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 1000 Value +11.9%. 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%. 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 finished the quarter in positive territory, with nine of the 11 sectors posting double-digit gains. Information Technology (+19.9%) and Industrials (+17.2%), both significantly impacted by China trade negotiations, were two of the best performing sectors. Real Estate (+17.5%) outperformed as REITs benefitted from a decline in long-term Treasury yields, and is now the best performing sector over the past 12 months. Energy (+16.4%) also posted an outsized gain, aided by a recovery in oil prices after a 4th quarter decline. The worst performing sectors were Health Care (+6.6%) and Financials (+8.6%), 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 Value Equity strategy composite returned 10.1% (gross) and 10.0% (net) for the first quarter of 2019. The strategy underperformed the S&P 500 and Russell 1000 Value for the quarter.

Figure 1: Value Equity Returns vs. Benchmark

	Q1	1 Yr	3 Yr	5 Yr	10 Yr
Value Equity (gross)	10.1	7.9	13.0	9.0	14.4
Value Equity (net)	10.0	7.5	12.5	8.5	13.8
Russell 1000 Value Index	11.9	5.7	10.5	7.7	14.5
S&P 500 Index	13.7	9.5	13.5	10.9	15.9

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 420 basis points (Russell 1000 Growth Index vs. Russell 1000 Value Index). In addition, with the significant decline in volatility, Low Quality stocks (B or worse rated balance sheet) outperformed High Quality stocks (B+ or better) by 440 basis points.

Portfolio Changes:

Purchases / Additions

A position in **AT&T (T)** was purchased in the 1st quarter. Shares of the company had declined to historically low valuation levels based on its P/E ratio and dividend yield, on concerns related to its DirecTV and Time Warner acquisitions. However, with the acquisition of Time Warner finally complete, management has put forth a clear plan to use free cash flow to pay down debt and create economic value through the integration of its wireless network, its TV distribution business, and WarnerMedia. The company is expected to produce approximately $26B of free cash flow in 2019; with a dividend obligation of about $14B, its payout ratio based on free cash is less than 55%. From there, management is committed to using remaining free cash to repay debt, and aims to reduce its leverage ratio to 2.5x by the end of 2019.

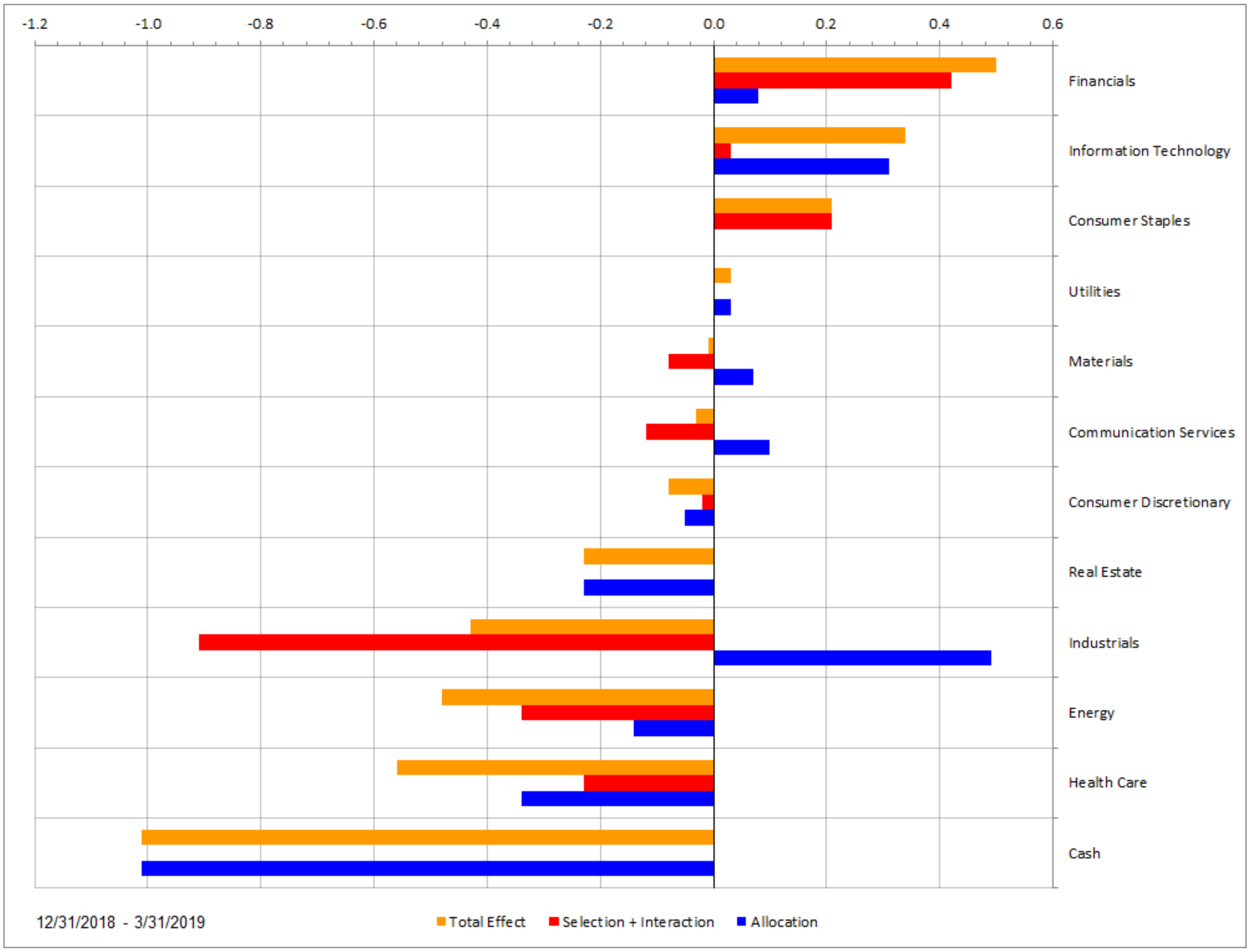
AT&T's wireless unit still accounts for over half of its total EBITDA and has strong earnings prospects going forward, particularly with the rollout of 5G service in the coming months and years. Its DirecTV unit, while experiencing subscriber losses from cord cutting, now accounts for only 15% of total EBITDA and aims to increase subscriber numbers with its DirecTV Now OTT offering. Finally, its WarnerMedia business, including the valuable HBO franchise, is performing well and plans to rollout a new direct-to-consumer streaming service later this year. AT&T trades at only 8.9x 2019 EPS with a 6.4% dividend yield.

