

# Dividend All-Cap Value II

A TOTAL RETURN STRATEGY | QUARTERLY UPDATE AS OF DECEMBER 31, 2018



## Investment Objectives

- Long-term total return > Russell 3000 Value index plus 200 to 400 bps
- Target yield  $\geq$  150% of the Russell 3000 Value index

## 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. The Strategy invests in well-managed, financially strong companies with high and growing dividends, targeting companies that are also trading at meaningful discounts to our assessed valuations. Typical investment criteria include:

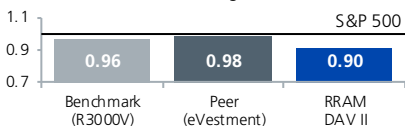
- Minimum market capitalization of \$1 B at the time of purchase
- Indicated dividend yield of at least 2%

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 18% 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**  
29 years of experience; managed Portfolio since inception  
Bellarmine University, BA  
Boston College, MBA



**Thomas S. Forsha, CFA**  
20 years of experience; managed Portfolio since July 2007  
The Ohio State University, BS  
University of Chicago, MBA



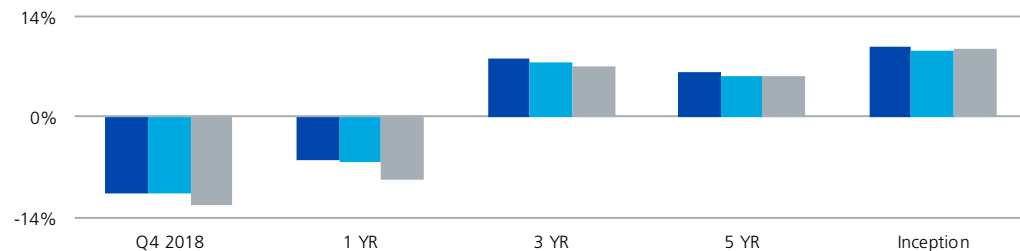
**James C. Shircliff, CFA**  
45 years of experience; managed Portfolio since inception  
University of Louisville, BS



**Andrew R. McIntosh, CFA**  
14 years of experience; managed Portfolio since 2018  
University of Iowa, BBA

Discovering value,  
off the beaten path®

## Performance Summary



	Q4 2018	1 YR	3 YR	5 YR	Inception
DAV II Composite - Gross	-10.65%	-5.89%	8.09%	6.23%	9.80%
DAV II Composite - Net	-10.73%	-6.24%	7.68%	5.82%	9.26%
Russell 3000 Value	-12.24%	-8.58%	7.01%	5.77%	9.47%
Out / Underperformance	+1.59%	+2.69%	+1.08%	+0.46%	+0.33%

Portfolio Yield: 4.11%<sup>1</sup>

Performance is shown gross and net of fees. 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. Information 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. Peer beta presented; peer information provided for the eVestment US All Cap Value Equity Universe as of the date of publication and is subject to change. 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

**U.S. stocks plummeted in Q4** as lofty valuations, rising fed rates, and declining growth expectations intersected with a festering trade war and the prospect of a partial government shutdown. The toxic combination weighed heavily on investor sentiment with **the S&P 500 posting its second worst December on record (-9.03%) and biggest yearly drop (-4.38%) since 2008**. Although the index failed to technically reach bear market territory, on Christmas Eve it **closed within 64 bps of a -20% decline from its September 20 high-water mark**.

From a style perspective, across all market caps, **growth stocks lagged value for the quarter but remained well ahead for the year. Dividend yield was a positive performance factor in Q4**, but results were mixed for the year.

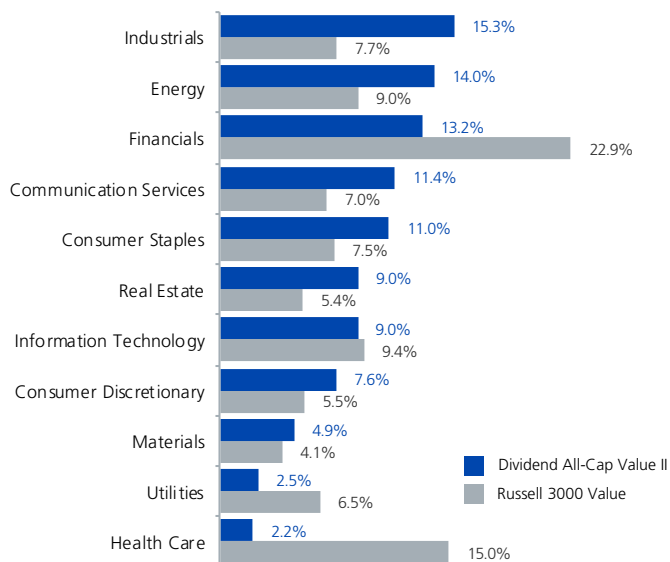
The Dividend All-Cap Value II Composite outperformed the benchmark for Q4 and 2018. **Strong stock selection, particularly within the Industrials and Energy sectors, drove results.**

The sector with the highest contribution to relative return in the Portfolio for Q4 was **Communication Services**. The top contributing holding for the quarter was **Starbucks Corp. (SBUX)**, the largest coffee retailer in the world. In November, SBUX reported strong fiscal Q4 results with **better-than-expected global same-store sales growth of +3% on improvement in both the U.S. and China, SBUX's largest markets**. The results reinforced management's strategy of beverage and food innovation and digital engagement to drive higher sales growth at existing stores. Management provided fiscal 2019 same-store sales guidance that was also better than expected. Additionally, they noted the Nestlé partnership for Starbucks-branded packaged goods is expected to be earnings accretive in 2020, a year earlier than expected. In October, SBUX used the \$5 B in Nestlé partnership proceeds to execute an accelerated share repurchase program for ~6% of shares outstanding. Management is making rapid progress on its \$25 B return of capital plan announced in July.

