

Investment perspectives



Steven Hill

Portfolio Manager

First Investors Special Situations Fund

First Investors Special
Situations Fund (Class A)



Class A shares rated 4 overall stars by Morningstar among 650 Small Blend funds for the period ended 1/31/18 based on risk-adjusted performance.¹

Key highlights:

- Team takes a fundamental approach to small-cap value investing
- Upcoming trends to watch include: tax reform impact on financials, industrials and materials; M&A activity; and regulatory climate
- Optimistic about equity markets given economic indicators

An interview with Steven Hill

We recently sat down with Steven Hill, portfolio manager of the **First Investors Special Situations Fund**, to get his thoughts on his team's investment process, his outlook for the year and some specifics about the Fund.

Can you tell us about your approach to small-cap investing?

Steven Hill (SH): First, it is important to understand that our team's approach to small-cap investing is based on fundamental analysis. While it is helpful to have a view of the larger macro environment, it is not the sole determinant of our process. Naturally, there are exceptions, such as during the 2008 financial crisis when we felt we needed to reduce our exposure to financials. That said, our focus primarily is on company fundamentals.

What does your investment universe look like?

SH: We focus on U.S. small-cap stocks with a value bias, meaning their fundamentals are being discounted by the market for some reason. This could be due to the company facing recent internal struggles, experiencing reduced competitiveness in the marketplace, or perhaps having to restructure or downsize before regaining its profitability. Whatever the circumstance, our goal is to invest in these companies at their inflection points, just before they are ready to experience an upswing in their performance.

Can you describe your sell discipline?

SH: All of our investments have a thesis and a price target. Our thesis is simply the list of reasons why we believe an investment will deliver compelling returns. Specific examples may include a new product launch or geographic expansion. But generally, the reasons rely on representations by management about future plans and milestones. If we are wrong, and management fails to meet a milestone, then we re-evaluate our thesis to determine if we should form a

new one. If not—if our thesis is “blown”, so to speak—then that's a compelling reason to sell. Another compelling reason to sell is a more obvious one: the investment has exceeded our price target. If we believe management has successfully met its milestones but that the market has over-valued its success, then we will sell.

A less common reason to sell—but important to mention nevertheless—is any change in the valuation of the company's fundamentals that would cause its style to drift. For example, if a small value investment is a success, but then the subsequent stock price rise causes it to be re-rated as a mid-cap core stock, then we may sell.

Your team talks a lot about catalysts. Can you share what you mean by that and provide a few examples?

SH: Sure. We define a catalyst as a discrete change or event in the near term, or special situations, that unlocks a company's profits. Common examples for us include the synergies that arise from M&A (Mergers and Acquisitions), new product launches, cost rationalizations, market share gains, and price increases.

Is there any specific sector that you are particularly interested in today?

SH: Sectors that we are focused on have industries that may benefit the most from Trump's election. Lower tax rates should accelerate earnings growth. Also, a more lax regulatory environment may increase the odds of M&A. That said, we still have our work cut out for us. Many companies in these industries may have suffered disappointing financial results for extended periods of time and Trump's election doesn't “automatically”

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¹ Effective 3/1/18, the First Investors Special Situations Fund's Morningstar category changed to US Fund Small Value from US Fund Small Blend. For the 3-, 5- and 10-year periods, respectively, the Fund was rated 4, 3 and 4 stars among 650, 557 and 400 funds in the US Fund Small Blend funds category for the time period 1/31/18. The Morningstar Rating™ for funds, or “star rating”, is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts) with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10-year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods. Past performance is no guarantee of future results.

First Investors Special Situations Fund Top Holdings as of 12/31/17

Security	% of Total Net Assets
American Financial Group, Inc.	2.4%
Orbital ATK, Inc.	2.0%
Sterling Bancorp	1.7%
Trinseo SA	1.5%
AptarGroup, Inc.	1.5%
Century Communities, Inc.	1.2%
Berkshire Hills Bancorp, Inc.	1.2%
Brown & Brown, Inc.	1.1%
MKS Instruments, Inc.	1.1%
Centene Corp.	1.1%
Total	14.8%

This information is solely for illustrative purposes. The portfolio as of the date of this report may or may not be the same as the portfolio on the date this material is used.

First Investors Special Situations Fund Sector Allocations as of 12/31/17

Security	% of Total Net Assets
Financials	21.0%
Consumer Discretionary	15.4%
Industrials	14.4%
Information Technology	10.0%
Materials	9.8%
Health Care	6.0%
Real Estate	5.4%
Energy	4.4%
Utilities	4.0%
Consumer Staples	3.8%
Telecommunications Services	0.6%
Cash Equivalents	5.4%

This information is for illustrative purposes only and includes only invested cash; therefore, the sum of all sectors as a percentage of net assets may not equal 100%.

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make them good investments. We still need to dig deep into understanding historical performance and assessing the future prospects of these companies.

Looking ahead a bit into 2018, what are the key trends impacting small caps?

SH: We think there are a couple of trends to be aware of moving into the new year. First, the new tax act passed in December will have a profound impact on many small-cap stocks. Several sectors that are currently being taxed at high rates, such as financials and industrials, will be disproportionately affected by the legislation. We think that banks and insurers, in particular, will benefit from the corporate tax cut. Industrials are also likely to be significantly impacted due to their tax rates. REITs (Real Estate Investment Trusts), on the other hand, may not be affected much given their tax structures. Most small cap biotech companies don't pay taxes anyway, since they haven't generated any profits yet. Second, the M&A climate is very interesting to us. Small caps have traditionally been takeover targets, especially given their smaller size. This is definitely an area we plan to keep an eye on in 2018.

What are your thoughts on the larger investment environment as we move forward this year?

SH: I'm optimistic, especially when considering competing asset classes. Bonds are facing rising interest rates. China's growth rate has leveled off. The U.K. voted for Brexit in 2016, but the withdrawal negotiations are still ongoing. Meanwhile, in the U.S.,

manufacturing is rebounding, inflation remains somewhat contained, and oil prices are recovering. While it's true business loan growth is below expectations, that doesn't appear to be a cause for alarm. Perhaps more concerning are the wage pressures that are now filtering into economic data; these same pressures have contributed to recent market volatility.

What is the cash position in the Fund?

SH: Ideally, we aim to always be fully invested in the market. Having said that, we typically have 1-2% in cash at a given time.

How large is your top 10 and what's the largest position you'll take?

SH: We always try to keep the top 10 holdings under 20% of the total portfolio assets.

Are sector allocations deliberately targeted?

SH: Good question. Sector weightings are largely a result of our bottom-up investment process. Investments that fit our investment process may be added to our fund regardless of their sector. That said, we are mindful of significant sector overweights and underweights. The point is that our Fund does not take "sector bets", and going too far in any particular sector's weighting is something we monitor.

These views represent the opinions of the Portfolio Manager and are not intended as investment advice or to predict or depict the performance of any investment. These views are as of the close of business on January 29, 2018, based on the information available at the time and are subject to change at any time based on market or other conditions. We disclaim any responsibility to update such views.

All investments involve risk, including possible loss of principal. You can lose money by investing in a fund. There is no guarantee that the Fund's investment objective will be achieved. The principal risks of investing in the First Investors Special Situations Fund are: Exchange Traded Fund Risk, Market Risk, REIT Risk, Security Selection Risk, Small-Size and Mid-Size Company Risk and Undervalued Securities Risk. Past performance is no guarantee of future results.

First Investors Funds are managed by Foresters Investment Management Company, Inc. and distributed by Foresters Financial Services, Inc.; each is a wholly owned subsidiary of Foresters Financial Holding Company, Inc.

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