



Large Cap Value Equity

Market Commentary

Large cap stocks continued their upward path in the first quarter, though the drivers of these gains differed from those of late 2016. Markets struggled to process and predict the impact of legislative outcomes across a variety of industries. As a result, sectors that did well in the post-election surge took a step back, and others, particularly Health Care and Information Technology, advanced. Similarly, the style characteristics that propelled equities higher in November and December also shifted. Investors rewarded size this quarter – with stocks of large cap companies generally beating those of smaller companies – and displayed a renewed interest in higher quality businesses with good growth prospects. Companies with the highest return on capital profiles dramatically outperformed those with the lowest and as a whole growth outperformed value, standing in clear contrast to the trends observed in Q4 2016.

As economic cycles mature, divergence in operating results and stock price performance increases, providing opportunities for active managers. Such opportunities can be harder to find in early portions of market cycles, when stock prices tend to be driven by a single factor, such as Quantitative Easing in the most recent case. In our view, great businesses with strong balance sheets, the ability to reinvest for growth, and that are not reliant on policy decisions are the best starting point for a successful investment strategy. These types of companies go in and out of market favor, but they also tend to quietly and steadily compound value.

Portfolio Performance & Developments

At the end of 2016, many observers, ourselves included, worried that equity valuations embedded expectations that shaded toward optimistic. But during the first three months of 2017, the Cooke & Bieler Large Cap Value portfolio's holdings disproportionately delivered on or exceeded these hopeful expectations, with virtually all our companies performing well fundamentally. The portfolio performed well on an absolute basis, but also generated its best result relative to the Russell 1000[®] Value (RLV) Index in eight years.

The portfolio benefitted from both sector positioning and effective stock selection. Contributions were broad-based: the strategy added value relative to the RLV in eight of the nine sectors in which it had weight, and its top five individual contributors came from five different sectors. An underweight position in Energy and zero weight position in Telecommunications Services were especially additive, as was stock selection in Financials, Consumer Staples and Industrials. We had reduced the portfolio's Financials and Industrials holdings early in the quarter based on our view of relative valuations, and these decisions also helped results. In Health Care, the portfolio benefitted from both an overweight position as well as the strong price performance of its holdings. The only significant offset occurred in Information Technology, as the market favored higher beta software and hardware storage companies.

Market Outlook

The RLV has returned almost 20% over the last 12 months as investors anticipate growth in overall corporate profits for the first time in three years. Gains from here, and indeed support for current valuations, will depend on that optimism being borne out. However, after years of sub-par growth and with a generally favorable macro-economic outlook, there is room for positive surprises as well. Regardless, our investment decisions are based on a detailed understanding of fundamentals and a disciplined approach to quality and valuation.

Sources: Bank of America Merrill Lynch; Bloomberg; FactSet; Russell Investments; Strategas

The material presented represents the manager's assessment of the Large Cap Value institutional portfolio and market environment at a specific point in time and should not be relied upon by the reader as research or investment advice regarding any particular sector.

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