



Large Cap Value Equity

Market Commentary

The Cooke & Bieler Large Cap Value portfolio significantly underperformed the Russell 1000[®] Value Index (RLV) in the quarter, posting its worst relative performance in over a decade. This disappointing showing resulted from rallies where we weren't: in lower quality, commodity-driven businesses and in those with high dividend yields. By pushing real interest rates into negative territory, the world's central banks are all but forcing investors into assets that are increasingly risky on one hand and high-yielding on the other. This combination of distortions created significant headwinds for the portfolio, which was comprised of high-quality companies with favorable underlying economics – economics that justify considerable reinvestment rather than maximum dividend payout.

"High quality" has many dimensions, but one marker is Return on Invested Capital (ROIC). Over the last five years, the median ROIC of portfolio companies was 11.2% versus a median of 6.0% for the companies in the RLV. In this quarter, companies in the Index with the *lowest* ROIC generated an 8.1% return, compared to 2.7% for those with the *highest* ROIC. It is axiomatic that high ROIC companies with the ability to expand their invested capital will grow faster and generate better fundamental returns than their low ROIC counterparts. So holding valuations constant, we believe strongly that the stocks of the portfolio's higher ROIC companies should outperform over time.

Investors' quest for yield was the quarter's other main driver. For the quarter across the RLV, the highest dividend paying quintile returned 8.6%, and the lowest, 2.9%. While dividends are an important part of an investor's total return, for the most part today the companies with the highest current yields will struggle to grow their earnings and cash flow over time, leaving the dividend yield as the dominant source of return. Absent further declines in interest rates, the returns on these stocks will prove disappointing to investors.

Portfolio Performance & Developments

For the quarter, the relative impact of both stock selection and sector allocation decisions was negative. Selection was hurt by Cooke & Bieler's high-quality bias as well as the portfolio's lack of exposure to companies that would benefit from a continued decline in interest rates. The portfolio's overweight position in Health Care helped relative performance, but in general, its cyclical tilt was a drag as was its underweight in Utilities and Telecommunication Services, which benefited from falling interest rates.

Weak stock selection results were attributable to short-term exogenous factors; the portfolio's constituents are virtually all performing well fundamentally. The market's weakness and volatility gave us the opportunity to add two new companies to the strategy at the end of the quarter: a provider of private label credit cards and marketing services and an iconic jewelry firm that we have previously owned. We exited two holdings during the quarter that had reached fair value. The portfolio continues to be considerably overweight attractively valued stocks of high-quality Consumer Discretionary and Industrials companies.

Market Outlook

Over time, return on capital and management's stewardship of it are the determinants of stock returns. In this regard, we are very optimistic about the portfolio's relative performance prospects. We have invested in a collection of financially strong companies with favorable underlying economics that are reflected in attractive returns on invested capital. The value compounding ability of the portfolio's holdings uniquely position it to both capture upside in a favorable market environment and protect during an extended downturn

Sources: FactSet; Bloomberg; Russell Investments

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.

[Additional Cooke & Bieler Large Cap Value Performance Disclosures](#)