EQUITY INVESTMENT CORPORATION

2019 Fourth Quarter Commentary
Mid-Cap Value

January 2020

If 2018 was a year where nothing besides cash worked, 2019 was its mirror image – virtually every type of investment soared in price. The Russell Midcap® Value Index (RMCV) was no exception, climbing 27.1%. Our Mid-Cap Value (MCV) SMA gained 18.3% (gross)*. Over the fourth quarter, the RMCV increased 6.4%, while our MCV SMA composite rose 5.3% (gross)*. Net of a 3% hypothetical maximum annual SMA fee, results for MCV were 14.9% for the year and 4.5% for the quarter.[1]

<u>Investment Environment</u>

This year's strong equity market performance was driven by significant valuation expansion despite anemic earnings growth. As a proxy for the broad market, 2019 S&P® 500 operating, or pro-forma, earnings per share are expected to be approximately flat compared to last year, yet the multiple paid on those earnings expanded 29%.[2] When coupled with dividends, this multiple expansion represented nearly all of the S&P 500's performance in 2019. While our valuation models allow us to pay a premium for growth, there is a limit. When it's reached, we're quick to sell, reducing price/valuation risk in the process, no matter how much we may like a holding. While this sometimes costs us relative performance, particularly in strong up markets, our price discipline has served us well over our history.

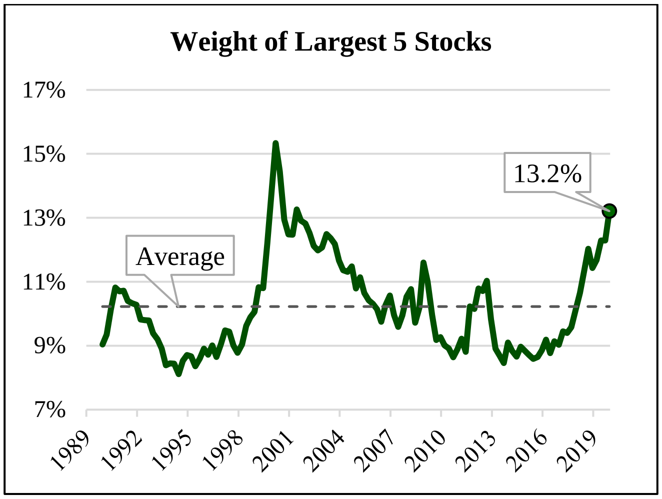
As we close the decade, we reflect on where we are and, though the future is uncertain, where we may be headed. We are now officially in the longest economic expansion since 1945. The 2010s were the first decade without a recession going all the way back to the 1850s.[3] During the last decade, the unemployment rate dropped from 9.9% to 3.5%, 10-year Treasury yields fell from 3.9% to 1.9%, and the S&P 500 posted gains in 9 out of 10 years.[4]

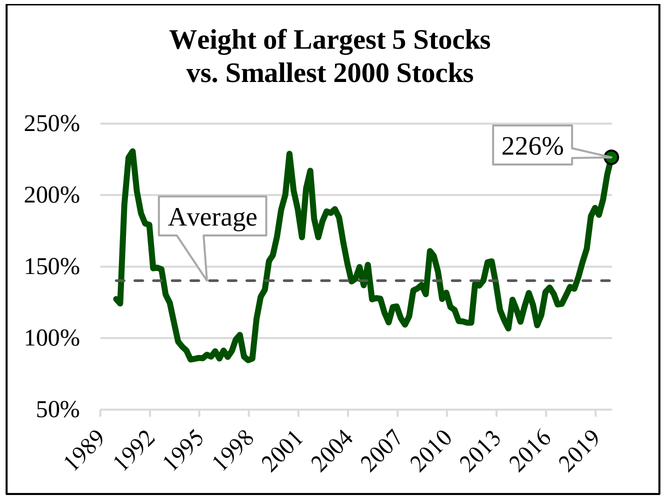
This backdrop colors the current investment environment, one that feels familiar to us. It bears more than a passing resemblance to the market of the late '90s, albeit in most aspects on a somewhat more subdued scale. To elaborate, here are five similarities:

Market Valuations are Elevated: Today, the S&P 500 trades at approximately 19.4x next twelve-month pro-forma earnings, above long-term averages, though not as high as the late '90s. This valuation is predicated on: 1) strong 2020 expected earnings growth (history has shown that actual tends to disappoint versus original expectations), and 2) historically high expected margins across all sectors. Should either of these fail to materialize, that valuation will move higher (absent any stock-price changes), maybe significantly so. For perspective, the market currently trades at approximately 25x trailing twelve-month GAAP earnings.[5]

Other Signs of Optimism Abound: The percentage of unprofitable IPOs has matched or overtaken both 1999 and 2008 levels, and the overall percentage of money-losing public companies is close to an all-time high, yet most indices are also at record highs.[6] Private-equity deal multiples are at historical highs too, driven by near all-time high leverage,[7] while junk-bond yields are near all-time lows.[8] In short, pricing is indicative of a risk-taking market.

