Small Cap Value Equity
Q1 2019 Commentary

Market Review:

The US equity market got off to a strong start in 2019 with the S&P 500 returning +13.7% and the Russell 2000 +14.6%. It was the best quarter for the S&P 500 in ten years, since the 3rd quarter of 2009, and the best opening quarter of a year since 1998. Equities rebounded from the sharp selloff in the 4th quarter of 2018, when the S&P 500 was down 13.5% and the Russell 2000 declined 20.2%. Concerns that caused the 4th quarter decline, including fears of hawkish Fed policy and a worsening trade war with China, largely abated in the 1st quarter.

Every sector in the Russell 2000 finished the quarter in positive territory, with nine of the eleven sectors posting double-digit gains. Information Technology (+22.6%), significantly impacted by China trade negotiations, was the best performing sector. Energy (+19.9%) also posted an outsized gain, aided by a recovery in oil prices after a 4th quarter decline. Real Estate (+17.6%) outperformed as REITs benefitted from a decline in long-term Treasury yields. The worst performing sectors were Financials (+8.6%) and Consumer Staples (+7.5%), although both recorded strong quarterly returns.

After raising the benchmark federal funds rate four times in 2018, Fed Chair Jerome Powell said at the outset of 2019 that the central bank “will be patient” in its approach to monetary policy. The Fed left rates unchanged throughout the quarter, and following its March meeting Powell indicated there would be no increases in 2019. Furthermore, he said the bank will end its balance sheet tightening program at the end of September. This dovish policy and language contrasted sharply with the Fed’s guidance in the 4th quarter and contributed to the rebound in stocks. Equities were also buoyed by progress in trade talks between the US and China, as President Trump announced a postponement of the March 1st deadline to increase tariffs on roughly $200B of Chinese imports. Trump continues to seek an agreement that would increase US exports to China, boost protection of intellectual property and end pressure on US companies to transfer technology to Chinese partners.

Although stocks rose on positive developments in the quarter, the market also overcame a number of headwinds that it will continue to contend with going forward. In the US, although the economy remains strong by historical measures, a number of indicators point to slowing growth. GDP for the 4th quarter came in at 2.2%, well below the 4.2% and 3.4% figures recorded in the 2nd and 3rd quarters, respectively, as manufacturing activity and consumer spending slowed. The situation contributed to the Treasury yield curve inverting in March, as the yield for 10-year Treasuries fell below that for 3-month notes, the first such occurrence since 2007. Outside the US, a slowing global economy led the IMF to reduce its global growth forecast for 2019 to 3.5%, down from its 3.7% forecast last October. In China, the government announced GDP growth of 6.6% in 2018, the country’s lowest growth rate in 28 years. Finally, the UK Parliament and Prime Minister Theresa May failed on multiple attempts to come to a Brexit agreement, a situation that has created significant uncertainty in the European and global economies.

Performance Analysis:

The Small Cap Value Equity strategy composite returned 11.2% (gross) and 11.1% (net) for the first quarter of 2019. The strategy underperformed the Russell 2500 Value Index and the Russell 2000 for the quarter.

Figure 1: Small Cap Value Equity Returns vs. Benchmark

	Q1	1 Yr	3 Yr	5 Yr	10 Yr	Since Incept*
Small Cap Value Equity (gross)	11.2	2.2	5.6	0.5	10.8	11.4
Small Cap Value Equity (net)	11.1	1.4	4.8	-0.3	10.1	10.5
Russell 2500 Value Index	13.1	1.8	9.9	6.0	15.0	11.0
Russell 2000 Index	14.6	2.1	12.9	7.1	15.4	9.4

**June 1992. Performance for periods greater than 1 year is annualized.*

The strong market recovery in Q1, following the precipitous Q4 sell-off, was broad-based with all sectors participating in the rally. Growth outperformed Value in Q1 by 520 basis points (Russell 2000 Growth Index vs. Russell 2000 Value Index). In addition, non-dividend payers outperformed dividend payers, and non-earners (companies with negative operating income) gained more than earners.

