A Dynamic Approach to Large Cap Value Investing

Upending the Approach to Traditional Active Management

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The Dynamic Large Cap Value Team believes an enhanced approach to traditional, active equity management should emphasize both fundamental factor and current market analyses.

Many traditional active equity managers, using a defined investment process, focus on identifying stocks that they believe have the potential to outperform a stated market benchmark. Managers stay consistent to their process through market cycles and often acknowledge there will be periods when their approach is out of favor. The manager tolerates these cycles without modifying the approach by focusing on long-term results over a full market cycle. There is no doubt that this approach can generate excess returns over long periods of time for proven managers. But what about a different approach to active management, one that not only focuses on a disciplined investment process but understands the different phases of a market cycle and the types of characteristics that outperform during these different phases? This paper explores an enhanced approach to traditional active management and focuses on a process that strives for greater consistency of excess returns through an emphasis on both fundamental factor analysis in conjunction with an analysis of the current market environment.

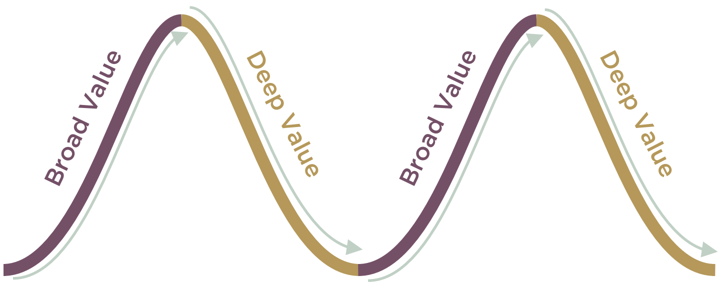
The Diversified Value Equity team at Brandywine Global has focused on value-driven investment research and portfolio management for over 30 years. Our research process is centered on identifying fundamental factors and portfolio characteristics that show long-term patterns of excess returns. In the early 2000s, our research team began exploring the idea that there could be different phases of valuation dispersion that occur over a market cycle. Upon analyzing the phases over full market cycles, we observed that certain portfolio characteristics tended to perform better in some environments than others. After significant research, we identified two distinct value phases for the Russell 1000 Value benchmark; we categorize these phases as broad and deep value environments.

Broad and Deep Value Phases

We identified the broad and deep value phases by looking at valuation spreads between the cheapest quartile stocks and the median stocks out of the top 1000 U.S. stocks by market capitalization and observed that when valuation spreads peaked—and thus began to narrow—deep-value investing began to outperform. Conversely, when valuation spreads narrowed—and then began to widen—broad-value investing began to outperform. We found that these distinct cycles within value appeared to be long-term trends that typically last between 2-7 years. We also observed that some fundamental factors performed better in one environment—broad or deep value—versus the other. **Through our research, we noted that we could improve the consistency of excess returns and limit drawdowns relative to the benchmark by adjusting our approach to focus on factor exposures consistent with the current market environment.**

A broad-value environment is characterized by narrow (and widening) dispersion among individual stocks. Broad-value environments often present themselves in the later stages of a bull market when valuation spreads in the index have narrowed and spreads begin to widen as stocks separate themselves as the market matures, as shown in **FIGURE 1** on the next page. Individual companies' earnings dynamics are more important than deeply discounted valuations at this point in the cycle. Our

1 | Valuation Spreads – Long Term Trends



Source: Brandywine Global

research shows that a portfolio with an emphasis on high-quality characteristics (e.g. return on equity), as well as relative price strength, often performs best in a broad-value environment, which typically—but does not always—occur during the mid-to-late phase of the market cycle.

Conversely, a deep-value environment is characterized by wide (and narrowing) dispersion among individual stocks. Deep-value environments often present themselves in the early stages of a bull market, when significant valuation anomalies exist, as the market has separated what it perceives as the "winners and losers," thus creating value opportunities. Mean reversion begins to take place as these deeply discounted securities lead the market higher, causing valuation spreads to start tightening again. A deep-value environment is generally associated with an earlier stage of the market cycle, although there can be anomalies.

