EQUITY INVESTMENT CORPORATION

2020 Third Quarter Commentary
Mid-Cap Value

October 2020

The stock market advanced for the second quarter in a row, though value indexes remain in negative territory year to date. Our Mid-Cap Value SMA (MCV) fell 1.1% gross* in the third quarter. In comparison, the Russell Midcap® Value Index (RMCV) gained 6.4%. Net of an assumed maximum annual 3% SMA fee, our MCV composite decreased 1.8%.[1]

Year to date, large-cap stocks have outperformed mid-caps, and mid-caps have outpaced small-caps. For instance, the Russell Top 200® Value Index declined 11.0%, while the RMCV dropped 12.8%, and the Russell 2000® Value Index fell 21.5%. Our MCV composite decreased 15.1% gross*, trailing the RMCV. Net of an assumed maximum annual 3% SMA fee, our MCV composite declined 17.1%.

Investment Environment: Is 2020 the permanent state of affairs?

The five largest names in the S&P 500® Index (Apple, Microsoft, Amazon, Google, and Facebook) are all up strongly this year. As a result, these five stocks now account for nearly 23% of the total index weight, a level that surpasses the index concentration in the tech-bubble and approaches levels not seen since the 1960s and '70s.[2] Meanwhile, in the broader Russell 3000® Index, the median stock is still down 15% year to date and down nearly 30% from its 52-week high.[3]

While value stocks outperformed growth stocks during September, they remain deeply out of favor compared to growth. In fact, looking at over 25 years of style data, value stocks posted their worst relative performance ever in the year ended August 2020 when the Russell 3000® Growth Index (R3000G) rose 42.6% versus just a 0.4% increase for the Russell 3000® Value Index (R3000V), a stunning 42.4% spread. For perspective, in the year ended February 2000, at the tech bubble's height, the largest spread occurred when the R3000G gained 35.1% versus a decline of 2.3% for the R3000V.[4]

Relative to value, the majority of growth's outperformance this year, and indeed over the past few years, has come from multiple expansion rather than improving fundamentals. As seen in the following chart, growth stocks are now nearly as expensive as they were at the tech bubble's top in 2000. Value stocks, meanwhile, trade roughly in line with historical average valuations and more cheaply than during the tech bubble. Thus, the spread or premium paid for growth over value is even closer to the tech-bubble peak when measured in relative terms.

