



# Mid Cap Value Equity

## Market Commentary

The first quarter of 2016 highlighted the importance of a long-term perspective in two ways. First, the quarter's extreme volatility – both the early-period retreat and the late-period rally – were, from our vantage, unrelated to any meaningful economic development. Second, a number of Cooke & Bieler Mid Cap Value portfolio holdings that saw intense 2015 sell-offs disproportionate to the severity of any underlying fundamental setbacks recovered strongly in Q1, without any significant change in their underlying prospects.

The start to 2016 was the worst ever recorded for the broad equity market. Fear of impending disaster, both foreign and domestic, drove less stalwart investors away from stocks. By February 11th, worries of global recession pushed the Russell Midcap® Value Index (RMV) into correction territory and oil prices down 29%. This environment allowed us to selectively add to the portfolio's holdings at attractive prices. Our long-term perspective allowed us to recognize and take advantage of the gaps that emerged between value and price.

And then, of course, sentiment turned. The RMV rebounded over 17% before quarter end, and oil roared back up 46%. Both finished in positive territory, turning a wild quarter into a strong 3.9% point to point RMV return.

## Portfolio Performance & Developments

The Cooke & Bieler Mid Cap Value portfolio performed well on both an absolute and relative basis during this tricky quarter, thanks particularly to strong stock selection. Two holdings led the charge in the Consumer Discretionary sector, but the portfolio also saw strength in the Financials and Industrials sectors.

Sector weights did not have a material effect on relative performance, with the exception of the portfolio's zero weight positioning in Utilities, which was a significant drag on relative results. We continue to think Utilities are overvalued and that it is shortsighted to accept the bond-like returns these companies offer in exchange for equity risk. More specifically, the typical Utility returns 70% of its earnings to shareholders in the form of dividends generating a 3.5% yield. Investing the remaining 30% of its earnings back into the business generates long-term EPS growth of about 3%, giving investors a 6.5% expected return, assuming no change in trading multiple. With the average Utility P/E currently at 19x, we think that further multiple expansion is unlikely. Any contraction, of course, would reduce the 6.5% return generated by fundamentals. We are finding better risk/reward trade-offs elsewhere.

## Market Outlook

Overall, we are pleased to report a solid quarter with hard-won gains against the best-performing of the nine major Russell indices. We continue to find great companies at reasonable valuations, and firmly believe that the portfolio will perform well if the economy continues to grind forward, but also provide a degree of downside protection if it does not. We are excited about the portfolio's current positioning and its enviable collection of reasonably valued, financially strong, well-positioned companies that can dependably grow earnings and cash flows, and we are confident it will continue compounding value at an above average rate.

Sources: FactSet; Bloomberg; Russell Investments; The Financial Times

The material presented represents the manager's assessment of the Mid 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 Mid Cap Value Performance Disclosures](#)