

# TCW Relative Value Dividend Appreciation

SECOND QUARTER 2019 | INFOFLASH

**Philosophy:** A strategy which employs a highly disciplined, analytically-driven investment process utilizing quantitative and qualitative resources to generate investment ideas. Primarily invests in equities of companies with dividend paying records.

## Key Issues

- Early in the second quarter, economic data suggested a rosier outlook for the U.S. economy and reports out of China showed growth in exports, employment, and orders. Also, there was increased optimism for a U.S./China trade deal and a continued dovish view from the U.S. Federal Reserve. The preliminary reading for 1Q:19 U.S. GDP came in at 3.2%+ (with the second and third readings just a touch lighter at 3.1%), higher than estimates. This marks the first time since 2015 that growth in the first quarter topped 3%. In May, U.S. equities fell primarily from a setback in U.S./China trade negotiations. While the two sides appeared close to an agreement, optimism was upended by President Trump's announcement on May 5 the U.S. would increase tariffs on \$200 billion of Chinese imports to 25% from 10% with the added threat on an additional \$325 billion. China, unsurprisingly, countered with new tariffs on \$60 billion of U.S. imports. Additionally, just after agreeing to lifting tariffs on metal imports from Mexico and Canada mid-month, Mr. Trump threatened to impose tariffs on Mexican imports in retaliation to the migrant issue at the countries' shared border, only to reverse after the two sides came to an agreement. Even amidst trade tensions, U.S. equities rallied strongly in June due in part to the increased likelihood of a Fed rate cut. Although the Committee took no action at its June meeting, investors largely expect rate cuts this year, perhaps as early as July when it next convenes. Additionally, European Central Bank President Draghi said the zone's central bank is prepared to provide more stimulus to combat economic sluggishness and is ready to cut interest rates which are already at/near zero. Finally, stocks got a boost after Presidents Trump and Xi reaffirmed their intent to meet at the G-20 in Osaka at the end of June.
- Over the course of the second quarter, the best performing sectors in the S&P 500 were financials (8.0%), materials (6.8%), information technology (6.1%), and consumer discretionary (5.3%). Energy (-2.8%) was the worst performer and the only sector in the negative followed by healthcare (1.4%), real estate (2.5%), and utilities (3.5%). The portfolio's sector weights detracted most notably due to the overweight in energy while the overweight in financials was beneficial. Looking at security selection, the most notable contribution to relative performance came from the portfolio's information technology stocks, while the portfolio's utilities and materials holdings were the biggest detractors.
- Over the last decade, many investment professionals have been tested by two simultaneously occurring phenomena: the rise of passive investing and the stronger performance of growth stocks relative to value that make value investing appear broken. As growth approaches its 11th year of outperforming value, the price-to-book ratio and rolling 10-year relative performance remain at stretched levels. Historically, these extreme levels have reversed with value sizably outperforming growth over multiple years. The dilemma investors face is whether 1) they should continue to "ride" momentum and the S&P 500 (which are showing signs of fatigue with mega market caps and technology-led selloffs), or 2) consider value stocks with attractive valuations that have been overlooked and oversold as a result of the growth decade. We believe prudent investors should maintain diversification in both styles to avoid chasing potential seismic changes as well as curtail risk and be in the position to gain throughout economic cycles which should smooth returns over time.

## Top Ten Holdings

AS OF JUNE 30, 2019

Name	% of Portfolio
1. Chevron Corp.	4.6
2. JPMorgan Chase & Co.	4.2
3. Cypress Semiconductor Corp.	4.2
4. Intercontinental Exchange Inc.	3.9
5. Citigroup Inc.	3.7
6. Gilead Sciences Inc.	3.6
7. MetLife Inc.	3.5
8. Cisco Systems Inc.	3.3
9. AT&T Inc.	3.2
10. Johnson Controls International PLC	3.2

Source: TCW. Based on a managed account model portfolio. Portfolio characteristics and holdings are subject to change at any time. It should not be assumed that an investment in the securities listed was, or will be, profitable.

