

# EQUITY INVESTMENT CORPORATION

## *2019 First Quarter Commentary*

### *Mid Cap Value*

April 2019

The first quarter of 2019 was as good as the fourth quarter of 2018 was bad. The Russell Midcap<sup>®</sup> Value Index (RMCV) gained 14.4%, nearly erasing its 15.0% fourth quarter deficit. Likewise, our Mid-Cap Value (MCV) SMA composite increased an 8.7% gross\*, rebounding from a 10.5% drop in the fourth quarter of last year. Net of a 3% hypothetical maximum annual SMA fee, results for MCV would be 7.9% for the quarter.<sup>1</sup>

After a brief hiatus in the fourth quarter of 2018, growth resumed its winning ways, outperforming value across all cap sizes. Growth stocks have outperformed value in eight of the last nine quarters and for most of the past decade. Their valuations are now near 15-year highs relative to value stocks.<sup>2</sup>

#### **Investment Environment**

Given the market's sharp drop in the fourth quarter of 2018, perhaps the mirror-image rebound this quarter shouldn't be a surprise. Economic uncertainty, which precipitated the 2018 decline, has not, however, abated. We continue to see slowing macro activity in China and Europe, and closer to home, corporate debt levels are elevated, the yield curve is inverted, and corporate earnings have been disappointing. There has also been notable fundamental weakness in bellwether cyclicals such as auto, housing, semiconductor, and transportation stocks.

Analysts now expect full-year 2019 earnings per share for the S&P 500 to grow approximately 3%, and even that modest growth is heavily dependent on a strong fourth quarter.<sup>3</sup> So, for now, the market seems to be looking past near-term softness and betting on a stronger future.

We have no special insight as to what the future holds. However, we do believe that volatility creates investment opportunities. As the market fell in the fourth quarter of 2018, especially in December, we added to many of our existing holdings, and as a result, lowered cash and short-term investments (SHV) in our representative account to 32% as of December 31, 2018. Despite the strong market rebound in the first quarter, we were able to initiate a new position, and we continue to have a number of ideas under consideration. Broadly speaking, we are seeing more attractive opportunities in economically sensitive stocks, while seeing increased risk in historically less economically sensitive ones.

#### **Portfolio Review**<sup>4</sup>

During the quarter, we purchased a new position in Alliance Data Systems (ADS) and trimmed our position in Mack-Cali Realty. We added to Kroger after it fell on earnings weakness and added back to eBay and Molson Coors after harvesting tax losses in December. The net effect of these trades reduced our cash and short-term investments at quarter-end to around 26% in our representative account.

ADS is a private label credit card lender with smaller businesses in loyalty-based digital marketing and a leading coalition loyalty program in Canada called Air Miles. The stock has underperformed recently on concerns about economic weakness and slowing growth in its credit card business. ADS has a history of effectively managing its portfolio through credit cycles, including during the financial crisis when its loans generally performed better than general purpose bank credit card portfolios. As its legacy mall-based apparel retailers have struggled, ADS has increasingly diversified its business toward higher-growth customers such as furniture retailers Wayfair and Ikea, and cosmetic retailer Ulta Beauty. A shifting retailer landscape has been a reality for ADS throughout its history. We think the low price we paid more than reflects the risks and offers the opportunity for good returns going forward.

Thank you for your continued partnership with EIC and the trust you have placed in us.

### **Investment Team**

**W. Andrew Bruner, CFA, CPA**

**R. Terrence Irrgang, CFA**

**Ian Zabor, CFA**

### **Disclosures**

<sup>1</sup>*EIC's MCV results are those of our Mid-Cap Value SMA composite gross\* (before) and net (after) assumed maximum annual SMA fees of 3% (0.25% per month). SMA fees include transaction costs, portfolio management, custody, and other administrative fees. \*Gross returns for the EIC SMA composite are "pure" gross returns, do not reflect the deduction of any expenses, including trading costs, and are presented as supplemental information to the full disclosure presentations which are considered an integral part of this report. All returns include reinvestment of dividends and interest. Indices are unmanaged, do not incur management fees, costs or expenses, and cannot be invested in directly. Past performance is not indicative of future results. **Individual account results may differ from those of the composite.***