Portfolio Changes:

Purchases

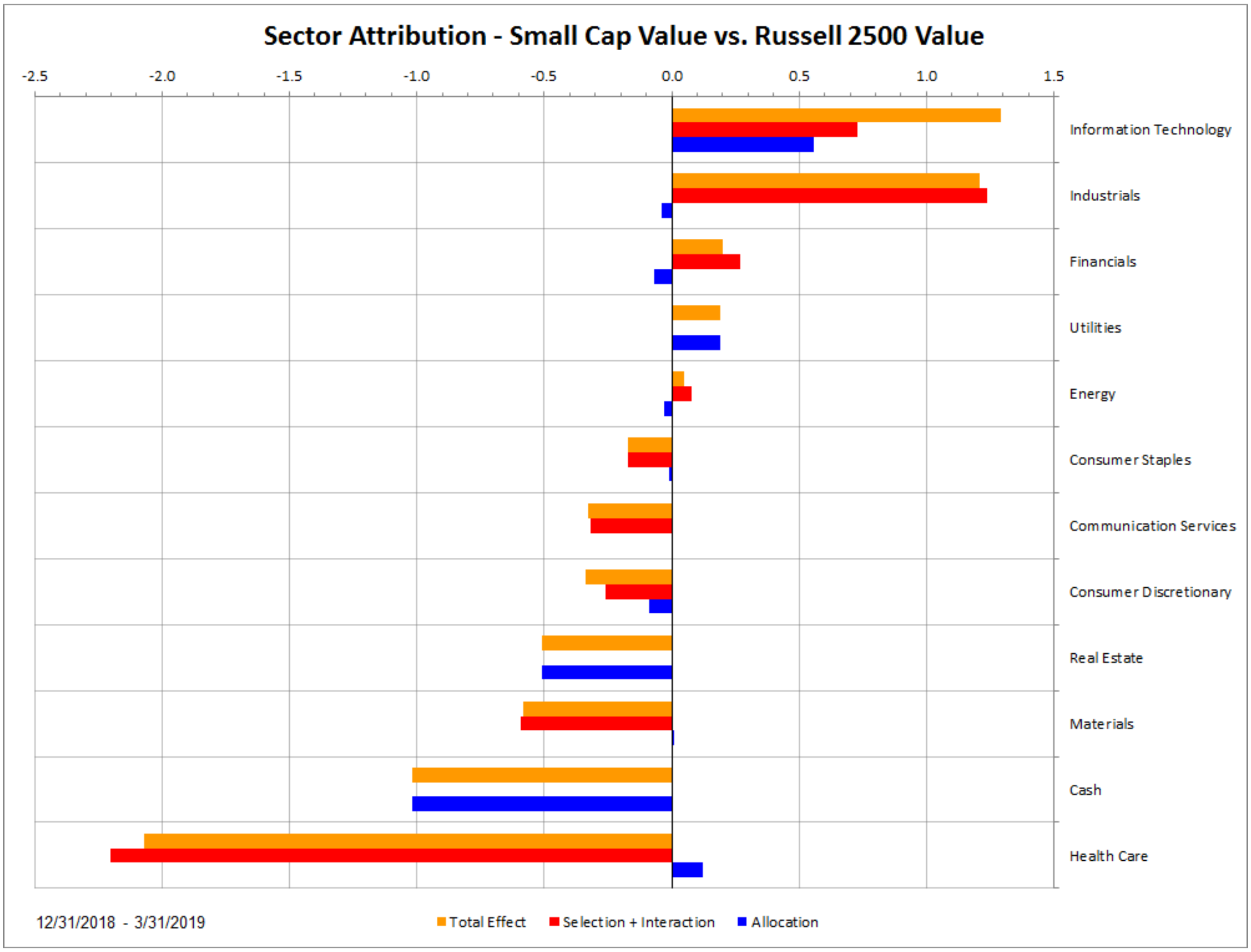
There were no purchases in the quarter.

Sales

Motor Car Parts of America (MPAA) – We exited our position in Motor Car Parts of America over concerns related to its new business launches, and ability to manage its future inventory levels.

Portfolio Attribution:

Attribution Effects – Small Cap Value vs. Russell 2500 Value 12/31/2018 – 3/31/2019



Source: SCCM/Bloomberg, 3/31/2019.

