

PMV December 2017 Quarterly Review

U.S. equities advanced for the ninth consecutive quarter during Q4 of 2017, an impressive feat even in the midst of a bull market. Perhaps even more remarkable, the S&P 500 Index made a record 70 new all-time highs in 2017 and never experienced a single negative return month -- the first such perfect year in U.S. market history. Volatility remained unusually low, as a mere -3% correction last spring was the largest equity drawdown of the year. While we (and our clients) certainly appreciate a healthy stock market, these unprecedented records suggest investor exuberance and may provide reason for portfolio caution. As a result, Reinhart's research team is focusing on our private market value ("PMV") discipline and remains committed to risk management and capital preservation.

During Q4 2017, Reinhart's Mid Cap PMV strategy gross performance slightly lagged the Russell Midcap Value Index. The cash drag of ~40bps alone accounted for over 100% of the negative delta. Portfolio stock selection was positive during Q4 by ~115bps with strength primarily in Real Estate. Unfortunately security selection within Health Care cost PMV ~90bps due to one problem stock, which was subsequently sold. Despite this blemish, overall contribution ratios were healthy in Q4. In fact, looking at portfolio holdings with double-digit percentage changes, positive movers outnumbered negative ones 13-to-2.

An important trend to point out during Q4 was the intra-period turnaround in PMV performance. After a rough start to the quarter, relative returns improved significantly in late November and December. The portfolio had a strong finish to EPS season and several of our holdings received corporate buyout attention. The market environment also seemed to shift towards value after many months of momentum-led behavior. While it may be premature to claim a change in market tone, we find the recent emphasis on valuations and fundamentals quite encouraging for the PMV strategy.

Looking forward, our team continues to emphasize attractively valued holdings in Consumer Discretionary (non-retail) and Technology (business services). The portfolio is underweight Real Estate and Materials due to extended valuations. Overall, we find ourselves researching out-of-favor but high-quality companies, scouring the mid cap universe for stocks trading at 30% discounts to PMV. Although the broader market is expensive, we believe the skewed equity environment has created some under-valued pockets for patient, long term investors.

Although our investment team is admittedly frustrated with 2017 performance compared to the Russell Midcap Value Index, Reinhart has a track record of success utilizing the PMV process to generate top quintile peer performance over the past decade (*Morningstar Direct 9/30/17*). We will continue working diligently to improve the portfolio while adhering to our value discipline. Over the past 75 years, value has outperformed growth in almost every rolling decade. It appears that U.S. corporate tax reform could act as a catalyst for market rotation back into value stocks (due to higher domestic exposure) and the PMV strategy stands ready to capitalize on these opportunities in 2018.

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Russell Midcap Value Index: an unmanaged index that measures the performance of those Russell Midcap companies with lower price-to-book ratios and lower forecasted growth values. An investment cannot be made directly to an index.