This publication is for general information purposes only and is not intended to offer investment advice or be the basis for an investment decision. Nothing in this document constitutes an offer to sell or the solicitation of an offer to buy securities. Investing in any strategy has risks. An account is subject to price volatility. The value of an account's portfolio will change as the prices of its investments go up or down. Equity investments entail equity risk and price volatility risk. The value of stocks and other equity securities will change based on changes in a company's financial condition and in overall market and economic conditions. Before embarking on the described investment program, an investor should carefully consider the risks and suitability of the described strategy based on their own investment objectives and financial position. The strategy will not invest in initial public offerings. The processes described herein are illustrative only and are subject to change. The information contained herein may include estimates, projections and other "forward-looking statements." Actual events may differ substantially from those presented herein. TCW assumes no duty to update any such forward-looking statements or any other information or opinions in this document. TCW makes no representation that future investment performance will conform to past performance and it should never be assumed that past performance foretells future performance. TCW's portfolio managers make investment decisions based on various sources of information and analysis and are not necessarily based on the economic information set forth herein. All information is as of the date of this publication unless otherwise indicated.

Any opinions expressed are current only as of the time made; are subject to change without notice; are solely those of the author and do not represent the views of TCW as a firm or of any other portfolio manager or employee of TCW. TCW assumes no duty to update any such statements. Any holdings of a particular company or security discussed herein are under periodic review by the author and are subject to change at any time, without notice. In addition, TCW manages a number of separate strategies and portfolio managers in those strategies may have differing views or analysis with respect to a particular company, security or the economy than the views expressed herein.



## Representative Buys and Sells

### BUYS (Ticker; Sector)

#### McKesson Corp. (MCK; Healthcare)

McKesson is a leading medical distribution and healthcare information company. MCK operates through the following segments: U.S. Pharmaceutical and Specialty Solutions, European Pharmaceutical Solutions, and Medical-Surgical Solutions. The dominant U.S. Pharmaceutical and Specialty Solutions segment represents 80% of revenues and distributes pharmaceutical and other healthcare-related products and provides pharmaceutical solutions to pharmaceutical manufacturers in the U.S. The European Pharmaceutical Solutions segment provides distribution and services to wholesale, institutional, and retail customers and serves patients and consumers in 13 European countries. The Medical-Surgical Solutions segment focuses on medical-surgical supplies and provides logistics and other services to healthcare providers in the United States. The catalysts are new management, restructuring, and cost reduction. Brian Tyler, who had been MCK's COO, was promoted to CEO effective April 1, 2019. In April 2019, Mr. Tyler began a process of optimizing, restructuring, and repositioning MCK's business to improve revenue growth and profitability. Most recently, management increased the targeted annual cost saving from restructuring by \$100 million to \$400-500 million to be completed by the end of 2021. The company expects to meet and exceed this milestone through the repositioning and restructuring of its UK and European operations. Also key will be the continued successful execution of its medical supply business.

#### Ameriprise Financial, Inc. (AMP; Financials)

Ameriprise Financial sells life insurance products and wealth management services. The company also has over \$459 billion in assets under management and \$891 billion in total assets under administration. The primary catalyst is restructuring with a secondary catalyst of new products/new markets. Since it was spun-off from American Express in September of 2005, AMP has begun a steady transformation from predominantly a life insurance company to a formidable advice & wealth (A&W) management and asset management (AM) company. Among the more notable acquisitions have been H&R Block Financial Advisors and Columbia Asset Management. Of particular note, A&W has been especially robust, boasting 19% earnings growth in 2018 along with a healthy 22.4% pre-tax margins and double digit wrap account balance growth, while at the same time increasing advisory productivity by 10%. Management is investigating whether an AM joint venture would be feasible as Ameriprise has an impressive track record in cost cutting. Additionally, with recent approval from the Federal Reserve, Ameriprise is expected to launch a federal savings bank which could potentially provide net interest income from over \$3 billion of client cash.