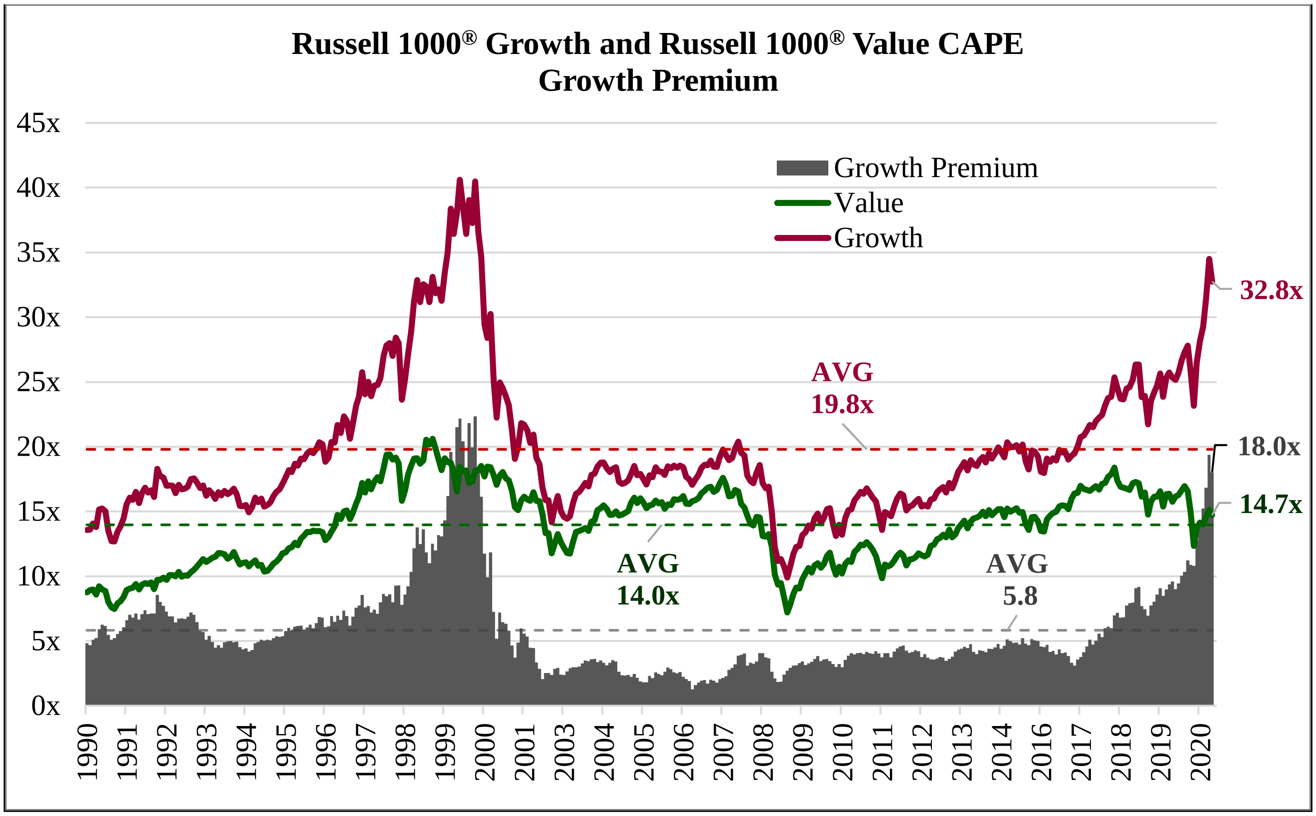

Chart 1 Data Source: S&P Global Intelligence. See footnote 5.

While we have discussed the richness of the growth universe and the relative attractiveness of value for several years now, the 2020 market environment's unique nature has only exacerbated those trends. The uncertainty and novelty of the COVID-19 pandemic introduced a deeply bifurcated market of haves and have nots. Any companies that have facilitated remote work or remain open and service consumer demand saw their share prices soar. Conversely, any sectors or companies directly impacted by COVID-19 related closures or demand curtailment were punished. This divergence has cut across traditional sector lines, with some stocks previously thought of as safe faring poorly this year. In contrast, amid one of the deepest recessions on record in terms of unemployment and Gross Domestic Product (GDP) declines, several deeply cyclical discretionary and technology names have been safe havens.

Against this backdrop of extreme stock market winners and losers, there is increasing evidence that the economy is bouncing back. While the rebound is uneven and businesses most directly affected by COVID-19 (e.g., restaurant dining and air travel) remain significantly depressed, manufacturing, employment, new business creation, and consumer sentiment all point to economic recovery. Some businesses, such as housing and other big-ticket consumer discretionary categories, are quite strong, providing fuel to the rebound and supporting the idea that the consumer is healthier than was feared in March and in much better shape than in 2008. While COVID-19 has accelerated several pre-existing trends, and some of its consequences will persist, a crucial implication of the emerging recovery is that business activity should revert toward pre-pandemic norms. In contrast, the market is pricing in a continuation of this year's unusual trends.

A longer-term look at value

It may seem that underperformance of the magnitude experienced by value stocks over the last few years has an air of permanence to it, but it's worth looking at the historical record, as seen in the next chart.

