



January 14, 2019

Dear Friends and Investors,

**U.S. stocks plummeted in Q4** as lofty valuations, rising fed rates, and declining growth expectations intersected with a festering trade war and 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**.

Unfortunately, small caps did plunge into bear market territory with the Russell 2000 index declining **-26.89%** from its August 31 peak, before modestly rebounding into year end. From a style perspective, across all market caps, **growth stocks lagged value for the quarter but remained well ahead for the year**. For the first time since 2008, all nine style boxes delivered negative returns for the year.

**International and global stock indices generally outperformed the U.S. for Q4, but trailed for the year**. For Q4, the MSCI EAFE and Emerging Markets indices returned **-12.50%** and **-7.40%**, respectively, versus **-13.52%** for the S&P 500. For 2018, the MSCI EAFE and Emerging Markets indices returned **-13.36%** and **-14.25%**, respectively, versus **-4.38%** for the S&P 500.

| Composite Performance Summary <sup>1</sup> |                 |               |                     |               |                        |               |                           |               |                         |               |                   |               |                          |                |
|--|-----------------|---------------|---------------------|---------------|------------------------|---------------|---------------------------|---------------|-------------------------|---------------|-------------------|---------------|--------------------------|----------------|
|  | Small Cap Value |               | Small-Mid Cap Value |               | Dividend All-Cap Value |               | Dividend All-Cap Value II |               | Focused Absolute Value® |               | Long-Short Equity |               | International Equity ADR |                |
|  | Q4              | 2018          | Q4                  | 2018          | Q4                     | 2018          | Q4                        | 2018          | Q4                      | 2018          | Q4                | 2018          | Q4                       | 2018           |
| <b>Gross</b>                               | <b>-15.34%</b>  | <b>-5.68%</b> | <b>-16.63%</b>      | <b>-5.61%</b> | <b>-10.76%</b>         | <b>-6.26%</b> | <b>-10.65%</b>            | <b>-5.89%</b> | <b>-12.54%</b>          | <b>-3.04%</b> | <b>-4.00%</b>     | <b>-3.43%</b> | <b>-10.96%</b>           | <b>-12.44%</b> |
| <b>Net</b>                                 | <b>-15.53%</b>  | <b>-6.49%</b> | <b>-16.77%</b>      | <b>-6.23%</b> | <b>-10.89%</b>         | <b>-6.79%</b> | <b>-10.73%</b>            | <b>-6.24%</b> | <b>-12.62%</b>          | <b>-3.40%</b> | <b>-4.21%</b>     | <b>-4.26%</b> | <b>-11.09%</b>           | <b>-12.92%</b> |
| Benchmark <sup>2</sup>                     | -18.67%         | -12.86%       | -17.12%             | -12.36%       | -12.24%                | -8.58%        | -12.24%                   | -8.58%        | -12.24%                 | -8.58%        | -7.00%            | -1.42%        | -12.52%                  | -13.56%        |
| + / -                                      | <b>+3.33%</b>   | <b>+7.18%</b> | <b>+0.49%</b>       | <b>+6.75%</b> | <b>+1.48%</b>          | <b>+2.32%</b> | <b>+1.59%</b>             | <b>+2.69%</b> | <b>-0.30%</b>           | <b>+5.54%</b> | <b>+3.00%</b>     | <b>-2.01%</b> | <b>+1.56%</b>            | <b>+1.12%</b>  |

**It was a strong year for River Road, with nearly all strategies outperforming their respective benchmarks**. In addition to attractive Q4 results, the **Small Cap Value (SCV)** and **Small-Mid Cap Value (SMID)** Composites delivered the strongest relative performances for 2018, outperforming by **+718 bps** (+637 bps net) and **+675 bps** (+613 bps net), respectively, driven by strong stock selection. Attractive performance for both strategies in recent years has supported outstanding long-term investment results. For example, **the SCV Strategy, which recently celebrated its 21st anniversary, has delivered +321 bps (+239 bps net) of gross annualized outperformance since inception with a beta of just 0.70**. We believe the SCV Strategy's long-term alpha generation reflects the true potential of active management and, in particular, the enduring power of RRAM's Absolute Value® investment approach.

River Road's **Dividend All-Cap Value (DAV and DAV II) Composites also outperformed their benchmark for Q4 and 2018**. Strong stock selection drove results for Q4, particularly within the lagging **Energy (+115 bps)** and **Industrials (+114 bps)** sectors. Unsurprisingly, dividend yield was a top performing factor for stocks in Q4 as investors sought safe havens amidst the market turmoil.

