EQUITY INVESTMENT CORPORATION

2017 Second Quarter Commentary
Mid-Cap Value

July 2017

The stock market rose again in the second quarter with growth indices well outpacing their value counterparts. The S&P 500® Index gained 3.1%; the Russell Midcap® Growth Index gained 4.2%; while the Russell Midcap® Value Index was up a more modest 1.4%. Our Mid-Cap Value SMA (MCV) composite rose 1.6% for the quarter (gross of fees[1]), outperforming its benchmark. Net of 3% hypothetical maximum annual SMA fees, the second quarter returns for MCV would be 0.8%.

While our performance this quarter has been ahead of our benchmark, the combination of slow earnings growth and increasing stock prices, coupled with minimal market volatility, continues to present a challenging investment environment for us. Consequently, cash levels remain elevated in both seasoned and model MCV portfolios. As a reminder, cash is a residual of our disciplined stock-selection process and neither a strategic call on market levels nor an attempt at market timing. Our process dictates that we raise valuations whenever warranted on existing holdings and prospective new investments. These valuation increases, which tend to occur when companies are sustainably growing earnings, allow us to continue to hold existing stocks in the portfolio, even as they near our original target price, or buy new stocks, even if their prices have not declined. Absent earnings growth however, and with ever rising stock prices, we are ultimately forced to sell stocks at a faster rate than we can replace them, which results in increased cash levels. This is the situation we find ourselves in today.

Investment Opportunities

The recent "risk on" trend warrants repeating our words of caution to investors about potential market drawdowns and the length of time required to recover from them. A closer evaluation of the S&P demonstrates our concern over valuations. First quarter earnings growth for the S&P 500 came in at a strong 20% but was disproportionately driven by energy earnings turning positive as opposed to being negative last year. Only two other major sectors, information technology and financials, grew earnings at double digit rates, and in both cases they were up against prior-year earnings that had declined from the year before. Overall, S&P 500 earnings are still ***below*** the peak they reached in the third quarter of 2014 and have only grown a ***cumulative*** 15% over the last five years ending the first quarter of 2017 while the index has returned approximately 70% over the same period. At today's levels, the S&P 500 trades at 24x trailing GAAP earnings and a slightly better 22x on a pro-forma basis. Small- and mid-cap stocks appear even more expensive. While these levels are not the highest at which the market has ever traded, they are elevated by historical standards, hence our cautious stance.

It seems that after several years of market gains, many investors have become either braver or complacent. However, there is some doubt, and the questions we hear most often from clients seem to fit into a variation on the journalistic W's: *What, When and Why*? **What** is causing the market to remain so strong and placid? **When** will this trend end? **Why** will it end?

As to the, "what" is causing the market to remain so strong and placid, there is no shortage of factors that may be playing a part. Increases in passive indexing and algorithmic trading, low interest rates, a modest but positive expansionary economic backdrop and a benign credit cycle, all may be contributing in some way to current low volatility and the rise in stock prices, and thus company valuations. We believe the explanation is much simpler – in large part, the market continues to go up because it has been going up for so long. It appears to us that a self-fulfilling cycle is attracting investors almost solely based on past performance and not on the current realities of valuation and fundamental growth.

As to "when" the trend will end, it is difficult to predict, yet the length of this expansion and the abnormally low level of volatility experienced are both already at historically outlier levels.

As to "why" the market may alter course, we can point to many potential causes in advance. On the global front, there is a credit binge in China and a related housing bubble in both Canada and Australia that are comparable or worse to the one we experienced in the United States. Closer to home, short term interest rates are moving higher, which may present challenges to the credit markets and borrowers. Government action in the form of significant changes to the healthcare system and trade policy, or the inability to pass tax reform, could negatively surprise market participants. Finally, we might simply have a garden variety recession or tightening credit cycle. Any of these factors, or others currently unforeseen, may possibly reintroduce the notion of cyclicality and risk into investors' minds. We are not predicting any one outcome, rather just as we have positioned portfolios over the years, we strive to protect against a range of outcomes while prudently stewarding and growing our investors' capital.