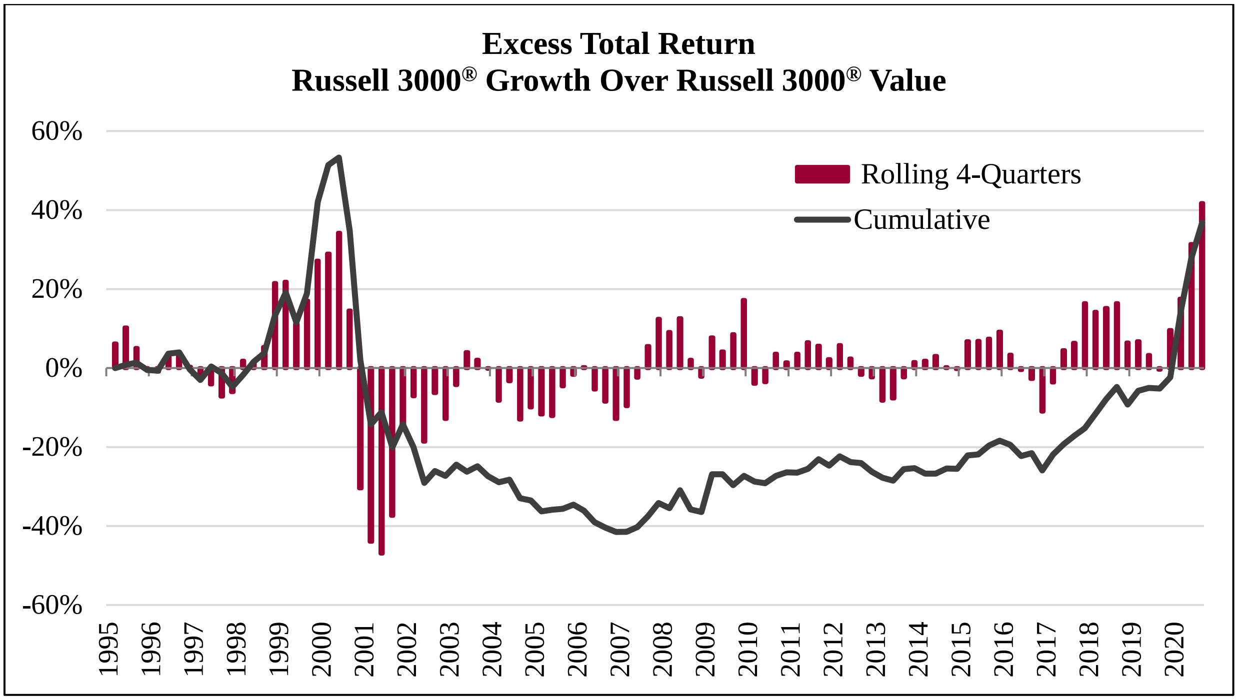

Chart 2 Data Source: S&P Global Market Intelligence. See footnote 6.

For most of the mid-1990s, the performance of growth and value stocks was neck and neck. In 1998, growth started to pull away, propelled higher in 1999, peaked in 2000, and just as quickly fell back to earth in terms of performance parity with value. But then, because of a combination of modestly disappointing fundamentals, still elevated valuations, and a lack of momentum, growth continued to underperform value until bottoming in 2007. Growth started outperforming value from that point forward, although it has only been in 2020 that growth has pulled even with and surpassed value's longer-term performance. Even with this year's incredible performance spread, growth has *still* underperformed value from the market's peak in 2000.[7]

Our view of the superiority of value from current starting levels is not just a simplistic call for mean reversion of valuations, though that has happened in the past and would favor value. Rather, a cheaper entry price increases an investor's odds of outperformance, even accounting for higher earnings growth in the growth-stock universe. Our research shows that, whether a value or a growth stock, the majority of company earnings are used for either dividends or share buybacks. The lower a price an investor pays for today's earnings, the better the total return on that investment in either increased dividend yield or higher earnings per share (EPS) growth due to more significant share buybacks at lower prices.

Undoubtedly, there will continue to be individual winners in the growth space. But for the performance math to collectively work for growth stocks from here, they will need to further expand multiples or deliver higher long-term earnings growth than they have historically generated, an observation that we think is lost on most investors. We cannot predict how far the growth-value divergence will reach or when and how it will correct. However, at current levels, we believe that value stocks offer reasonable future returns, while growth stocks are priced for minimal forward returns or worse. In short, the odds have shifted dramatically in favor of value.

Portfolio Positioning[8]

We initiated one new purchase during the quarter and completed a few trims and adds, all with the idea of reducing exposure to stocks with overly optimistic valuations while increasing exposure to cheaper but still high-quality stocks. With this in mind, we added to Discovery Inc., Ingredion, and MSC Industrial, while trimming PPG Industries and T. Rowe Price.

In September, we purchased a 2.5% position in Walgreens Boots Alliance (WBA). WBA operates the largest retail pharmacy network in the United States (US) and worldwide. Within the US, where WBA earns the bulk of its consolidated profit, the company has approximately a 21% share of retail prescriptions dispensed. WBA also owns a 28% stake in AmerisourceBergen (ABC), another EIC holding. In recent years, WBA has struggled with margin pressure, which has driven adjusted profit down by about 35% since 2018. Pharmacy benefit manager consolidation and public pressure to reduce drug prices have led to a persistent decline in reimbursement rates passed on to retail pharmacies. More recently, increased price transparency on retail goods and de-emphasis of tobacco products have weighed on high-margin sales in the front of the store. While we expect reimbursement pressures to persist, there are signs of stabilization in the convenience store business. In our view, the good news is that there is little evidence of pharmacy traffic degradation, and the company continues to consistently grow revenue. With the stock currently trading at a price multiple of roughly 7.5x expected 2020 EPS (or 6.7x excluding its ABC stake), the market is pricing in a perpetual decline in earnings power going forward. We think WBA presents an attractive risk-reward tradeoff at this price.

