COOKE & BIELER

Q3 2016

All Cap Value Equity

Market Commentary

U.S. equities generated solid returns in the third quarter. Many alternatives to stocks remain unappealing, while the continuing combination of moderate economic growth, low inflation, and accommodative monetary policy is supporting robust valuations and driving the bull market, now the second longest on record. Volatility was low, with the Standard & Poor's 500® Index changing by less than 1% daily for almost two months, the longest such period in two years.

With volatility low, the "risk-on" trade remained in full force. Smaller cap companies outperformed larger, and high beta stocks dominated as well. The highest beta quintile within the Russell 3000® Value Index (the Index) outperformed the lowest quintile by 1500 basis points. Similarly, stocks of companies generating no earnings advanced sharply, while cyclical industries such as Information Technology, Consumer Discretionary, and Materials outperformed the broader Index.

Portfolio Performance & Developments

Reflecting the favorable equity investing environment, the Cooke & Bieler All Cap Value portfolio generated solid absolute returns during the quarter. And though a risk-on backdrop generally presents relative performance headwinds for our style, the portfolio modestly outperformed the Index, reclaiming a bit of the ground lost during the second quarter when the portfolio encountered strong headwinds associated with the market's strong preference for current yield, lower quality, and commodities-driven businesses.

Sector allocation decisions, always the result of our bottom-up, fundamental research as opposed to macro predictions, drove the strategy's success this quarter. The portfolio's significant underweight in Utilities and Telecommunication Services was especially helpful as those sectors lagged meaningfully. For both groups, this effect marked a reversal from trends seen during the first half of the year, when declining interest rates pushed many investors toward high-yielding stocks.

Stock selection results were mixed but overall negative for the quarter. Good performance among most of the portfolio's Financials, Industrials, and Materials holdings was offset primarily by poor performance among two of its Consumer Discretionary holdings. We continue to be constructive on both.

Despite the market's preference for low quality much of the year, the impact of stock selection decisions for the year-to-date period have been favorable and portfolio companies overall are healthy and thriving. Importantly, we believe the valuations of their stocks do not adequately reflect the strength of their longer-term fundamental prospects. On the other hand, the portfolio is devoid of increasingly risky, high-yielding stocks that have become very expensive relative to their underlying fundamentals. The market's single-minded focus on current yield has also given us the opportunity this year to add a group of very high quality companies to the portfolio at reasonable prices.

Market Outlook

Many active managers have found the yield-driven backdrop a difficult terrain to navigate. Some have thrown in the towel in the face of this grind, but we have stayed true to our belief that long-term success is built by owning businesses with attractive fundamentals and not just attractive current yields.

Sources: Bank of America Merrill Lynch; Bloomberg; FactSet; Russell Investments; S&P Dow Jones Indices LLC
The material presented represents the manager's assessment of the All 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.

Additional Cooke & Bieler All Cap Value Performance Disclosures