CanterburyConsulting

Quarterly Asset Class Report

Global Equity

canterburyconsulting.com

December 31, 2016

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

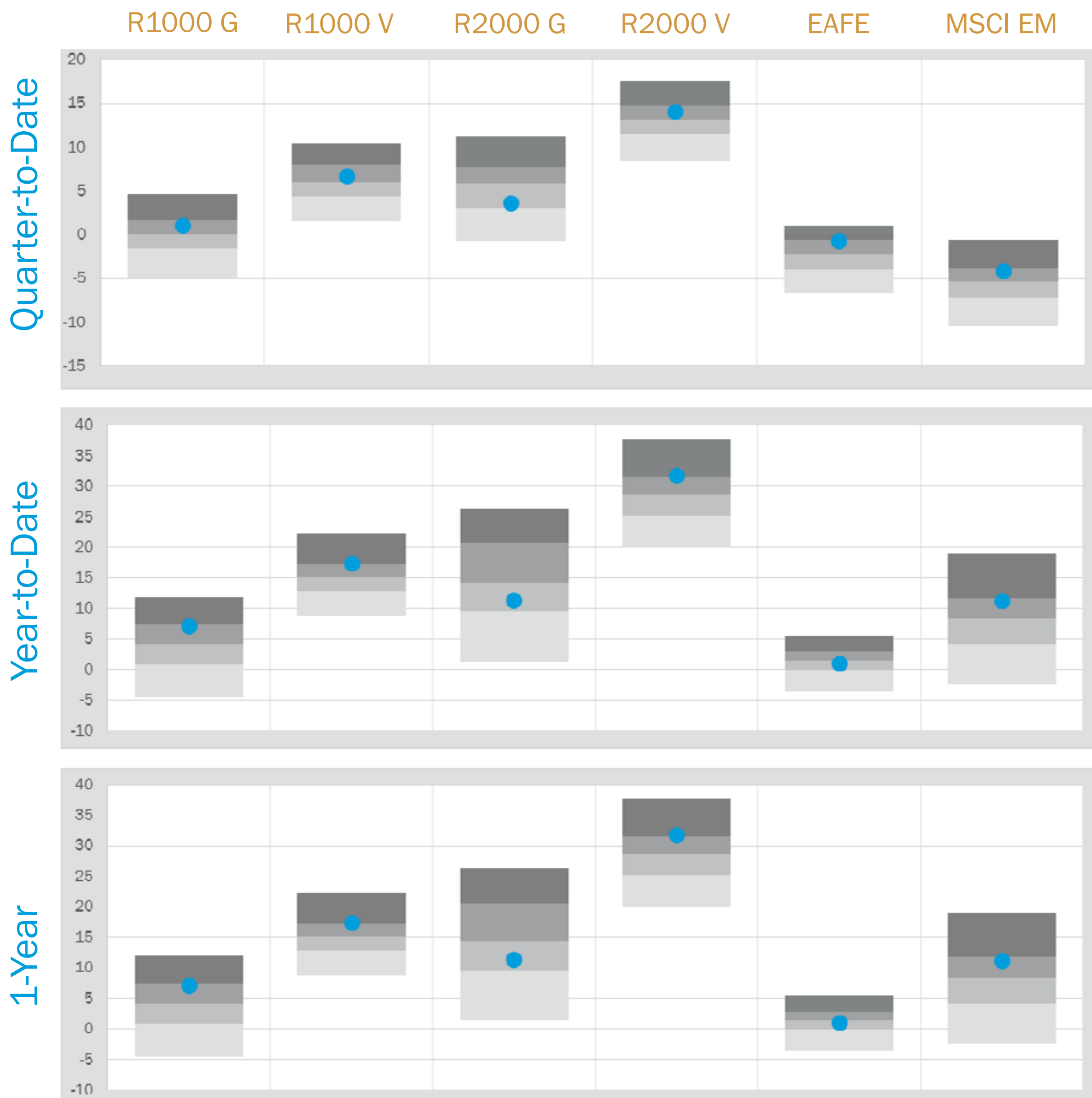
(iii) Exhibit returns uncorrelated to fixed income markets

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 December 31, 2016



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

- In U.S. equities, value beat growth and small-caps beat large-caps during the fourth quarter. Following the election of Donald Trump, markets anticipated that corporate tax reform, lessened regulation, and infrastructure spending would lead to faster economic growth along with higher inflation and interest rates. As a result, banks, commodity stocks, and small companies rallied while technology and health care stocks fell out of favor.