River Road's **Focused Absolute Value® (FAV) Composite** trailed the benchmark for Q4 (-30 bps gross; -38 bps net) as poor stock selection, particularly within the Communication Services and Health Care sectors, weighed negatively on results. However, this headwind did little to diminish significant outperformance for 2018, with the Strategy delivering **+554 bps** (+518 bps net) of outperformance and the highest absolute return in the firm. **The concentrated all cap FAV Strategy has now outperformed its benchmark in eight of the 10 calendar years since inception (seven of 10 net) with a highly attractive upside/downside capture ratio**.

Looking beyond the United States, **RRAM's International Equity ADR (iADR) Composite** also outperformed its benchmark for Q4 and 2018. For Q4, **Japan had the highest geographic contribution to relative performance (+105 bps)**, driven

<sup>1</sup> Please see the attached disclosures. Past performance is no guarantee of future results.

<sup>2</sup> Benchmarks: SCV - Russell 2000 Value; SMID - Russell 2500 Value; DAV - Russell 3000 Value; DAV II - Russell 3000 Value; FAV - Russell 3000 Value; Long-Short Equity - 50% Russell 3000 index/50% ICE BofAML US Treasury Bill (0-3 M) (Local Total Return); rebalanced daily; iADR - iShares MSCI EAFE ETF.



primarily by stock selection (+95 bps).<sup>3</sup> River Road's newest strategy has recently celebrated its five-year anniversary, has outperformed the benchmark since inception, and has done so with a beta and standard deviation that are materially lower than the benchmark. We believe iADR offers a compelling investment option for clients seeking non-U.S. equity exposure through a direct investment in U.S.-listed shares. The Strategy is available for separate and model accounts. **For more information on the iADR Strategy, please contact Rob Wainwright at 502.371.2280.**

The **Long-Short Equity (LS) Composite** significantly outperformed its blended index in Q4 (+300 bps gross; +279 bps net), with strong performance from both long and short holdings. **We were particularly pleased the Portfolio declined just -5.83% (-6.04% net) during the S&P 500's -19.36% drawdown between September 21 and December 24,** significantly exceeding its capital protection objective. The Portfolio averaged **48%** net market exposure during the quarter. For 2018, the LS Composite underperformed the blended index, returning **-3.43%** (-4.26% net) versus **-1.42%** for the blended benchmark. Relative performance for 2018 was negatively impacted by whipsaw volatility earlier in the year, which negatively impacted the Strategy's Drawdown Plan, and the Portfolio's value tilt relative to a core benchmark. For the year, the long and short portfolios declined by **-4.60%** and **-4.84%**, respectively, and net market exposure averaged **54%**.<sup>4</sup>

With regard to firm news, **RRAM completed a nearly yearlong project to refresh the firm's proprietary security conviction rating system.** We reviewed and updated criteria definitions and guidelines, enhanced the precision of the five point rating system to include half-point increments, and modified sizing models. The review incorporated all members of the investment team and concluded with an offsite meeting where criteria-specific recommendations were collectively assessed and approved. **We hope to have updated process white papers available for clients by the end of Q1.**

The conviction review also included discussion on how to better incorporate environmental, social, and governance (ESG) principles into our investment process. **River Road recognizes ESG policies and behaviors can impact the investment risk and return profiles of the companies in which we invest.** ESG factors are considered in our investment process when they impact our assessment of the firm's business model, including its sustainability and risks and the shareholder orientation of management. **A priority for 2019 will be to formally evaluate and document our ESG policy. Additionally, River Road plans to become a UNPRI signatory.**

In Q4, **we concluded our first formal client survey.** Working with Focus Consulting Group (FCG), our primary objective is to improve our client service and communication. **We sincerely appreciate both your participation and constructive comments.** In the next two weeks, we will review the results with FCG and develop a formal action plan.

Lastly, we are excited to announce **Allen F. Harris has joined the firm as Associate Equity Research Analyst.** Prior to joining River Road, Allen worked as a research associate at RFG Advisory. Allen received his B.A. in Economics from Yale University, and has passed Level II of the CFA program.