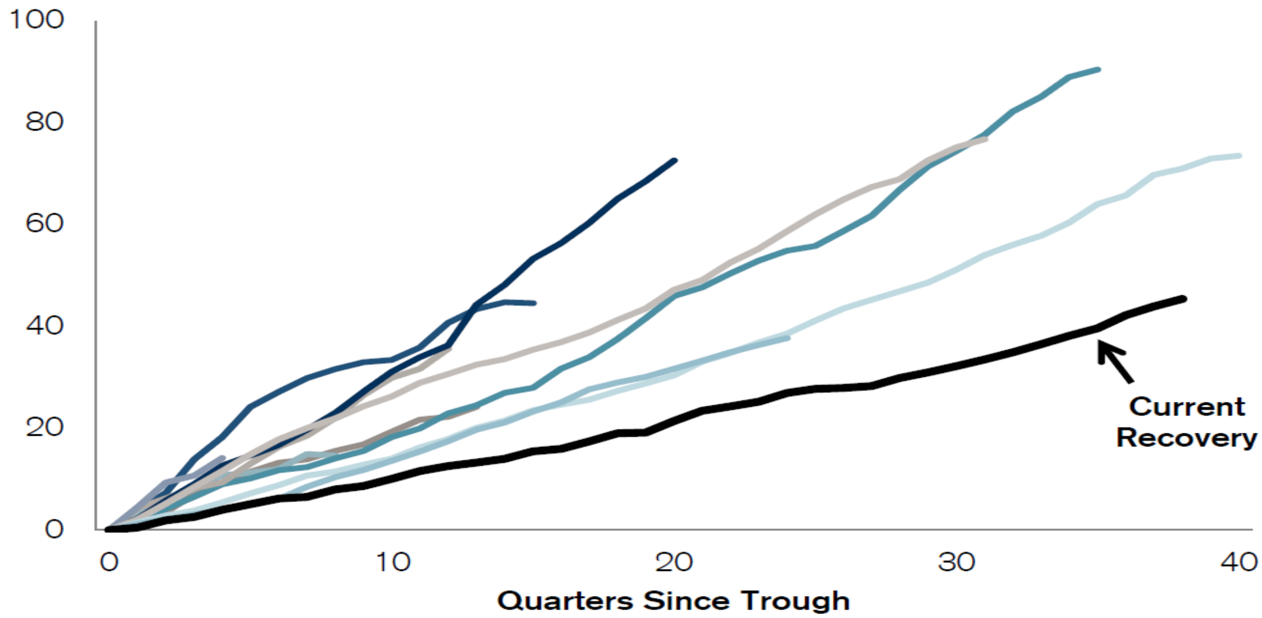
The following attribution analysis of the Small Cap Value Equity portfolio utilizes the Russell 2500 Value as the benchmark of comparison for the first quarter of 2019.

Our overweight allocation and strong stock selection made ***Information Technology*** the largest contributor to relative performance for the quarter. Outperformance here was led by Progress Software (+25.6%). The portfolio also benefitted from our strong stock selection in ***Industrials***, as Team Inc. (+46.7%), Quanta Services (+25.4%), and Rev Group (+23.2%) outperformed. Stock selection within the ***Healthcare*** sector detracted from relative performance as Capital Senior Living (-41.3%) underperformed due to its reported weak occupancy figures. Additionally, stock selection in ***Materials*** detracted from relative performance as Loma Negra (-1.6%) underperformed due to market participants' concerns over the macro economy in Argentina.

Market Outlook:

The strong equity market rally in the first quarter, driven by the Fed's shift to a dovish policy stance and signs of a resolution to the China trade war, largely ignored deteriorating global economic data and downward earnings revisions. The market's optimism is focused on stabilizing global growth, naturally occurring and through renewed monetary and fiscal stimulus. These periodic mid-cycle consolidations over the past ten years have helped to sustain the length of this now historic bull market. While the current cycle is now one of the longest, the sub-par growth in this recovery can further extend the cycle, especially in light of continued accommodative Fed policy and continued corporate earnings growth.

Figure 2: Cumulative GDP Growth Post-Recessions



Note: 1949 to present; Cumulative nominal GDP since trough indexed to 0.
Source: Credit Suisse, "Equity Strategy Navigator," April 2019.

With US equity markets rallying on improving conditions, sentiment has shifted to elevated optimism and favorable technicals and momentum continue to aid the market in its attempt to break through to new highs. Meanwhile, equity risk premiums have declined significantly and should signal a degree of caution. Multiple expansion has been the driver of the rally thus far and while earnings estimates have stabilized, the previous tailwinds of ultra-loose monetary policy and corporate share buybacks are less present and meaningful going forward. Record levels of corporate and government debt and valuation excesses in pockets of the US equity market are factors likely affecting growth and returns ahead.

Thank you for your continued support. Feel free to reach out to us if you have any questions.

Best Regards,
Schafer Cullen Capital Management, Inc.

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The Russell 2500 Value Index is designed to measure the performance of the mid-sized and small capitalization companies in the United States equities market. The index is a composite of roughly 2,500 securities with a median market capitalization value of $1 billion. The Russell 2000 Index is a market-cap weighted index measuring the performance of approximately 2,000 smallest-cap American companies in the Russell 3000 Index, which is made up of 3,000 of the largest U.S. stocks. The S&P 500 Index is a market capitalization-weighted index of 500 companies in leading industries of the US economy. The index is unmanaged and has no fees. Comparisons to indices are inherently unreliable indicators of future performance. The strategies used to generate the performance may vary from those used to generate the returns depicted in the indices. An individual cannot invest directly in an index.

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