- Emerging markets sank during the quarter, led lower by India, China, and Mexico. Trump's anti-free trade campaign rhetoric, the strengthening U.S. dollar, and higher U.S. interest rates contributed to the decline.

- The median active manager in each category aside from small-cap growth underperformed its respective benchmark net of fees during the quarter.

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)	20.70	15.99	2.31			++
Valuation	R2000 Current P/E (Small Cap)	48.82	43.49	0.52		-	
Valuation	Avg P/E Ratio (Large/Small)	0.42	0.44	-0.22		-	
Valuation	Russell Top 200 EV/EBITDA^ (Large Cap)	12.46	10.02	1.68			+
Valuation	R2000 EV/EBITDA (Small Cap)	20.44	13.78	2.12	++		
Valuation	Avg EV/EBITDA Ratio (Large/Small)	0.61	0.74	-1.16	+		
Valuation	Russell Top 200 P/S (Large Cap)	2.09	1.58	1.82			+
Valuation	R2000 P/S (Small Cap)	1.27	1.02	1.26	+		
Valuation	Avg P/S Ratio (Large/Small)	1.64	1.55	0.81		-	
Solvency	Russell Top 200 Debt/EBITDA (Large Cap)	4.56	4.70	-0.18		-	
Solvency	Russell 2000 Debt/EBITDA (Small Cap)	7.24	5.54	1.58	+		
Solvency	Avg Debt/EBITDA Ratio (Large/Small)	0.63	0.87	-1.04	+		
Growth	Russell Top 200 LT EPS Gr (Fwd) (Large Cap)	8.37	8.76	-0.01		-	
Growth	R2000 LT EPS Gr (Fwd) (Small Cap)	8.86	10.77	-1.03	+		
Growth	Avg Growth Ratio (Large/Small)	0.94	0.81	0.03		-	
Economy	Case Shiller Home Price (YoY)	5.10	-0.29	0.61		-	
Economy	Total Leading Economic Indicators	124.60	111.25	1.33			+
Economy	Currency (USD v Broad Basket)	102.21	83.23	2.47			++
Economy	Curve Steepness 2's to 10's	1.26	1.71	-0.62		-	

**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
- Both large and small-cap stocks are trading at rich valuation multiples on all three metrics
- Leverage continues to be a greater issue for small-cap stocks than for large-cap stocks
- Growth estimates are only slightly higher for small-cap stocks than for large-cap stocks despite much higher valuations. This indicates that investors are willing to pay up for growth in small companies
- Positive leading economic indicators and a strong dollar are positives for small-cap stocks, which tend to be more domestically-oriented
- 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	20.96	16.85	1.86			+
	MSCI ACWI Current P/E	21.08	16.80	1.09	+		
	Avg P/E Ratio (US /ACWI)	0.99	1.01	-0.15		-	
	S&P 500 EV/EBITDA^	13.07	10.03	2.08			++
	MSCI ACWI EV/EBITDA	11.87	9.62	1.80	+		
	Avg EV/EBITDA Ratio (US/ACWI)	1.10	1.04	1.33			+
	S&P 500 P/S	1.99	1.48	1.75			+
	MSCI ACWI P/S	1.47	1.22	1.26	+		
	Avg P/S Ratio (US/ACWI)	1.35	1.21	1.45			+
Solvency	S&P 500 Debt/EBITDA	4.56	4.71	-0.19		-	
	MSCI ACWI Debt/EBITDA	6.64	6.40	0.37		-	
	Avg Debt/EBITDA Ratio (US/ACWI)	0.69	0.73	-0.64		-	
Growth	S&P 500 LT EPS Gr (Fwd)	8.35	8.66	-0.05		-	
	MSCI ACWI LT EPS Gr (Fwd)	20.81	9.74	0.86		-	
	Avg Growth Ratio (US/ACWI)	0.40	0.96	-0.76		-	
Economy	Currency (USD v Broad Basket)	102.21	83.23	2.47			++

