



Large Cap Value Equity

Market Commentary

After retreating slightly and struggling to gain traction most of the summer, the U.S. stock market rallied strongly in September with smaller cap and Energy stocks leading the charge. In the end, Q3 was another positive quarter for stocks – the eighth consecutive one for the market as measured by the S&P 500 Index. The Russell 1000[®] Value Index (RLV) returned just over 3% in the quarter, bringing its year-to-date performance to nearly 8%.

Portfolio Performance & Developments

Against this backdrop and after a year of very meaningful outperformance, the Cooke & Bieler Large Cap Value strategy posted solid absolute results, but lagged its benchmark, the RLV. Unlike the trend witnessed in the first half of the year, stocks of higher quality companies did not noticeably outperform others in the third quarter. In fact, stocks of lower quality businesses dominated in some sectors.

Though there were puts and takes, our bottom-up-driven sector allocations did not meaningfully impact relative results; underperformance was instead attributable to the negative impact of stock selection. Here, the most prominent drag on relative results was largely a stylistic sin of omission. The C&B Large Cap Value strategy's holdings in the Materials sectors noticeably underperformed their Index peers, many of which are highly levered to commodity prices, and some of which surged off low levels in the quarter. We have generally avoided these typically lower-quality businesses, where durable competitive advantages are scarce and underlying economics are largely a function of inherently volatile and unpredictable commodities prices. We prefer to invest in Materials companies that have structural competitive advantages, plentiful reinvestment opportunities, and generate high returns on invested capital – all drivers of an attractive value compounding algorithm not reliant on rising commodity prices for success. In contrast, the strategy's Industrials and Consumer Staples holdings were additive.

Though this quarter's showing illustrates that no approach works all the time, underlying economics dictate that ours should add value over the long-run. Overall, the C&B Large Cap Value strategy's holdings appear to be performing well fundamentally and we view this quarter's performance shortfall not with concern but as more of a pause after a strong run of outsized relative returns.

Market Outlook

During the quarter, the Fed announced it would begin shrinking its balance sheet, marking the latest installment in this slowly ebbing period of extraordinary monetary stimulus. This transition away from stimulus brings with it a set of concerns, but also of opportunities. As we have written before, the various forms of quantitative easing have supported many companies of questionable quality. As monetary policy becomes more restrictive and rates potentially rise, weaker companies will find it increasingly hard to compete with their higher-quality peers. As a result, returns should be increasingly based on more divergent company specific fundamentals rather than on macro factors.

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

The material presented represents the manager's assessment of the Large 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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