Turning to sales, we completely sold out of our position in Mohawk Industries when a recent lawsuit alleging accounting impropriety reduced our confidence in its earnings and management quality. We also sold Target based on valuation, as its market capitalization exceeded the guideline for our mid-cap portfolio.

We continue to see significant value in financials today, and they remain our largest sector weighting at slightly over 34% at quarter-end. As we are always mindful of risk, it's worth noting that this weight is only roughly 6% higher than our average weighting since inception and below our all-time high weighting of 36.5%. Through year-end 2019, the financial sector broadly kept pace with the S&P 500 over the past five years and only modestly underperformed over the past ten years, despite persistently low interest rates and the fact that growth stocks outperformed value for both periods.[9] However, this year, banks, which represent nearly half of our financial weighting, have been hit with the double whammy of COVID-19 recessionary fears and low interest rates. The sudden and rapid rise in unemployment along with second-quarter declines in GDP necessitated a sharp and sizeable increase in loss provisioning by banks, depressing or eliminating near-term earnings, and prompting investors to worry, pricing them as if they would repeat their performance of the financial crisis.

But the reality is that banks today are in substantially better shape than in 2008. Leverage is lower, and asset quality is higher. While there are COVID-19 related trouble spots, no category or sector individually or cumulatively represents the magnitude of loan problems faced by banks in 2008. All of our bank holdings recently passed a 2020 Federal Reserve mandated stress test that considered conditions directionally similar to the financial crisis, without requiring capital raises nor considering any government stimulus. Since that test, we have had two rounds of stimulus (with more likely on the way), and economic conditions continue to improve. Moreover, comments from CEOs and CFOs at our banks have been positive about the outlook for loss provisioning and capital returns. While low interest rates remain a headwind, all of our banks have significant non-interest income components. Today's low valuations on banks do not anticipate or even require rising interest rates for the stocks to generate good returns to investors going forward.

At quarter-end, our representative portfolio continued to have attractive characteristics – it traded at an average price-to-earnings ratio of 15.8x, generated an 8.1% return on equity,[10] paid a 3.6% dividend yield, and carried an average credit rating of BBB to BBB+.[11]

As always, we thank you for your business and your partnership with EIC.

Investment Team

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Please see disclosures on the following page.

[1]*EIC's MCV results are those of our Mid-Cap Value SMA composite gross* (before) and net (after) assumed maximum annual SMA fees of 3% (0.25% per month). SMA fees include transaction costs, portfolio management, custody, and other administrative fees. *Gross returns for EIC SMA composites are "pure" gross returns, do not reflect the deduction of any expenses, including trading costs, and are presented as supplemental information to the full disclosure presentations, which are considered an integral part of this report. All returns include reinvestment of dividends and interest. Indexes are unmanaged, do not incur management fees, costs or expenses, and cannot be invested in directly. Past performance is not indicative of future results.* ***Individual account results may differ from those of a composite. Client net returns are reduced by EIC's management fees or may possibly be reduced by brokerage firm wrap fees, which include transaction costs, portfolio management, custody, and other administrative fees.***

[2]*Source; Markowicz, Sean, "Big Tech's market might in five charts." 16 September 2020. https://www.schroders.com/en/insights/economics/big-techs-market-might-in-five-charts/. 29 September 2020.*

[3]*Data Source: S&P Global Market Intelligence, Russell 3000 Index constituents. Median value of YTD % change from 12/31/2019 to 9/30/2020 closing prices, % change of 9/30/2020 closing price from 52-week high.*

[4]*Data Source: S&P Global Market Intelligence, Russell 3000 Growth Index, Russell 3000 Value Index. Rolling 12-month returns from 1/31/1995 through 9/30/2020, ranking by excess return of growth index over value index.*

[5]*Russell 1000 Growth modified CAPE (green line), Russell 1000 Value modified CAPE (red line), Russell 1000 Growth modified CAPE premium over Russell 1000 Value modified CAPE (gray area) for each month-end from 1/31/1990 to 9/30/2020. Modified CAPE (Cyclically Adjusted Price-to-Earnings) is the ratio of index prices to trailing 10-year average index level earnings before taxes (EBT) calculated on a time-weighted basis. Annual index level EBT is imputed by dividing the year-end index price by an aggregated price to EBT multiple of index constituents.*

