Value Equity
Q3 2018 Commentary

Market Review:

US equities surged in the 3rd quarter of 2018, with the S&P 500 advancing 7.7% and the Russell 1000 Value up 5.7%. It was the strongest quarterly return for the S&P 500 since the 4th quarter of 2013. Health Care was the best performing sector, up 14.5%. The sector rallied on news that the Trump administration is considering drug pricing policies that would not significantly alter the current drug supply chain or pharmaceutical industry profits. Information Technology (+12.4%) continued to outperform and the Industrials sector rebounded (+10.0%) after being the worst-performing sector in the 2nd quarter; several leading transportation and capital goods firms posted strong earnings and the Purchasing Managers' Index rose in August to its highest level in 14 years. Energy (+0.6%) and Materials (+0.4%) were the laggards in the quarter. Energy stocks declined in July and August on concerns of rising supply and slowing global economic growth, and Materials stocks struggled partly on declining commodity prices.

Now a full decade from the financial crisis of 2008, the bull market that began in March 2009 is the longest-running bull market in history. Stocks' ongoing advance has been supported by a host of positive economic data, including GDP growth for the 2nd quarter at 4.2%, unemployment at 3.9%, and consumer confidence at its highest level in 18 years. Moreover, year-over-year EPS growth for the S&P 500 is expected to be over 20% for 2018, the highest level of growth since 2010. However, the bull market will have to contend with a number of increasing headwinds going into 2019. The Federal Reserve, which increased interest rates another quarter percentage point in September, is expected to raise rates again in December and continue its tightening policy for the foreseeable future. Furthermore, while the US, Mexico and Canada reached a last minute compromise to revamp NAFTA, the Trump administration remains in conflict with China over trade disputes. After imposing 10% tariffs on an additional $200B of Chinese imports, bringing the total to $250B, China retaliated with tariffs on an additional $60B of US imports on top of $50B instituted earlier in the year. The trade war has raised concerns from business leaders about the potential disruption of supply chains and increases in materials costs.

Performance Analysis:

The Value Equity strategy composite returned 7.8% (gross) and 7.6% (net of fees) in the third quarter of 2018. The Russell 1000 Value returned 5.7% and the S&P 500 returned 7.7% for the quarter.

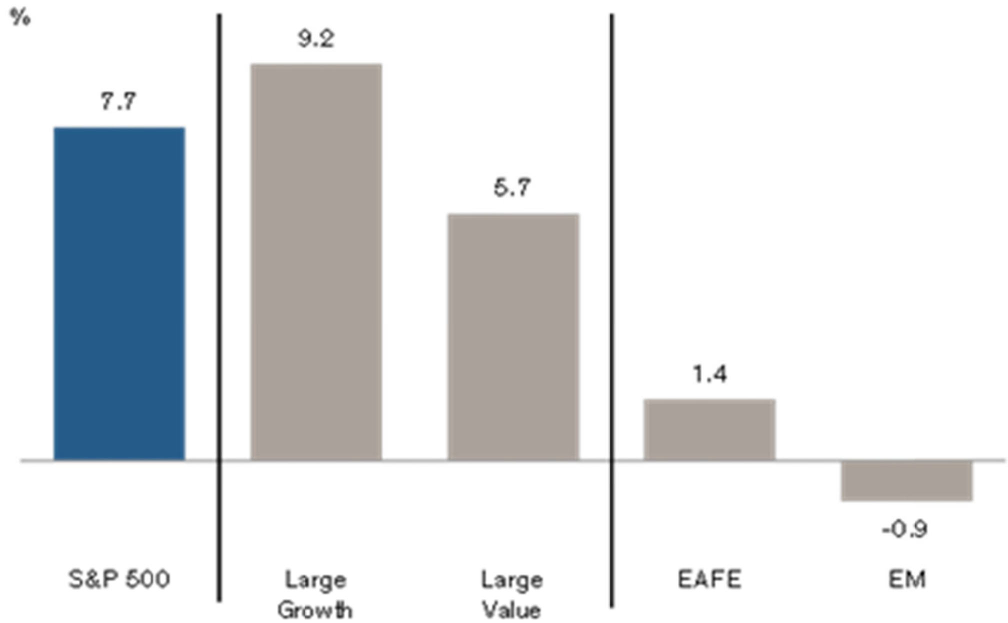
Figure 1: Value Equity Returns vs. Benchmark

	Q3	YTD	1 Yr	3 Yr	5 Yr	10 Yr
Value Equity (gross)	7.8	7.2	12.4	15.7	11.9	10.6
Value Equity (net)	7.6	6.8	11.8	15.2	11.2	9.9
Russell 1000 Value Index	5.7	3.9	9.5	13.6	10.7	9.8
S&P 500 Index	7.7	10.6	17.9	17.3	14.0	12.0

**December 31, 1993. Performance for periods greater than 1 year is annualized.*

In the quarter, Growth further outperformed Value with the Russell 1000 Growth Index +9.2% and the Russell 1000 Value Index +5.7%, a 347 basis point spread. Year-to-date, the Growth over Value spread has widened to 1,317 basis points driven by the dominance of Technology and Consumer Discretionary. International stocks, despite compelling valuations, lagged on concerns of slowing growth, escalating US trade tensions and the stronger US dollar.

