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Small Cap Value – Trailing three-year commentary (12/31/18)

Summary Attribution Commentary

- For the three-year period ending December 31, 2018, the American Beacon Small Cap Value Fund (Institutional Class) returned 5.13% versus the Russell 2000 Value Index (“R2V”) return of 7.37% for the same period.
- Over the period, stock selection was the primary detractor for the Fund which was slightly offset by a positive contribution from sector allocation.
- From a stock selection standpoint, the worst sectors were Industrials, Materials, and Consumer Discretionary. On the positive side, Information Technology and Real Estate selection added value relative to the Index.
- From a sector allocation standpoint, overweighting the Information Technology sector contributed positively to returns. Also, a meaningful underweight to the Real Estate sector added value. On the other hand, allocation to the Energy sector detracted value over the period as it was the worst performing sector in the Index as did an underweight to the Utilities sector, the best performing sector in the Index.

Additional Talking Points

- Looking back over the three-year period the beginning of the measurement period was the first half of 2016 when rates were low before the Fed hiked rates substantially, and investors were chasing yield. Performance wise higher yielding defensive “bond proxy” sectors dominated. The R2V was up around 6% in the first six months of 2016 and was driven by the sectors which we often refer to as the “RUST” sectors – Real Estate, Utilities, Staples and Telecom. During this period Utilities were up ~24%, Real Estate was up ~15%, and Consumer Staples were up ~21%, all of which the Fund was underweight. As a result, the Fund trailed the benchmark by approximately 2.4% in the first six months of the period.
- A flight to these RUST sectors also occurred during the final 9 months of the three-year period but this time it was driven by macro fears in the market – trade tariffs, BREXIT, rate hikes, and recessionary concerns grabbed the headlines. This was particularly pronounced during 4Q18 when equity markets sold off significantly, and small caps were not immune. The R2V was down almost 19% and the Fund was down nearly 21%. Over this period the top performing sectors in the Index again were the RUST sectors - Utilities down 2%, Consumer Staples and Real Estate both down a little over 14%.
- The Small Cap Value Fund is typically underweighted to Utilities. As a whole, the underlying stocks in the sector given the nature of their business models, add in the fact they are highly regulated and profitability is controlled by regulators do not typically have promising growth prospects, and thus do not fit well with the Equilibrium Time Analysis (“ETA”) model that we use to hire and monitor our

sub-advisors. Over the three-year period Utilities were the top performing sector within the R2V (up 13.3%) and the Fund averaged a 3.8% underweight to the benchmark detracting 14 basis points from relative returns. In periods where Utilities lead the market this will be a natural headwind to the portfolio that we do not believe will persist over longer periods of time.

- Looking at the SCV Fund three-year relative returns, bookend style headwinds caused performance to trail the benchmark. That said, the Fund was still in the upper half of its peer group for three years (47th percentile in Morningstar).
- While we normally don't focus on such short-term periods, 2019 is off to a good start. Through January 30th the Fund is up 11.52%, ahead of the R2V by 1.19% and ahead of the Morningstar peer group by 0.52%.
- Importantly, over three-year rolling periods the American Small Cap Value Fund has outperformed its Morningstar peer group **90%** of the time over the course of twenty years.
- As mentioned above in the summary attribution, stock selection was the biggest detractor for the Fund over the period. The largest detractors were selection in the Industrials, Materials, and Consumer Discretionary sectors. The best sector for stock selection was Information Technology.

Sector	Average Weight (3 year)	Fund Performance (3 Year Annualized)	Benchmark Performance (3 Year Annualized)	Relative Impact
Industrials	20.0%	9.54%	12.25%	-52 bps
Materials	5.5%	2.77%	12.16%	-45 bps
Consumer Discretionary	13.8%	0.51%	3.67%	-44 bps
Information Technology	14.6%	12.69%	10.98%	+17 bps