

NorthPointe Capital

Large Cap Value – an Educated Bet on America

The Future of America

In Warren Buffett's shareholder letter recapping Berkshire Hathaway's performance in 2016, he redoubled his position on the future of this country:

"I'll repeat what I've both said in the past and expect to say in future years: Babies born in America today are the luckiest crop in history."

If America's best days are truly ahead, an investor would be wise to capitalize on its continued prosperity. Directly investing in publicly traded large cap value companies is a straight forward way to benefit from the future of America. Large Cap Value investing combines the power and innovation of American business with the soundness of a time-tested investment philosophy. A portfolio of Large Cap Value Companies can provide a sound, safe, and secure method to follow the advice of the "Oracle of Omaha".

What is Large Cap Value Investing?

What is "Large Cap Value"? The phrase can be broken down into two parts. "Large Cap" is a term used to define companies with large or big market capitalizations. Many of the companies that you have dealings with every day would be considered "large cap". The "Value" part of the phrase refers to the relative characteristics of the companies. To simplify the idea, the stock prices for "value" companies typically trade at a discount to their peers or even the value of their assets. Conversely, "Growth" companies trade at a premium per share to their peers. A typical value company might be in the energy, industrial, or banking space while a typical growth company might be in the technology or healthcare sector.

The Russell 1000 Value® Index is often used to track the performance of Large Cap Value companies. The top holdings in the Russell 1000 Value® Index are quite familiar to us all.

Top 10 Holdings in the Russell 1000 Value® Index as of December 31st, 2017

Berkshire Hathaway Inc.

JPMorgan Chase & Co.

ExxonMobil Corporation

Johnson & Johnson

Bank of America Corporation

Wells Fargo & Company

AT&T Inc.

Chevron Corporation

Proctor & Gamble Company

Intel Corporation

These US large cap value companies have a tremendous footprint in the world economy. In 2017, the companies in the Russell 1000 Value index generated more than \$9.8 trillion in sales – nearly as much as the entire gross domestic product of China.¹ By way of comparison, the gross domestic product of the United States was \$17.2 trillion over that same period.

¹ Russell 1000 Value Constituent Annual Sales data pulled from FactSet as of 31Dec17 from Compustat North America Financial Database. Chinese GDP numbers from FRED.

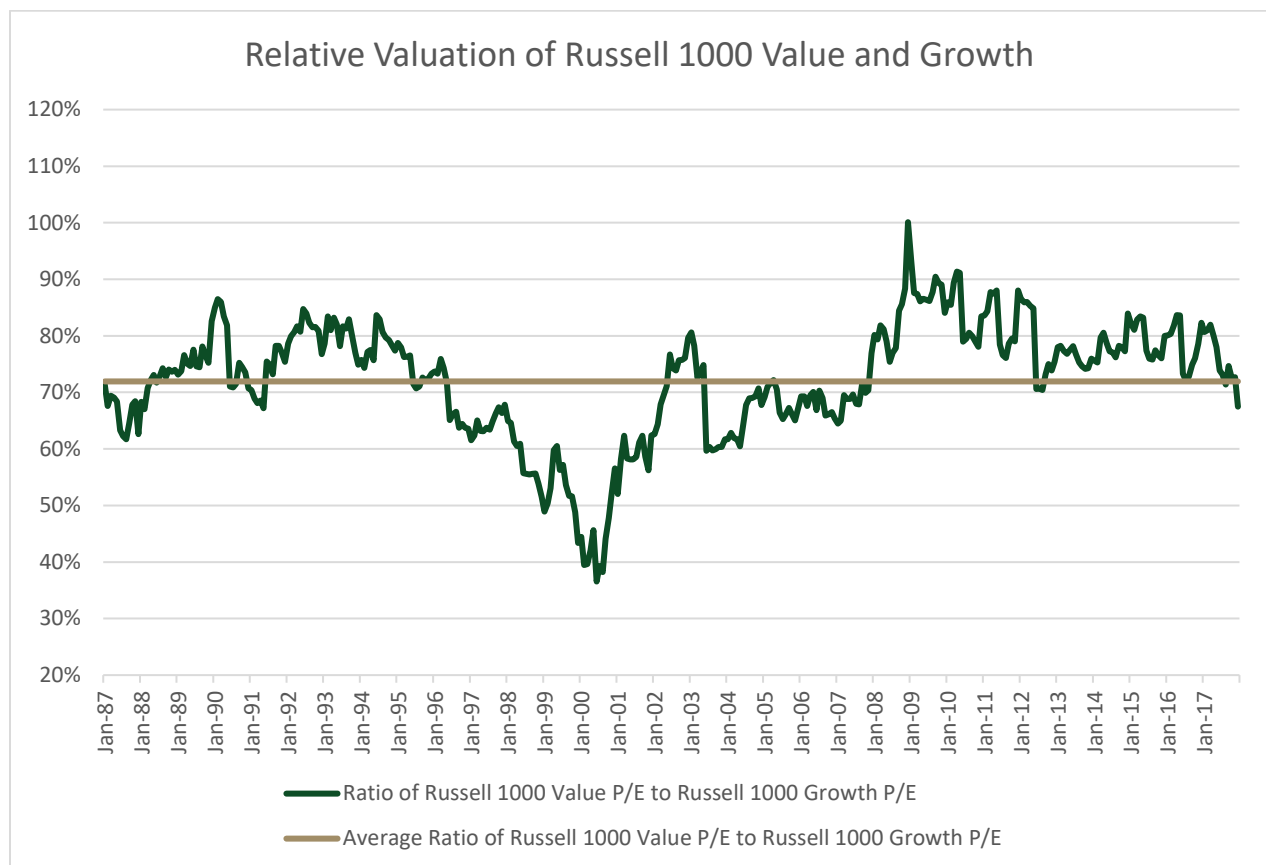
Over the Long Term, Value Strategies are Winners