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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
- Global growth estimates increased significantly during the quarter, both in and outside of the U.S.
- The U.S. dollar strengthened significantly following the election. The dollar's strength hurts U.S. exporters and benefits foreign companies that export goods and service to 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	23.14	18.35	0.39		-	
	MSCI ACWI Current P/E	21.08	16.80	1.09	+		
	Avg P/E Ratio (EAFE/ACWI)	1.10	1.07	0.10		-	
	MSCI EAFE EV/EBITDA^	10.54	9.11	1.29			+
	MSCI ACWI EV/EBITDA	11.87	9.62	1.80	+		
	Avg EV/EBITDA Ratio (EAFE/ACWI)	0.89	0.95	-2.20	++		
	MSCI EAFE P/S	1.09	0.97	0.64		-	
	MSCI ACWI P/S	1.47	1.22	1.26	+		
	Avg P/S Ratio (EAFE/ACWI)	0.74	0.80	-1.55	+		
Solvency	MSCI EAFE Debt/EBITDA	9.22	9.10	0.13		-	
	MSCI ACWI Debt/EBITDA	6.64	6.40	0.37		-	
	Avg Debt/EBITDA Ratio (EAFE/ACWI)	1.39	1.42	-0.51		-	
Growth	MSCI EAFE LT EPS Gr (Fwd)	-17.82	5.69	-0.46		-	
	MSCI ACWI LT EPS Gr (Fwd)	20.81	9.74	0.86		-	
	Avg Growth Ratio (EAFE/ACWI)	-0.86	0.84	-0.43		-	
Economy	USD/EUR	1.05	1.31	-2.02	++		

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^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

- Non-U.S. developed countries are trading at elevated valuations but still appear attractive relative to 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 turned negative during the quarter while estimates for the R.O.W. increased
- The U.S. dollar appreciated significantly vs. the euro. The dollar's strength 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

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	15.42	13.49	0.71		-	
	MSCI ACWI Current P/E	21.08	16.80	1.09	+		
	Avg P/E Ratio (EM/ACWI)	0.73	0.80	-0.68		-	
	MSCI EM EV/EBITDA^	9.30	8.02	1.02			+
	MSCI ACWI EV/EBITDA	11.87	9.62	1.80	+		
	Avg EV/EBITDA Ratio (EM/ACWI)	0.78	0.83	-0.58		-	
	MSCI EM P/S	1.16	1.22	-0.20		-	
	MSCI ACWI P/S	1.47	1.22	1.26	+		
	Avg P/S Ratio (EM/ACWI)	0.79	1.02	-1.11	+		
Solvency	MSCI EM Debt/EBITDA	5.19	3.46	1.98			+
	MSCI ACWI Debt/EBITDA	6.64	6.40	0.37		-	
	Avg Debt/EBITDA Ratio (EM/ACWI)	0.78	0.55	1.41			+
Growth	MSCI EM LT EPS Gr (Fwd)	-6.63	9.17	-0.51		-	
	MSCI ACWI LT EPS Gr (Fwd)	20.81	9.74	0.86		-	
	Avg Growth Ratio (EM/ACWI)	-0.32	0.97	-2.89			++

- 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 turned negative for emerging markets equities during the quarter. Investors believe in stronger growth prospects in developed markets, particularly the U.S.
- Advantage: global equities relative to emerging markets equities

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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%	67.7%
Mid Cap ($3B - $25.5B)	25.0%	40.0%	26.2%
Small Cap (< $3B)	2.5%	12.5%	6.2%

Region	Minimum	Maximum	MSCI ACWI
U.S.	45.0%	65.0%	52.4%
Non-U.S. Developed	25.0%	40.0%	36.7%
Emerging Markets	5.0%	20.0%	11.0%

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