Winner Take All Mentality: In the following charts, we are seeing market concentrations led by prominent tech stocks that are at outlier levels. The left-hand chart shows that the top five stocks by market cap (Apple, Microsoft, Alphabet, Amazon and Facebook) currently represent over 13% of the Russell 3000 Index weight. Over the last 30 years, this level was only eclipsed for a few quarters in the blow-off top of the tech bubble.

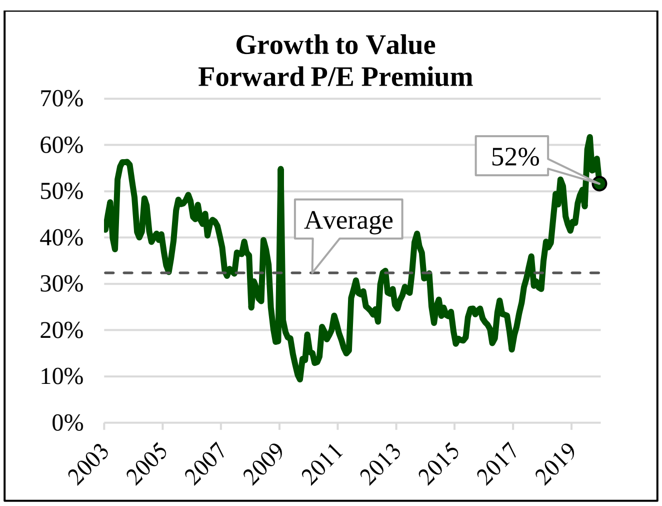


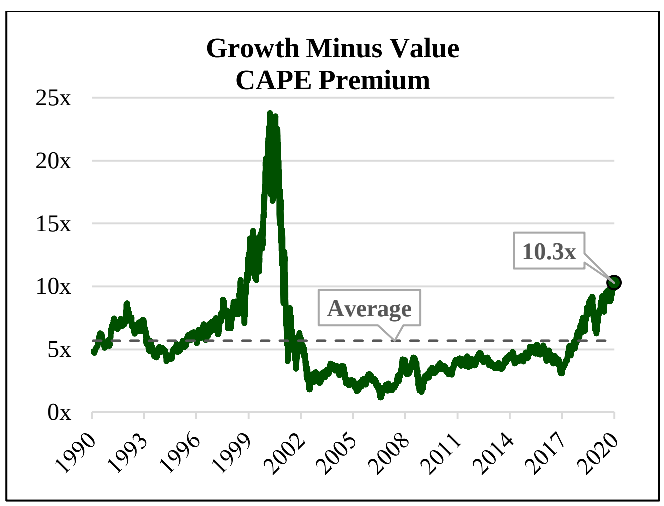


Data Source: S&P Capital IQ, quarterly index weight of Russell 3000 Index constituents.

In the right-hand chart, the weight of these same five stocks is plotted relative to the weight of the bottom 2000 stocks, essentially the entire small-cap universe. Today, the index weight for these five companies is over 2x the index weight of the entire small-cap universe, a level matched only twice in the last 30 years. Not owning these stocks has made it difficult to beat the indices. Nonetheless, history and the law of large numbers suggest that a handful of mega-caps may have difficulty repeating that outperformance in the future.

