

# Dividend All-Cap Value II

A TOTAL RETURN STRATEGY | QUARTERLY UPDATE AS OF SEPTEMBER 30, 2016



## Investment Objectives

- Long-term Total Return > Russell 3000 Value index plus 200 to 400 bps
- Target Yield > Russell 3000 Value index plus 150 bps

## Strategy Highlights

River Road's Dividend All-Cap Value II (DAV II) Strategy utilizes a fundamentally driven research process to identify attractive purchase candidates from an all cap universe of high yielding equity securities. This Strategy invests in well-managed, financially strong companies with high and growing dividends, targeting companies that are also trading at a meaningful discount to our assessed valuation. Typical investment criteria include:

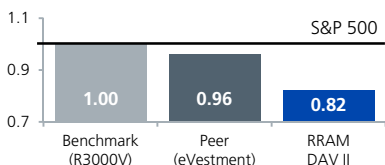
- Minimum market capitalization of \$1 B at the time of purchase
- Indicated dividend yield of at least 2%

The stock selection process is complemented by a risk averse approach that employs balanced diversification and a structured sell discipline.

## Low Volatility Returns

- Target Volatility < Russell 3000 Value
- Ranked among the top 10% of peers over the prior five-year period<sup>2</sup>

### Beta vs S&P 500 (Trailing 5 YR)<sup>2</sup>



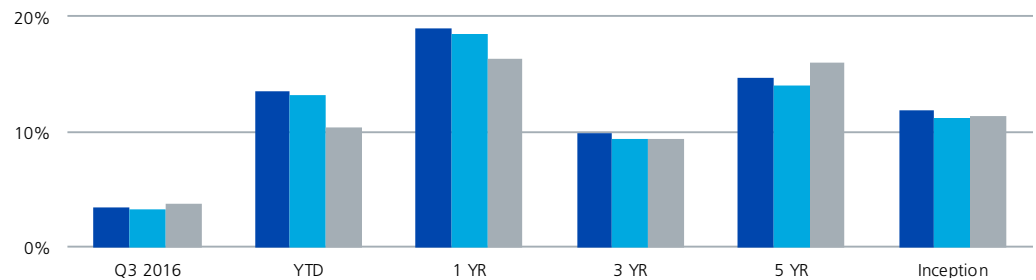
## Portfolio Managers

**Henry W. Sanders III, CFA**  
27 years of experience; managed Portfolio since inception  
Bellarmine University, BA  
Boston College, MBA

**Thomas S. Forsha, CFA**  
18 years of experience; managed Portfolio since inception  
The Ohio State University, BS  
University of Chicago, MBA

**James C. Shircliff, CFA**  
43 years of experience; managed Portfolio since inception  
University of Louisville, BS

## Performance Summary



	Q3 2016	YTD	1 YR	3 YR	5 YR	Inception
DAV II Composite - Gross	3.42%	13.61%	18.97%	9.86%	14.70%	11.82%
DAV II Composite - Net	3.32%	13.26%	18.50%	9.42%	14.11%	11.21%
Russell 3000 Value	3.87%	10.40%	16.38%	9.46%	16.09%	11.38%
Out / Underperformance	-0.45%	+3.21%	+2.59%	+0.40%	-1.39%	+0.44%

Portfolio Yield: 3.42%<sup>1</sup>

Performance is shown gross and net of fees as of September 30, 2016. Inception date: January 1, 2011. Out/underperformance compares Dividend All-Cap Value II gross performance and Russell 3000 Value. <sup>1</sup>Gross of fees; indicated portfolio yield does not anticipate special dividends. Data presented based on a representative portfolio within the Strategy. <sup>2</sup>Volatility, measured as beta and standard deviation, is based on trailing 60 month gross of fee composite performance. Average peer beta presented; peer information provided for the eVestment US All Cap Value Equity Universe. eA collects information directly from investment management firms and other sources believed to be reliable from which it conducts quarterly reviews to classify all products and create peer universes. River Road does not pay eA to be included in the universe, and may not be included in the universe, but does pay for access to this service and data. Source: River Road Asset Management LLC, eVestment Alliance (eA), FactSet Research Systems Inc., Russell Investment Group, and Standard and Poor's. Past performance is no guarantee of future results. Please see reverse side for important disclosure information.

