AMG Yacktman Special Opportunities Fund - Year-End Update - December 31, 2016

SEMI-ANNUAL INVESTOR LETTER

Class I | YASSX | Class Z | YASLX

YACKTMAN ASSET MANAGEMENT

AMG Yacktman Special Opportunities Fund – Year-End Update – December 31, 2016

For the twelve months ending December 31, 2016, the **AMG Yacktman Special Opportunities Fund** (the Fund) delivered a return of 25.04%. The benchmark, the MSCI All Country World Index (ACWI) All Cap, returned 8.40% during the same period.

2016 was a good year. We outperformed the benchmark in relative terms by 16.64% and generated attractive returns on an absolute basis. During the first six months of the year, we added capital to several existing positions on temporary price declines. These actions paid off as share prices recovered in the second half of the year. Compounding capital over the long-term is the ultimate objective and we believe the Fund remains well-positioned to achieve our goal.

One of the key advantages of the Fund is a broad investment mandate. Competitive advantages are eroding faster than ever as the pace of change in business accelerates. We believe it is critical to structure an investment strategy that can adapt and respond to these changes. Our ability to "go anywhere" in search of investment opportunities—including up-and-down the market cap spectrum and in various asset classes around the world—provides valuable flexibility. 2016 demonstrated this advantage, as a high-yield bond was both our top holding and largest contributor to performance. In a market characterized by high valuations, elevated profit margins and overleveraged balance sheets, obvious values are rare. Our large and flexible investment universe offers more opportunities to uncover value, allowing us to navigate this kind of environment.

One challenge of such a large universe is filtering—how to organize and sort so many potential opportunities? We use a number of tools to scour the landscape of potential investments, but reading and synthesizing financial information is a big part of the process. Beyond annual reports and financial filings, we also delve into books on broader topics. One of the best books this year is the autobiography *Shoe Dog* by Phil Knight, the founder of Nike. It is a fascinating account written in a refreshing style that tells the story of the creation and growth of the company. One passage stood out:

"I'd met other accountants who knew numbers, who had a way with numbers, but Hayes was to the numbers born. In a column of otherwise unspectacular fours and nines and twos, he could discern the raw elements of Beauty. He looked at numbers the way the poet looks at clouds, the way the geologist looks at rocks. He could draw from them rhapsodic song, demotic truths. And uncanny predictions. Hayes could use numbers to tell the future. Day after day I watched Hayes do something I'd never thought possible: He made accounting an art."

Our strategy is to start with our primary source material, the financial statements. The numbers weave a story about a business and how it generates cash. Does the business charge high prices and earn healthy margins or compete on low cost and rapid asset turnover? Does management prefer to grow via acquisition or return capital to shareholders? Does the business react well during a market meltdown like 2008-2009? The financial numbers help answer these questions and suggest areas for deeper exploration. A holistic approach of analyzing the industry, business model, management and growth prospects is required, but we start with the numbers first.

Fund Review

Financial Metrics[1]	YASLX / YASSX	MSCI ACWI All Cap Index	S&P 500® Index	Russell 2000® Index
Price/Earnings (P/E)	12.72x	17.79x	19.41x	21.09x
Price/Book (P/B)	1.07x	1.88x	2.61x	2.01x
Price/Cash Flow (CF)	8.00x	11.40x	13.15x	15.57x
Price/Sales (P/S)	0.58x	1.35x	1.99x	1.24x
Debt to Equity	47.3%	89.3%	98.8%	81.1%
ROA%	5.6%	6.1%	7.4%	3.6%

Just like our investment approach begins with a company's numbers, the financial metrics of the Fund also tell a story. The table above represents a snapshot of the Fund's metrics relative to the market. Despite 25%+ returns in 2016, valuation levels for the Fund are still 30-50% below the corresponding indices. We continue to own quality businesses at below-average prices. Why do we focus so much on valuation? Buying at a low price relative to business value provides a margin of safety. Price matters. And we believe holding good businesses at 50% off is a recipe for excellent long-term returns.

Contributors / Detractors

Our three largest contributors were Emeco Holding's 9.875% 2019 Notes (Emeco), America's Car-Mart Inc. (Car-Mart) and Texhong Textile Group Ltd (Texhong).

The largest contributor was our only fixed-income investment. As outlined in our 2015 year-end letter, we started building a position in Emeco's debt due to the combination of equity-like rates of return with much lower risk (the notes are the senior security in the capital structure). Emeco faced challenges in the first half of 2016, and the company was forced to exit its Canadian oil sands business due to low oil prices. The bonds briefly fell into the low 50s in response. At that price, the remaining

[1] Source: FactSet; Weighted average metrics; as of 12/31/16. Portfolio characteristics are subject to change.

property, plant and equipment was valued at only pennies on the dollar in a liquidation scenario, an outcome we felt was very unlikely. Results improved in the second half of 2016 along with the rally in commodity prices, which boosted utilization, pricing and used equipment values. Despite the improved business performance, management recognized that the existing capital structure was a challenge for the long-run. After much negotiation (and several false starts), the company announced an ambitious merger plan between Emeco and two other equipment rental companies in conjunction with a debt-to-equity swap. As part of this transaction, we will receive equity in the combined company along with a new debt security (which matures two years later than our original bond and at a slightly lower interest rate). This transaction substantially de-risks the balance sheet by allowing greater headroom on interest coverage and reducing cash outflows required to maintain the rental fleet. Both are positive for the bonds, which recovered to the high-70s by the end of 2016. We also enjoyed a healthy interest rate on the bond coupons along the way. Many funds are prevented by mandate from buying such a security. Emeco's contribution therefore showcases the value in our flexible approach.