Sales / Reductions

There were no sales in the quarter.

Portfolio Attribution:

Attribution Effects –Value Equity vs. Russell 1000 Value 12/31/2018 – 3/31/2019



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

The following attribution analysis of the Value Equity portfolio utilizes the Russell 1000 Value as the benchmark of comparison for the first quarter of 2019.

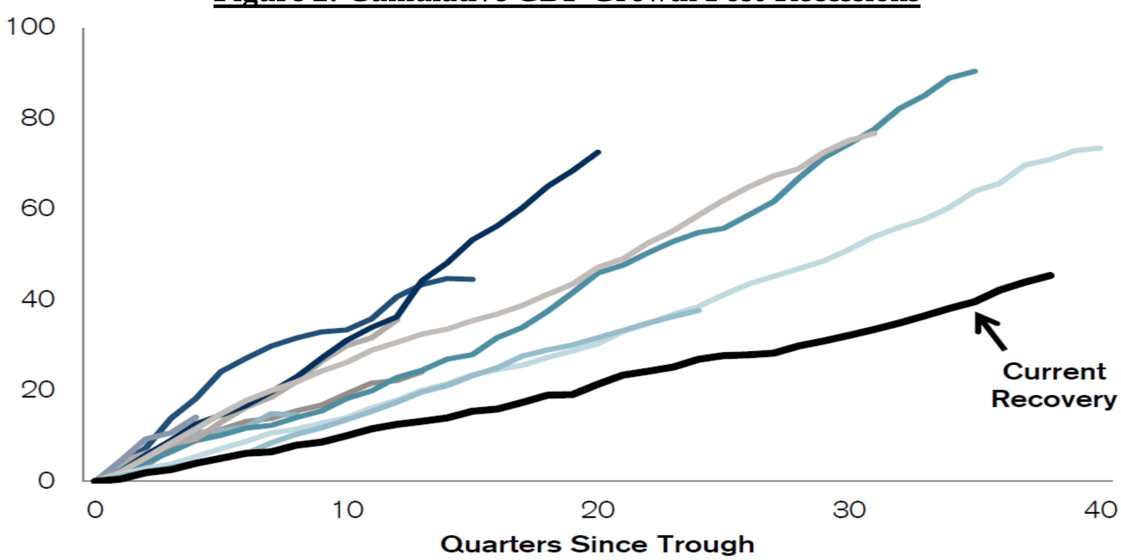
Our strong stock selection made ***Financials*** the largest contributor to relative performance for the quarter. Citigroup (+20.4%) continued to improve efficiency and increase its return on tangible equity, and bank stocks recouped much of their 4th quarter losses. Travelers (+15.2%) outperformed as the property and casualty insurer is seeing improved pricing in its business insurance segment as well as better profitability in auto insurance. Allstate (+14.6%) also benefitted from improving pricing in its auto and homeowners lines, resulting in a lower combined ratio last quarter. Our overweight allocation and strong stock selection in ***Information Technology*** benefitted relative performance. Cisco Systems (+25.6%) is growing revenue across all its product segments and recurring subscription revenue now accounts for two-thirds of its total software revenue. Oracle (+19.4%) outperformed as the software firm continues to grow its cloud services, particularly its various software-as-a-service offerings. Microsoft's (+16.6%) cloud computing platform, Azure, saw revenues increase 76% year-over-year last quarter and other offerings including its gaming services continue to grow. Strong stock selection in ***Consumer Staples*** aided performance as Mondelez (+25.4%) remains a bright spot in the packaged foods industry with increasing consumer demand for snacks.

