COOKE & BIELER

Q4 2017

Mid Cap Value Equity

Market Commentary

After posting robust, steady gains in the first three quarters of 2017, U.S. equities delivered another quarter of positive returns – the ninth consecutive one for the market as measured by the S&P 500 Index. Investors responded enthusiastically as the prospect of tax reform materialized, increasing the likelihood of continued earnings growth fueled by a lower corporate tax rate.

The major Russell U.S. equity indices ended Q4 and 2017 in positive territory as large cap stocks outperformed small cap stocks, reversing a trend that dominated in 2016. The Russell Midcap® Value Index (RMV) returned 5.50% for the quarter, closing the year up 13.34%.

Portfolio Performance & Developments

For the fourth quarter of 2017, Cooke & Bieler's Mid Cap Value Strategy posted solid absolute returns, but lagged the RMV. Sector allocation was positive for the quarter, led by the underweight in bond-proxy sectors (Utilities and Real Estate). However, poor stock selection results drove relative underperformance for the quarter with the largest drag coming from the Consumer Discretionary sector. The retail component of the Consumer Discretionary sector performed exceptionally well on expectations of a strong holiday season and the potential benefits of tax reform. The strategy's Consumer Discretionary holdings are less affected by seasonality, but are less exposed to the secular headwinds plaguing retailers that could prevent them from earning competitive returns through a full cycle. Selection was strong within the Financials and Information Technology sectors, although not enough to overcome the deficit from Consumer Discretionary.

For the full year, the C&B Mid Cap Value Strategy performed well in both relative and absolute terms. Sector allocation was strongly positive for the year. The underweight in Energy during a period of declining oil prices helped boost performance as did the underweight in Real Estate. Stock selection was a drag on performance for the year, hurt by poor results in the Consumer Discretionary sector. These results were due in part to underexposure to retailers but also to a former holding whose fundamentals deteriorated. While disappointing stocks are never welcome, we believe this is an example of the importance of our monitoring process and sell discipline. Through our ongoing research including conversations with management and quarterly Accountability Statements – an essential part of our investment process – we concluded what we had considered temporary headwinds were instead potentially insurmountable structural challenges. In accordance with our sell discipline, we eliminated the position and reallocated capital to other holdings with attractive valuations and sound fundamentals.

Market Outlook

Expectations and valuations arguably are high, leaving little room for disappointments and unforeseen bumps in the road. At the same time, traction in the economy appears solid and the benefits of tax reform should allow fundamentals to improve. Given this backdrop, dispersion among stocks and sectors is likely to increase, creating opportunities for active managers. As always, our work at Cooke & Bieler is focused on adding value through our bottom-up stock selection process, underpinned by our meticulous identification, rigorous research and analysis, and continuous monitoring of the business fundamentals which drive value over time.

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

Additional Cooke & Bieler Mid Cap Value Performance Disclosures