, the Russell 2000 Value Index, by the thinnest of margins and beating the Russell 2000 Index, which rose 14.8% for the same period.

What Worked… And What Didn't

All of the portfolio's nine equity sectors made a positive impact on 2021 performance. Industrials, Information Technology, and Consumer Discretionary made the most sizable positive contributions, while the smallest positive impacts came from Consumer Staples, Real Estate, and Energy. Specialty retail in Consumer Discretionary, electronic equipment, instruments & components in Information Technology, and road & rail in Industrials contributed most at the industry level. Conversely, communications equipment in Information Technology, insurance, and consumer finance (both in Financials) were the largest detractors for the calendar year.

At the position level, the Fund's top contributor was Arkansas-based freight and logistics solutions provider ArcBest. In its third-quarter earnings release, the company announced record quarterly revenue and operating income, with consolidated quarterly revenues of more than $1 billion. ArcBest also benefited from its acquisition of Chicago-based truckload brokerage company MoLo Solutions. The second top contributing position for the calendar year was Shoe Carnival, a discount footwear retailer. Many of the company's competitors have closed their doors, helping its business. In addition, Nike consolidated the number of stores that can sell its products, which included Shoe Carnival. The company was also able to discontinue deep discounting due to stronger demand, leading to margin expansion. Kulicke & Soffa Industries is a leader in manufacturing equipment and tools used to assemble and package semiconductor devices. Kulicke is benefiting from record industry wafer fab equipment spending and a structural increase in the complexity of chip packaging due to increased advanced packaging or multi-die packaging techniques. Approximately 50% of all semiconductors processed utilize the company's wire bonding equipment. Additionally, Kulicke has been benefiting from new product introductions in the mini-LED packaging market, which is growing quickly.

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The biggest detractor was fitness equipment manufacturer Nautilus. The company's third quarter results were hurt by inflation, as well as by global shipping and supply chain challenges, which made profitability unlikely. For these reasons, we exited our position. James River Group, the portfolio's next biggest detractor, focuses on "Excess & Surplus" insurance. Its stock saw its most severe dip in 2021's first half. The company then took a charge in the fourth quarter related to its non-core reinsurance division that, while fairly small, came on the heels of the much larger charge taken earlier in the year in its commercial auto business (specifically Uber), which led its shares to drift lower. Current management has been attempting to fix the issues created by the prior team, though our own concerns about the timing and extent of the fixes led us to reduce our position significantly. Super-regional property and casualty insurance holding company Heritage Insurance Holdings also detracted. The company, which has significant business in coastal areas, was hurt by poor weather in Florida during 2021. We believe that Heritage Insurance can benefit from premium insurance rate increases. The stock is inexpensive, and we maintained our position.

The portfolio's very narrow disadvantage versus the Russell 2000 Value was attributable to sector allocation. Financials detracted most at the sector level due to stock selection while our much lower exposure to Energy also hurt, as did our cash position. Conversely, stock selection in 2021 was especially strong in Industrials, Health Care, and Information Technology. Our underweight in the second sector was also beneficial.

Top Contributors to Performance 2021[1] (%)

ArcBest	2.91
Shoe Carnival	1.90
Kulicke & Soffa Industries	1.69
OneWater Marine Cl. A	1.65
Rent-A-Center	1.13

[1] Includes dividends

Top Detractors from Performance 2021[2] (%)

Nautilus	-0.65
James River Group Holdings	-0.43
NETGEAR	-0.40
Heritage Insurance Holdings	-0.39
Haverty Furniture	-0.36

[2] Net of dividends

Current Positioning and Outlook

We expect that 2022 will be a good year for small-cap value as all signs point to continued economic strength, though we're mindful that continuing COVID resurgences could disrupt this positive backdrop. In addition, the Fed has clearly signaled that interest rates will rise in 2022, which should bode well for value investors like us. There had been a disconnect between the stagnant 10-year Treasury yield and the Fed's language until recently. Though the 10-year yield, however, it is beginning to rise. We believe the equity market is incorporating this view, as seen by the weak performance of many long-duration assets like richly valued, non-earning, story-based growth stocks. We see the semiconductor supply chain issue lasting through most of 2022, and labor shortages and wage pressures look likely to continue. Inflation is with us now and is real. In this context, we have been buying selectively, adding, for example, to our technology weighting, pharmaceutical companies with proven products and promising pipelines, and homebuilders and other housing related companies in the area of home furnishings.