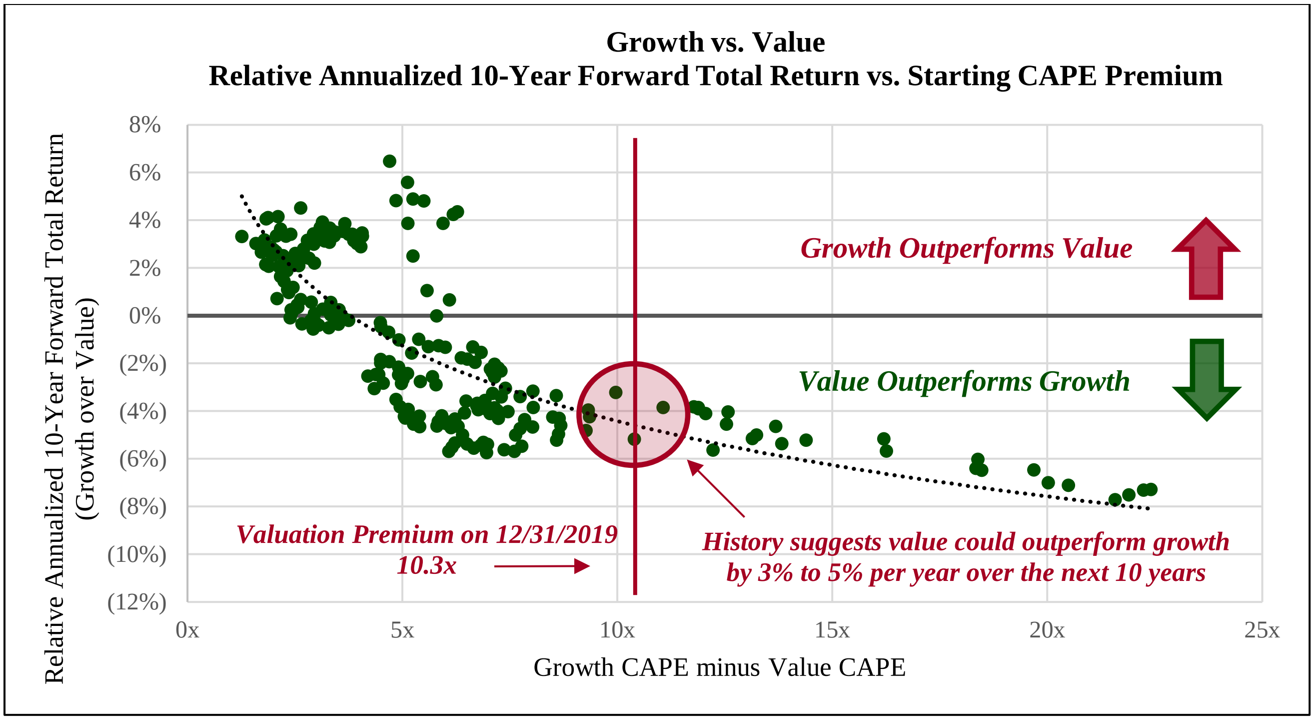
Attractive Investment Opportunities: Despite elevated valuations in general, market volatility over the last couple of years has created significant valuation disparities. While growth typically trades at a premium to value, it recently traded at its highest premium in the last 15+ years (left chart below), despite comparable fundamentals (earnings growth plus dividends).[9] The chart on the right tells a similar tale. It shows the difference between the modified Cycle Adjusted Price-Earnings Ratios (CAPE) of the Russell 1000 Growth and Value.[10] Only the late '90s tech bubble saw higher multiples paid for growth over value. Similar valuation disparities exist between low volatility (expensive) and high volatility (cheaper) stocks, and between large-caps (expensive) and small-caps (cheaper). Our research efforts are focused on these areas of attractiveness.





Data Source: Morningstar Direct℠ (left chart), see footnote 9; S&P Capital IQ (right chart), see footnote 10.

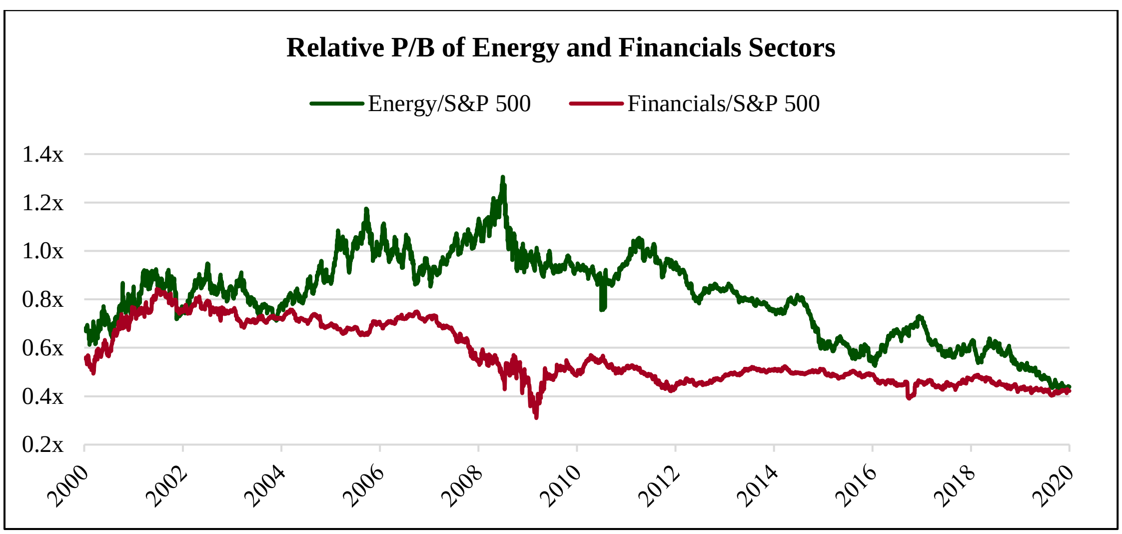
On the next page, we'd like to share a chart that shows the historic premium of growth to value, along with the subsequent over/under performance of the two investment styles.[11]



Data Source: S&P Capital IQ, see footnote 11.

