

Diversified Small Cap Value Equity

Quarterly Commentary

MARKET AND STRATEGY PERFORMANCE

Equity markets saw accelerated gains after the surprise U.S. election results, lifted in part by the anticipation of higher economic growth, lower taxes, and a reduced regulatory environment. Markets reached new all-time highs in December as stocks positively exposed to rising interest rates and pro-cyclical stocks surged. With rising inflation expectations, interest rates spiked sharply and the Treasury yield curve steepened. The yield on the 10-Year Treasury climbed 85 basis points (bps) during the quarter to end the year at 2.45%. As expected, the Federal Reserve hiked interest rates by a quarter point in a repeat of last December's move. Solid economic data also helped drive equity markets higher. Gross domestic product (GDP) for the third quarter was revised higher to 3.5%, the highest growth in two years, although early estimates for the fourth quarter are closer to 2%. The labor market added to signs of an improving economy as job growth remained healthy and annual wage growth rose to new cyclical highs of 2.9% in December. The unemployment rate ticked higher to 4.7% due to an increase in labor force participation. Consumer confidence now exceeds pre-recession levels after climbing following the election. Housing data was mixed as contracts to buy existing homes in November fell with the rise in interest rates and limited inventory, but new home sales rose. A pickup in mortgage rates and continued low inventory levels are potential headwinds to sustaining steady housing growth in 2017. Oil prices rose from \$48 to nearly \$54/bbl during the quarter as OPEC agreed to cut production. Globally, the increase in populism from Brexit and the U.S. election poses risks to global trade, and the world is intently watching the U.S. as the Trump administration begins to outline policy positions.

The S&P 500 Index climbed 3.8% during the quarter, extending the gain for the full year to 12%. With the strong market rally, small cap stocks outperformed large stocks by a wide margin, and value stocks outpaced growth. The Russell 2000 Value Index gained 14.1% in the quarter and finished the year up 31.7%. The sharp steepening of the yield curve benefited the net interest margins of banks, leading to strong performance within the financial sector. Cyclical and commodity-related segments of the market also had strong gains, including industrials, energy, and materials. With the sharp rise in interest rates, higher dividend paying sectors like real estate, consumer staples, and utilities underperformed, and health care also lagged. On a factor basis, lower-valued stocks based on price-to-book (P/B) and price-to-earnings (P/E) outperformed, lifted by the strong performance of financials during the quarter.

STRATEGY CHANGES, POSITIONING, AND OUTLOOK

The Diversified Small Cap Value strategy composite gained 17.48% gross of fees (17.25% net) for the fourth quarter, outperforming the Russell 2000 Value Index return of 14.07% by over 300 basis points. For the year, the strategy returned 32.88% on a gross basis (31.85% net of fees) versus 31.74% for the benchmark. Financial stocks were the top contributors for the quarter and a positive contributor for the full year. Improvement in economic, regulatory, and spread lending environment expectations propelled overweight bank stocks to gain near 25% in the quarter and over 40% for the year, contributing to financial outperformance. Investors exited higher-yielding Real Estate Investment Trusts (REITs) and utility stocks in favor of the stronger return potential from cyclicals and industrials as interest rates ticked higher. The strategy's 6.2% underweight to utilities and 9.9% underweight to real estate contributed nearly a percentage point each to quarterly outperformance as these sectors lagged the market. The utilities underweight added even more for the full year, and real estate also was a positive contributor for the full year even after some strength in the first half. An overweight and strong stock selection in capital goods, commercial & professional services, and airlines drove relative industrial gains for the year and quarter. Low exposure to the healthcare sector and avoidance of lagging care facilities benefitted relative returns in a low return sector for the year and quarter. A near-zero exposure to higher-valuation pharmaceuticals and biotechnology contributed to relative gains.

On a factor basis, low P/E value outperformed in the fourth quarter. The strategy's overexposure to low P/E along with an underweight in non-earning companies was a positive for the quarter. The quality bias, as measured by

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the overweight to high return on equity (ROE), outperformed, adding to returns for the quarter. For the year, however, higher ROE lagged, which was a headwind. Another headwind was the underperformance of high momentum in the quarter, which detracted from relative returns. Gains in media and for-profit education were not enough to overcome the lagging consumer discretionary performance in homebuilding and household wares. Overweight positions in poor-performing chemicals, containers, and paper detracted from relative returns within materials.

Technology had the largest sector decrease in the quarter with a -2.8% reduction after valuations sales in semiconductor equipment and the acquisition sale of Lexmark International in hardware. The majority of the proceeds were reinvested in exploration and production (E&P) companies, boosting the energy weight by 1.3%. Consumer discretionary had a net increase of +0.9% with +1.1% additions in automotive retailing offset by declines in homebuilding and housewares. Finance increased net +0.7% with additions in mortgage banks, thrifts, and consumer finance offset by value and capitalization sales of regional banks. Materials increased +0.8% after new purchases in commodity and specialty chemicals offset by valuation sells in steel companies. Reductions for the full year 2016 include a -6.4% decline in utilities and a -3.7% drop in technology made up of a -2% decrease in semiconductor equipment, -1.8% less in software and services, and a -0.7% decline in hardware. Net increases for the full year 2016 include a +4.8% increase in industrials through adding +2.8% to capital goods and +1.8% in transportation. Materials increased +2.9%, including adding +2% in chemical stocks. Energy gained +2% through +2% equipment additions and +1.5% new E&P, only partially offset by a -2% reduction in oil and gas refining. The strategy has remained fully invested throughout the year with an average 1.6% cash position.