The so-called father of value investing, Benjamin Graham describes the difference between value and growth investing:

Experience has taught us that, while there are many good growth companies worth several times net assets, the buyer of such shares will be too dependent on the vagaries and fluctuations of the stock market. By contrast, the investor in shares ... at or about their net-asset value can always consider himself the owner of an interest in sound and expanding businesses, acquired at a rational price – regardless of what the stock market might say to the contra

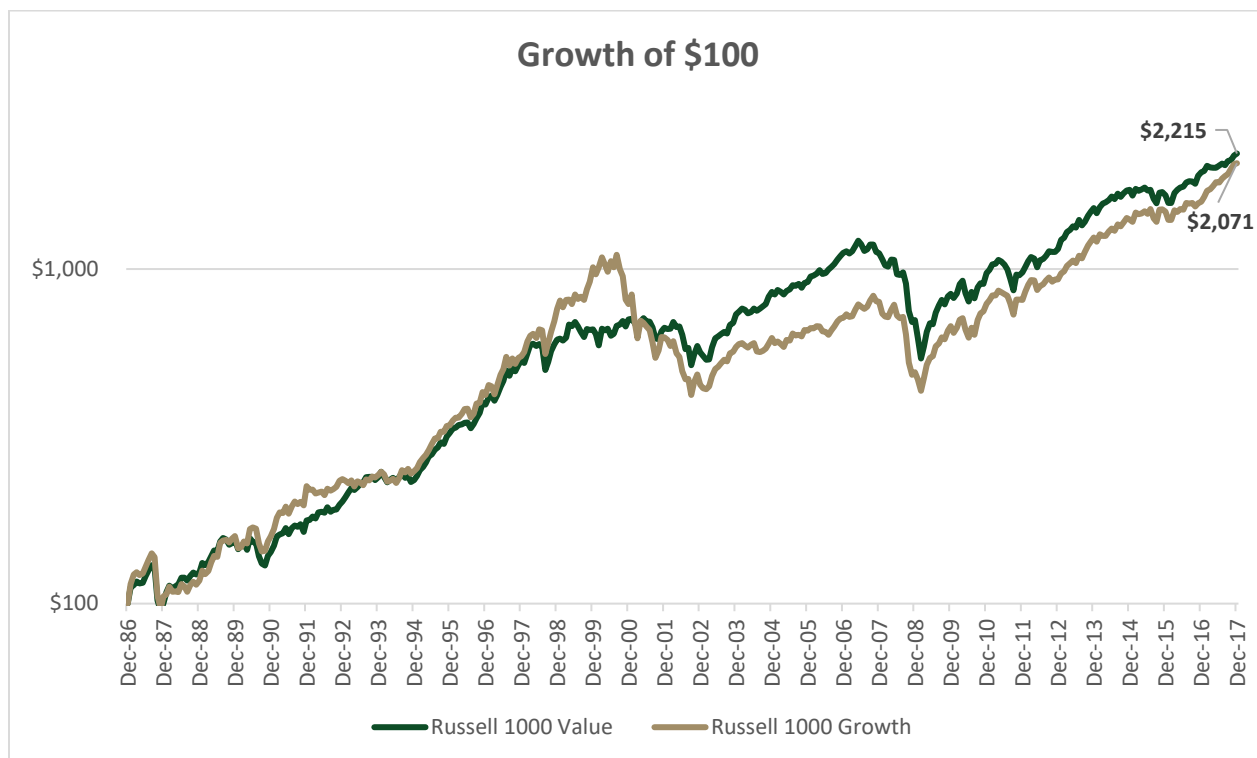
Much like a shrewd consumer, Benjamin Graham and other value investors wait for quality businesses to go “on sale” before purchasing. This sets up the value investor’s portfolio for long term success regardless of the “vagaries and fluctuations of the stock market.”

