EQUITY INVESTMENT CORPORATION

2017 Year-End Commentary

Mid-Cap Value

January 2018

Stocks finished the year with a bang, rising for the ninth consecutive quarter. The Russell Midcap Value Index increased 5.5% while our Mid-Cap Value (MCV) SMA composite gained 5.8% gross*. Net of a 3% hypothetical maximum annual SMA fee, results would be 5.0% for the quarter.[1] For the year, the Russell Midcap Value Index gained 13.3% and our MCV SMA composite increased 12.6% gross*. Net of a 3% hypothetical maximum annual SMA fee, 2017 results would be 9.3%. Relative to the Russell Midcap Value, for the quarter our value added was attributable to a combination of our stock selection and our sector over/under weights. Conversely, cash detracted from relative performance for the quarter and the year as valuations continue to present challenges for our conservative approach.

As mentioned last quarter, style continued to be an important factor in 2017, with growth outperforming value by the widest margin since 2009. Moreover, growth stocks have now outperformed value stocks for the majority of the past eleven years. In fact, despite some reversion in 2016 (especially post election), 2017 has extended the longest period of growth-stock dominance in decades.

Perhaps the defining characteristic of the U.S. equity market in 2017 was the lack of volatility. In fact, by some measures it was the quietest year since the Beatles appeared on the Ed Sullivan Show in 1964. According to the Wall Street Journal Market Data Group, the absolute daily percentage change for the S&P 500 in 2017 was 0.3%, the smallest in 53 years.[2] Several milestones like this were set in 2017. For example, the S&P 500 has risen for 14 straight months through last month, an unprecedented streak. Likewise, the index hasn't experienced a drop of 3% or more from an all-time high since November 7, 2016, a record-setting length of time.[3]

<u>Investment Environment</u>

We recognize that there have been positive developments in the overall investment climate, but we enter 2018 similarly cautious to recent years. It is encouraging that 2017 full year earnings will likely register strong growth, but measured over a multi-year period, in our opinion earnings progress has been lackluster. In fact, 2017 will barely surpass the previous peak in earnings achieved in 2014. Market prices were up in line with earnings growth in 2017, leaving valuations similar to the beginning of the year. We believe that starting valuation, as much or more than any other factor, determines likely forward return prospects. At 25x trailing GAAP and 21x pro-forma earnings, the market, as reflected by the S&P 500, remains expensive by historical standards.[4]

Another positive development for equity investors is the tax-reform legislation Congress passed in late 2017. All else being equal, this legislation should make a meaningful contribution to earnings growth in 2018, particularly for domestically focused businesses like financials and retail. However, we caution that the longer-term bottom-line effects may or may not prove permanent, since any growth in earnings is largely a one-year impact. As such, investors should express some level of skepticism in assigning permanently higher earnings, growth rates and valuations to those companies meaningfully affected by the legislation. Our observation of market prices over the last 15 months suggests the opposite may be occurring.

On the debt side, short-term interest rates continue to rise as a result of Federal Reserve tightening, and the expectation is for further rate increases into 2018. On the longer end of the curve, rates have risen much less, creating a flattening yield curve. This bears watching. In the past, flattening to negative yield curves have anticipated slowdowns in the economy, a viewpoint which is very much at odds with the prevailing economic sentiment. The high-yield bond market remains priced near historic low levels in terms of bond spreads, or excess yield over Treasuries, affording little room for error when the credit cycle turns. Finally, for the first time since 2008, 2-year Treasury Bonds, a relatively short term and safe investment, now yield more than the dividend yield on the S&P 500, a relationship that may have ramifications for the equity markets going forward.

With that as backdrop, our mission remains the same: constructing a portfolio of stocks that offers reasonable odds of investment success across a range of potential market outcomes. Today, we are faced with an interesting environment that has some elements of the last two periods of market excesses in the late ’90s and 2005-2007. Though valuations are broadly high today, we feel they are not as excessive as some sectors, most notably Information Technology and Consumer Staples, were in the late ’90s. And, while there are earnings quality and debt concerns today, in our view nothing approaches the level of existential risk that financials presented in ’05-’07.

Even though we think risks are not as significant as either of those two prior periods, we do believe they are spread more broadly and persistently. Unlike the late ’90s, it is difficult for us to find cheap (and safe) stocks, and issues around corporate leverage, pro-forma earnings and (perhaps) unsustainably high margins are more widespread than in ’05-’07. Given this environment, we are not focusing on one big risk to avoid, as we largely were in the two prior periods, but rather fighting some of today’s risks on multiple fronts while marginally tilting away from those we believe to be the worst offenders. As we have often said, what is NOT in your portfolio is often AS important to your returns as what is IN your portfolio.

Portfolio Review

During the quarter we sold The Hanover Insurance Group as it reached our assessment of full value after very strong price performance. We trimmed T Rowe Price Group as well. Due to its strong price increase, we believe reducing our exposure is prudent risk management.

We added to our position in Target in response to relative price weakness caused by company-specific challenges. The company remains structurally sound with good long-term investment characteristics, and we believe its challenges are sufficiently reflected in the stock price.

Other Updates

We have two noteworthy items to share with you. First, we have moved our offices. You can now find us three miles down the road at 1776 Peachtree Street, Suite 600S, Atlanta, GA 30309. We were spread across three floors in our previous space. Now, we are located on one floor, making it easier for us to collaborate and function as a team. Second, as we mentioned in our update last summer we had launched a search for a research analyst to join our team. We are pleased Robert “Bo” Ladyman joined our team last month. Bo comes to us with over eight years of analyst experience, most recently at Resolution Capital, and we believe he will prove an asset to the team.

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

Investment Team

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Please see disclosures on the next page.

Disclosures

[1]*EIC's MCV results are those of our* <u>*Mid-Cap Value SMA*</u> *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. 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.*

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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[2]*Vlastelica, Ryan, "The Last Time Stocks Were This Quiet Was the Year the Beatles Went on Ed Sullivan." MarketWatch, Inc., 20 December 2017. https://www.marketwatch.com/story/the-last-time-stocks-were-this-quiet-was-the-year-the-beatles-went-on-ed-sullivan-2017-12-14. 18 January 2018.*

[3]*Bilello, Charlie, "2017: The Year in Charts." Pension Partners. 05 January 2018. http://pensionpartners.com/2017-the-year-in-charts." 18 January 2018*

[4]*Source: Standard & Poors. Trailing twelve month earnings as of September 30, 2017; forward earnings estimates for calendar year 2017. Prices as of January 3, 2018, from Yahoo! Finance.*

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 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 Return[1] (Supplemental)	Hypothetical 3% annual Net Rate of Return[1]	Benchmark Return of Russell Midcap® Value Index[3]	Composite 3-Yr St Dev	Benchmark 3-Yr St Dev	Dispersion[2] of Annual Returns (St Dev)	Number of Portfolios	Composite Assets ($ Millions)	UMA Assets[3] ($ Millions) (Supplemental)	GIPS® Firm Assets ($ Millions)	Total Assets[3] ($ Millions) (Supplemental)
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

[1] *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).

[2] 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.

[3]"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 September 30, 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, 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. 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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