[6]*Data Source: S&P Global Market Intelligence, Russell 3000 Growth Index, Russell 3000 Value Index. Rolling 4-quarter returns from 3/31/1995 to 9/30/2020, excess return of growth index over value index (red bars), cumulative excess return of growth index over value index (gray line).*

[7]*Data Source: S&P Global Market Intelligence, Russell 3000 Growth Index, Russell 3000 Value Index. Rolling 12-month returns from 2/29/2000 through 9/30/2020.*

[8]*Portfolio data is from representative Mid-Cap Value accounts. Actual portfolio holdings may vary for each client, and there is no guarantee that a particular client's account, "wrap", or advisory program will hold any, or all, of the securities identified. The securities identified and described above do not represent all of the securities purchased, sold, or recommended for client accounts. The reader should not assume that an investment in the securities identified was or will be profitable.*

[9]*Data Source: Yahoo! Finance, Financial Select Sector SPDR Fund (XLF), S&P 500 Index (S&P 500). Total return for five and ten years ended 12/31/2019.*

[10]*Data Source: Morningstar Direct[SM]. Weighted average trailing twelve month P/E and ROE of the representative All-Cap Value and Large-Cap Value accounts at 9/30/2020. The price-earnings ratio (P/E) relates a company's share price to its earnings per share. Return on equity (ROE) is calculated by dividing a company's net income by its shareholders' equity. ROE is considered a measure of how effectively management is using a company's assets to create profits.*

[11]*Data Source: S&P Global Market Intelligence as of 9/30/2020. The rating provided is the weighted average of credit-quality ratings on the underlying securities within the representative Mid-Cap Value portfolios and not the portfolios themselves. Credit-quality ratings represent Standard & Poor's opinion as to the quality of the securities they rate. The ratings range from AAA (extremely strong capacity to meet its financial commitments) to D (in default). Ratings are relative and subjective and are not absolute standards of quality.*

Equity Investment Corporation (EIC) is an SEC registered independent investment advisor incorporated in the state of Georgia. EIC was founded in 1986. Effective September 30, 2016, substantially all of the assets and liabilities of the firm were acquired by three members of the investment team who collectively have more than 40 years of experience at EIC. Accounts continue to be managed using the same investment process, and the firm continues to operate as EIC. Performance numbers are the value-weighted, time-weighted, total return composite results of fully discretionary Mid-Cap Value wrap (SMA) accounts. The strategy invests in high-quality, well-managed mid-cap companies, while at the same time avoiding those that look inexpensive relative to their historical record but are actually in structural decline. Prior to January 1, 2013, the composite was called the Mid-Cap Value Wrap Composite. Returns are generally presented net of foreign withholding taxes on dividends, interest income, and capital gains; however, returns for some accounts are presented gross of foreign taxes depending on the treatment by their custodian. All accounts included in the composite are managed according to similar investment guidelines. The composite creation date is January 1, 2004, and SMA accounts comprise 100% of the composite. Performance includes reinvestment of dividends, and EIC's returns also include interest earned on cash. The benchmark index is the Russell Midcap® Value Index (which excludes an advisory fee), and was chosen because it is representative of the composite's investment style. The Russell Midcap® Value Index measures the performance of the mid-cap value segment of the US equity universe. It is a subset of the Russell Midcap® Index and includes approximately 800 of the Russell 1000® companies with lower price-to-book ratios and lower expected long-term mean earnings growth rates.

