CanterburyConsulting

Quarterly Asset Class Report

Global Equity

canterburyconsulting.com

September 30, 2016

Role in the Portfolio

Canterbury Consulting recommends and communicates asset-class strategy with the objective of constructing a diversified portfolio of long-only equity strategies designed to (in aggregate):

(i) Provide growth of portfolio assets in excess of inflation and spending rates

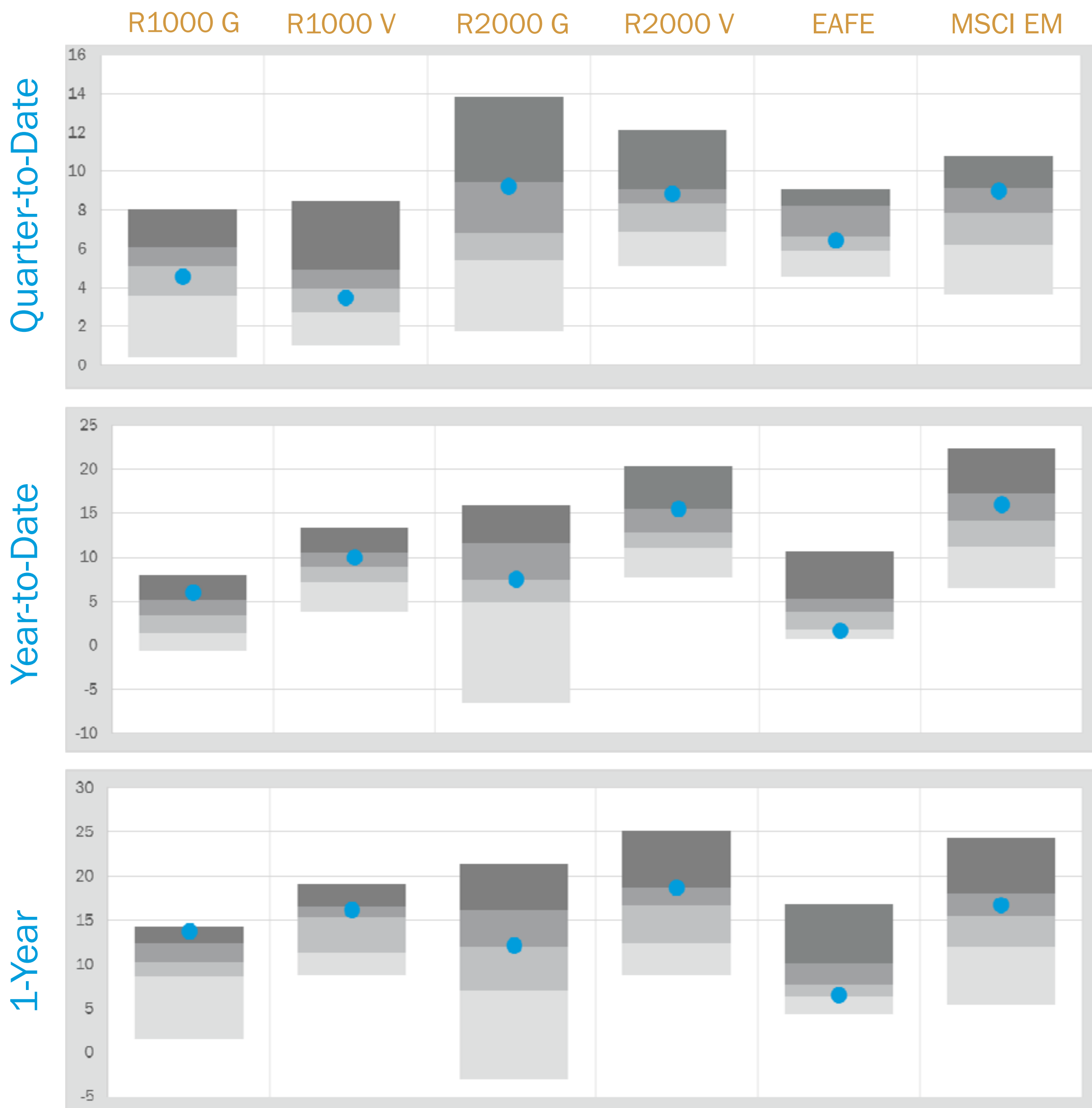
(ii) Maintain comparable exposure to the global equity market

