COOKE & BIELER

Q1 2017

All Cap Value Equity

Market Commentary

U.S. 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. The style characteristics that propelled equities higher in November and December also shifted. Unlike last quarter, size was not a factor. Growth outperformed value, also standing in clear contrast to the trend 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 All Cap Value portfolio's holdings delivered nicely on these hopeful expectations. The strategy overcame modest style headwinds and performed well on both an absolute basis and when compared to the Russell 3000® Value Index (RAV), recording a fine quarter in a challenging environment.

The portfolio benefitted from both sector positioning and effective stock selection. At the sector level, a significant underweight in Energy contributed meaningfully to relative results as the benchmark's constituents declined nearly 7%. 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 relative performance. In Health Care, the portfolio benefitted from both an overweight position and the strong performance of its holdings.

At the individual security level, the portfolio's Consumer Staples stood out – all three holdings were up double digits. The only meaningful offset was a Consumer Discretionary holding. Along with several trims and adds to existing positions, we also initiated two positions.

Market Outlook

The RAV has returned 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 our disciplined approach to quality and valuation.

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

Additional Cooke & Bieler All Cap Value Performance Disclosures