									Advisory-Only (UMA) and Managed Assets		
Year Ended Dec - 31	Gross* Rate of Return[1] (Supplemental)	Hypothetical 3% annual Net Rate of Return[1]	Benchmark Return of Russell Midcap® Value Index	Composite 3-Yr St Dev	Benchmark 3-Yr St Dev	Dispersion[2] of Annual Returns (St Dev)	Number of Portfolios	Composite Assets ($ Millions)	UMA Assets[3] ($ Millions) (Supplemental)	GIPS® Firm Assets ($ Millions)	Total Assets[3] ($ Millions) (Supplemental)
2020 (through 9/30)	-15.1%	-17.1%	-12.8%	16.4%	21.1%	0.6%	11	$1.9	$1,537.8	$1,524.4	$3,062.2
2019	18.3%	14.9%	27.1%	9.4%	12.8%	0.7%	22	$5.5	$1,942.4	$2,245.1	$4,187.5
2018	-6.4%	-9.2%	-12.3%	8.4%	12.0%	0.7%	21	$4.7	$1,721.0	$2,219.9	$3,940.9
2017	12.6%	9.3%	13.3%	7.5%	10.3%	1.0%	20	$5.4	$2,044.9	$2,790.7	$4,835.6
2016	16.6%	13.2%	20.0%	8.4%	11.3%	1.0%	15	$4.3	$2,044.5	$2,994.4	$5,038.9
2015	-2.1%	-5.0%	-4.8%	8.9%	10.7%	1.0%	9	$2.3	$1,590.0	$3,658.9	$5,248.9
2014	15.2%	11.8%	14.8%	8.9%	9.8%	N/A	5	$1.8	$1,657.7	$3,862.6	$5,520.3
2013	33.6%	29.7%	33.5%	10.5%	13.7%	N/A	3	$1.1	$1,009.2	$3,286.3	$4,295.5
2012	11.3%	8.0%	18.5%	10.7%	16.8%	N/A	3	$0.9	$665.6	$2,301.1	$2,966.7
2011	5.3%	2.2%	-1.4%	15.3%	22.8%	N/A	1	$0.2	$314.5	$1,127.9	$1,442.5
2010	22.8%	19.3%	24.8%	17.9%	27.1%	0.4%	7	$1.7	$77.9	$836.9	$914.8
2009	28.1%	24.4%	34.2%	17.6%	25.0%	0.9%	8	$1.5	$10.5	$541.2	$551.8
2008	-20.4%	-22.8%	-38.4%	13.0%	18.7%	1.2%	11	$1.7	$0.0	$362.6	$362.6
2007	4.4%	1.3%	-1.4%	8.3%	9.1%	0.7%	16	$3.2	$0.0	$448.1	$448.1
2006	12.2%	8.9%	20.2%	7.3%	8.7%	0.5%	20	$6.6	$0.0	$487.2	$487.2
2005	6.0%	2.9%	12.7%	N/A	N/A	0.8%	29	$8.6	$0.0	$463.6	$463.6
2004	19.8%	16.3%	23.7%	N/A	N/A	N/A	32	$10.5	$0.0	$388.1	$388.1

[1] *Gross returns, presented as supplemental information, are "pure" gross and do not reflect the deduction of any expenses, including trading costs, for SMA accounts. Net returns are calculated by reducing gross returns with an annual SMA fee of 3.0% (0.25%/month).

[2] Dispersion is an asset-weighted standard deviation for the accounts in the composite the entire year (or year-to-date). "N/A" represents when dispersion is not statistically meaningful due to an insufficient number of portfolios in the composite for the entire year.

[3] "Total Assets" include our regulatory assets under management ("GIPS® Firm Assets") and our advisory-only "UMA Assets". EIC has no trading discretion for UMA accounts and provides a model portfolio to the program sponsor or overlay manager. The "UMA Assets" and "Total Assets" amounts are shown as supplemental information.

Additional Notes: The three year annualized standard deviation measures variability of the composite and the benchmark returns over the preceding 36 month period.

See next page for additional disclosures

Performance has been measured on a monthly basis from January 1, 2004, to present. Periods are geometrically linked to obtain the quarterly and annual results. Eligible new accounts are added to the composite at the beginning of the first full quarter under EIC management. Trade date accounting with monthly valuations and adjustments for large cash flows are used. Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. The US Dollar is the currency used to express performance. Returns include the reinvestment of all income. There are no non-fee paying accounts. Economic and market conditions have differed over the time period displayed, and likewise will be different in the future. Policies for valuing portfolios, calculating performance and preparing compliant presentations are available upon request.

EIC claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS® standards. EIC has been independently verified for the periods January 1, 1986, through June 30, 2020. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS® standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS® standards. Verification does not ensure the accuracy of any specific composite presentation. The verification reports, as well as a complete list and description of all the firm's composites, are available upon request by contacting Equity Investment Corporation, 1776 Peachtree Street NW, Suite 600S, Atlanta, GA 30309. Prospective clients should be aware that results are historical and do not imply future rates of return or volatility for EIC or the indices, which may be materially different from the past and from each other.

Investment management fees are based on market values of the assets under management. In addition to a management fee, some accounts pay an all-inclusive fee based on a percentage of assets under management. Other than brokerage commissions, this fee includes portfolio monitoring, consulting services, and in some cases, custodial services. EIC's maximum annual fees for SMA accounts (charged quarterly) are 0.75%. Total fees charged may equal 3% per year. SMA schedules are provided by independent SMA sponsors and are available upon request from the individual sponsor. Further information about fees and compensation is discussed in EIC's form ADV Part 2 (www.adviserinfo.sec.gov).

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