<sup>2</sup>*Data Source: Morningstar Direct<sup>SM</sup>. Ratio of monthly Russell 3000 Growth Index Price/Projected Earnings to monthly Russell 3000 Value Index Price/Projected Earnings. For the period April 1, 2004 through March 31, 2019. Forward P/E is Price/Projected Earnings calculated by Morningstar based on the asset-weighted average of each company's month-end share price to estimated consensus earnings per share for the company's fiscal year.*

<sup>3</sup>*Data Source: S&P Capital IQ. Year-over-year forecast of quarterly and calendar year 2019 earnings per share growth for S&P 500 based on consensus earnings estimates. Data as of April 11, 2019.*

<sup>4</sup>*Portfolio data is from a representative Mid-Cap Value account. Actual portfolio holdings may vary for each client, and there is no guarantee that a particular client's account, "wrap," or advisory program will hold any, or all, of the securities identified. The securities identified and described above do not represent all of the securities purchased, sold or recommended for client accounts. The reader should not assume that an investment in the securities identified was or will be profitable.*

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*S&P 500 and Russell indices are sourced from S&P Capital IQ.*

# Mid-Cap Value SMA Composite Performance Description

Equity Investment Corporation (EIC) is an SEC registered independent investment advisor incorporated in the state of Georgia. EIC was founded in 1986. Effective September 30, 2016, substantially all of the assets and liabilities of the firm were acquired by three members of the investment team who collectively have more than 40 years of experience at EIC. Accounts continue to be managed using the same investment process, and the firm continues to operate as EIC. Performance numbers are the value-weighted, time-weighted, total return composite results of fully discretionary Mid-Cap Value wrap (SMA) accounts. The strategy invests in high-quality, well-managed mid-cap companies, while at the same time avoiding those that look inexpensive relative to their historical record but are actually in structural decline. Prior to January 1, 2013, the composite was called the Mid-Cap Value Wrap Composite. Returns are generally presented net of foreign withholding taxes on dividends, interest income, and capital gains; however, returns for some accounts are presented gross of foreign taxes depending on the treatment by their custodian. All accounts included in the composite are managed according to similar investment guidelines. The composite creation date is January 1, 2004, and SMA accounts comprise 100% of the composite. Performance includes reinvestment of dividends, and EIC's returns also include interest earned on cash. The benchmark index is the Russell Midcap® Value Index (which excludes an advisory fee), and was chosen because it is representative of the composite's investment style. The Russell Midcap® Value Index measures the performance of the mid-cap value segment of the US equity universe. It is a subset of the Russell Midcap® Index and includes approximately 800 of the Russell 1000® companies with lower price-to-book ratios and lower expected long-term mean earnings growth rates.