(iii) Exhibit returns uncorrelated to fixed income markets

Role	Asset Categories	Risks
Growth	**Public and Private Equity**	**Market Decline**
Capital Preservation	Fixed Income, Hedge Funds	Rising Interest Rates, Highly Correlated Markets
Inflation Protection	Real Assets: Real Estate, Commodities	Deflation

- Canterbury global equity portfolios are expected to deliver consistent net of fees excess returns and moderate tracking error versus the MSCI All Country World Index over longer periods of time
- Relative to the index, Canterbury equity portfolios will employ higher allocations to small- and mid-cap equities, comparable volatility (achieved through manager selection), and moderate tracking error

Performance (%) as of September 30, 2016



Blue dots represent the returns of the benchmark; gray floating bar charts represent the peer groups by quartile
Source: Morningstar Direct

- After trailing for most of the year, growth outperformed value in the third quarter. The median large-cap active manager beat its benchmark, while small-cap and EM managers tended to fare worse on a relative basis

- In the year to date, less than 25% of active large growth managers have beat their benchmark, while over 75% of developed international equities managers outperformed theirs. High dispersion across countries, currencies, and economic sectors have potentially made the international equity space a more fertile ground for alpha generation despite lower returns

- With the exception of international developed, global equities have enjoyed a considerable rally over the past year, causing many managers to be cautious in their outlook, especially with the specter of higher interest rates looming

Market Capitalization Mix

	Equity: U.S. Market Cap	**Current**	**10 Year Avg**	**Deviation from Mean***	**Large**	**Neutral**	**Small**
Valuation	Russell Top 200 Current P/E (Large Cap)	20.22	15.88	2.26			++
	R2000 Current P/E (Small Cap)	43.56	42.53	0.10		-	
	Avg P/E Ratio (Large/Small)	0.46	0.43	0.33		-	
	Russell Top 200 EV/EBITDA^ (Large Cap)	12.47	9.99	1.75			+
	R2000 EV/EBITDA (Small Cap)	21.40	13.61	2.58	++		
	Avg EV/EBITDA Ratio (Large/Small)	0.58	0.75	-1.42	+		
	Russell Top 200 P/S (Large Cap)	2.04	1.57	1.74			+
	R2000 P/S (Small Cap)	1.18	1.02	0.83		-	
	Avg P/S Ratio (Large/Small)	1.72	1.54	1.66			+
Solvency	Russell Top 200 Debt/EBITDA (Large Cap)	4.62	4.74	-0.14		-	
	Russell 2000 Debt/EBITDA (Small Cap)	8.19	5.46	2.58	++		
	Avg Debt/EBITDA Ratio (Large/Small)	0.56	0.89	-1.37	+		
Growth	Russell Top 200 LT EPS Gr (Fwd) (Large Cap)	7.34	8.77	-0.02		-	
	R2000 LT EPS Gr (Fwd) (Small Cap)	9.53	10.88	-0.73		-	
	Avg Growth Ratio (Large/Small)	0.77	0.80	-0.01		-	
Economy	Case Shiller Home Price (YoY)	5.02	-0.34	0.61		-	
	Total Leading Economic Indicators	124.10	111.23	1.28			+
	Currency (USD v Broad Basket)	95.46	82.86	1.76			+
	Curve Steepness 2's to 10's	0.83	1.67	-1.09	+		

**Deviation from mean represents how many standard deviations the current value is above or below the 10-year average, also known as the "Z-Score". '+' denotes one standard deviation, and '++' denotes two standard deviations in favor of the asset class*
^EV/EBITDA, also known as the "enterprise multiple," is a ratio used to determine the value of a company. Unlike P/E, the enterprise multiple takes debt into account. This is often the ratio used by companies looking to acquire another business