## Portfolio Review

The rally in stocks since February gained momentum in Q3 as the Federal Reserve again passed on the opportunity to raise rates and investors celebrated by markedly increasing their appetite for risk. **Across asset classes, sectors, market caps, and style factors, investors eschewed traditionally defensive investments in favor of more volatile, more cyclical, higher beta, and lower quality ones.**

Cyclical sectors outpaced defensive and the dividend-heavy Utilities and Telecommunication Services sectors declined. **Among dividend stocks, the cyclical sectors led as well, suggesting the underperformance was driven by low beta.**

The Portfolio **modestly underperformed** the benchmark for the quarter, returning **+3.42%** (+3.32% net) versus **+3.87%** for the Russell 3000 Value index, a gap of **-45 bps (-55 bps net)**. Considering the headwinds for dividend-focused strategies, we were pleased with relative performance. **Year to date, the DAV II Composite is ahead of the benchmark by +321 bps (+286 bps net).**

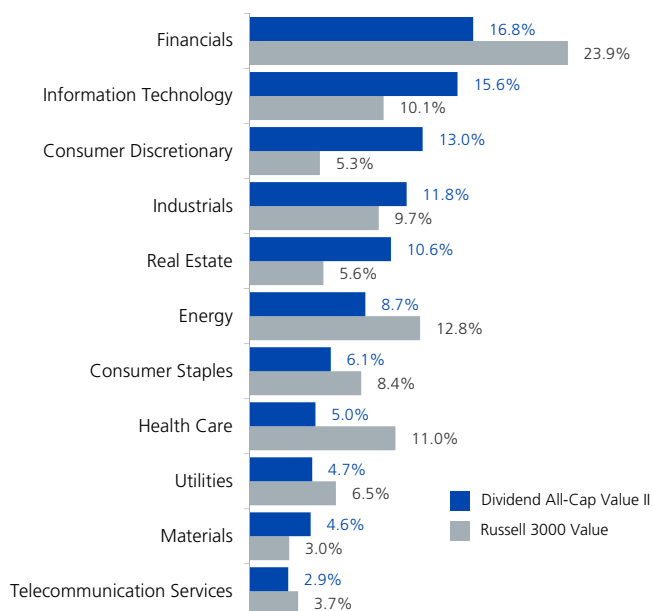
The sector with the highest contribution to relative return in the Portfolio for Q3 was **Information Technology**. The top contributing holding in the Portfolio during the quarter was **Microsoft Corp. (MSFT)**, a leader in operating system and productivity software. MSFT reported strong quarterly results with +5% constant currency growth driven by the cloud. Office 365 and Azure revenue continued to ramp quickly during the quarter with **+59%** and **+108%** constant currency revenue growth, respectively. In September, MSFT raised its dividend +8% and announced a **new \$40 B share repurchase program**.

The sector with the lowest contribution to relative return for Q3 was **Financials**. The bottom contributing holding in the Portfolio during the quarter was **GEO Group Inc. (GEO)**, a REIT that owns and operates correctional and detention facilities providing services to federal, state, local, and foreign governments. In an August 18 memo, **Deputy Attorney General Sally Yates directed the Federal Bureau of Prisons (BOP) to begin "the process of reducing – and ultimately ending – [its] use of privately operated prisons."** While the BOP comprises just 14% of GEO's annual operating revenue, **the stock's severe negative reaction (down as much as -50% intraday and down -40% at the close) implied the federal government, including U.S. Immigration and Customs Enforcement as well as the U.S. Marshals Service, was immediately exiting all contracts with privately managed prisons.** For a number of reasons, including budgetary and prison capacity considerations, we do not believe it is practical or even possible for the BOP (let alone, the entire federal system) to substantially reduce its reliance on private prisons. Indeed, on September 30, GEO announced the BOP entered a two-year extension for the second largest of GEO's facilities it has under contract.

We expect ongoing episodic volatility in the quarters to come. Overvaluation and interest rate concerns will likely continue to weigh on defensive sectors and cyclical sectors should fare better as the earnings recession finally comes to an end. **There has been little change in our positive relative outlook for the Dividend All-Cap Value II Strategy.** We believe that the past quarter supports our belief that the Portfolio is relatively well positioned if fears of overvaluations or rising interest rates weigh on dividend-focused sectors.

