SCHAFER | CULLEN
CAPITAL MANAGEMENT

Value Equity
Q2 2020 Commentary

Market Review:

The 2nd quarter marked the best quarter in over 20 years for the US equity market, a remarkable rebound from one of its worst quarters in history. The S&P 500 returned 20.5%, while the Russell 1000 Value returned 14.3%. For the S&P 500, it was the best quarter since 1998, following its worst 1st quarter ever. Only three months ago, investors were gripped by fear of the consequences of the coronavirus pandemic, worldwide lockdowns, record unemployment claims, and a plunge in economic growth. Yet investor sentiment reversed just as quickly as it declined, thanks in part to unprecedented fiscal and monetary stimulus from governments and central banks worldwide.

Globally, Covid-19 cases reached 10.5 million with over 500,000 fatalities. The US alone recorded 2.7 million cases with approximately 130,000 fatalities. Weekly unemployment claims smashed the previous record at 6.9 million in March and have since declined to just under 1.5 million. In April, U.S. retail sales declined a record 14.7%, then rose 17.7% in May, a record increase (The Wall Street Journal, 6/16/2020). The crisis facing the country was compounded with widespread protests and unrest in nearly every major city following the death in Minneapolis of George Floyd.

Consumer Discretionary (+32.9%) was the top performing sector, as retailers benefitted from consumers stocking up on essential items, a gradual re-opening of non-essential stores, and an enormous surge in online shopping. Information Technology and Energy were the next best performing sectors, both returning 30.5%. Technology continued to benefit from the lockdown, particularly cloud computing applications related to workplace collaboration and online entertainment. In April, leading oil producing nations including the US, Saudi Arabia and Russia agreed to a record cut in daily production of 9.7 million barrels per day, a pact that was extended in June. The WTI oil benchmark nearly doubled in the quarter to $39 after an unprecedented and chaotic dive into deeply negative territory in April. Utilities (+2.7%) and Consumer Staples (+8.1%) were the two worst performing sectors, as defensive, lower volatility stocks lagged. Financials (+12.2%) also underperformed largely due to the uncertain recovery for banks. The Federal Reserve released the results of its annual stress tests, ordering the largest banks to suspend share repurchases in the 3rd quarter and also capping dividends at their 2nd quarter levels.

Although every state began phased re-openings, with most non-essential retail and manufacturing resuming operations, investors are clearly relying on the Federal government to help bridge the gap until the economy fully reopens. Assets on the Federal Reserve's balance sheet now exceed $7 trillion, up from $4 trillion at the beginning of the year, and the Federal budget deficit is now forecasted to be $3.8 trillion for the 2020 fiscal year. Lawmakers are discussing a second stimulus bill for July, following the $2.2 trillion stimulus passed in March. Internationally, European Union members are discussing an $840 billion stimulus plan on top of a roughly $1.5 trillion stimulus effort from the European Central Bank.

Performance Analysis:

The Value Equity strategy composite returned 14.3% (gross of fees) and 14.1% (net of fees) for the second quarter of 2020 versus 14.3% for the Russell 1000 Value and 20.5% for the S&P 500. Year-to-date, the strategy returned -14.2% versus -16.3% for the Russell 1000 Value and -3.1% for the S&P 500.

