

## Equity Strategies • Large Cap Value

The Large Cap Value portfolio is focused on seasoned companies that generally have capitalizations above \$10 billion. These companies are selected using a bottom-up, fundamental research process that seeks to identify individual businesses that possess substantial competitive advantages and that are trading at discounts to intrinsic value. The portfolio typically is comprised of 23-25 holdings and is expected to result in low to moderate turnover. The portfolio is suitable for clients whose primary objective is capital appreciation and whose secondary objective is dividend income.

### Portfolio Commentary

The broad equity markets posted negative results for Q3, with the S&P 500 down -6.4%, its first quarterly loss since the fourth quarter of 2012. The Large Cap Value strategy also posted a decline in Q3 of -5.0%, bringing its year-to-date return to -3.2% (gross of fees).

*For detailed performance data and disclosures see:*

[http://www.confluenceinvestment.com/equity\\_strategies#prod\\_40](http://www.confluenceinvestment.com/equity_strategies#prod_40)

Why is 2015 turning out to be a tough year for equity investors? For the first time in years, we were without the tailwind of QE (ended in Q4 2014) and, more importantly, had the prospect of the first fed funds rate increase since 2006. This has created a lot of anxiety as to the timing of the first increase and the pace and magnitude of future increases. Investor reaction, via increased volatility, is normal behavior as the Fed's past moves in moving rates upward have been the primary cause of recessions post-World War II. With our domestic economy already growing below historical trend and the fear of rates rising, investors have been favoring businesses with above-average growth profiles while turning a blind eye on their valuations.

The top market performers have been skewed toward social media/technology and biotech/healthcare. Amazon and Netflix are up +65% and +112%, respectively, year-to-date, and have been the primary contributors to the performance of not just the "Growth" segment of the market but also the broad market, the S&P 500. The "Growth" and "Value" segments have diverged as the Russell 1000 Growth Index posted a marginal loss of -1.5% while the Russell 1000 Value Index was down -9.0%. At times like these we

like to remind ourselves of a Benjamin Graham adage, "In the short run, the market is a voting machine, but in the long run it is a weighing machine." Hence, we maintain our long proven philosophy of owning great businesses at bargain prices.

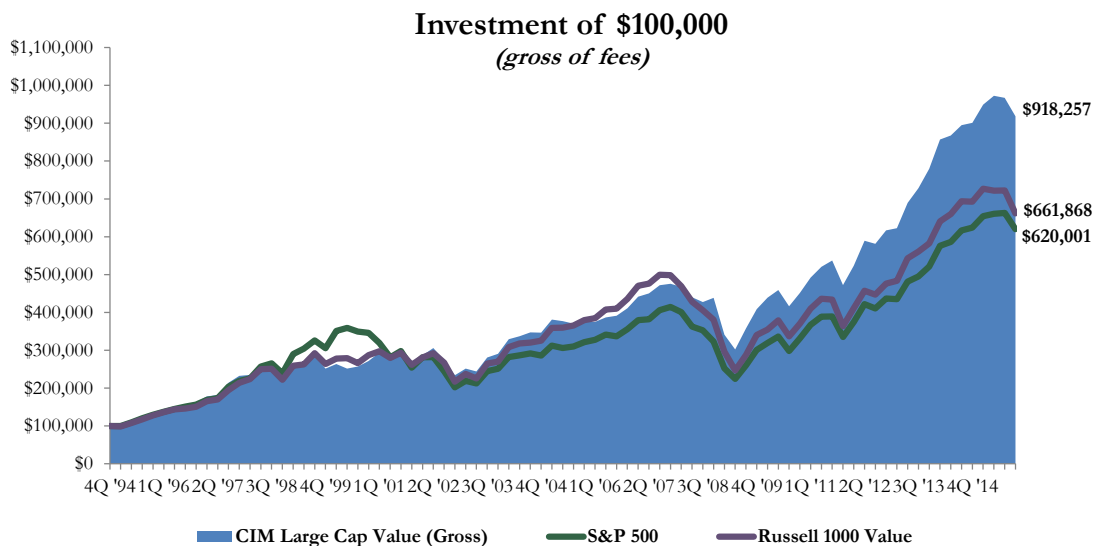
During the quarter, we exited shares of Emerson Electric (EMR). EMR was sold as the company's fundamentals continue to deteriorate and management struggles to demonstrate a clear long-term strategy. EMR's most recent quarterly results failed to meet already reduced guidance and the outlook remains challenged given the end markets served and geographic exposure. More specifically, the oil and gas industries' curtailment of capital spending is negatively impacting their vendors, such as EMR which has large exposure to the sector. EMR also has substantial exposure to international economies, with 60% in international sales. Many of these markets are experiencing slowdowns in growth, which is only extrapolated by the strength in the dollar. With EMR's valuation trading near its historic average, the shares presented more downside risk which is why they were sold.

Our current view calls for a lengthy period of rising but low interest rates as the employment landscape remains sluggish with a low participation rate. There is ample global capacity which should keep inflation subdued. We expect to see a slow pace of rate increases. This should allow the economy to maintain growth and equities to maintain their footing in spite of higher interest rates, albeit with higher volatility.

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Top 10 Portfolio Holdings (as of 9/30/15)

Company	Market Capitalization (\$ billions)	Portfolio Weight
Markel Corp.	11.2	4.9%
Mastercard Inc.	102.0	4.6%
W.R. Berkley Corp.	6.7	4.6%
American International Group, Inc.	73.5	4.5%
Expeditors International of Washington, I	8.9	4.4%
Stryker Corp.	35.4	4.3%
Express Scripts Inc.	54.7	4.2%
Compagnie Financiere Richemont SA	39.7	4.2%
Diageo (Adr 1:4)	67.4	4.1%
Wells Fargo & Company	263.6	4.0%



**Confluence Investment Management LLC**

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