One measure investors consider when determining whether a portfolio or index exhibits a value style is the Price to Earnings ratio. Put simply, this measure tells how much an investor is paying (the price) for each dollar the company is generating (the earnings). By definition, P/E measures for the Russell 1000® Value Index will be at a discount from the Russell 1000® Growth Index.²



² Russell 1000 Value and Growth P/E data from the FactSet Portfolio Analysis tool.

Mr. Graham’s insight has proven to be correct by the long-term outperformance of large cap value indices as compared to growth indices. Over the 31-year history of Russell Index data, the Russell 1000 Value Index has returned an annualized 10.51% compared to the 10.27% annualized return of the Russell 1000 Growth Index. The compound difference between these two returns is even more compelling. Investors putting \$100 in each of these two indices at their inception 31 years ago would have \$2,215 in the Russell 1000 Value portfolio and \$2,071 in the Russell 1000 Growth portfolio today.³



Summary Return Statistics

	Compound Annual Growth Rate	Growth of \$100 over 29 Year History
Russell 1000® Value Index	10.51%	\$2,215
Russell 1000® Growth Index	10.27%	\$2,071

³ Russell Index return data from eVestment Alliance.

Safe and Secure

In addition to the strong long-term performance record of value strategies in the large cap stock space, value strategies improve investor experience with lower risk. One common way investors measure risk is the standard deviation of trailing returns. This measures the variability of return patterns over time. The lower the variation, the less volatile and, therefore, the less risky the investment is perceived to be.

Returns Volatility over 31 Year Russell Index History (1987 - 2017)⁴

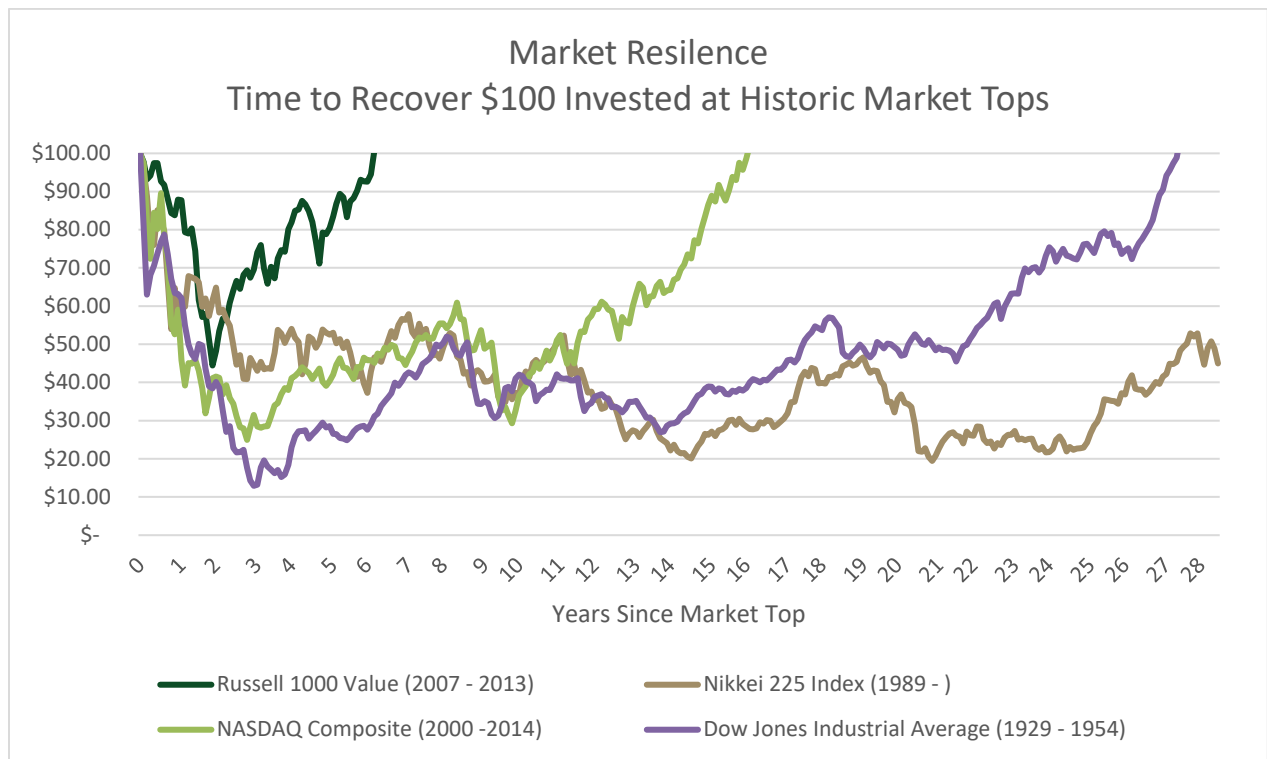
	Average Annual Standard Deviation of Returns
Russell 1000® Value	15.69%
Russell 1000® Growth	20.07%