It promises to be a busy year ahead. In closing, we would like to reiterate to you, our associates, and business partners our pledge to **pursue investment excellence with passion and discipline; to continue investing in our firm, associates, and portfolios; and to always maintain the unique culture and values we embraced the day we founded River Road.**

We hope you enjoy reading River Road's portfolio commentary and outlook and welcome your questions and feedback.

R. Andrew Beck  
*President & CEO,  
Senior Portfolio Manager*

James C. Shircliff, CFA  
*Chief Investment Officer &  
Senior Portfolio Manager*

Henry W. Sanders, III, CFA  
*Executive Vice President &  
Senior Portfolio Manager*

<sup>3</sup> Classifications determined by applying Bloomberg's country of risk methodology.

<sup>4</sup> Relative long and short portfolio performance is gross of fees. Gross of fees performance does not reflect the effect of management fees (performance would have been lower). Please refer to the net of fees performance provided when considering this Strategy. The long portfolio and short portfolio information is based on a representative portfolio within the Strategy and excludes the impact of cash. Short portfolio performance excludes the impact of the cost to borrow and index hedges applied during the drawdown plan.



#### **Disclosures:**

River Road Asset Management, LLC ("RRAM") is a registered investment adviser formed in April 2005 and is majority owned by Affiliated Managers Group, Inc. Registration of an investment adviser does not imply a certain level of skill or training. This presentation may be presented by an employee of Affiliated Managers Group, Inc., AMG Funds, or another AMG entity, which are affiliates of RRAM. RRAM claims compliance with the Global Investment Performance Standards (GIPS®). The firm maintains a complete list and description of composites and a presentation that complies with the requirements of the GIPS® standards, which is available upon request by contacting Thomas D. Mueller, CPA, CFA at (502) 371-4100 or thomas.mueller@riverroadam.com. For all composites, the U.S. dollar is the currency used to express performance and includes the reinvestment of income. Composite performance is presented gross of foreign withholding taxes on dividends, interest income, and capital gains. All composite performance is after the deduction of trading costs.

#### **Small Cap Value Composite Disclosures:**

Inception date: January 1, 1998. The composite contains fully discretionary accounts that seek capital appreciation by investing primarily in small cap value domestic equity securities that trade at a discount to our assessed valuation as determined using RRAM's proprietary Absolute Value® approach. For this composite, RRAM defines a small cap company as one whose market capitalization is less than \$4 B. The Manager selects securities from a universe of companies with a market capitalization at the time of initial purchase typically between \$50 MM and \$4 B, employing a value-driven, bottom-up fundamental approach. The official benchmarks for the Small Cap Value Equity Composite are the Russell 2000 Value and Russell 2000. Net of fee composite performance is calculated using actual management fees, which includes performance fees for some periods.

As of December 31, 2018, net of fees returns for the Small Cap Value Composite are as follows for the month, QTD, YTD, 1 year, 3 year, 5 year, 10 year, and Inception to Date periods: -8.39%, -15.53%, -6.49%, -6.49%, 10.18%, 5.88%, 11.02%, and 9.87%. As of December 31, 2018, returns for the Russell 2000 Value are as follows for the month, QTD, YTD, 1 year, 3 year, 5 year, 10 year, and Inception to Date periods: -12.09%, -18.67%, -12.86%, -12.86%, 7.37%, 3.61%, 10.40%, and 7.48%.

Performance presented prior to April 1, 2005 occurred while the original members of the Portfolio Management Team were affiliated with a prior firm and those Portfolio Management Team members were the only individuals primarily responsible for selecting the securities to buy and sell. A review of this track record for compliance with portability requirements of the GIPS® standards was conducted by Ashland Partners & Company.

#### **Small-Mid Cap Value Composite Disclosures:**

Inception Date: March 1, 2007. The composite contains fully discretionary accounts that seek capital appreciation by investing primarily in small-mid cap value domestic equity securities that trade at a discount to our assessed valuation as determined using RRAM's proprietary Absolute Value® approach. For this composite, RRAM defines a small to mid-cap company as one whose market capitalization is less than \$10 B. RRAM selects securities from a universe of companies with a market capitalization at the time of initial purchase typically between \$250 MM to \$10 B, employing a value driven, bottom-up fundamental approach. The official benchmark of the Small-Mid Cap Value Composite Portfolio is the Russell 2500 Value. Net of fee composite performance is calculated using actual management fees.