Figure 2: 3Q18 US and Global Performance



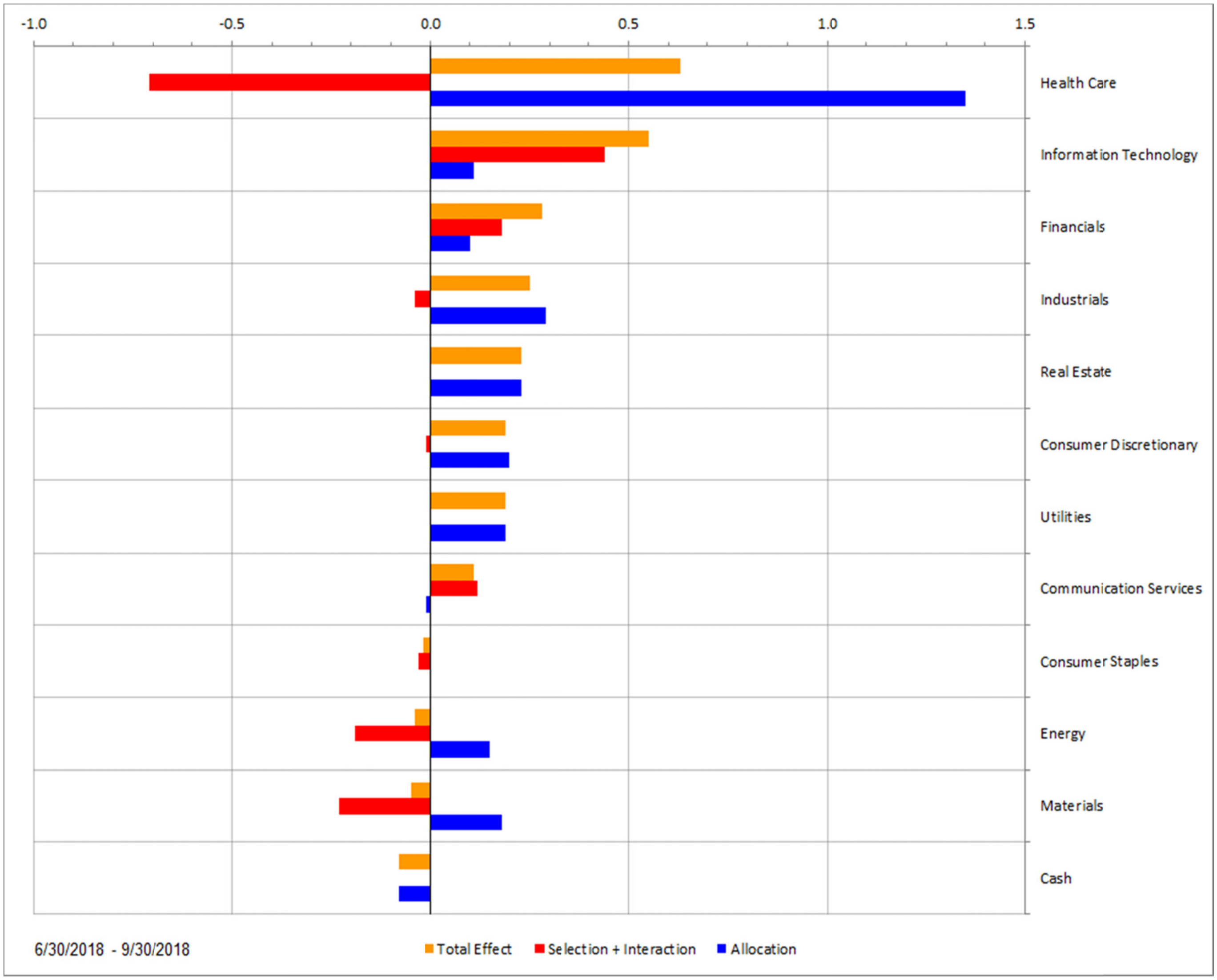
Note: figures shown are total returns. Source: Credit Suisse, Equity Strategy Navigator, 10/1/18.

Portfolio Changes:

There we no changes in the portfolio during the second quarter.

Portfolio Attribution:

Attribution Effects –Value vs. Russell 1000 Value 6/30/2018 – 9/30/2018



Source: SCCM/Bloomberg, 9/30/2018.

The following attribution analysis of the Value Equity portfolio utilizes the Russell 1000 Value as the benchmark of comparison for the third quarter of 2018.

