



# Large Cap Value Equity

## Overview

The second quarter was a bumpy ride for the U.S. stock market. The rally that began late last year continued through April, was upended in May by renewed concerns about the economy and a more protracted trade war, then was revived in June by the Fed's clear pivot toward monetary easing. The June recovery was enough to push major indices into solidly positive territory for the quarter, capping a strong first half of the year which saw stocks up double digits. Returns were strongest for large cap stocks, but otherwise underlying market dynamics lacked discernable themes. The Russell 1000® Value Index (RLV) returned 3.84%, with every sector except Energy posting gains, led by Financials and Industrials.

## Portfolio Performance & Developments

Cooke & Bieler's Large Cap Value Strategy returned 5.39% gross of fees (5.23% net of fees), handily beating the RLV and building on its healthy Q1 outperformance. Both stock selection and sector allocation contributed to returns, while style factors were a modest headwind, mainly due to the underperformance of value and the strategy's below-benchmark market capitalization. Stock selection, accounting for almost 40% of the quarter's outperformance, was mixed across sectors. Favorable results in Materials, Health Care, Information Technology, and Energy, where the strategy's focus on quality likely helped given the sector's struggles, were somewhat offset by underperformance among the strategy's Consumer Staples, Financials, and Industrials holdings, which gave back some of their strong first quarter relative performance. Fundamental progress continued to be solid across most of the portfolio's holdings, which we believe will bode well for the future.

## Five Largest Contributors/Detractors

	Avg Weight (%)	Total Return (%)	Contrib. to Return (bps)		Avg Weight (%)	Total Return (%)	Contrib. to Return (bps)
Allergan	2.3	15.0	40	State Street	2.5	-14.1	-38
FNF Inc.	3.3	11.1	36	Philip Morris Int'l	2.1	-9.8	-24
Intercont'l Exchange	2.7	13.2	35	Alliance Data Systems	1.0	-19.6	-24
Amdocs	2.3	15.3	34	Arrow Electronics	3.2	-7.5	-24
TE Connectivity	1.8	19.2	32	Carnival	2.2	-7.3	-15

Source: FactSet

Past performance is not indicative of future results. The performance attribution is an analysis of a representative Large Cap Value institutional portfolio's gross of fees return relative to the Russell 1000® Value Index. The holdings identified do not represent all of the securities purchased, sold, or recommended for Cooke & Bieler's Large Cap Value clients. To obtain the calculation's methodology and a list showing every holding's contribution to the overall account's performance during the quarter, contact your client service representative or email your request to [contact@cooke-bieler.com](mailto:contact@cooke-bieler.com).

## Largest Contributors

**Allergan (AGN)**, a pharmaceuticals company known for multiple high-profile prescription drugs, including well-known treatments such as Botox, was the largest contributor this quarter. The stock was up significantly on news that AGN had agreed to be acquired by AbbVie Inc. in a cash-and-stock deal.

**Fidelity National Financial (FNF)**, a title insurer and real estate services provider, was the second-largest contributor. Investors saw falling interest rates as a positive for housing transactions (both purchase and refinance), which are the main driver of FNF's earnings. In addition, they made progress toward gaining regulatory approval for their acquisition of Stewart Title which should be meaningfully accretive to earnings.

**Intercontinental Exchange (ICE)**, a leading operator of financial exchanges and provider of financial data, was the third-largest contributor. Although its price performance was poor in Q1, ICE's first quarter earnings demonstrated the resilience of the company's mostly subscription-based business model by showing revenue growth in a difficult environment for exchanges. Investors also seemed encouraged by ICE's investments in new markets, including fixed income and – more speculatively – cryptocurrency trading.

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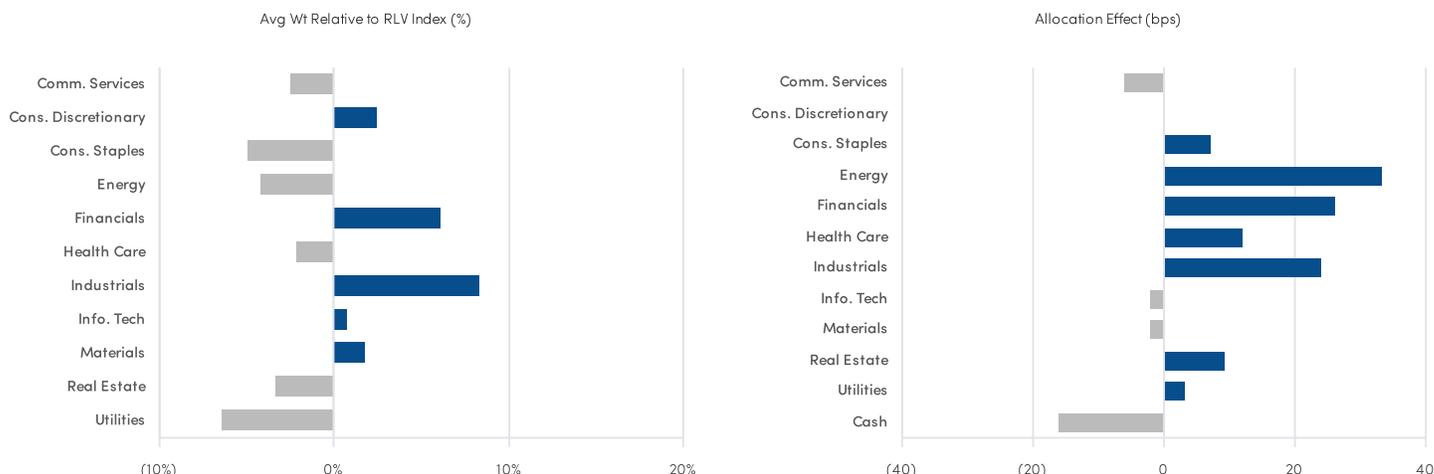
## Largest Detractors

**State Street (STT)**, a financial holding and investment management company, was the largest detractor this quarter. Interest rate compression, as well as increased fee pressure from other competitors, strained STT's revenue generation this quarter.