### SELLS (Ticker; Sector)

#### State Street Corp. (STT; Financials)

State Street provides foreign exchange, custody, and shareholder services, as well as exchange traded funds and asset management. The company is on track to successfully executing the primary catalyst, restructuring/cost cutting, having realized most of the \$1.1 billion target of combined cost saves. Additionally, the acquisition and integration of Charles River Development (CRD) provides a differentiated new product that will incorporate an end-to-end risk and trading platform to trade execution and custody services. However, as its clients have faced significant fee pressure, it too is dealing with ongoing fee compression, as its revenues and assets under custody have continued to trend down. This headwind has caused margins to remain fairly static despite management progress on the cost front. We believe that while CRD synergies are likely to materialize, it will take time for the thesis to be played out. Despite its positive longer-term prospects and cost cutting achievements, the near-term macro pressures are deemed to be too material, and thus the position was sold.

Source: TCW

Note: Sector weights calculated as percent of equities.

Based on a managed account model portfolio. Portfolio characteristics and holdings are subject to change at any time. The investment strategy does not target any specific numbers or ranges for these characteristics. Accordingly, these characteristics can vary greatly. The estimates are forward-looking statements based on assumptions. This would include forward earnings estimates and growth rates, among other things, and all associated calculations, including projected price/earnings ratios. Actual results may vary materially from the estimates due to the numerous economic, financial and market conditions. There is no assurance that forecast estimates will be realized. The index is not available for direct investment; therefore its performance does not reflect a reduction for fees or expenses incurred in managing a portfolio. The securities in the index may be substantially different from those in the strategy.

Reflects up to the three largest buys (new buys) and up to the three largest sells (complete sells) for the quarter. There is no assurance that any securities discussed herein will remain in an account; be purchased in the portfolio at the time this report is received or that securities sold have not been repurchased. It should not be assumed that any of the securities transactions or holdings discussed were, or will prove to be, profitable or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein.

Russell 1000® Value: The Russell 1000® Value Index is representative of the U.S. market for large capitalization stocks containing those companies in the Russell 1000® Index with lower price-to-book ratios and lower forecasted growth.

London Stock Exchange Group plc and its group undertakings (collectively, the "LSE Group"). © LSE Group 2018. FTSE Russell is a trading name of certain of the LSE Group companies. Russell® is a trade mark(s) of the relevant LSE Group companies and is/are used by any other LSE Group company under license. All rights in the FTSE Russell indexes or data vest in the relevant LSE Group company which owns the index or the data. Neither LSE Group nor its licensors accept any liability for any errors or omissions in the indexes or data and no party may rely on any indexes or data contained in this communication. No further distribution of data from the LSE Group is permitted without the relevant LSE Group company's express written consent. The LSE Group does not promote, sponsor or endorse the content of this communication.

S&P 500: Widely regarded as the best single gauge of the U.S. equities market, this world-renowned index includes a representative sample of 500 leading companies in leading industries of the U.S. economy. Although the S&P 500 focuses on the large-cap segment of the market, with over 80% coverage of U.S. equities, it is also an ideal proxy for the total market.

## Portfolio Profile

AS OF JUNE 30, 2019

	TCW	S&P 500 Index	Russell 1000® Value Index
Number of Securities	45	505	722
Price-to-Cash Flow	8.8x	12.9x	10.1x
Price-to-Sales	1.5x	2.4x	1.8x
Price-to-Earnings Ratio Avg.–Next 12 Months	13.5x	17.0x	14.4x
Price-to-Book Value	1.9x	3.5x	2.2x
Projected EPS Growth-F2 Year (annualized)	10.0%	10.8%	9.5%
Dividend Yield	2.9%	2.0%	2.6%
Market Capitalization			
Average (\$ Wtd.)	\$110.8 bil	\$242.2 bil	\$129.5 bil
Average (Eq. Wtd.)	\$85.3 bil	\$53.0 bil	\$26.5 bil
Median	\$39.6 bil	\$22.7 bil	\$9.5 bil

## Sector Analysis

AS OF JUNE 30, 2019