Portfolio Review

During the second quarter, we exited our position in Whole Foods Markets after the announcement that Amazon would acquire it. Whole Foods' stock rose to the agreed price, slightly above our own assessment of the firm's value, where we sold. Shortly thereafter, we purchased a small position in Kroger, which has seen its shares slump in recent years on increasing grocery competition and fell farther with the Amazon/Whole Foods announcement in anticipation of even greater challenges to come. While Amazon's entry into grocery is likely to intensify an already difficult environment, Kroger is accustomed to the hyper-competitive grocery business, is a well-managed operator with nationwide scale, and was available to us at an attractive entry price.

We also initiated a position in Target Corporation. The stock dropped substantially when management lowered analyst guidance earlier in the year and fell again on the news of Amazon's purchase of Whole Foods. Despite the well documented challenges of the current retail environment and the presence of formidable competitors, we entered at a price that we think underestimates Target's value.

Finally, we added modestly to our position in Diamond Offshore. Diamond has been a poor performer on continued commodity weakness and concerns about offshore drilling activity. Nonetheless, Diamond is prudently capitalized, conservatively managed, and free cash flow positive. While it faces ongoing risk, potential upside is considerable, and we believe it merits a small weighting in our portfolios.

We thank you for your continued partnership with EIC and are here to support you in any way we can.

Investment Team

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See disclosures on the next page.

[1]Disclosures

Returns are presented in conjunction with our full disclosure presentation, which is 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. Results are historical and do not imply future rates of returns or volatility for EIC or for the indices, which may be materially different from the past and from one another. ***Individual account results may differ from those of a composite. Client net returns are reduced by EIC's management fees and may possibly be reduced by brokerage firm wrap fees, which include transaction costs, portfolio management, custody, and other administrative fees.***

EIC's MCV results are those of our Mid-Cap Value SMA Composite gross (before all fees) and net of (after) assumed maximum annual SMA fees of 3% (0.25% per month). SMA fees include transaction costs, portfolio management, custody, and other administrative fees.

The securities identified and described above do not represent all of the securities purchased, sold or recommended for client accounts. Actual portfolio holdings may vary for each client, and there is no guarantee that a particular client's account will hold any, or all, of the securities identified. The reader should not assume that an investment in the securities identified was or will be profitable.

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Equity Investment Corporation (EIC) is an SEC registered independent investment advisor incorporated in the state of Georgia. Effective September 30, 2016, assets of the firm transferred from Jim Barksdale, who founded the firm in 1986, to 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. 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. SMA 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 fees. 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 mid-cap companies with lower price-to-book ratios and lower forecasted growth rates. It is a subset of the Russell Midcap® Index which consists of approximately 800 stocks and represents the mid-cap segment of the US equity universe.

									Advisory-Only (UMA) and Managed Assets		
Year Ended Dec - 31	Gross Rate of Return²	Hypothetical² (3% annual) Net Rate of Return	Benchmark Return of Russell Midcap® Value Index³	Composite 3-Yr St Dev	Benchmark 3-Yr St Dev	Dispersion¹ of Annual Returns (St Dev)	Number of Portfolios	Composite Assets ($ Millions)	UMA Assets* ($ Millions)	GIPS® Firm Assets ($ Millions)	Total* ($ Millions)
2017 (through 6/30)	2.9%	1.4%	5.2%	7.6%	10.9%	0.5%	16	$4.5	$1,960.6	$2,786.3	$4,746.8
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

*"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.

¹ Dispersion is an asset-weighted standard deviation for the accounts in the composite for the entire year (or year to date).

² Results include SMA accounts and gross returns are shown as supplemental information. Gross returns for SMA accounts are stated gross of all fees and transactions costs; net returns are simulated by reducing gross returns of the composite by an annual SMA fee of 3% (0.25%/month).

N/A – Information is not statistically meaningful due to an insufficient number of portfolios in the composite for the entire year.

<u>Additional Notes</u>: 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.

Equity Investment Corporation (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 March 31, 2017. 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, 3007 Piedmont Road NE, Suite 200, Atlanta, GA 30305. 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. 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).

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