In addition to low return variability, large cap value stocks hold up well in times of market turbulence. The Dow Jones Industrial Average was down more than 87% after Black Tuesday leading the United States into the Great Depression. The National Association of Securities Dealers Automated Quotations (NASDAQ) fell in value by more than 75% between February 2000 and September 2002 as a result of the collapse of the internet bubble and finally, the Japanese Nikkei Index fell almost 80% from its peak in 1988 to its lows in 2009. Yet, the Russell 1000® Value Index, dominated by financial stocks, suffered its worst blow during the financial crisis of 2008 losing some 58% of its value. The large value space actually weathered its “perfect storm” quite well when compared with other significant market collapses.

Equally important, large cap value stocks proved to be far more resilient compared to other large cap stocks following their corrections. While it took the Russell 1000 Value four years to recover its prior highs after the financial crisis, it took the NASDAQ Composite more than 10 years to recover its pre-2000 highs and the Dow Jones Industrial Average took more than 22 years to recover the high water mark set in 1929. The Nikkei, on the other hand, has still not recovered its previous high.

⁴ Standard deviation is a measure of the dispersion of a set of data from its mean. Standard deviation is applied to the annual rate of return of an investment to measure the investment's volatility. Standard Deviation of Returns as calculated by eVestment Alliance.

Market Recovery Comparison Charts



Market Drawdown and Resiliency Statistics⁵

	Market Top Value	Market Bottom Value	Maximum Drawdown Percentage Change	Maximum Drawdown Duration (Months)	Months to Recover Previous High
Russell 1000® Value	850.91	378.16	-55.56%	21	47
Dow Jones Industrial Average	362.35	46.85	-87.07%	33	302
NASDAQ Composite	4,696.69	1172.06	-75.04%	31	177
Nikkei 225	3,8915.87	7568.42	-80.55%	230	N/A

Focus on America but Get Access to the World

Companies in the Russell 1000 Value Index are typically US domiciled companies who also benefit from the advantages of global diversification. A percentage of revenues of Russell 1000 Value companies are generated in countries other than the United States. Further, these foreign revenues are earned in more than 70 different countries helping to diversify revenue streams and reduce business risk. A strong and recognizable image benefits these companies worldwide. Of the world's twenty-five most valuable brands in 2017 according to Forbes magazine, twelve are represented in the Russell 1000 Value index.⁶