- There are various valuation metrics used to determine the relative attractiveness of the equity universe – Canterbury prefers Price/Earnings, EV/EBITDA, and Price/Sales. No one metric is a sole determinant
- Large-cap stocks are trading at historically high valuations, while small-cap stocks are trading at normal P/E and P/S ratios
- Leverage continues to be a greater issue for small-cap stocks than for large-cap stocks
- Growth estimates are slightly below historical averages for both small- and large-cap stocks, with neither side having a relative advantage
- Strong leading economic indicators and a strong dollar are positives for small-cap stocks, but a flattening yield curve (typically seen in the late stages of the economic cycle) is more supportive of large-caps
- No relative advantage between large-cap and small-cap U.S. equities

Source: Russell

Region Mix – U.S. vs. Global

Equity: Region (U.S./Global)

		Current	10 Year Avg	Deviation from Mean*	U.S.	Neutral	R.O.W.
Valuation	S&P 500 Current P/E	20.42	16.74	1.72			+
	MSCI ACWI Current P/E	21.35	16.69	1.20	+		
	Avg P/E Ratio (US /ACWI)	0.96	1.01	-0.54		-	
	S&P 500 EV/EBITDA^	13.26	9.98	2.34			++
	MSCI ACWI EV/EBITDA	12.08	9.58	2.09	++		
	Avg EV/EBITDA Ratio (US/ACWI)	1.10	1.04	1.24			+
	S&P 500 P/S	1.94	1.47	1.69			+
	MSCI ACWI P/S	1.47	1.22	1.25	+		
	Avg P/S Ratio (US/ACWI)	1.32	1.21	1.26			+
Solvency	S&P 500 Debt/EBITDA	4.69	4.73	-0.05		-	
	MSCI ACWI Debt/EBITDA	6.72	6.39	0.51		-	
	Avg Debt/EBITDA Ratio (US/ACWI)	0.70	0.73	-0.53		-	
Growth	S&P 500 LT EPS Gr (Fwd)	4.18	8.63	-0.78		-	
	MSCI ACWI LT EPS Gr (Fwd)	5.17	9.36	-0.33		-	
	Avg Growth Ratio (US/ACWI)	0.81	0.97	-0.22		-	
Economy	Currency (USD v Broad Basket)	95.46	82.86	1.76			+

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- Both U.S. and rest of the world ("R.O.W.") stock valuations are well above historical norms. On a relative basis, the R.O.W. valuations appear more attractive
- Debt levels are normal for both U.S. and R.O.W. stocks
- Growth estimates across the board have come down, particularly in the U.S., where earnings are now expected to grow slower than in the R.O.W.
- The U.S. dollar weakened during the quarter but remains elevated. A strong dollar hurts U.S.-based companies that export goods and services while helping foreign companies that sell their goods in the U.S.
- <u>Advantage: non-U.S. relative to U.S. equities</u>

Source: MSCI and Standard & Poor's

Region Mix – Non-U.S. Developed vs. Global

	Equity: Region (Non-U.S. Dev/Global)	Current	10 Year Avg	Deviation from Mean*	Non-U.S. Dev	Neutral	R.O.W.
Valuation	MSCI EAFE Current P/E	20.01	18.21	0.14		-	
	MSCI ACWI Current P/E	21.35	16.69	1.20	+		
	Avg P/E Ratio (EAFE/ACWI)	0.94	1.07	-0.44		-	
	MSCI EAFE EV/EBITDA^	10.73	9.09	1.52			+
	MSCI ACWI EV/EBITDA	12.08	9.58	2.09	++		
	Avg EV/EBITDA Ratio (EAFE/ACWI)	0.89	0.95	-2.25	++		
	MSCI EAFE P/S	1.10	0.98	0.68		-	
	MSCI ACWI P/S	1.47	1.22	1.25	+		
	Avg P/S Ratio (EAFE/ACWI)	0.75	0.80	-1.38	+		
Solvency	MSCI EAFE Debt/EBITDA	9.18	9.06	0.12		-	
	MSCI ACWI Debt/EBITDA	6.72	6.39	0.51		-	
	Avg Debt/EBITDA Ratio (EAFE/ACWI)	1.37	1.42	-0.80		-	
Growth	MSCI EAFE LT EPS Gr (Fwd)	7.49	6.20	0.03		-	
	MSCI ACWI LT EPS Gr (Fwd)	5.17	9.36	-0.33		-	
	Avg Growth Ratio (EAFE/ACWI)	1.45	0.89	0.14		-	
Economy	USD/EUR	1.12	1.32	-1.58	+		