The Dynamic Large Cap Value Strategy: A Combination Approach

The core of our process in the Dynamic Large Cap Value strategy is a multifactor model that ranks securities in its investment universe by value, quality, and sentiment factors. We ask ourselves three questions:

1. **Value:** is the stock attractively priced?
2. **Quality:** does the company efficiently generate earnings, deploy capital, and use conservative accounting?
3. **Sentiment:** does the current price movement show that the stock has recently turned a corner or could this be a value trap?

We believe all three factor groupings—value, quality, and sentiment should outperform in the long run, the factor groupings and the 10 underlying factors themselves react and behave differently in each market environment. To account for this, we developed two aptly named quantitative models: **a broad-value and deep-value model**. Each model includes factors from the three categories listed above, but with differing factor weights reflective of each factor's historical performance in that particular market environment. **FIGURE 2** provides a complete list of factors for each market environment.

2 | Factor Weights Differ Based on Model

Dynamic Value Shifting Tool - Models

Deep Value Model

+	Value Factors	
	+	Price-to-Book
	-	Price-to-Earnings
	Sentiment Factors	
	Unchanged	Price Momentum
	-	Price Trend
	+	Price Volatility
-	Quality Factors	
	-	Return on Equity (ROE)
	-	ROE Growth
	+	Share Buyback
	Unchanged	Book Growth

Broad Value Model

-	Value Factors	
	-	Price-to-Book
	+	Price-to-Earnings
	Sentiment Factors	
	Unchanged	Price Momentum
	+	Price Trend
	+	6-Month Price Reversal
	-	Price Volatility
+	Quality Factors	
	+	Return on Equity (ROE)
	+	ROE Growth
	-	Share Buyback
	Unchanged	Book Growth

- Decrease Weighting

+ Increase Weighting

Portfolio maintains a bias to higher quality in both models

Value Shifting Tool Triggers

Deep Model: Market valuation spreads become wide then begin to narrow

Broad Model: Market valuation spreads become narrow then begin to expand

We then analyze the market valuation dispersion environment using our proprietary shifting tool to determine the current phase of value that we believe is likely to outperform, broad or deep value. Given the environment, we position our portfolio using factor weights for the preferred model. The shifts from broad to deep value occur every 2-7 years, once our switching tool signals the trend is in place. Our most recent shifts included a move from broad to deep value in August 2020, and from deep to broad value in July 2022. The end result of our process is a portfolio of 75-150 stocks that we believe have attractive value, quality, and sentiment factors relative to the Russell 1000 Value Index.

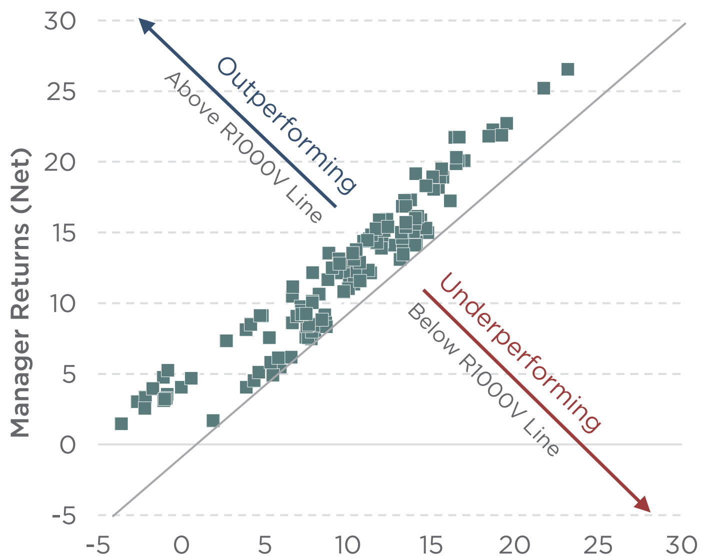
The dynamic shift between models doesn't drive return—it enhances returns. The shift is the core of our process—value, quality, and sentiment analysis at the stock level—which drives the overall risk/return profile of the portfolio.

Results

By recognizing and adapting our process to a changing market environment, we have been able to produce a more efficient risk/return profile with higher alpha (FIGURE 3), historical excess returns, and a reduced frequency and magnitude of drawdowns relative to the benchmark. The objective of our Dynamic Large Cap Value strategy is to efficiently—meaning, with a high information ratio—generate excess returns relative to the Russell 1000 Value Index. Our value models are designed to minimize drawdowns both relative to the benchmark and in absolute terms, while reducing volatility as much as possible relative to the index – ultimately providing a smoother, more consistent ride.

