



## Memorandum

To	Joe Gilbert, Kentucky Retirement System
From	RVK, Inc.
Subject	Equity Manager Commentary Fiscal Year 2016
Date	October 25, 2016

### Market Commentary

Meaningful volatility and uncertainty was experienced across all markets during the 2016 fiscal year, which made for a challenging investment period. During the fiscal year, global equity markets produced mixed results, with U.S. equity markets, as measured by the Russell 3000 Index, returning 2.1% amid improving U.S. economic conditions. In contrast, developed non-U.S. equity markets, as measured by the MSCI ACW ex U.S. Index, returned -9.7% and emerging markets, as measured by the MSCI EM Index, declined 12.1%. Global growth concerns, Greece's default on their loan repayment to the International Monetary Fund, the Chinese government intervention, political unrest, U.S. dollar strengthening, "Brexit" vote, and a significant decline in commodity prices weighed on international markets.

U.S. large cap outperformed mid and small cap and was the only domestic equity sub-composite in the KRS portfolio to end the fiscal year in positive territory, which lifted the portfolio's total U.S. equity composite to produce a gain of 1.4%. Domestic value equity outperformed growth over the fiscal year, as River Road outperformed its benchmark and Westfield Capital struggled on both an absolute and relative basis.

In contrast to domestic equity markets, developed international markets finished the fiscal year with only one quarter of positive returns (CY4Q15). While the dispersion between international growth and value reversed temporarily in the second fiscal quarter, the MSCI ACW ex U.S. Growth finished the fiscal year with a return of -6.2% versus -14.3% for the MSCI ACW ex U.S. Value. Similarly, the portfolio's dedicated non-U.S. growth manager, American Century outperformed the portfolio's value-focused mandate, LSV. Developed international small cap stocks had mixed results during the first half of the fiscal year, but the start of 2016 proved more difficult and culminated with the UK's EU referendum. The vote caused a sharp increase in market volatility, particularly in

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developed Europe. Over the fiscal year, MSCI ACW ex U.S. Small Cap Index returned -5.5% and the MSCI ACW ex U.S. Index declined -9.7%. The portfolio's international small cap holdings fell -5.3% over the same period, but outperformed the non-U.S. equity composite as a whole, which returned -8.5%.

### Equity Manager Commentary

Summary commentary of manager performance for the fiscal year 2016 is provided below. RVK does not have any business concerns with any of the current KRS equity managers.

### U.S. Equity

#### **River Road Asset Management**

- The portfolio outperformed the Russell 3000 Value by over 560bps. Overall stock selection and sector allocation drove the outperformance during the period and resulted in a positive total effect in seven of ten sectors.
- The most significant positive impacts on relative performance were from stock selection in the Financials and Consumer Staples sectors. The outperformance in Financials was driven by the strong return of REIT holdings.
- The most significant negative impacts on relative performance were from the overweight in Consumer Discretionary and stock selection in Utilities.

#### **Westfield Capital**

- Westfield Capital underperformed the Russell 3000 Growth. Performance was influenced by a number of global geopolitical and economic concerns that overshadowed mostly positive economic news in the U.S.
- Stock selection within Information Technology, Industrials, Financials, and Health Care sectors was the leading driver of the portfolio's underperformance during the period. Also detracting from returns was the portfolio's underweight of Telecommunication Services and Consumer Staples and its overweight of the Energy sector.

#### **Systematic Financial Management**

- The portfolio underperformed relative to the Russell Mid Cap Value Index. A headwind has been investor's response to geopolitical developments by continuing to rotate into low-volatility and high-dividend stocks.
- The strategy's positive performance can be attributed to both the positive sector allocation as well as stock selection. Positive stock selection in Health Care, Energy and Consumer Discretionary were additive.

- The major detractors to performance for the period were driven by poor stock selection in Finances, Industrials and Utilities.

### **Sasco**

- Underperformance for the year is primarily attributed to an overweight position and poor stock selection in the Materials sector. Investments in Freeport McMoRan (FCX), Allegheny Technologies (ATI) and Owens Illinois (OI) were key detractors as dollar strength and tepid global demand negatively impacted materials companies broadly.
- Sasco's underweight in the Utilities sector was also a source of performance drag, as these "yield plays" outperformed the market in a declining interest rate environment.
- The portfolio's voids in the Information Technology, Financial and Health Care sectors detracted modestly from performance. Headwinds were partially offset by stock selection in the Energy, Consumer Discretionary and Industrials sectors.

### Non-U.S. Equity

#### **Lazard International Strategic Equity**

- Lazard outperformed the MSCI ACWI ex U.S. Index over the trailing 1-year time period by over 200 basis points. The strategy's positive performance can be attributed to both positive sector allocation as well as stock selection.
- Notably, the portfolio's overweight to Consumer Defensive. Despite negative attribution from the strategy's overweight to Consumer Cyclical, strong stock selection turned this sector into the best performer over the trailing 1-year.
- Positive stock selection in Materials and Telecommunication was also additive during the same time period.
- From a geographical standpoint, the portfolio's underweight position in Canada, coupled with poor stock selection was a primary detractor over the trailing 1-year period. Positive stock selection in the Eurozone, Japan, and the UK were additive.

#### **LSV International Concentrated Value Equity**

- Style was the biggest detractor for LSV during the trailing year as value stocks underperformed growth stocks outside of the U.S. and low volatility stocks dominated results over the past year.
- The MSCI ACWI ex U.S. Min Vol Index rose 2.8% during the trailing year, 13.0% better than the standard index over the same period. LSV is underweighted low volatility stocks which did not help performance. The best performing sector in the last year was Consumer Staples.

### **American Century Non-U.S. Growth Equity**

- American Century's portfolio outperformed the MSCI ACWI ex U.S. Index, which can be attributed to strong stock selection which added over 150 basis points of excess returns. However, the currency attribution was a significant detractor of performance.
- Stock selection in consumer discretionary, healthcare and materials was additive. Additionally, stock selection and an underweight in financials aided as did an underweight in energy.
- The portfolio was hurt on a relative basis by stock selection in industrials, information technology, and underweight in consumer staples, telecommunication services and utilities.

### **Franklin Templeton Non-U.S. Equity**

- The strategy fared better than its benchmark, the MSCI All Country World ex U.S. Index. Stock selection drove relative performance, with security selection in the Health Care, Consumer Discretionary and Materials sectors contributing to relative returns. Stock selection in the Energy and Financials sectors detracted from relative performance.
- In terms of sector allocations, an underweight in Financials supported relative performance, but an underweight in Consumer Staples detracted from relative returns, given the market volatility over the back half of the period.
- Regionally, an overweight in the United Kingdom dampened relative performance, while emerging markets exposure was beneficial.