Growth generally trades at a premium to value. Beyond a certain point, however, there is a negative correlation between starting relative valuation and subsequent longer term returns. Today's valuation premium of greater than 10x earnings on a modified CAPE basis suggests, if history is a guide, that growth could underperform value by 300 – 500 basis points annually for the next 10 years.

Manager Style Drift: As we saw in the late '90s, many value managers today have drifted towards a growth or core approach in an attempt to keep up with a market where growth is the dominant theme. While there are many ways to make money in the market, we believe that value managers are hired for a particular style that is distinct from and often has a low correlation to growth investing. As seen in the chart below, the financials and energy sectors of the S&P 500 currently trade at or near the lowest relative Price/Book (P/B) valuations to the market in 20 years.



Data Source: S&P Capital IQ, P/B ratios of S&P 500 Energy and Financials sectors to P/B ratio of total S&P 500.

Together these two sectors represent roughly 24% of the Russell Midcap Value index but less than 6% of the Russell Midcap Growth index.[12] If a "value" manager is not invested in these areas, instead focusing their time and attention on technology stocks, they may be earning superior short-term returns versus the value index, but they may be drifting from their stated style and thus offering little diversification benefit. Our representative Mid-Cap Value portfolio's weighting in these two sectors currently totals 41%.

Portfolio Review [13]

New purchases during the fourth quarter for midcap portfolios included Discovery Inc., Cadence Bancorporation, Ingredion Inc., National Fuel Gas Co., and Old Republic International Corporation.

Discovery is an operator of cable television networks specializing in unscripted content. In addition to its namesake Discovery Network, the company's networks include HGTV, Food Network, Travel Channel, Investigation Discovery, OWN and TLC. Internationally, it also owns the popular Eurosport Network. The company attracts loyal viewers to its programming in attractive targeted demographics, which has led to rising advertising revenue. Carriage fee revenue is pressured by cord-cutting, but over-the-top streaming services, which overwhelmingly include Discovery's channels in their bundles, help offset traditional cable losses. Overall, earnings and cash flow have grown while the concerns about cord-cutting have led to a weak stock price over the past several years, resulting in an attractive entry valuation. Strong margins, return on capital, and cash flow all support the investment case for Discovery.

Cadence is a community bank with $17.8 billion in assets and approximately 100 branches across six southern states. The bank is conservatively levered, loans are prudently diversified, and both returns on capital and operating metrics are strong. Despite these qualities, at our purchase price, the bank traded at only a slight premium to tangible book value, yet is well positioned to continue to grow and earn attractive returns on capital.

Ingredion (formerly Corn Products International) primarily wet-mills corn into its underlying components and further processes them into starches, sweeteners and co-products (such as corn oil and animal feed), which it sells to the food, beverage, brewing and animal nutrition industries. Shares have come under pressure over the past two years as higher supply chain and commodity costs have negatively impacted margins. We believe this weakness has afforded us an opportunity to buy a stable business with a strong balance sheet at a reasonable price.

National Fuel Gas is a diversified natural gas company, which owns regional pipelines and a gas utility in western New York state. NFG also produces natural gas, primarily in the Marcellus Shale and Utica Shale, and owns gathering, storage and processing infrastructure serving both its own gas production as well as that of independent producers. In a time when typical utilities and pipeline companies trade at historic premiums, NFG trades near a historically low valuation due to pessimism about the effect of the declining commodity price on its gas production business. In our opinion, the company's diversified business model provides more stability and better prospective returns than is factored into today's stock price.

Finally, Old Republic International is a property and casualty insurer, with the bulk of its business in general commercial insurance, primarily business liability coverage across various industries. It is also one of the nation's largest title insurance companies. The business is conservatively managed and well-run, and our purchase price should offer good prospective returns.

For the quarter, aside from numerous trades harvesting tax-losses, we trimmed existing positions in Kroger and Target and sold our position in Truist Financial.