As of December 31, 2018, net of fees returns for the Small-Mid Cap Value Composite are as follows for the month, QTD, YTD, 1 year, 3 year, 5 year, 10 year, and Inception to Date periods: -10.22%, -16.77%, -6.23%, -6.23%, 11.13%, 6.22%, 11.62%, and 6.33%. As of December 31, 2018, returns for the Russell 2500 Value are as follows for the month, QTD, YTD, 1 year, 3 year, 5 year, 10 year, and Inception to Date periods: -11.05%, -17.12%, -12.36%, -12.36%, 6.59%, 4.16%, 11.62%, and 5.36%.

#### **Dividend All-Cap Value Composite (DAV) and Dividend All-Cap Value II Composite (DAV II) Disclosures:**

Inception Date DAV: October 1, 2003. Inception Date DAV II: January 1, 2011. The composites contain fully discretionary accounts that seek to provide long term capital appreciation and high current income by investing primarily in a diversified, all-cap basket of income producing equity securities that trade at a discount to our assessed valuation as determined using RRAM's proprietary Absolute Value® approach. The composites are primarily invested in dividend-paying common stocks. The composites may also be invested in a broad range of foreign stocks, publicly traded partnerships, convertible preferred stocks, Real Estate Investment Trusts ("REITs"), investment companies, and royalty income trusts. For the DAV II Composite only, the securities must have a market capitalization of typically at least \$1 B at the time of initial purchase. RRAM employs a value-driven, bottom-up approach. The official benchmark for the composites is the Russell 3000 Value. Net of fee DAV composite performance is calculated using actual management fees. For periods including non-fee paying accounts, net was calculated for those accounts by applying the highest fee schedule effective at that time. Net of fee DAV II composite performance is calculated using actual management fees, which includes performance fees for some periods. For periods including non-fee paying accounts, net was calculated for those accounts by applying the highest fee schedule effective at that time.

As of December 31, 2018, net of fees returns for the Dividend All-Cap Value Composite are as follows for the month, QTD, YTD, 1 year, 3 year, 5 year, 10 year, and Inception to Date periods: -9.44%, -10.89%, -6.79%, -6.79%, 7.21%, 5.36%, 11.16%, and 9.69%. As of December 31, 2018, returns for the Russell 3000 Value are as follows for the month, QTD, YTD, 1 year, 3 year, 5 year, 10 year, and Inception to Date periods: -9.78%, -12.24%, -8.58%, -8.58%, 7.01%, 5.77%, 11.12%, and 7.85%.

Performance presented prior to April 1, 2005 occurred while the original members of the Portfolio Management Team were affiliated with a prior firm and those Portfolio Management Team members were the only individuals primarily responsible for selecting the securities to buy and sell. A review of this track record for compliance with portability requirements of the GIPS® standards was conducted by Ashland Partners & Company.

As of December 31, 2018, net of fees returns for the Dividend All-Cap Value II Composite are as follows for the month, QTD, YTD, 1 year, 3 year, 5 year, and Inception to Date periods: -9.28%, -10.73%, -6.24%, -6.24%, 7.68%, 5.82%, and 9.26%. As of December 31, 2018, returns for the Russell 3000 Value are as follows for the month, QTD, YTD, 1 year, 3 year, 5 year, and Inception to Date periods: -9.78%, -12.24%, -8.58%, -8.58%, 7.01%, 5.77%, and 9.47%.

#### **Focused Absolute Value® Composite Disclosures:**

Inception Date: January 1, 2009. **The team of analysts involved with recommending investments for Focused Absolute Value® has changed and may continue to change over time.** The portfolio managers may not have historically approved all trades prior to execution. Fully invested is as defined by RRAM and this standard may change over time. Prior to September 30, 2014, the composite was known as the Research Fund Composite.

The composite contains fully discretionary accounts that seek capital appreciation by investing primarily in equity securities that trade at a discount to our assessed valuation as determined using RRAM's proprietary Absolute Value® approach. For this composite, RRAM selects securities from a universe of companies that are held by other RRAM strategies, which typically includes all market capitalizations. RRAM employs a value-driven, bottom-up fundamental approach. One client account is a current employee of RRAM. The official benchmark for the composite is the Russell 3000 Value. Fully invested is as defined by RRAM. Net of fee composite performance is calculated using actual management fees. For periods including non-fee paying accounts, net was calculated for those accounts by applying the highest fee schedule.

