



# Small Cap Value Equity

## Market Commentary

After delivering nine consecutive quarters of positive returns, U.S. equities, as measured by the S&P 500 Index, delivered the first quarter of negative returns since the third quarter of 2015. Volatility also returned during the first quarter. In 2017, there were eight days in which the S&P 500 advanced or declined more than 1%. In the first quarter of 2018, there were 23.

The Russell 2000® Value Index fell 2.64% in 1Q. Declines, while not dramatic, were broad-based with most sectors posting negative returns with the exception of Health Care and Financials.

## Portfolio Performance & Developments

For the first quarter of 2018, Cooke & Bieler's Small Cap Value Strategy underperformed the Index. Portfolio positioning was a positive as the portfolio was underweight the poorly performing Real Estate and Energy sectors. Positioning is always dictated by our bottom-up process and recently we have struggled to find high quality small-cap Energy firms as many have hard to assess risks and demanding valuations. Similarly, in Real Estate, where nearly 95% of the index weight is REITs, we have struggled to find compelling competitive differentiation and appropriately conservative balance sheets.

Positive allocation results were more than offset by poor stock selection. In Industrials, machinery manufacturers experienced headwinds due to lingering downcycles in key end markets. Additionally, stocks of building products manufacturers lagged as investors grew concerned about rising input costs and the potential negative impact of rising interest rates on housing market momentum. Selection in Health Care and Consumer Discretionary was also negative as multiple holdings underperformed. Our disciplined review process is always central to our investment approach and all the more so during periods of underperformance. Our analysts rigorously benchmark each holding against our written expectations to distinguish fundamental deterioration from sentiment-driven price changes. For the most part we believe that our theses remain intact and that the quarter's underperformance is not cause for longer-term concern.

## Market Outlook

While we are always disappointed to report a down quarter, a more volatile market creates temporary disconnects between stock prices and long-term value drivers. As always, good assessment of long-term business fundamentals in the face of these disconnects is a requisite skill for investors like us. We remain confident that our proven and experienced stock picking ability – underpinned by our disciplined process, rigorous research efforts, and unique culture – will allow us to continue generating value for our clients.

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

The material presented represents the manager's assessment of the Small Cap 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. Past performance is no guarantee of future results.

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