Both Car-Mart and Texhong were top contributors in the first half of the year, and they kept up their strong results to finish out the second half of 2016. In 2015, Car-Mart's lending results slipped, forcing an increase in the provision for credit losses. Management responded by stopping new store openings to focus on "self-help" initiatives and collection efforts. We applaud the decision to slow expansion—the market applies such constant pressure to grow (often at all costs) that few leaders push the pause button to focus on execution. Car-Mart's results quickly improved, with charge-offs reducing and same store sales accelerating. Most importantly, management took advantage of the weak stock price to aggressively repurchase shares (buying back 3.3% of the company in a single quarter). Better execution and a lower share count caused earnings per share to more than double year-over-year in the six months ending October 31, 2016. The stock price followed the earnings recovery.

Texhong continues its outstanding execution in the tough industry of yarn making. In commodity businesses like textiles, low cost wins. For Texhong, consider general and administrative (G&A) costs per ton of yarn (all in RMB currency): in 2004, G&A costs were 1,971/ton compared to 799/ton in 2016, as higher sales spread out over a fixed cost base, a natural case of operating leverage. The increase of almost 1,200/ton is more than 5% of the average cost of yarn in 2016—this 5% advantage accrues directly to Texhong's margins. Smaller players (there are almost 100k yarn producers in China) must sell at the same price as Texhong despite a much less efficient cost structure. Texhong has a *unit* cost advantage and this advantage is increasing as the business scales. We do not think the market recognizes the company's leadership position or significant cost advantage, and we continue to own shares.

Our three largest detractors in 2016 were Aggreko Plc (Aggreko), Immunodiagnostic Systems Holdings Plc (IDS) and Marshall Motors Holdings Plc (Marshall). All three were small positions, limiting the impact. The common link between the holdings is their location in the United Kingdom, where weakness in the British Pound exacerbated marginal stock price declines.

Aggreko, the temporary power rental company, suffered due to its exposure to Emerging Markets in its Power Solutions business and the sharp decline in shale activity in its Rental Solutions business. The roll-off of profitable legacy contracts signed before the market downturn, including in Japan, Argentina and for the U.S. military, led to a reset of the earnings base. We view this downturn as cyclical, as there remains a growing structural gap between global power supply and demand. We believe that temporary power will be a necessary part of the solution for this gap, and Aggreko is well-placed as the market leader. Order intake saw a significant jump in 2016, an encouraging leading indicator, and earnings should improve due to the combination of a right-sized cost structure and new technology initiatives.

IDS, the maker of in-vitro diagnostic (IVD) immunoassays, continues its turnaround. An aggressive cost savings initiative is underway, with operating costs down 22% in the most recent half year at constant exchange rates. The company's sales mix continues to shift from legacy Vitamin D products (now in decline) towards its own proprietary assays. Automated assay revenues were up 16% in the latest interim report versus a 3% gain in the previous period. This acceleration is an encouraging sign, and we expect momentum to continue with new assay launches and a redesigned sales process.

Marshall, a U.K. auto dealership group, is a recent addition to the Fund. The stock price was down marginally due to negative headlines surrounding Brexit and peaking new auto sales. The auto market is inherently cyclical, and we view the original equipment manufacturers (OEMs) as tough businesses given a heavy fixed cost structure, volatile margins and often significant union and/or pension concerns. As a rule, we demand a lower purchase price when investing in cyclical industries. Auto dealers, however, are sneakily good businesses which benefit from OEM-assigned territories and possess a local monopoly on new car sales. Dealers are also supported by OEMs with generous financing terms to fund car inventory, which lowers the amount of capital required in the business. This industry structure allows dealers to capture the high-margin revenue stream from service and parts on new and like-new cars. This service income stream is very profitable, with gross margins typically above 40% compared to less than 10% for new or used cars. In Marshall's case, aftersales represents only 11% of revenue but 42% of gross profit. The market has concerns about slowing new car sales in the U.K., which have declined post-Brexit after reaching record levels in 2015. We are much more focused on the total number of cars on the road. Even with declining new car sales, a growing pool of potential aftermarket vehicles will be a tailwind for the sector. In May 2016, Marshall announced a major acquisition which almost doubled earnings power, yet the stock remains below its IPO price. At only four times run-rate earnings, we feel Marshall is far too cheap for the quality of the business.