As of December 31, 2018, net of fees returns for the Focused Absolute Value Composite are as follows for the month, QTD, YTD, 1 year, 3 year, 5 year, and Inception to Date periods: -10.98%, -12.62%, -3.40%, -3.40%, 10.75%, 7.45%, and 15.81%. As of December 31, 2018, returns for the Russell 3000 Value are as follows for the month, QTD, YTD, 1 year, 3 year, 5 year, and Inception to Date periods: -9.78%, -12.24%, -8.58%, -8.58%, 7.01%, 5.77%, and 11.12%.

#### **Long-Short Equity Composite Disclosures:**

Inception date: July 1, 2010. The composite contains a fully discretionary account that seeks equity-like returns with reduced volatility over a full market cycle by investing primarily in long equity securities that trade at a discount to our assessed valuation and selling short equity securities that trade at a premium to our assessed valuation as determined using RRAM's proprietary Absolute Value® approach. The composite will invest in short securities. The long and short portfolios will typically represent 50-100% and 10-90% of the total composite, respectively. Additionally, the composite may use options, futures, and other derivatives but these will not represent a significant portion of the composite. The official benchmarks for the composite are the Blended Index and the Russell 3000. The Blended Index was added as a benchmark effective 10/31/2016. The Blended Index represents a 50% weighting of the Russell 3000 Index and a 50% weighting of the ICE BofAML US Treasury Bill (0-3 M) (Local Total Return); rebalanced daily. Net of fee composite performance is calculated using actual management fees. For periods including non-fee paying accounts, net was calculated for those accounts by applying the highest fee schedule effective at that time.

As of December 31, 2018, net of fees returns for the Long-Short Equity Composite are as follows for the month, QTD, YTD, 1 year, 3 year, 5 year, and Inception to Date periods: -3.58%, -4.21%, -4.26%, -4.26%, 3.25%, 1.71%, and 6.59%. As of December 31, 2018, returns for the Russell 3000 are as follows for the month, QTD, YTD, 1 year, 3 year, 5 year, and Inception to Date periods: -9.31%, -14.30%, -5.24%, -5.24%, 8.97%, 7.91%, and 13.16%. As of December 31, 2018, returns for the blended index are as follows for the month, QTD, YTD, 1 year, 3 year, 5 year, and Inception to Date periods: -4.60%, -7.00%, -1.42%, -1.42%, 5.12%, 4.42%, and 6.88%.

#### **International Equity ADR Composite Disclosures:**

Inception Date: January 1, 2014. The composite contains fully discretionary accounts that seek capital appreciation by investing primarily in non-U.S. companies that trade at a discount to valuation. For this composite, RRAM defines non-U.S. companies as ADRs or other non-U.S. companies traded in the United States on an exchange, OTC, or pink sheets or otherwise. Three client accounts are for current employees of RRAM. For comparison purposes, the composite is measured against the MSCI EAFE Gross index (ETF performance temporarily used as a proxy for the benchmark). Net of fee composite performance is calculated using actual management fees. For periods including non-fee paying accounts, net was calculated for those accounts by applying the highest fee schedule.

As of December 31, 2018, net of fees returns for the International Equity ADR Composite are as follows for the month, QTD, YTD, 1 year, 3 year, and Inception to Date periods: -6.03%, -11.09%, -12.92%, -12.92%, 2.51%, and 0.90%. As of December 31, 2018, returns for the MSCI EAFE Gross are as follows for the month, QTD, YTD, 1 year, 3 year, and Inception to Date periods: -4.83%, -12.50%, -13.36%, -13.36%, 3.38%, and 1.00%. As of December 31, 2018, returns for the MSCI EAFE ETF are as follows for the month, QTD, YTD, 1 year, 3 year, and Inception to Date periods: -4.84%, -12.52%, -13.56%, -13.56%, 3.15%, and 0.78%.

Performance for the ETF is presented on a gross of management fee basis as calculated by FactSet Research Systems by applying net expense ratios per annual reports (actual fees charged). Current expense ratios are used in the absence of historical. This ETF is also presented net of foreign withholding taxes on dividends, interest income, and capital gains. The iADR Composite performance is gross of foreign withholding taxes, which makes performance higher than if it were net of foreign withholding taxes.

Performance presented prior to October 1, 2016 occurred while the Portfolio Manager was affiliated with prior firms and the Portfolio Manager was the only individual primarily responsible for selecting the securities to buy and sell. A review of this track record for compliance with portability requirements of the GIPS® standards was conducted by ACA Performance Services, LLC.

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