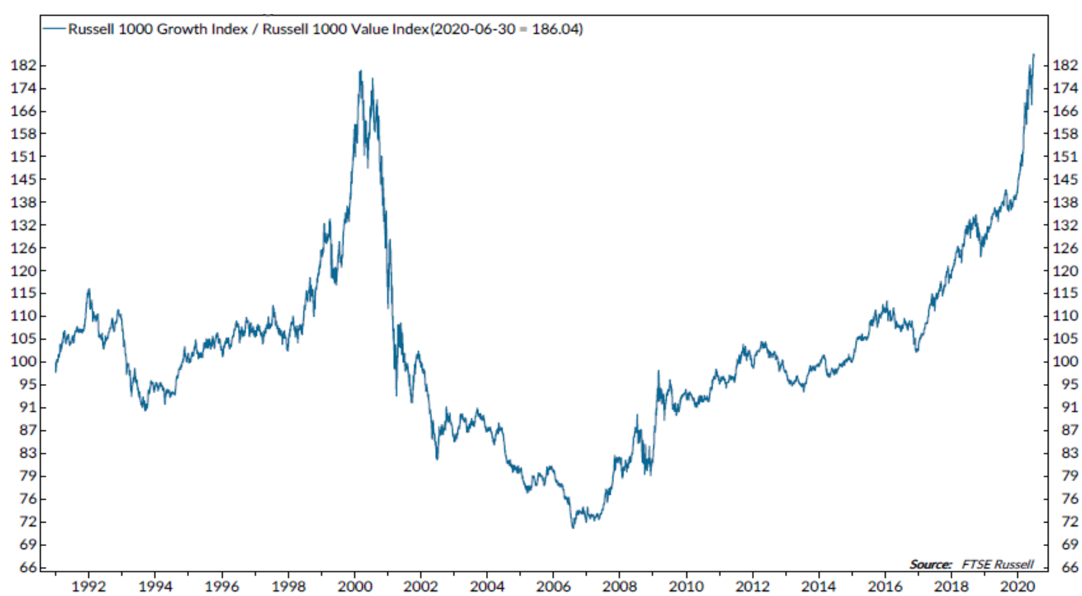
Figure 1: Value Equity Returns vs. Benchmark

June 30, 2020	MTD	QTD	YTD	1 Yr	3 Yr	5 Yr	10 Yr
Value Equity (gross)	0.4	14.3	-14.2	-6.5	4.6	6.7	11.4
Value Equity (net)	0.4	14.1	-14.4	-6.9	4.1	6.2	10.8
Russell 1000 Value Index	-0.7	14.3	-16.3	-8.8	1.8	4.6	10.4
S&P 500 Index	2.0	20.5	-3.1	7.5	10.7	10.7	14.0

Performance for periods greater than 1 year is annualized. ***Past performance is no guarantee of future results***

The flattening of Covid-19 case curve in developed markets and re-opening of economies in the second quarter fueled markets higher. Growth and Technology stocks, viewed as safe havens, led markets driven by continued uncertainty on the path of recovery and a dramatic rise in retail trading. In the first half of 2020, the NASDAQ surged 12.7% vs. the S&P 500's decline of 3.1%, the widest spread since 1983. The largest five stocks in the S&P 500 (Apple, Microsoft, Amazon, Google, and Facebook), all Technology stocks, were up on average 24.1% YTD driving the indices higher; the S&P 500 total return YTD without the largest five stocks was -8.6% (Bloomberg). In the quarter Growth outperformed Value (Russell 1000 Growth – Russell 1000 Value) by 1,360 basis points and 2,600 basis points for the year, the widest annual spread in Russell history (1979). Figure 2 shows the significant outperformance of Growth over Value, with levels currently reaching that of the 2000 Technology peak. Subsequent to the 2000 market collapse, Value enjoyed nearly a decade of outperformance.

