COOKE & BIELER

Q3 2017

Mid 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 Midcap® Value Index (RMV) returned just over 2% in the quarter, bringing its year-to-date performance to over 7%.

Portfolio Performance & Developments

The Cooke & Bieler Mid Cap Value strategy's results modestly outpaced those of the Index for the quarter, building on strong year-to-date and trailing twelve month periods. Unlike the trend witnessed in the first half of the year, though, stocks of high quality companies did not noticeably outperform others during Q3. In fact, stocks of lower quality businesses outperformed their higher quality counterparts – a headwind for the strategy, but not an insurmountable one.

From an attribution standpoint results were mixed. The biggest contributor to relative performance by far was very good stock selection in the outperforming Industrials sector where the strategy was meaningfully overweight. Also contributing to the strategy's solid relative performance was the combination of favorable stock selection and underweight positioning in two sectors that underperformed the benchmark – Consumer Staples and Real Estate.

Two items at the stock selection level largely offset these contributions. The first was a small number of company-specific issues, none of which we believe are permanent or reflective of broken investment theses. The second was a stylistic sin of omission. The C&B Mid Cap Value strategy's holdings in the Materials sector underperformed their Index peers, many of which are highly levered to commodity prices that surged off low levels in the quarter. We try to avoid these typically lower-quality businesses, where durable competitive advantages are scarce and underlying economics are 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. 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.

There was quite a bit of portfolio activity in the quarter, including the elimination of six holdings. Four of these holdings reached their price targets and two were sold for other investment opportunities with a more attractive combination of long-term fundamental prospects and valuations. These eliminations made room for four new companies.

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 Mid 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.

Additional Cooke & Bieler Mid Cap Value Performance Disclosures