RS LARGE CAP VALUE STRATEGY QUARTERLY COMMENTARY

RS Investments®
A VICTORY CAPITAL® INVESTMENT FRANCHISE

As of September 30, 2019

Market Commentary

U.S. equity market performance was volatile during the third quarter of 2019, reflecting uncertainties regarding future global growth rates and trade negotiations, as well as an evolving monetary policy. Throughout it all, however, the broad Russell 3000® Index ended the third quarter relatively unchanged (at 1.16%). In early September, economic data alleviated concerns about the speed with which the U.S. economy was slowing. Improvement in long-term U.S. Treasury yields and the slope of the yield curve coincided with improvement in equities. Value-oriented stocks, as measured by the Russell 3000® Value Index, increased 1.23% during the quarter. Mid- and large-cap stocks outperformed small-cap stocks during the quarter, as measured by the Russell family of indices, a continuation of the trend seen in 2018.

Broader returns were mixed among U.S. equity styles, as large-cap stocks delivered positive returns, with the Russell 1000® Index returning 1.42%, while small-cap stocks disappointed with a -2.40% return for the Russell 2000® Index. The underperformance has been most pronounced during this cycle in value indices vs. growth, and small-cap vs. large-cap. Although in the third quarter value outperformed growth within small- and mid-caps (by 3.6% and 1.9%, respectively), the Russell 2000® Value Index now trades at its largest discount relative to the Russell 1000® Growth Index since the early 2000s. Since the end of 2016, the Russell 1000® Value Index has underperformed the Russell 1000® Growth Index by more than 1,000 bps annualized, something not seen since the late 1990s.

Looking ahead, we expect the Fed to "slow walk" interest rates lower, and we think there is a very low probability that a meaningful trade resolution will occur prior to the November 2020 elections. We wouldn't expect the Fed to get more aggressive with interest rates unless there was a significant disruption in the market. However, the relative strength in both the U.S. economy and labor market continues to be a safe haven for the rest of the world, and we would expect U.S. markets to continue to benefit from a positive flow of funds despite full valuations. Credit quality remains excellent, GDP growth is positive, most investment grade corporate balance sheets are in good shape, and the consumer is healthy for now.

Performance Review

For the three months ended September 30, 2019, the RS Large Cap Value strategy outperformed its benchmark Russell 1000® Value Index (the "Index") and returned 2.65% net versus a return of 1.36% for the Index.

In the third quarter, relative outperformance was the result of positive selection in Consumer Discretionary, Health Care, and Financials, partially offset by negative stock selection within Energy, Materials, and Consumer Staples. Allocation was not a meaningful driver in the quarter.

Investment Strategy

The RS Value Team seeks to invest in good companies, led by strong management teams, which are attractively valued. Our decision to invest in any company starts with business analysis and an understanding of the company's unit-level economics. Our work on unit-level economics helps us determine the quality and key drivers of the business. We are Return on Invested Capital (ROIC)–focused investors and seek to invest in companies that can create shareholder value due to an improvement in the returns of the existing assets or through attractive reinvestment opportunities. We are long-term investors who use our investment time horizon as a competitive advantage and are attracted to out-of-favor and/or misunderstood companies in the market.

The next step in our process is to assess the management team. Our evaluation of a company's management team is critical to our investment decision. We regularly meet with management to gauge how they think about their business: Are they focused on (and compensated for) growing earnings at any cost, or do they understand return on invested capital (ROIC) and how value is created? Additionally, we perform detailed historical analyses of management's capital decisions—looking at acquisitions, asset sales, and measures of capital stewardship. This analysis provides us with the conviction to invest with strong management teams that are able to navigate through short-term market volatility and deliver long-term shareholder value.

The final step in our analysis is valuation. To the RS Value Team, value investing is buying a business at a discount to what we believe it is actually worth. We determine what a company is worth by assessing a company's current share price versus its future cash flow streams or long-term net asset value based upon the management team's plan for value creation. ROIC is the lens through which we analyze that value creation. Our research has shown that, over time, stock price performance has a higher correlation to improving ROIC as opposed to traditional valuation measurements like price to earnings (P/E). We seek to invest in companies that can create shareholder value due to an improvement in the returns of the existing assets or through attractive reinvestment opportunities. We pay close attention to a company's financial strength, scrutinizing financial statements, and we run various financial models to understand our downside. This quantitative analysis gives us confidence in our investment thesis, and helps us determine at what stock price we are comfortable investing.

Select Position Review

Below, we review two businesses in an effort to use tangible examples to highlight our investment process.

Freeport-McMoRan (FCX) is one of the world's largest copper producing companies. During the third quarter of 2019, Freeport returned -17.2%, lagging the broad equity indices and its sector, as well as copper prices, which fell 4.6% during the quarter. Concerns about global GDP growth (and specifically, growth in China—the world's largest consumer of copper), amidst escalating tensions between the U.S. and China around trade and tariffs, caused

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sentiment on the shares to dramatically worsen during the quarter. While we acknowledge that it is difficult to prognosticate commodity price movements in the short run, we note that even in a very low-growth world, copper supply going forward is muted, owing to substantially constrained capital expenditures across the industry, as well as deteriorating ore grades and above-ground political/regulatory risk surrounding new projects. This suggests that, all else being equal, copper pricing needs to rise from current levels in order to accommodate increased investment given the cost curve and risk profile. In the meantime, Freeport's shares appear to us to be discounting copper prices below current spot prices. Our investment thesis, predicated on (i) profitable, measured reinvestment opportunities in Indonesia and the Americas; (ii) moderate improvement in ROICs; and (iii) numerous opportunities for value creation through capital deployment as free cash flow grows in 2020-22 (debt paydown, share repurchases, dividend growth), is unchanged. We also continue to believe the company possesses assets of strategic value and is a candidate for industry consolidation. We purchased additional shares during the quarter.