Figure 2: Relative Performance Russell 1000 Growth / Russell 1000 Value Indices

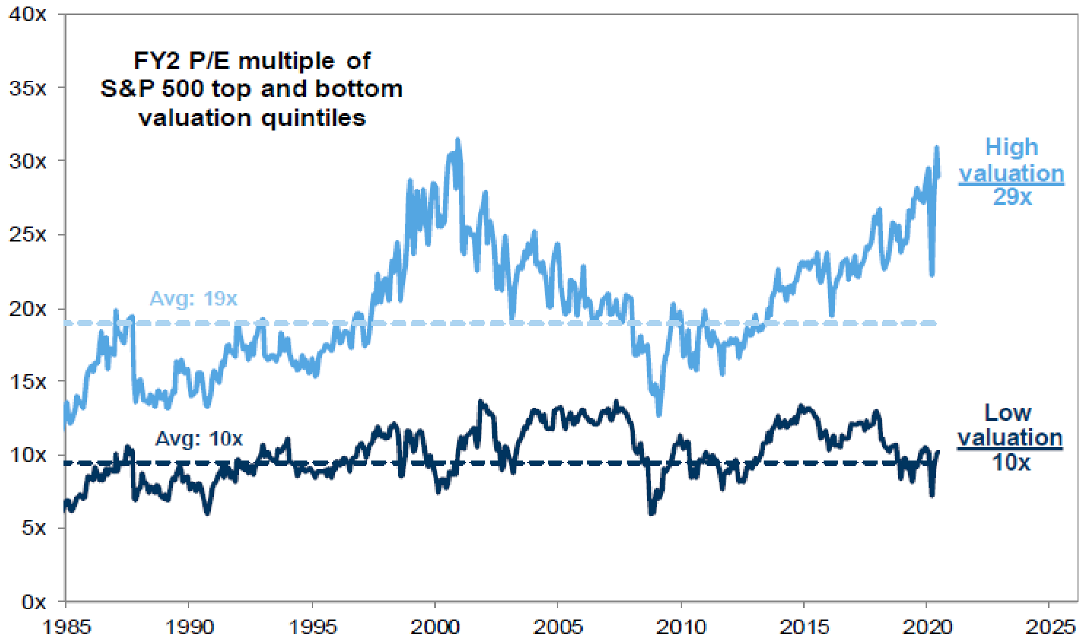


Source: Ned Davis Research, 6/30/2020.

Past performance does not guarantee future results. Investors cannot invest directly in an index

Figure 3 shows the valuation of the S&P 500 Highest and Lowest Price/Earnings quintiles – with current dispersion levels at their highest in 20 years. The Highest P/E quintile currently trades at 29x versus the long-term average of 19x and the Lowest P/E quintile at 10x.