Stock selection within ***Industrials*** detracted from relative performance. ABB (-0.7%) and Siemens (-0.4%) underperformed as European industrials firms cope with a slowing European economy, the fallout from Brexit and US-China trade negotiations. Our underweight allocation and stock selection within the ***Energy*** sector detracted from relative performance. Energy stocks outperformed as oil prices recovered from a sharp 4th quarter decline. Although ConocoPhillips (+7.5%) posted a strong return, it trailed the market in the quarter; the company has reduced its debt level and cut costs, and is now reporting improved free cash flow generation. Our overweight allocation and stock selection within ***Health Care*** detracted from relative performance. CVS Health (-17.1%) declined after it lowered its 2019 outlook due to challenges in its pharmacy benefits and long-term-care businesses; following its acquisition of Aetna, the combined company stands to benefit from ongoing consolidation within healthcare services. Pfizer (-1.9%) declined slightly in the quarter after posting strong gains in 2018, and the company should benefit from a robust drug pipeline over the next several years.

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.

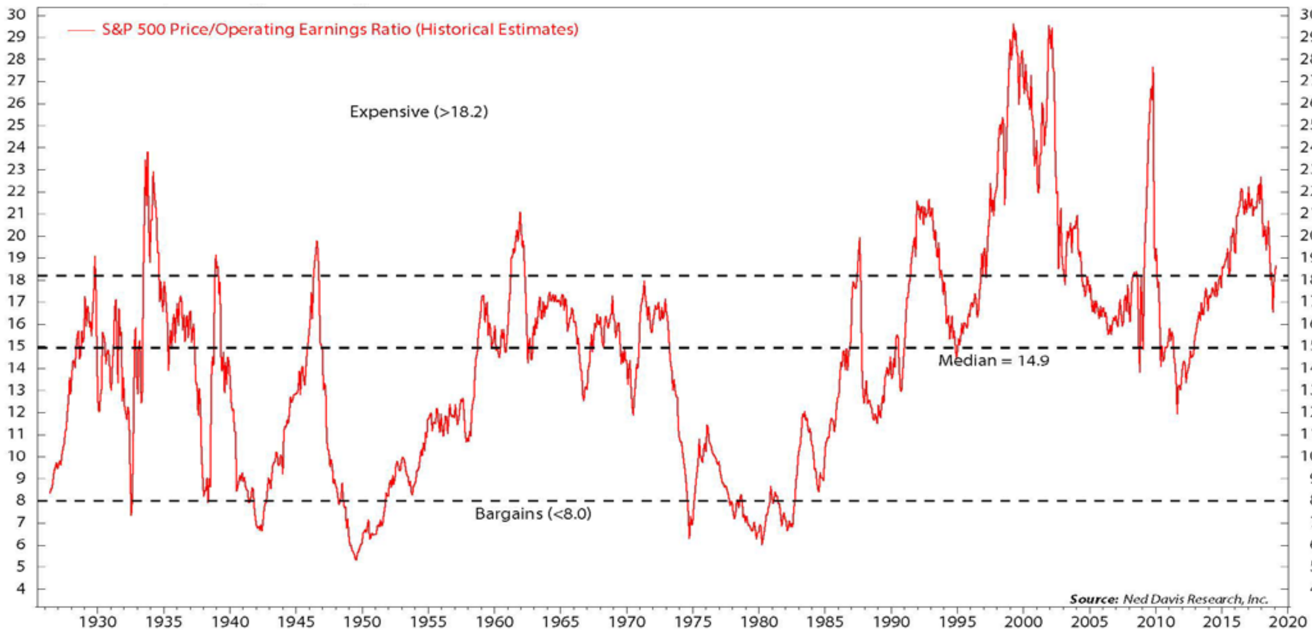
Figure 2: Cumulative GDP Growth Post-Recessions



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. The S&P 500 Index currently trades at 18.5x 2019 earnings while the median price/earnings ratio is 22.2x. Historically, when valuations on the index move into elevated territories, forward returns are more muted.

Figure 3: S&P 500 Price/Operating Earnings Ratio and Forward Index Performance



Median S&P 500 % Gain After Reaching Extremes Analysis Dates: 1926-03-31 - 2019-03-31			
Months Later	**PE >18.2**	**PE <8.0**	**All Periods**
3	-0.1	15.4	2.5
6	-8.4	13.6	4.8
9	-7.7	17.7	7.0
12	-1.7	12.4	9.6
24	0.8	33.6	16.9

Source: Ned David Research, March 31, 2019.

In the current market environment, we believe investors should be more mindful of risk, not less. We believe 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, we feel the valuation of our portfolio remains attractive. The strategy trades at 14.9x forward earnings versus 18.5x for the S&P 500 and 16.8x 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.

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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. The Russell 1000 Value Index measures the performance of the large-cap value segment of the US equity universe. It includes those Russell 1000 companies with lower price-to-book ratios and lower expected and historical growth rates. One cannot invest directly in an index.

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