Kroger continues to face intense grocery competition. While the stock has been volatile during our ownership period, we have added and trimmed advantageously, with good results. Our trim in the fourth quarter followed an 18% rise in the stock price since we added to the position in the third quarter. Target was our best performing stock in 2019. While earnings growth has resumed and Target's online initiatives are gaining traction, the stock price reflects much of the good news and we reduced our position size. Lastly, SunTrust was a long-term holding and strong performer. After its merger with BB&T, the combined entity, renamed Truist Financial, had a market cap well in excess of the midcap size parameters for this strategy, so we sold our holding.

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

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<u>Disclosures</u>

[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 EIC SMA composites 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 a composite.*

[2]Data Source: S&P Capital IQ. S&P 500 earnings per share for calendar year 2018 and consensus earnings estimates for calendar year 2019. Data as of January 14, 2020. Calculated using S&P 500 closing prices as of December 31, 2018, and December 31, 2019, from Yahoo! Finance.

[3]Data Source: The National Bureau of Economic Research, US Business Cycle Expansions and Contractions. <https://www.nber.org/cycles/>.15 January 2020.

[4]Data Source: Federal Reserve Bank of St. Louis, FRED® Economic Data, Unemployment Rate & 10-Year Treasury Constant Maturity Rate. <https://fred.stlouisfed.org/series/>. 15 January 2020.

[5]Data Source: S&P Capital IQ. S&P 500 next twelve months pro-forma price/earnings based on consensus earnings estimates and trailing twelve months GAAP price/earnings based on generally accepted accounting principles (GAAP) earnings. Data as of January 14, 2020.

[6]Source: Ritter, Jay, University of Florida, Proportion of U.S. IPOs that are lossmaking; Societe Generale/Quant Research, Money Losing Propositions. Quoted in Mackintosh, James, "Money-Losing Companies Mushroom Even as Stocks Hit New Highs." The Wall Street Journal. 09 January 2020. <https://www.wsj.com/articles/money-losing-companies-mushroom-even-as-stocks-hit-new-highs-11578608209>. 10 January 2020.

[7]Source: Morgan Stanley Wealth Management, @Robin Wigg, Leveraged buyout multiples keep climbing. Quoted in Borodovsky, Lev, "The Daily Shot; Heeding Financial Armageddon Predictions Can Be Costly."13 November 2019. <https://blogs.wsj.com/dailyshot/2019/11/13/the-daily-shot-heeding-financial-armageddon-predictions-can-be-costly/>. 15 January 2020.

[8]Data Source: Federal Reserve Bank of St. Louis, FRED® Economic Data, ICE BofAML US High Yield Master II Effective Yield. <https://fred.stlouisfed.org/series/>.15 January 2020.

[9]Russell 3000 Growth forward P/E premium over Russell 3000 Value forward P/E as a percentage of Russell 3000 Value forward P/E, calculated for each month-end January 31, 2003 to December 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 earnings per share for the company's fiscal year.

[10]Russell 1000 Growth modified CAPE premium over Russell 1000 Value modified CAPE calculated for each month-end January 31, 1990 to December 31, 1990, and daily from January 1, 1991 to December 31, 2019. Modified CAPE is the ratio of index prices to trailing 10-year index level earnings before taxes (EBT) on a time-weighted basis. Annual index level EBT is imputed by dividing the year-end index price by an aggregated price to EBT multiple of index constituents. Price to EBT is calculated by aggregating the available year-end market value of index constituents to the available adjusted trailing twelve months EBT (excluding unusual items) of index constituents.

[11]Russell 1000 Growth modified CAPE premium over Russell 1000 Value modified CAPE (x-axis) for each month-end January 31, 1990 to December 31, 2019, plotted against the subsequent annualized 10-year forward total return difference between the Russell 1000 Growth and Russell 1000 Value (y-axis) for each month-end January 31, 1990 to December 31, 2009. Annualized 10-year forward total return data is unavailable subsequent to December 31, 2009.

[12]Data Source: Morningstar Direct℠. Re-scaled weights of energy and financials sectors for the Russell 3000 Growth and Russell 3000 Value at December 31, 2019. Sectors are determined using the Global Industry Classification Standard ("GICS"). GICS® was developed by, and is the exclusive property of, Standard & Poor's Financial Services LLC ("S&P") and MSCI Inc. ("MSCI"). GICS is the trademark of S&P and MSCI. "Global Industry Classification Standard (GICS)" and "GICS Direct" are service marks of S&P and MSCI.

[13]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.

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.

									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	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)
2019	18.3%	14.9%	27.1%	9.4%	12.8%	0.7%	22	$5.5	$1,942.4	$2,245.1	$4,187.5
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

[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.

See next page for additional disclosures

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, 2019. 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).

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