Year Ended Dec - 31	Gross* Rate of Return <sup>1</sup> (Supplemental)	Hypothetical 3% annual Net Rate of Return <sup>1</sup>	Benchmark Return of Russell Midcap® Value Index	Composite 3-Yr St Dev	Benchmark 3-Yr St Dev	Dispersion <sup>2</sup> of Annual Returns (St Dev)	Number of Portfolios	Composite Assets (\$ Millions)	Advisory-Only (UMA) and Managed Assets		
									UMA Assets <sup>3</sup> (\$ Millions) (Supplemental)	GIPS® Firm Assets (\$ Millions)	Total Assets <sup>3</sup> (\$ Millions) (Supplemental)
2019 (through 3/31)	8.7%	7.9%	14.4%	8.5%	11.8%	0.4%	20	\$4.8	\$1,852.9	\$2,389.8	\$4,242.7
2018	-6.4%	-9.2%	-12.3%	8.4%	12.0%	0.7%	21	\$4.7	\$1,721.0	\$2,219.9	\$3,940.9
2017	12.6%	9.3%	13.3%	7.5%	10.3%	1.0%	20	\$5.4	\$2,044.9	\$2,790.7	\$4,835.6
2016	16.6%	13.2%	20.0%	8.4%	11.3%	1.0%	15	\$4.3	\$2,044.5	\$2,994.4	\$5,038.9
2015	-2.1%	-5.0%	-4.8%	8.9%	10.7%	1.0%	9	\$2.3	\$1,590.0	\$3,658.9	\$5,248.9
2014	15.2%	11.8%	14.8%	8.9%	9.8%	N/A	5	\$1.8	\$1,657.7	\$3,862.6	\$5,520.3
2013	33.6%	29.7%	33.5%	10.5%	13.7%	N/A	3	\$1.1	\$1,009.2	\$3,286.3	\$4,295.5
2012	11.3%	8.0%	18.5%	10.7%	16.8%	N/A	3	\$0.9	\$665.6	\$2,301.1	\$2,966.7
2011	5.3%	2.2%	-1.4%	15.3%	22.8%	N/A	1	\$0.2	\$314.5	\$1,127.9	\$1,442.5
2010	22.8%	19.3%	24.8%	17.9%	27.1%	0.4%	7	\$1.7	\$77.9	\$836.9	\$914.8
2009	28.1%	24.4%	34.2%	17.6%	25.0%	0.9%	8	\$1.5	\$10.5	\$541.2	\$551.8
2008	-20.4%	-22.8%	-38.4%	13.0%	18.7%	1.2%	11	\$1.7	\$0.0	\$362.6	\$362.6
2007	4.4%	1.3%	-1.4%	8.3%	9.1%	0.7%	16	\$3.2	\$0.0	\$448.1	\$448.1
2006	12.2%	8.9%	20.2%	7.3%	8.7%	0.5%	20	\$6.6	\$0.0	\$487.2	\$487.2
2005	6.0%	2.9%	12.7%	N/A	N/A	0.8%	29	\$8.6	\$0.0	\$463.6	\$463.6
2004	19.8%	16.3%	23.7%	N/A	N/A	N/A	32	\$10.5	\$0.0	\$388.1	\$388.1

<sup>1</sup> \*Gross returns, presented as supplemental information, are “pure” gross and do not reflect the deduction of any expenses, including trading costs, for SMA accounts. Net returns are calculated by reducing gross returns with an annual SMA fee of 3.0% (0.25%/month).

<sup>2</sup> Dispersion is an asset-weighted standard deviation for the accounts in the composite the entire year (or year-to-date). “N/A” represents when dispersion is not statistically meaningful due to an insufficient number of portfolios in the composite for the entire year.

<sup>3</sup> “Total Assets” include our regulatory assets under management (“GIPS® Firm Assets”) and our advisory-only “UMA Assets”. EIC has no trading discretion for UMA accounts and provides a model portfolio to the program sponsor or overlay manager. The “UMA Assets” and “Total Assets” amounts are shown as supplemental information.

**Additional Notes:** The three year annualized standard deviation measures variability of the composite and the benchmark returns over the preceding 36 month period.

Performance has been measured on a monthly basis from January 1, 2004, to present. Periods are geometrically linked to obtain the quarterly and annual results. Eligible new accounts are added to the composite at the beginning of the first full quarter under EIC management. Trade date accounting with monthly valuations and adjustments for large cash flows are used. Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. The US Dollar is the currency used to express performance. Returns include the reinvestment of all income. There are no non-fee paying accounts. Economic and market conditions have differed over the time period displayed, and likewise will be different in the future. Policies for valuing portfolios, calculating performance and preparing compliant presentations are available upon request.

EIC claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS® standards. EIC has been independently verified for the periods January 1, 1986, through December 31, 2018. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS® standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS® standards. Verification does not ensure the accuracy of any specific composite presentation. The verification reports, as well as a complete list and description of all the firm's composites, are available upon request by contacting Equity Investment Corporation, 1776 Peachtree Street NW, Suite 600S, Atlanta, GA 30309. Prospective clients should be aware that results are historical and do not imply future rates of return or volatility for EIC or the indices, which may be materially different from the past and from each other.

Investment management fees are based on market values of the assets under management. In addition to a management fee, some accounts pay an all-inclusive fee based on a percentage of assets under management. Other than brokerage commissions, this fee includes portfolio monitoring, consulting services, and in some cases, custodial services. EIC's maximum annual fees for SMA accounts (charged quarterly) are 0.75%. Total fees charged may equal 3% per year. SMA schedules are provided by independent SMA sponsors and are available upon request from the individual sponsor. Further information about fees and compensation is discussed in EIC's form ADV Part 2 ([www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov)).

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