Aramark (ARMK) is a leading provider of institutional food, facilities, and uniform services. Client verticals include education, health care, sports & leisure, prisons, and business & industry. ARMK's business is characterized by very stable contracted demand and a highly variable cost structure which allows it to generate significant and stable free cash flows even in more difficult economic environments. Our thesis on ARMK is that with the addition of two recent tuck-in acquisitions the company has the opportunity to noticeably improve ROIC through meaningful margin expansion over the next few years. This opportunity, combined with the continued secular outsourcing trend of institutional food and facility services, will lead to earnings power for ARMK significantly higher than current levels looking out to 2020 and beyond.

ARMK stock is up nearly 50% in 2019, with a 20% return occurring in Q3. During this past summer, activist investor Mantle Ridge established a 20% economic stake in the company. Mantle Ridge has been very successful in past investments, notably their fairly recent involvement with Canadian railroad company CSX, where Mantle Ridge took a board seat, replaced management, and oversaw a successful operational improvement at the company leading to a doubling of CSX's share price. With Mantle Ridge's involvement, the market has refocused attention with respect to the operational improvement opportunity at ARMK and the stock has responded. With shares up 50% YTD, we've trimmed our position slightly as the risk asymmetry that existed at the end of last year has diminished. That being said, we still maintain a core position in ARMK as shares are still undervalued relative to the earnings potential of the company.

Outlook

After more than a decade of consistent underlying conditions for equity investing following the financial crisis, fundamentals are shifting. Economic growth is slowing, and macro concerns have given investors pause and led to a rerating of certain risk assets. Implications from the continuing trade war, a partially inverted yield curve, and the uncertainty regarding the 2020 presidential election cycle do not appear to be appropriately discounted. However, the U.S. economy remains relatively healthy and continues to be a global leader. The health of the consumer is currently solid and is a critical element to continued economic prosperity.

Interest and mortgage rates continue near historically low levels, having fallen by over 120 basis points from the October 2018 highs as inflation remains benign and home price appreciation moderates. Although we are clearly late in the economic cycle, and the odds of a further economic slowdown are increasing, we continue to think it is too early to be able to call a recession in the next 12 months. However, we remain very watchful of the current economic slowing and of any potential offsetting impacts from monetary or fiscal policy.

Investment-grade corporations have decent balance sheets and are currently producing acceptable free cash flows. We are carefully monitoring aggregate corporate debt levels (especially the BBB- debt, which is a single notch above junk status), which now sit above pre-2008 crisis levels. The 2018 corporate tax cuts and the ability to repatriate foreign cash holdings should continue to drive M&A activity and capital returns, including buybacks and dividends. Profit margins remain near all-time high levels, currently 11%, and look to be at some risk from higher wages and input costs.

In our estimation, equity valuations have quickly bounced back to elevated levels. During the last four months of 2018, we moved to the seventh decile from the tenth decile on trailing operating earnings, only to rebound back to the ninth decile. Equities look most reasonable when comparing earnings yields to Treasury or even high-grade corporate bond yields. In any case, the values inherent in your portfolio should attract acquirers and other investors over time. Meanwhile, we believe equities are a superior asset allocation alternative to bonds over the longer term.

We thank you, as always, for your support.

Sincerely,

RS Value Team

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Performance quoted represents past performance and does not guarantee future results. Investing involves risk, including the possible loss of principal and fluctuation of value. There is no assurance the investment process will lead to successful investing.

Returns are expressed in U.S. dollars. Composite returns are net of transaction costs and net of non-reclaimable withholding taxes, if any, and reflect the reinvestment of dividends and other earnings.

Gross-of-fees returns are presented before management and custodial fees but after all trading expenses. Net-of-fees returns are calculated by deducting one-twelfth of the highest tier of the standard fee schedule in effect for the period noted (the model fee). The composite model fee for each period is either the highest tier of the current fee schedule or a higher value, whichever is required to ensure the model composite net-of-fee return is lower than or equal to the composite net-of-fee return calculated using actual fees. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size. The firm's fees are available on request and may be found on Part II of its Form ADV.

Index returns are provided to represent the investment environment during the periods shown. The index is fully invested, including the reinvestment of dividends and capital gains. Index returns do not include transaction costs, management fees or other costs. Non-U.S. indices are net of withholding taxes, if any.

The opinions are those of the authors as of 2019 and are subject to change at any time due to changes in market or economic conditions. The comments should not be construed as a recommendation of individual holdings or market sectors, but as an illustration of broader themes.

Portfolio holdings are subject to change and should not be considered a recommendation to buy or sell individual securities. A complete list of all recommendations of security selection is available by request for the previous 12 months. Victory Capital Management Inc., and its affiliates, as agents for their clients, and any of its officers or employees, may have a beneficial interest or position in any of the securities mentioned, which may be contrary to any opinion or projection expressed in this report. This information should not be relied upon as research or investment advice regarding any security in particular.

The RS Large Cap Value Strategy primarily invests in a diversified portfolio of large-cap companies.

Information relating to portfolio holdings is based on the representative account in the composite and may vary for other accounts in the strategy due to asset size, client guidelines, and other factors. The representative account is believed to most closely reflect the current portfolio management style.

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