Discovering value,  
off the beaten path<sup>®</sup>

### Sector Weightings



### Portfolio Contribution

Top Contributors		Yield <sup>3</sup>	Average Weight	Contribution to Return
MSFT	Microsoft Corp.	2.71%	3.86%	+0.51%
MSI	Motorola Solutions Inc.	2.15%	2.74%	+0.44%
INTC	Intel Corp.	2.75%	2.58%	+0.39%
GLW	Corning Inc.	2.28%	2.24%	+0.34%
QCOM	QUALCOMM Inc.	3.09%	1.27%	+0.33%
Bottom Contributors		Yield <sup>3</sup>	Average Weight	Contribution to Return
GEO	GEO Group Inc.	10.93%	1.42%	-0.48%
VZ	Verizon Communications Inc.	4.44%	2.94%	-0.18%
IRM	Iron Mountain Inc.	5.17%	3.33%	-0.16%
PII	Polaris Industries Inc.	2.84%	0.79%	-0.15%
WFC	Wells Fargo & Co.	3.43%	2.46%	-0.14%

### Portfolio Characteristics

	DAV II	R3000V
Number of Holdings	58	2,021
Dividend Yield	3.42	2.54
Price / Cash Flow	13.0	13.2
ROE (5 YR Avg)	17.7	11.9
EPS Growth (5 YR)	5.9	5.8
Div / Share Growth (TTM)	6.9	6.4
Cash	3.2%	
Annualized Standard Deviation <sup>1</sup>	9.78	11.35
Annualized Alpha <sup>1</sup>	1.84	
Beta <sup>1</sup>	0.80	
Turnover <sup>2</sup>	25.85%	

### Market Capitalization Breakdown

	DAV II	R3000V
Wtd Median Market Cap	\$30.72 B	\$48.84 B
Wtd Avg Market Cap	\$72.54 B	\$103.22 B
Large Cap > \$15.0 B	68.5%	73.3%
Mid-Cap \$2.0 - \$15.0 B	27.9%	21.8%
Small Cap < \$2.0 B	3.5%	4.9%

### Top 10 Holdings

Symbol	Company	% of Portfolio	Yield <sup>3</sup>
MSFT	Microsoft Corp.	3.55%	2.71%
IRM	Iron Mountain Inc.	3.22%	5.17%
PNC	PNC Financial Services Group Inc.	2.89%	2.44%
VZ	Verizon Communications Inc.	2.82%	4.44%
USB	U.S. Bancorp	2.69%	2.61%
OMC	Omnicom Group Inc.	2.62%	2.59%
BBT	BB&T Corp.	2.56%	3.18%
MSI	Motorola Solutions Inc.	2.44%	2.15%
GLW	Corning Inc.	2.37%	2.28%
WFC	Wells Fargo & Co.	2.26%	3.43%

Data as of September 30, 2016. Totals may not sum due to rounding. <sup>1</sup>Risk characteristics based on trailing 60 month gross of fee composite performance. <sup>2</sup>Average annual turnover since inception (January 1, 2011); partial periods excluded from average. <sup>3</sup>Gross of fees; indicated yield does not anticipate special dividends. Source: River Road Asset Management LLC, eVestment Alliance (eA), FactSet Research Systems Inc., Russell Investment Group, and Standard and Poor's.

Portfolio contribution calculated for the Q3 2016 period. To receive information regarding the methodology for calculating the top/bottom contributors or a list showing every holding's contribution to the overall DAV II Composite and/or representative portfolio performance contact thomas.mueller@riverroadam.com. The holdings identified do not represent all of the securities purchased, sold, or recommended. Past performance is no guarantee of future results.

**Representative Portfolios** - Unless otherwise noted as Composite, the data presented is based on representative portfolios within the Dividend All-Cap Value II Strategy. Since no single representative portfolio is available to represent the Strategy since inception, different representative portfolios are used for different periods (using the same selection criteria) to create a continuous representative portfolio. All representative portfolio data is shown as supplemental information to the Dividend All-Cap Value II Strategy presentation.

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The official benchmark for the composite is the Russell 3000 Value. All other indices are shown as additional information only.

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Most company share-related characteristics exclude outliers. Outlier exclusion methods include interquartile and inverse interquartile; the universe for determining outliers is the Russell 3000. For more information, please contact RRAM.

eVestment US All Cap Value Equity - US Equity products that invest primarily in small, mid, and large capitalization stocks with fundamental characteristics showing them to be under-priced or in slower growing economic sectors. The expected benchmarks for this universe would include the Russell 3000 Value, S&P 500, or Russell 1000 Value. Managers in this category will typically indicate a "Primary Capitalization Emphasis" equal to All Cap and a "Primary Style Emphasis" equal to Value.

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