Philosophy
The Focused Equity team believes that paying as little as possible for future value creation for businesses that generate or are capable of generating excess returns on capital and have higher barriers to entry will generate competitive investment returns.

Process
The Focused Equity strategy utilizes a four-step process which narrows the potential universe of 4,600 companies to 10-20 new opportunities. The process is centered on linking valuation with competitive business strategy. Valuation is categorized into three layers of value. Ideal investment candidates have no future value creation implied in the current stock price, earn above their cost of capital and have higher barriers to entry. The portfolio generally has 25-40 securities and maintains a flexible cash policy to remain liquid during times when the market is expensive and investment opportunities are limited. Generally, the Focused Equity strategy holds 10% or less in cash. The top 10 holdings typically represent 35% or more.

Factors Contributing to Performance
Within the Focused Equity strategy, sectors that outperformed their respective peers included Consumer Discretionary, and Health Care. Information Technology and Industrials materially underperformed while Energy, Financials, Consumer Staples, Materials, and Real Estate also lagged. Stock selection accounted for the underperformance. Cash holdings detracted from performance given the positive move in the overall market; however this was offset by a positive impact from sector allocation due to a zero weight in Utilities.

Stocks adding the most to performance were a global leader in providing biotechnology based therapies that has developed a deep and emerging pipeline, an online e-commerce company that has a high level of customer captivity, and a manufacturer and distributor of life science research and clinical diagnostics products. Stocks detracting the most from performance were a global business-to-business services company that provides highly specialized solutions to health care organizations and commercial businesses, a diversified provider of health care products that benefit from economies of scale, and a leading consumer products company that has leading market share positions in key product lines.

During the quarter we increased the weighting in the Consumer Discretionary and Industrial sectors while we decreased the weighting in Financials and Consumer Staples. Cash holdings decreased from 7.3% at the end of the second quarter to 4.2% at the end of the third quarter. Two new names were added during the quarter while one name was deleted. Each change was made in order to improve the overall risk/reward of the composite.

As the third quarter of 2016 came to a close, the strategy had an overweight in Industrial and Health Care sectors and an underweight in the Real Estate, Material, Consumer Discretionary, and Financial sectors. The weights of the Consumer Staples, Information Technology, Energy, and Telecommunication Services sectors are equal to the index. No positions were held in Utilities at the end of the quarter.

From a market cap perspective, the strategy maintained a zero weight in smaller cap stocks (companies with a market cap below $2 billion). The index weight for this segment is 5.3%. The strategy remained underweight mid-cap businesses which now comprise 11.6% of assets, compared to an index weight of 14.8%. Lastly, the strategy has continued to increase its exposure to larger cap businesses (companies with a market cap above $10 billion). The weight in this segment is currently 84.2% which is higher than the index weight of 79.9%. Due to smaller cap stocks outperforming, this allocation decision detracted from performance by nearly 20 basis points during the quarter.

Investments made in international companies, which comprised 5.2% of assets, underperformed the benchmark while domestic holdings lagged as well.

Portfolio Outlook and Positioning
As we are getting later in the cycle, fortunately we are only trying to find approximately 25 to 40 undervalued businesses; not 80 like the typical equity manager. According to our estimates, the portfolio is trading at 78 cents on the dollar at this point which is attractive in our view. Furthermore, our positioning has changed over approximately the last year as we have shifted the portfolio even higher in quality coupled with our belief the portfolio is slightly less cyclical; has slightly less operational leverage and less financial leverage than the index.

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at this point. Also, we have brought down our cash position marginally over the last few months as the market has done something it has never done in past cycles (over the last approximately 100 years), which is broadened out somewhat after getting extremely narrow. We believe this happened due to many central bank actions. Lastly, our upside capture has been solid historically; our goal is to deliver attractive downside capture as well, which is why we have repositioned the portfolio somewhat as we get later in the cycle.

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