3 | **Consistent Outperformance***

Rolling 5 Year Returns, Dynamic Large Cap Value vs. Russell 1000 Value, 12/31/2006 – 3/31/2023 (Net)



Conclusion

The Brandywine Global Dynamic Large Cap Value strategy was designed to enhance the traditional active management approach by combining a factor-driven process with analysis of the current market environment. We believe this enhanced approach creates the potential for greater consistency of excess returns while minimizing underperformance versus the Russell 1000 Value index. We believe that our disciplined, repeatable process that adapts to a changing market environment is a unique and effective approach to investing in a portfolio of large-cap value equities.

Additional information regarding our process and underlying research is available upon request.

*Supplemental to the attached GIPS report. The views expressed represent the opinions of Brandywine Global Investment Management, LLC ("Brandywine Global") and are not intended as a forecast or guarantee of future results. Brandywine Global's selection process may prove incorrect, which may have a negative impact on performance. Please refer to the attached GIPS report which includes performance foot notes, fee schedules, detailed index descriptions and disclosures. There is no guarantee that holding securities with relatively high (or low) price-to-earnings, price-to-book, price-to-cashflow ratios, or any other mentioned characteristic will cause the portfolio to outperform its benchmark or index. Our research process continuously evolves and seeks to improve client results. Backtest return, volatility and information ratio characteristics are subject to change and revision as new factors are incorporated. All securities trading, whether in stocks, options or other investment vehicles, is speculative in nature and involves substantial risk of loss. Characteristics, holdings and sector weightings are subject to change and should not be considered as investment recommendations. The Russell 1000 Value 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. The Russell 1000 Index is constructed to provide a comprehensive and unbiased barometer for the large-cap segment and is completely reconstituted annually to ensure new and growing equities are reflected. Indices are unmanaged and not available for direct investment. This information should not be considered a solicitation or an offer to provide any Brandywine Global service in any jurisdiction where it would be unlawful to do so under the laws of that jurisdiction. Past performance is no guarantee of future results.

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Around the Curve

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Annualized Returns (%) (Results shown in USD)

	Gross	Net	R1000V	S&P 500
QTD	0.17	0.01	1.01	7.50
YTD	0.17	0.01	1.01	7.50
1 Year	-3.99	-4.62	-5.91	-7.73
3 Year	21.51	20.73	17.93	18.60
5 Year	9.94	9.23	7.49	11.18
7 Year	11.27	10.55	9.02	12.42
10 Year	11.53	10.78	9.12	12.23
Since Inception	10.17	9.39	6.46	8.94

Inception Date: 1/1/2007

GIPS Information (%, unless otherwise noted) (Results shown in USD)

Year or YTD	Gross	Net	R1000V	S&P 500	# of Accounts	Market Value (M)	Total Firm Assets (M)	Composite Dispersion	Composite Rolling 3Y SD	R1000V Rolling 3Y SD	S&P 500 Rolling 3Y SD
2023	0.17	0.01	1.01	7.50	38	1,806	54,835	0.09	18.76	17.68	18.96
2022	-5.54	-6.16	-7.54	-18.11	37	1,774	52,601	0.02	21.42	21.25	20.87
2021	30.13	29.30	25.16	28.71	32	958	67,356	0.08	19.65	19.06	17.17
2020	8.26	7.56	2.80	18.40	30	812	63,872	0.26	20.47	19.62	18.53
2019	28.13	27.31	26.54	31.49	25	698	74,024	0.11	13.87	11.85	11.93
2018	-8.47	-9.07	-8.27	-4.38	16	724	70,070	0.20	12.28	10.82	10.80
2017	22.73	21.95	13.66	21.83	17	908	74,382	0.26	11.93	10.20	9.92
2016	10.95	10.16	17.34	11.96	14	721	65,498	0.21	12.42	10.77	10.59
2015	-2.93	-3.66	-3.83	1.38	9	461	68,819	0.11	12.59	10.68	10.47
2014	11.80	10.98	13.45	13.69	8	295	63,375	-	10.49	9.20	8.97
2013	47.50	46.44	32.53	32.39	3	35	50,050	-	13.57	12.70	11.94

