

# Dynamic Large 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 the 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. 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 to the U.S. election, poses risks to global trade.

The S&P 500 Index climbed 3.8% during the quarter, extending the gain for the full year to 12%. With the strong rally, small cap stocks outperformed large stocks by a wide margin, and value stocks outpaced growth. 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. With the sharp outperformance of financials and value stocks during the quarter, it is no surprise that on a factor basis lower-valued stocks, based on price-to-book (P/B) and price-to-earnings (P/E), outperformed.

The Dynamic Large Cap Value strategy composite returned 5.44% (5.25% net of fees) for the quarter while the Russell 1000 Value Index returned 6.68%. For the year, the strategy returned 10.94% (10.12% net), underperforming the 17.34% return of the benchmark. During the quarter and year, the contribution from our Value factor group was mixed. Our larger exposure to stocks with low P/E ratios and underweight to higher P/E was a positive, but our overweight to stocks with higher P/B ratios was a negative. Within the Sentiment group, our larger exposure to lower-momentum stocks and our underweight stocks with low volatility was positive for the quarter and year. Within our Quality group, our overweight of companies repurchasing shares was a positive while our underweight of companies with high return-on-equity (ROE) ratios was a negative for both the quarter and full year.

For the quarter, our underweight to banks within financials led to the majority of our underperformance, followed by semiconductors and semiconductor equipment within technology and packaged foods and meats within consumer staples. Our largest positive contributor was the industrial sector primarily from aerospace and defense, as well as airlines. Strong performance from media names within consumer discretionary followed by our underweight in real estate also benefited performance. For the year, semiconductors and semiconductor equipment within technology was our largest contributor to returns followed by our underweight in real estate and positive stock selection across several industries within the industrials sector. For the year, energy positioning weighed heavily on returns as our exposure to higher quality, particularly higher ROE and higher share buybacks, led to an overweight of underperforming refiners and no exposure to drillers or integrated oil and gas companies.

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## STRATEGY CHANGES, POSITIONING, & OUTLOOK

During the quarter, the model purchased names in diversified financials and banks within the financials sector while adding names to capital goods and transportation within industrials. We sold refiners within energy and biotechnology names within healthcare. We also reduced our weight in the materials sector through the sale of a stock in the chemicals industry and reduced our weight in technology by selling names in the software and services industry. Our largest overweight relative to the index is in the industrials sector, followed by the consumer discretionary and technology sectors. Our largest underweight remains in energy, followed by financials and utilities. We remain in the Broad Value model as valuation spreads are approximately one standard deviation below the long-term average. Although the lower-quality, deeper-valued stocks have outperformed, we feel over the next three years the higher-quality value stocks should again resume their longer-term pattern of outperformance.

Since the strategy's inception, we managed portfolio risk primarily by setting sector and industry weight constraints on the strategy. We now are enhancing our process by analyzing and managing factor and sector risk exposures, in addition to reviewing factor and sector weights relative to the benchmark. Through the use of risk models and our proprietary tools, we are managing the strategy for levels of factor risk that we deem unusually high. We expect to make adjustments based on this risk analysis only during outlier circumstances. When the risk tools do take effect, we will only partially moderate the most significant differences to the benchmark. For instance, as 2017 began, we added 3% to our energy sector after having no weight in the sector. In the process, we decreased our underweight from 13.6% to 10.6%. While we may decrease risk exposures at times, we expect to continue to be a high active share manager, seeking to outperform the benchmark by our original target of over 3% annually over the long term.

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## ANNUALIZED RETURNS (%) (Results shown in USD)

	Gross	Net	R1000V	SP500
QTD	5.44	5.25	6.68	3.82
YTD	10.94	10.12	17.34	11.96
1 Year	10.94	10.12	17.34	11.96
3 Year	6.38	5.59	8.58	8.86
5 Year	15.85	15.00	14.78	14.64
7 Year	14.47	13.62	12.71	12.82
10 Year	9.66	8.84	5.72	6.94
Since Inception	9.66	8.84	5.72	6.94

Inception Date: 1/1/2007

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

	Gross	Net	R1000V	SP500	# of Accounts	Market Value (M)	Total Firm Assets (M)	Composite Dispersion	Composite Rolling 3Y SD	R1000V Rolling 3Y SD	SP500 Rolling 3Y SD
2016	10.94	10.12	17.34	11.96	13	706	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
2012	17.58	16.72	17.51	16.00	2	9	42,894	-	15.60	15.51	15.09
2011	8.84	8.03	0.39	2.11	2	4	33,122	-	19.27	20.69	18.71
2010	13.36	12.53	15.51	15.06	3	5	31,996	-	21.58	23.18	21.85
2009	29.73	28.78	19.69	26.46	2	3	29,199	-	19.72	21.10	19.63
2008	- 30.67	- 31.21	- 36.85	- 37.00	2	2	32,755	-	-	-	-
2007	8.56	7.75	- 0.17	5.49	1	1	49,208	-	-	-	-

R1000V = Russell 1000® Value Index    SP500 = S&amp;P 500® 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: 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. This composite includes two non-fee paying portfolios which represents 100% of the composite assets from 2007 to 2009, 73.02% in 2010 and 72.96% in 2011. Benchmark: 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. 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 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: \$1 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. Institutional Client Commingled Account Management Investment Trust Fee Schedule: 0.750% 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.