**Philip Morris International (PM)**, a tobacco product manufacturer, was the second-largest detractor. PM's strong fundamental performance was overshadowed by negative investor sentiment impacting the tobacco industry as a whole. Most of this sentiment pertains to turbulence in the U.S. market, which has no bearing on PM's operations.

**Alliance Data Systems (ADS)**, a data-driven marketing solutions company and issuer of private-label cards, was the third-largest detractor. Investors were generally disappointed with weak revenues and receivables restructuring, but the largest contributor to ADS's weak performance this quarter was an inability to effectively monetize the sale of their Epsilon business unit.

## Sector Positioning



Source: FactSet  
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Sector allocations explained approximately 60% of the strategy's second quarter outperformance. Allocations were positive across seven of 11 sectors. The largest contributors were the portfolio's meaningful underweight in Energy and overweight in Financials and Industrials – the RLV's best performing sectors for the quarter. The relative performance drag from the sectors with negative allocation results totaled only 10 basis points. Exiting the quarter, the strategy remains underweight the high-yielding Utilities and Real Estate sectors and broadly overweight economically sensitive sectors including Industrials and Consumer Discretionary. Energy continues to be a significant underweight and partial offset to the portfolio's pro-cyclical tilt.



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## Initiations

**3M (MMM)** is a diversified materials sciences company, operating in the abrasives, adhesives, coatings, filtration, specialty materials, medical, and electronic categories. A focus on increasing their commercialization rate and speed-to-market, as well as healthy emerging markets exposure, should support their generous capital return policies. Margins in excess of 20% should provide good cash flow to support these initiatives as well as the company's disciplined acquisition program.

**Activision Blizzard (ATVI)** is a video game developer and publisher comprised of three reportable segments: Activision, Blizzard, and King. Video games are increasingly mainstream, with new gamers aging in but old gamers only partially aging out. Additionally, gaming's share of leisure time continues to grow. Among the large publishers, ATVI stands out for relying on owned intellectual property to generate its revenues. Concerns over the health of some of its long-running franchises and its ability to create new intellectual property gave us the opportunity to purchase.

**Leidos (LDOS)** is the largest government services and consulting firm. Modernization of government IT infrastructure, growing healthcare spending, and the heightened threat of cyberattacks all result in a good secular backdrop for the company's services. Its current valuation is attractive for a somewhat counter-cyclical business with recurring revenues, sticky long-term customer relationships, meaningful scale, and strong cash generation.

**Medtronic (MDT)** is the world's largest pure-play medical devices company. Solid and steady revenue growth driven by its leading market share positions across many segments of a growing global industry, operating margin improvement opportunities, and improved free cash flow conversion make MDT an attractive value compounder.

## Eliminations

**Abbott Laboratories (ABT)** and **Diageo (DEO)** were eliminated after reaching their price targets. **Cardinal Health (CAH)** and **RenaissanceRe (RNR)** were eliminated to make room for better opportunities. **Kraft Heinz (KHC)** was eliminated due to a reevaluation of packaged food industry trends.

## Outlook

Bumpy quarters like Q2 tend to reinforce investors' short-term focus. But rather than try to guess the next twist in the market, we find it more profitable to look to the long term and focus on fundamentals. Taking the long view, over the last 15 years – a period that saw two oil price spikes, a global financial crisis, unprecedented monetary intervention, and countless political shocks – the RLV has generated a fairly typical 7.8% annualized return. In other words, the confusion and cross currents of the second quarter are par for the course, presenting an opportunity to profit from others' impatience rather than a cause for alarm for long-term oriented investors. From a fundamental standpoint, the business environment remains mostly positive, albeit with pockets of weakness emerging as trade tensions begin to take their toll. Valuations, broadly speaking, seem fair – neither compellingly cheap, nor worryingly expensive. This combination leads us to believe returns will be volatile, but positive over time. We remain confident that our long-term approach and disciplined focus on fundamentals, balance sheets, and valuation are well suited to profit both from the opportunities created by volatility as well as the long-term compounding ability of quality businesses.

Sources: Bloomberg; FactSet; FTSE Russell; Market Watch; The New York Times; T. Rowe Price

Past performance is not indicative of future results. 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 security or sector. The above commentary and portfolio attribution are based on a representative Large Cap Value institutional portfolio for the quarter ending 6/30/19. Portfolio attribution is gross of fees. Certain client portfolios may or may not hold the securities identified above due to the respective account's guidelines, restrictions, required cash flows, or other relevant considerations. The performance attribution is an analysis of the portfolio's return relative to the Russell 1000® Value Index. The holdings identified do not represent all of the securities purchased, sold, or recommended for Cooke & Bieler's Large Cap Value clients. To obtain the calculation's methodology and a list showing every holding's contribution to the overall account's performance during the quarter, contact your client service representative or email your request to [contact@cooke-bieler.com](mailto:contact@cooke-bieler.com).

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