Figure 3: Valuation of the S&P 500 Highest and Lowest P/E Quintile

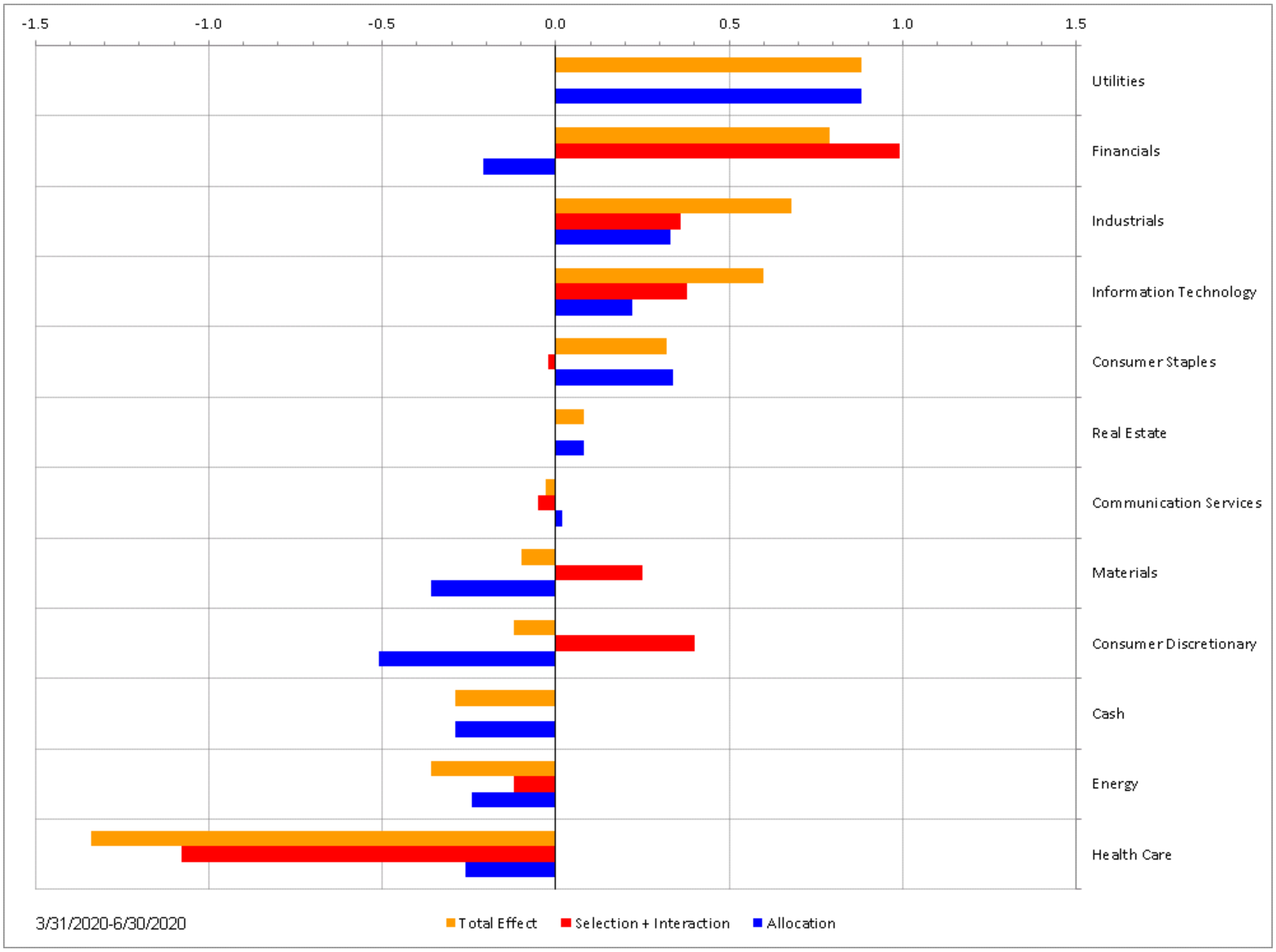


Source: Goldman Sachs, US Weekly Kickstart, 6/26/2020.

Declining Covid-19 case levels and mortality in developed markets and a broadening economic recovery in May led to a rotation into Value stocks, particularly cyclical Energy, Financials and Industrials which collapsed in the March market sell-off. While a resurgence (second wave) of Covid-19 cases in the US led to a June risk-off environment, the initial economic bounce favoring Value stocks gives an indication that a sustained economic recovery can lead to Value outperformance.

Portfolio Attribution:

Attribution Effects – Value Equity vs. Russell 1000 Value 3/31/2020 – 6/30/2020



Source: SCCM/Bloomberg, 6/30/2020.

Our overweight allocation and stock selection within ***Industrials*** made it our largest contributor to relative performance. The sector benefitted as cyclical stocks within the sector rebounded on optimism for re-openings. Siemens (+40.5%) outperformed as revenue and orders were more resilient than expected and the company is expected to move forward with a value enhancing spin-off of Siemens Energy in the 2nd half of the year. ABB (+30.7%) rebounded on optimism for recovery in short-cycle demand for its robotics and automation products. Raytheon Technologies (+24.5%) outperformed following the completion of its April merger with United Technologies, as its defense business exhibits resilience amidst economic uncertainty. Our underweight allocation to ***Utilities*** aided performance. Utilities (+2.7%) was the worst performing sector as defensive, lower volatility stocks lagged. Our stock selection within ***Financials*** benefitted relative performance. Morgan Stanley (+43.3%), Citigroup (+22.7%), Travelers (+15.6%) and Chubb (+14.1%) managed to recoup a portion of their 1st quarter declines, although these banks and insurers remain at discounted multiples with attractive yields. Our overweight allocation and stock selection within ***Information Technology*** benefitted relative performance. Technology stocks continued to benefit from the lockdown, particularly cloud computing applications related to workplace collaboration and online entertainment. Arrow Electronics (+30.0%) is benefitting from accelerating demand for infrastructure software and data storage solutions given the shift to a remote work environment. Microsoft

(+29.4%) continued to outperform as its cloud service, Azure, posted 59% growth year over year. Our stock selection within ***Materials*** aided performance as Newmont (+37.0%) benefitted from a rise in the price of gold.