Relative to the Russell 2000 Value benchmark, consumer discretionary and industrials are the most overweight sector at +6.9% and +6.1%, respectively. Finance remained the third most overweight sector, but only by 2.3% after relative gains in the benchmark, and the largest absolute sector weight at 34.9%. The strategy has smaller overweights in materials (+1.8%), energy (+1.2%), and telecommunications (+0.8%). The new real estate sector, created in August of 2016, has the largest underweight at -9.5% since the strategy does not hold REITs. Utilities are -5.9% under the benchmark weight, due to their overvalued status by our measures, and healthcare is -3% under the benchmark with zero exposure to pharmaceuticals also due to high valuations. Technology decreased from the prior quarter's +0.9% overweight to end the fourth quarter with a -1.7% underweight.

The strategy's bottom-up sector weights remain more pro-cyclical and positively exposed to higher interest rates, with overweights in industrials, materials, and consumer discretionary, as well as large underweights in utilities and real estate. However, in the event of a downturn, the strategy is also balanced by higher exposure to defensive factors, such as high ROE, low P/E, low share issuance, and a higher weight in stocks with positive earnings. We reach these positions through adherence to our bottom-up, value-oriented deselection process. While not forecast-driven, we do observe favorable value and small cap market trends that started in the middle of 2016, accelerated after the surprise election results in November, and have the potential to carry into 2017.

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ANNUALIZED RETURNS (%) (Results shown in USD)

	Gross	Net	R2000V	R2000
QTD	17.48	17.25	14.07	8.83
YTD	32.88	31.85	31.74	21.31
1 Year	32.88	31.85	31.74	21.31
3 Year	11.66	10.79	8.30	6.74
5 Year	18.21	17.29	15.05	14.44
7 Year	16.06	15.15	13.13	13.23
10 Year	7.40	6.55	6.26	7.06
Since Inception	12.03	11.15	10.98	9.70

Inception Date: 10/1/1988

GIPS INFORMATION (% , Unless Otherwise Noted) (Results shown in USD)

	Gross	Net	R2000V	R2000	# of Accounts	Market Value (M)	Total Firm Assets (M)	Composite Dispersion	Composite Rolling 3Y SD	R2000V Rolling 3Y SD	R2000 Rolling 3Y SD
2016	32.88	31.85	31.74	21.31	3	226	65,498	-	16.20	15.50	15.76
2015	- 2.25	- 3.03	- 7.47	- 4.41	3	200	68,819	-	14.15	13.46	13.96
2014	7.22	6.37	4.22	4.89	3	197	63,375	-	12.93	12.79	13.12
2013	41.36	40.26	34.52	38.82	3	291	50,050	-	16.16	15.82	16.45
2012	17.37	16.45	18.05	16.35	3	277	42,894	-	19.61	19.89	20.20
2011	- 1.75	- 2.54	- 5.50	- 4.18	3	245	33,122	-	25.74	26.05	24.99
2010	25.05	24.07	24.50	26.86	4	232	31,996	-	27.68	28.37	27.69
2009	16.19	15.28	20.58	27.16	9	615	29,199	0.42	24.94	25.62	24.83
2008	- 30.18	- 30.75	- 28.93	- 33.79	17	1,096	32,755	0.38	17.86	19.14	19.85
2007	- 11.33	- 12.04	- 9.78	- 1.57	20	1,951	49,208	0.47	11.11	12.59	13.16
2006	17.33	16.41	23.48	18.36	23	2,747	39,241	0.41	10.42	12.33	13.75

R2000V = Russell 2000® Value Index R2000 = Russell 2000® Index

Organization: Brandywine Global Investment Management, LLC (the "Firm") is a wholly owned, independently operated, subsidiary of Legg Mason, Inc. The Firm has prepared and presented this report in compliance with the Global Investment Performance Standards (GIPS). For the periods July 1, 2000 through June 30, 2015, the Firm has been verified by Kreisler Miller. A verification includes assessing whether the Firm (1) complied with the composite construction requirements of the GIPS standards on a firm-wide basis, and (2) designed its processes and procedures to calculate and present performance results in compliance with the GIPS standards. A copy of the verification report is 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. Composite Description: Diversified Small Cap Composite (the "Composite") Inception date: October 1, 1988. Creation date: July 1, 2011. The Composite includes all fully discretionary, fee-paying, actively managed accounts with no minimum market value requirement and no investment restrictions. The Composite is primarily invested in small and micro capitalization U.S. common stocks with Price-to-Earning or Price-to-Book ratios in the bottom quartile, and attractive price momentum. The portfolios typically hold approximately 375 - 550 holdings. Benchmark: The Russell 2000 Value Index measures the performance of those Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values. The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index 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 measures the variability of the composite and the benchmark returns over the preceding 36-month period. Past performance is no guarantee of future results. A complete list describing the Firm's composites as well as any additional information regarding the Firm's policies for calculating and reporting performance results is available upon request. Fee Schedule: Institutional Client Separate Account Management Fee Schedule (minimum initial investment: \$20 million): 0.800% on the first \$20 million; 0.750% on the next \$30 million; 0.700% on the next \$50 million, and 0.650% on any portion of assets in excess of \$100 million. Institutional Client Commingled Account Management Group Trust Fee Schedule (minimum initial investment: \$1 million): 0.800% flat fee on all assets. Additional information on the Firm's fee schedule can be found in Form ADV Part 2A which is available upon request.

Past performance is no guarantee of future results.

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