The ***Health Care*** sector was the largest contributor to relative performance for the quarter driven by an overweight allocation in the portfolio. Health Care was the best performing sector for the benchmark in Q3, partly on news that the Trump Administration is considering policies to reduce rebates for pharmacy benefit managers, which could potentially benefit pharmaceutical firms. ***Information Technology*** sector aided relative performance for the quarter driven by strong stock performance combined with an overweight allocation in the portfolio. The sector continued to outperform the broader market, making it the best-performing sector year to date. Oracle was the standout performer in the quarter, returning +17.5%. Microsoft (+16.4%) continued its impressive performance as revenues for its cloud computing platform, Azure, grew 85% in the quarter and an improvement in revenue and cash flow from its 2016 acquisition of LinkedIn added to the positive sentiment. Cisco (+13.9%), which, like Microsoft, is transitioning to a long-term subscription based model, nearly doubled its subscriber base for its Catalyst

9000 series of network switches; in addition, it saw double-digit revenue growth in the quarter for its software applications and security businesses. The strategy benefitted from our underweight allocation and strong stock performance in the ***Financials*** sector where JP Morgan (+8.9%), Allstate (+8.6%) and Citigroup (+7.9%) all provided solid returns in the quarter. Overweight aloocation in ***Industrials*** aided relative performance for the quarter. Finally, our underweight allocation to ***Real Estate, Consumer Discretonary and Utilities*** benefitted the strategy in the quarter.

Our stock performance within the ***Materials*** sector was the largest detractor to relative performance in the quarter due to stock selection. Stock selection in the ***Energy*** sector was a drag on performance although our underweight allocation aided relative performance. Oil prices declined in the first half of the quarter before recovering in September, but remained flat overall. ConocoPhillips (+11.6%) continues to see increasing free cash flow from robust oil and gas production and an improved cost structure. ***Consumer Staples*** was a minor drag on relative performance although portfolio stocks performed in-line with the benchmark sector.

Market Outlook:

US equities have surged higher on strong corporate earnings growth, record levels of share buybacks and a resurgence of US economic growth in the context of slowing international growth. The stimulative effects of fiscal easing, namely US corporate tax reform and higher budget deficits, have lifted current year growth and served to counter the effects of monetary tightening. The divergent sentiment between US and international markets, further fueled by elevated trade tensions and tariffs, has led to a stronger dollar and significant flows into the US. It remains to be seen whether the extreme performance differential between US and global markets will persist, similar to the Growth versus Value disparity that is now approaching a record length.

The bull market leadership has been led by the Technology sector; at current levels, the market capitalization of the five largest S&P 500 stocks (all technology stocks: Amazon, Apple, Facebook, Google, and Microsoft) have a combined market capitalization larger than that of the smallest 281 members of the S&P 500. In 2018, six stocks (Amazon, Apple, Facebook, Google, Microsoft, and Netflix) have generated 50% of S&P 500 returns. Encouragingly, the recent broadening of the US equity market with leadership from the Health Care and Industrials sectors brings fresh support to an otherwise narrow market. The Technology sector has thrived, in part benefitting from relatively low levels of regulation and antitrust oversight; the Technology and E-commerce sector has ~27K regulations, among the least-regulated sectors, versus Manufacturing at ~215K and Finance at ~128K regulations[1]. However, Technology faces increasing risks from federal regulation as US regulatory agencies and legislative bodies, following in the steps of European Union, are now examining technology firms' anti-competitive behaviors, consumer privacy lapses, and allegations of bias behavior. While it is difficult to predict whether federal action will be taken, increased scrutiny is likely to rein in the overt competitive ambitions of these targeted companies.

Meanwhile, the growth of passive investments through ETFs, indexation, swaps and quantitative funds over the past decade have transformed the equity market structure and trading volumes. Through May 2018, total ETF assets under management (AUM) reached $5.0 trillion globally, up from $0.8 trillion in 2008. JPM Equity Strategy estimates that Indexed funds now account for up to 45% of equity AUM globally, while Quant Funds comprise an additional 15-20% of equity AUM. It is estimated that active single-name trading accounts for only ~10% of trading volume while 90% of trading volume comes from

[1] BofA/ML Sector Focus Point, 10/1/18.

Quant, Index, ETFs and Options[2]. The dominance of these products pose a risk as herd behavior and rules-based investing could potentially lead to liquidity disruptions and steep market declines.

In the current market environment, we believe investors should be more mindful of risk, not less. The most effective way to manage risk is to adhere to an investment discipline focused on valuation and quality, which is the core tenet of our investment approach. Relative to fixed income and equity benchmarks, the valuation of our portfolio remain attractive. The strategy trades at 15.4x forward earnings versus 18.7x for the S&P 500 and 17.6x for the Russell 1000 Value.

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.

[2] JPM Perspectives, 9/4/18.