Our overweight allocation and stock selection within ***Healthcare*** detracted from relative performance. Pharmaceutical stocks underperformed in the quarter partly on concerns surrounding the November elections and potential heightened regulation of drug prices. Pfizer (+1.2%) reported a disappointing clinical trial for its leading drug, Ibrance, for use in treating early-stage breast cancer; however, the drug remains a leader in the treatment of metastatic breast cancer where it continues to experience strong sales growth. Merck (+1.3%) lowered its full-year outlook partly on a decrease in physician-administered drugs, which have been interrupted by Covid-19. Yet the company's leading immuno-oncology drug, Keytruda, saw sales increase 46% year-over-year. Our underweight allocation and stock selection within ***Energy*** detracted from performance. Energy was the second best-performing sector, as leading oil producing nations including the US, Saudi Arabia and Russia agreed to a record cut in daily production of 9.7 million barrels per day. Chevron (+24.9%) surged higher in the quarter but slightly lagged the overall sector. Lastly, our underweight allocation to ***Consumer Discretionary*** detracted from performance. Discretionary was the top performing sector for the quarter, as retailers benefitted from consumers stocking up on essential items, a gradual re-opening of nonessential stores, and a surge in e-commerce.

Portfolio Changes:

Purchases / Additions

Lowe's Companies (LOW) – A position in Lowe's was added to the strategy in the quarter. Lowe's, the second largest home improvement retailer globally, distributes building materials and supplies through stores in North America, with the majority of sales generated in the US. Lowe's and the home improvement industry have structural moats relative to other retailers that have been disrupted by Amazon and other digital-only retailers. With a footprint of nearly 2,000 stores, the company benefits from professional and residential consumer behavior preferences towards in-store purchases given the need for advice, selection and speed of receiving products. The housing market, while cyclical, is expected to benefit from low interest rates spurring new home purchases and remodeling. US home ownership at 65% remains below the long-term historical average. A significant catalyst for the stock is the arrival of a seasoned management team that is focused on driving improving execution that could deliver better top and bottom line growth going forward. Marvin Ellison became CEO in 2018 was formerly part of the team at Home Depot that was instrumental in the improvement of their US stores. Lowe's is in the midst of a turnaround aimed at accelerating top-line growth and improving margins through implementing a set of initiatives focused on gaining market share with Pro Customers, growing its ecommerce/digital business, and improving its supply chain. These improvements could also help LOW achieve and sustain comparable same store growth of 3%+. From a valuation standpoint, at purchase, LOW traded at a P/E of 11.0x, representing a ~40% discount to Home Depot, and had 3.3% dividend yield with a strong dividend growth track record.

Sales / Reductions

CVS (CVS) – Our position in CVS was sold from the Value strategy in the quarter. The company faces headwinds in its retail up-front and pharmacy benefit manager businesses over the long-term. In addition, the strategy has an overweight allocation to the Healthcare sector and the portfolio's other securities in the sector are deemed as more attractive.

Market Outlook:

The equity market rally that began off the March 23rd market lows is one of the strongest in history with the S&P 500 up 36% through the second quarter. While the unfolding Covid-19 pandemic and resulting global economic shut-downs triggered the fastest bear market on record, unprecedented monetary and fiscal stimulus eventually helped to stabilize capital markets. V-shaped improvements in some economic data in addition to record liquidity injections have fueled markets higher. Economic data that have bounced back to prior levels have benefitted from an uplift from rising off of significant lows. Historically, market recoveries have been led by Value (Figure 4); in all of the past fourteen recessions, Value has outperformed the S&P 500 coming out of each downturn (BofA/ML, Covid-19 and the Economy, June 2020). And in this recovery, Energy has been the best performing sector, up 61%, from the March 23rd low through the end of Q2.