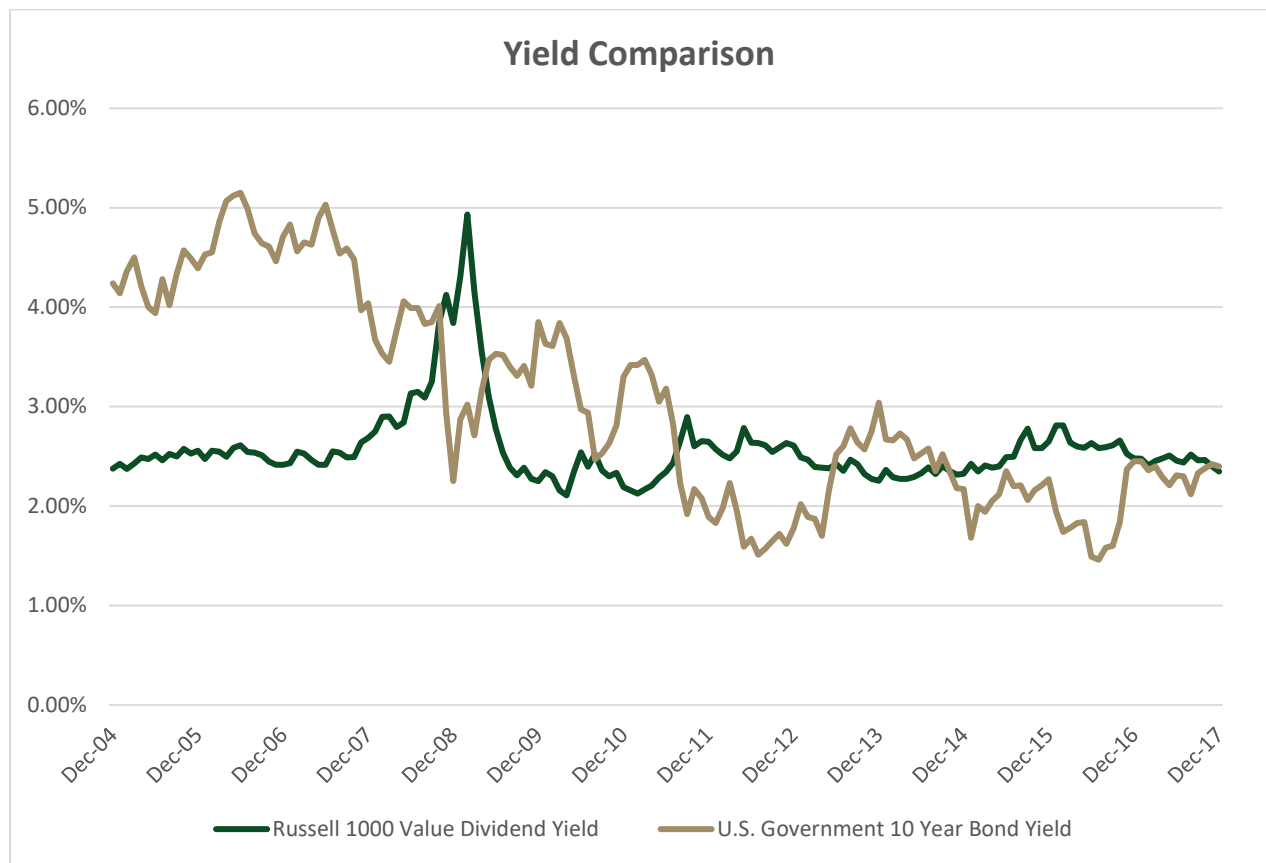
⁵ Drawdown data is from Federal Reserve Index Data.

⁶ List published by Forbes, accessed 12Feb18: <https://www.forbes.com/powerful-brands/list/#tab:rank>

Fixed Income Alternative

Another benefit of the large cap value investing is the significant income stream generated in the form of dividends. Over the history of the Russell 1000 Value® Index, dividend reinvestment represented one third of the total annual returns of the Russell 1000 Value® Index.

The combination of the dividend yield and equity appreciation is another distinguishing characteristic of large cap value strategies. In fact, the dividend yield of the Russell 1000® Value index has been comparable to yields on 10-year U.S. Government Treasury Bonds⁷ especially in recent years where historically low fixed income yields have tightened or, at times, even reversed the spread.



⁷ It is important to consider the differences between the Russell 1000 Value Index and U.S. Government 10 Year Bonds when comparing yields. US Government Treasury Bonds are debt obligations issued and backed by the full faith and credit of the U.S. government. Because they are considered to have low credit or default risk, they generally offer lower yields relative to other bonds. The Russell 1000® Value Index is published by Russell Investments. The Russell 1000® Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000® companies with lower price-to-book ratios and lower expected growth values. The Russell 1000 Index measures the performance of the large-cap segment of the U.S. equity universe. It is a subset of the Russell 3000® Index and includes approximately 1000 of the largest securities based on a combination of their market cap and current index membership. The Russell 1000 represents approximately 92% of the U.S. market. Investors cannot invest directly into an index.

Where to Go from Here

After examining what Large Cap Value investing is and how it is poised to perform well over time, it is easy to understand why a well-constructed portfolio of Large Cap Value companies can form an appropriate backbone for any diversified investment strategy.

Please visit our website for more information about NorthPointes' investment strategies.

Past performance is no guarantee of future results

Investing involves risk including loss of principal.

The opinions expressed herein are those of NorthPointe Capital, LLC as of the date of this report and are subject to change at any time. Although the third-party information has been obtained from and is based on sources the Firm believes to be reliable, the Firm does not guarantee the accuracy of the information, and it may be incomplete or condensed. This report is for informational purposes only and is not intended as a recommendation with respect to the purchase or sale of any security.

The Russell 1000[®] Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000[®] companies with lower price-to-book ratios and lower expected growth values.

The Russell 1000Growth index measures the performance of the Russell 1000's growth segment, which is defined to include firms whose share prices have higher price/to/book ratios and higher expected earnings growth rates.

Index returns are for illustrative purposes only and do not represent actual investment performance.

Index performance returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged, and one cannot invest directly in an index.