Average Annual Total Returns Through 12/31/21 (%)

	QTR[1]	YTD[1]	1YR	3YR	5YR	10YR	15YR	20YR	SINCE INCEPT.	DATE
Small-Cap Value	8.19	28.24	28.24	12.34	6.74	7.58	5.93	8.41	9.10	06/14/01
Russell 2000 Value	4.36	28.27	28.27	17.99	9.07	12.03	7.19	9.18	9.16	N/A
Russell 2000	2.14	14.82	14.82	20.02	12.02	13.23	8.69	9.36	9.07	N/A

Annual Operating Expenses: Gross 1.62 Net 1.49

[1] Not annualized.

Important Performance and Disclosure Information

Important Performance and Expense Information

All performance information reflects past performance, is presented on a total return basis, reflects the reinvestment of distributions, and does not reflect the deduction of taxes that a shareholder would pay on fund distributions or the redemption of fund shares. Past performance is no guarantee of future results. Investment return and principal value of an investment will fluctuate, so that shares may be worth more or less than their original cost when redeemed. Shares redeemed within 30 days of purchase may be subject to a 1% redemption fee, payable to the Fund, which is not reflected in the performance shown above; if it were, performance would be lower. Current month-end performance may be higher or lower than performance quoted and may be obtained at www.royceinvest.com. Gross operating expenses reflect the Fund's gross total annual operating expenses for the Service Class and include management fees, 12b-1 distribution and service fees, and other expenses. Net operating expenses reflect contractual fee waivers and/or expense reimbursements. All expense information is reported as of the Fund's most current prospectus. Royce has contractually agreed, without right of termination, to waive fees and/or reimburse expenses to the extent necessary to maintain the Service Class's net annual operating expenses (excluding brokerage commissions, taxes, interest, litigation expenses, acquired fund fees and expenses, and other expenses not borne in the ordinary course of business) at or below 1.49% through April 30, 2022.

Current month-end performance may be obtained at our Prices and Performance page.

Notes to Performance and Other Important Information

The thoughts expressed in this report concerning recent market movements and future prospects for small company stocks are solely the opinion of Royce at December 31, 2021, and, of course, historical market trends are not necessarily indicative of future market movements. Statements regarding the future prospects for particular securities held in the Funds' portfolios and Royce's investment intentions with respect to those securities reflect Royce's opinions as of December 31, 2021 and are subject to change at any time without notice. There can be no assurance that securities mentioned in this report will be included in any Royce-managed portfolio in the future.

As of 12/31/21, the percentage of Fund assets was as follows: ArcBest was 1.4%, Shoe Carnival was 2.4%, Kulicke & Soffa Industries was 2.5%, OneWater Marine Cl. A was 2.6%, Rent-A-Center was 2.4%, Nautilus was 0.0%, James River Group Holdings was 0.1%, NETGEAR was 0.0%, Heritage Insurance Holdings was 0.2%, Haverty Furniture was 1.5%, MoLo Solution was 0.0%

Sector weightings are determined using the Global Industry Classification Standard ("GICS"). GICS was developed by, and is the exclusive property of, Standard & Poor's Financial Services LLC ("S&P") and MSCI Inc. ("MSCI"). GICS is the trademark of S&P and MSCI. "Global Industry Classification Standard (GICS)" and "GICS Direct" are service marks of S&P and MSCI.

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This material contains forward-looking statements within the meaning of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), that involve risks and uncertainties, including, among others, statements as to:

-the Funds' future operating results,

-the prospects of the Funds' portfolio companies,

-the impact of investments that the Funds have made or may make, the dependence of the Funds' future success on the general economy and its impact on the companies and industries in which the Funds invest, and

-the ability of the Funds' portfolio companies to achieve their objectives.

This discussion uses words such as "anticipates," "believes," "expects," "future," "intends," and similar expressions to identify forward-looking statements. Actual results may differ materially from those projected in the forward-looking statements for any reason.

The Royce Funds have based the forward-looking statements included in this commentary on information available to us on the date of the commentary, and we assume no obligation to update any such forward-looking statements. Although The Royce Funds undertake no obligation to revise or update any forward-looking statements, whether as a result of new information, future events, or otherwise, you are advised to consult any additional disclosures that we may make through future shareholder communications or reports.

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