Figure 4: Relative Performance of Value vs. the S&P 500 After Recessions

NBER Peak / Trough dates		Value vs SPX performance			
Peak	**Trough**	**Start**	**End (or 12mth)**	**# Mth**	**Rel. Perf. vs SPX**
August 1929	March 1933	05/31/32	8/31/1932	3	78.3%
May 1937	June 1938	05/31/40	5/31/1941	>12	27.2%
February 1945	October 1945	08/31/45	11/30/1945	3	11.1%
November 1948	October 1949	03/31/50	1/31/1951	10	29.7%
July 1953	May 1954	12/31/53	12/31/1954	>12	21.5%
August 1957	April 1958	12/31/57	12/31/1958	>12	26.1%
April 1960	February 1961	06/30/60	5/31/1961	11	9.8%
December 1969	November 1970	12/31/69	8/31/1970	8	9.0%
November 1973	March 1975	11/30/74	11/30/1975	>12	14.7%
January 1980	July 1980	11/30/80	11/30/1981	>12	28.3%
July 1981	November 1982	06/30/83	6/30/1984	>12	16.8%
July 1990	March 1991	12/31/91	6/30/1992	6	18.1%
March 2001	November 2001	10/31/01	6/30/2002	8	10.3%
December 2007	June 2009	02/28/09	4/30/2010	14	25.9%

Source: BofA/ML, Covid-19 and the Economy, 6/30/2020. **Past performance does not guarantee future results.**

The bull case for equities is underpinned by a number of positives. Markets can be driven higher by historically high levels of cash in money market funds (sidelines) and bond flows. While absolute valuations are high – current Price/Earnings, Price/Book, P/E to Growth, EV/Sales, and EV/EBITDA metrics are all above 90th percentile relative to historical levels (Goldman Sachs) – relative valuations are more attractive given the low interest rate environment.

While equities can continue to grind higher, risks are now building to the overall market and the most popular stocks in broad indices. World economies face steep uphill battles in their attempt to return to pre-Covid levels as the virus has yet to burn out and there is no certainty around the timeline and effectiveness of vaccines and treatments. The US Presidential Election poses a risk if a Democratic agenda takes hold, likely resulting in higher taxes and increased regulation. In addition, the market has become increasingly concentrated in expensive Technology stocks. Concentration within the S&P 500 with the Top 5 stocks (Microsoft, Apple, Amazon, Google, and Facebook), all technology stocks, is now at near record levels –

those stocks now comprise 22% of the index, a level not seen since the 1970's. Meanwhile, these five stocks account for 7% of S&P 500 revenues and 12% of S&P 500 earnings (refer to Figure 5).

Figure 5: Weight (%) of the Top 5 Stocks in the S&P 500

Source: Morgan Stanley, 6/30/2020.

Investors often believe current trends will persist – currently, that momentum and Growth could continue to outperform for the foreseeable future. However, history has proven that the largest stocks – either due to sheer size, valuation or other factors – eventually underperform as price to value revert to normalcy.

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 16.3x forward earnings versus 19.7x for the Russell 1000 Value and 22.0x for the S&P 500.

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 an unmanaged index of 500 large-capitalization publicly traded U.S. stocks representing a variety of industries. The **Russell 1000 Value Index** measures the performance of the large-cap value segment of the US equity universe. 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. Schafer Cullen Capital Management makes no representation as to the methodology used to generate the returns of any indices mentioned.

Beta is a measure of the volatility, or systematic risk, of a security or a portfolio in comparison to the market as a whole. **Downside Capture Ratio** represents the degree to which a strategy outperformed or underperformed the benchmark in periods when the benchmark return was negative. The lower the downside capture ratio, the better.

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