- Non-U.S. developed countries remain attractively valued versus the R.O.W. based on all three valuation metrics, even after a quarter in which they outperformed the R.O.W.
- Debt levels are in line with historical norms, with neither region having an advantage
- Growth estimates for non-U.S. developed companies increased during the quarter and are now higher than those of their global counterparts
- The U.S. dollar was mostly unchanged vs. the euro during the quarter but remains at an elevated level. This benefits European exporters who have costs in euros and revenues in dollars
- <u>Advantage: non-U.S. developed equities relative to the rest of the world</u>

Source: MSCI

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Region Mix – Emerging Markets vs. Global

	Equity: Region (EM/Global)	**Current**	**10 Year Avg**	**Deviation from Mean***	**EM**	**Neutral**	**R.O.W.**
Valuation	MSCI EM Current P/E	15.43	13.38	0.75		-	
	MSCI ACWI Current P/E	21.35	16.69	1.20	+		
	Avg P/E Ratio (EM/ACWI)	0.72	0.80	-0.74		-	
	MSCI EM EV/EBITDA^	9.46	7.93	1.24			+
	MSCI ACWI EV/EBITDA	12.08	9.58	2.09	++		
	Avg EV/EBITDA Ratio (EM/ACWI)	0.78	0.83	-0.51		-	
	MSCI EM P/S	1.22	1.22	-0.02		-	
	MSCI ACWI P/S	1.47	1.22	1.25	+		
	Avg P/S Ratio (EM/ACWI)	0.83	1.03	-0.94		-	
Solvency	MSCI EM Debt/EBITDA	5.11	3.36	2.14			++
	MSCI ACWI Debt/EBITDA	6.72	6.39	0.51		-	
	Avg Debt/EBITDA Ratio (EM/ACWI)	0.76	0.54	1.41			+
Growth	MSCI EM LT EPS Gr (Fwd)	4.86	9.37	-0.18		-	
	MSCI ACWI LT EPS Gr (Fwd)	5.17	9.36	-0.33		-	
	Avg Growth Ratio (EM/ACWI)	0.94	0.98	-0.09		-	

- Valuations are stretched across the globe, but emerging markets ("EM") stocks are relatively attractively valued compared to the R.O.W.
- Similar to domestic small-cap stocks, the risk to EM equities lies in their high debt levels arising from cheap borrowing conditions
- Growth estimates came down during the quarter for both EM and R.O.W., but neither region has a significant advantage
- <u>No relative advantage between emerging markets and the rest of the world</u>

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Source: MSCI

Portfolio Characteristics

Recommended Ranges

Market Cap (U.S.)	Minimum	Maximum	R3000
Large Cap (> $25.5B)	50.0%	70.0%	67.6%
Mid Cap ($3B - $25.5B)	25.0%	40.0%	26.3%
Small Cap (< $3B)	2.5%	12.5%	6.1%

Region	Minimum	Maximum	MSCI ACWI
U.S.	45.0%	65.0%	53.5%
Non-U.S. Developed	25.0%	40.0%	36.2%
Emerging Markets	5.0%	20.0%	10.3%

Client objectives and constraints may cause allocations to vary from recommended ranges

- Canterbury has been decreasing its home country bias as U.S. equity valuations remain stretched and the strong dollar presents a headwind for American companies with global operations
- Our market cap exposures are currently in a more neutral position. Valuation, growth, and economic indicators do not support a major shift at this time
- As the equity market cycle matures, Canterbury believes its utilization of active managers that can avoid overvalued regions, sectors, and securities will be a strong value-add