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Conclusion

Looking ahead to 2017, we believe the portfolio is well-positioned and are confident about the upside in our existing positions. Meanwhile, we will continue our search for new investment opportunities. There is always volatility in *some* market, asset class or country, and the Fund is uniquely positioned with a flexible mandate to help take advantage of lower prices wherever they occur. When the inevitable turmoil arrives, our strategy remains the same—start with the numbers. To our shareholders, we appreciate your continued support of the AMG Yacktman Special Opportunities Fund.

Disclosure

Investors should carefully consider the Fund's investment objectives, risks, charges and expenses before investing. For this and other information, please call 800.835.3879 or visit amgfunds.com to download a free prospectus. Read it carefully before investing or sending money.

Past performance is no guarantee of future results.

A short-term redemption fee of 2% will be charged on redemptions of Fund shares within 60 days of purchase.

The Fund's investment management fees are subject to a performance adjustment, which could increase or reduce the investment management fees paid by the Fund. The prospect of a positive or negative performance adjustment may create an incentive for the Fund's portfolio manager to take greater risks with the Fund's portfolio. In addition, because performance adjustments are based upon past performance, a shareholder may pay a higher or lower management fee for performance that occurred prior to the shareholder's investment in the Fund. The performance adjustment could increase the Investment Manager's fee (and, in turn, the Subadvisor's fee) even if the Fund's shares lose value during the performance period provided that the Fund outperformed its benchmark index, and could decrease the Investment Manager's fee (and, in turn, the Subadvisor's fee) even if the Fund's shares increase in value during the performance period provided that the Fund underperformed its benchmark index.

Investments in international securities are subject to certain risks of overseas investing including currency fluctuations and changes in political and economic conditions, which could result in significant market fluctuations. These risks are magnified in emerging markets.

The Fund may suffer significant losses on assets that it sells short. Unlike the possible loss on a security that is purchased, there is no limit on the amount of loss on an appreciating security that is sold short.

The Fund can invest in securities of different market capitalizations (small-, mid- and large-capitalizations) and styles (growth vs. value), each of which will react differently to various market movements.

The Fund is subject to currency risk resulting from fluctuations in exchange rates that may affect the total loss or gain on a non-U.S. Dollar investment when converted back to U.S. Dollars.

The Fund is subject to the special risks associated with investments in micro-cap companies, such as relatively short earnings history, competitive conditions, less publicly available corporate information, and reliance on a limited number of products.

The Fund is subject to risks associated with investments in small- and mid-capitalization companies such as greater price volatility, lower trading volume, and less liquidity than the stocks of larger, more established companies.

Companies that are in similar businesses may be similarly affected by particular economic or market events; to the extent the Fund has substantial holdings within a particular sector, the risks associated with that sector increase.

A greater percentage of the Fund's holdings may be focused in a smaller number of securities which may place the Fund at greater risk than a more diversified fund.

The Funds are subject to the risks associated with investments in debt securities, such as default risk and fluctuations in the perception of the debtor's ability to pay its creditors.

Changing interest rates may adversely affect the value of an investment. An increase in interest rates typically causes the value of bonds and other fixed income securities to fall.

High-yield bonds (also known as "junk bonds") are subject to additional risks such as the risk of default.

The Fund may use derivatives, such as options and futures, which can be illiquid, may disproportionately increase losses, and have a potentially large impact on performance.

Price/earnings (or P/E) ratio is a comparison of the company's closing stock price and its trailing 12-month earnings per share.

Price/book (or P/B) ratio is calculated by dividing the market price of a company's outstanding stock by its book value (total assets of a company less liabilities) and then adjusting for the number of shares outstanding. Stocks with negative book values are usually excluded from this calculation.

The price-to-cash-flow (or P/CF) ratio is a stock valuation indicator that measures the value of a stock's price to its cash flow per share. The ratio takes into consideration a stock's operating cash flow (OCF), which adds non-cash earnings such as depreciation and amortization to net income.

The price-to-sales (or P/Sales) ratio is a valuation ratio that compares a company's stock price to its revenues. The price-to-sales ratio is an indicator of the value placed on each dollar of a company's sales or revenues.

EV/EBIT equals a company's enterprise value (market capitalization plus debt, minority interest and preferred shares, minus total cash and cash equivalents) divided by earnings before interest and tax.

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Debt/Equity (D/E) Ratio, calculated by dividing a company's total liabilities by its stockholders' equity, is a debt ratio used to measure a company's financial leverage.

Return on assets (ROA) is the percentage a company earns on its assets in a given year. The calculation is net income divided by average total assets. The better the company, the more profit it generates as a percentage of its assets.

The MSCI All Country World Index (ACWI) All Cap covers approximately 14,000 securities and includes large, mid, small and micro cap size segments for all Developed Markets countries in the index together with large, mid and small cap size segments for the Emerging Markets countries.

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The S&P 500 Index is a capitalization-weighted index of 500 stocks. The S&P 500 Index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Russell 2000® Index is composed of the 2000 smallest stocks in the Russell 3000® Index and is widely regarded in the industry as the premier measure of small-cap stock performance.

Unlike the Fund, the Indices are unmanaged, are not available for investment and do not incur expenses.

AMG Funds are distributed by AMG Distributors, Inc., a member of FINRA/SIPC.