The sector with the lowest contribution to relative return in the Portfolio for Q4 was **Utilities**. The largest negative contributor during the quarter was **Marathon Petroleum Corp. (MPC)**, the largest independent petroleum product refining, marketing, retail, and transportation business in the United States. In October, the company closed on its merger with Andeavor, making its **new 16 refinery network the largest in the U.S., responsible for 15% of total domestic refining capacity**. It announced strong results for Q3 2018 in November, reporting EBITDA of \$2 B for the second consecutive quarter, and **increased synergy estimates by \$400 MM to \$1.4 B** during its Analyst Day in early December. However, MPC's stock price declined alongside its refining peers during the quarter (despite only ~50% of its EBITDA coming from its refining segment) as concerns about the global economy grew.

With a trade war with China, a partial U.S. government shutdown, and a divided Congress, markets seem to have a lot to digest in 2019. However, the recent correction has removed some of the valuation risk in the market. Thus, **if domestic economic and corporate earnings growth remain meaningfully positive and the Fed is restrained with additional hikes, the market could end up with a modestly positive return in 2019**. Negative sentiment and bombastic headlines should keep risk tolerance low and volatility high, which combined with a decent fundamental landscape for stocks, could create a strong backdrop for both dividend stocks and active value managers like River Road.

Sector Weightings



Portfolio Contribution

Top Contributors		Yield <sup>3</sup>	Average Weight	Contribution to Return
SBUX	Starbucks Corp.	2.24%	1.60%	+0.18%
OMC	Omnicom Group Inc.	3.28%	1.92%	+0.13%
VTR	Ventas Inc.	5.41%	1.78%	+0.12%
VZ	Verizon Communications Inc.	4.29%	2.09%	+0.11%
TRI	Thomson Reuters Corp.	2.90%	1.41%	+0.10%

Bottom Contributors		Yield <sup>3</sup>	Average Weight	Contribution to Return
MPC	Marathon Petroleum Corp.	3.12%	2.94%	-0.82%
TGT	Target Corp.	3.87%	2.73%	-0.68%
STAY	Extended Stay America Inc.	5.68%	1.93%	-0.47%
QCOM	QUALCOMM Inc.	4.36%	1.95%	-0.42%
SBRA	Sabra Health Care REIT Inc.	10.92%	1.38%	-0.41%

Characteristics

	DAV II	R3000V
Number of Holdings	60	2,112
Dividend Yield <sup>3</sup>	4.11	2.84
Price / Cash Flow	11.7	12.3
ROE (5 YR Avg)	19.3	12.0
EPS Growth (5 YR)	7.3	4.8
Div / Share Growth (TTM)	11.1	10.2
Cash	3.8%	
Annualized Standard Deviation <sup>1</sup>	10.47	10.92
Jensen Alpha <sup>1</sup>	0.85	
Beta <sup>1</sup>	0.92	
Turnover <sup>2</sup>	26.48%	

Market Capitalization Breakdown

	DAV II	R3000V
Wtd Median Market Cap	\$33.94 B	\$58.20 B
Wtd Avg Market Cap	\$63.79 B	\$110.31 B
Large Cap > \$15.0 B	69.3%	74.0%
Mid-Cap \$3.0 - \$15.0 B	22.6%	19.3%
Small Cap < \$3.0 B	8.1%	6.7%

Top 10 Portfolio Holdings

Symbol	Company	% of Portfolio	Yield <sup>3</sup>
FAST	Fastenal Co.	3.32%	3.06%
USB	U.S. Bancorp	2.88%	3.24%
GLW	Corning Inc.	2.84%	2.38%
BBT	BB&T Corp.	2.76%	3.74%
MPC	Marathon Petroleum Corp.	2.73%	3.12%
IRM	Iron Mountain Inc.	2.71%	7.54%
TGT	Target Corp.	2.52%	3.87%
KMB	Kimberly-Clark Corp.	2.44%	3.51%
CMCSA	Comcast Corp. (CI A)	2.30%	2.23%
WMT	Walmart Inc.	2.22%	2.23%

GICS sector and market cap breakdowns reflect percent of equity; stocks without a reported sector or market cap (e.g. corporate reorganizations, mergers, acquisitions, dissolutions) are not presented. <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). <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 Q4 2018 period. For the purpose of assessing top and bottom contributors, the contribution of child securities is aggregated with that of the parent for corporate actions that occurred during the most recent calendar quarter. The holdings identified do not represent all of the securities purchased, sold, or recommended. To receive information regarding the methodology for calculating the top/bottom contributors or a list showing every holding's contribution to the overall Dividend All-Cap Value II Composite and/or representative portfolio performance contact Thomas D. Mueller, CFA, CPA at (502) 371-4100 or thomas.mueller@riverroadam.com. Past performance is no guarantee of future results.

**Representative Portfolios** - Unless otherwise noted as Composite, the information 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. Representative portfolio information is supplemental to the Composite 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.

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