Data as of March 31, 2023   R1000V = Russell 1000 Value   S&P 500 = S&P 500   Organization: Brandywine Global Investment Management, LLC (the "Firm") is a wholly owned, independently operated, subsidiary of Franklin Resources, Inc. Brandywine Global Investment Management, LLC claims compliance with the Global investment Performance Standards (GIPSÂ®) and has prepared and presented this report in compliance with the GIPS standards. Brandywine Global Investment Management, LLC has been independently verified for the periods January 1, 1993 through June 30, 2021. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. The Dynamic Large Cap Value Composite has had a performance examination for the periods January 1, 2007 through June 30, 2021. The verification and performance examination reports are available upon request. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request. Disclosed total firm assets represent the total market value of all discretionary and nondiscretionary, fee-paying and non-fee-paying assets under the Firm's management. GIPSÂ® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. Composite Description: Dynamic Large Cap Value Equity Composite (the "Composite") Inception date: January 1, 2007. Creation date: January 1, 2007. The Composite includes all discretionary accounts invested in a portfolio of large capitalization U.S. common stocks. The strategy employs a pure quantitative strategy. Securities are screened from the universe of U.S. companies based on their trailing P/E, P/B (companies must fall in the value segment of the universe using P/E, P/B). The combined quantitative multi factor selection process results in holdings of 100 - 250 company's stocks. Sector weights are a result of bottom-up stock selection and may deviate from the weightings in the benchmark index. Primary Benchmark Description: The Russell 1000 Value Index measures companies from the Russell 1000 Index that exhibit lower price to book and price to earnings ratios and lower forecasted growth values. Secondary Benchmark Description: The S&P 500 is a broad measure of U.S. domestic large cap stocks. The 500 stocks in this capitalization-weighted index are chosen based on industry representation, liquidity, and stability. Performance Calculation: Preliminary data, if so noted, reflects unreconciled data for the most recent reporting period. Portfolios are valued daily on a trade date basis and include dividends and interest as well as all realized and unrealized capital gains and losses. Return calculations at the portfolio level are time-weighted to account for periodic contributions and withdrawals. Performance results are calculated on a before tax, total return basis. Prior to July 1, 2007, portfolios were included in the Composite beginning with the first full quarter of performance through the last full quarter of performance. After July 1, 2007, portfolios are included in the Composite beginning with the first full month of performance through the last full month of performance. Composite returns are reported on quarterly basis. The Composite returns consist of size-weighted portfolio returns using beginning of period values to weight the portfolio returns. Monthly linking of interim performance results is used to calculate quarterly and annual returns. Composite's valuations and returns are computed in U.S. Dollars ("USD"). The results are presented in USD or in other currencies (to accommodate overseas investors), the latter by converting monthly USD returns into other currency returns using the appropriate currency exchange rate returns. Gross returns reflect the deduction of trading expenses. Net of fee returns reflect the deduction of trading expenses and the highest investment management fees charged within the composite membership as stated in the fee schedule below. Composite dispersion is calculated using the asset-weighted standard deviation method for all portfolios that were in the Composite for the entire year. Composite dispersion is not presented for periods with five or fewer portfolios. The number of accounts and market values are as of the end of the period. The three-year annualized standard deviation, calculated using gross-of-fee returns, measures the variability of the composite and the benchmark returns over the preceding 36-month period. Gross-of-fees returns are used to calculate the presented risk measures. A complete list of composites, and limited distribution pooled funds descriptions as well as a list of broad distribution pooled funds is available upon request. Fee Schedule: Institutional Client Separate Account Management Fee Schedule (minimum initial investment: $5 million): 0.650% on the first $10 million; 0.450% on the next $40 million; 0.400% on the next $50 million; 0.300% on the next $100 million, and 0.250% on any portion of assets in excess of $200 million. Additional information on the Firm's fee schedule can be found in Form ADV Part 2A which is available upon request. One composite member has a base fee and performance fee that is capped at 48bps if excess return exceeds 4% on a rolling 12 quarter basis. **Past performance is no guarantee of future results.**