Small Cap Value Equity
Quarterly Commentary

The year 2015 was not a banner year for investors, particularly those who employ the value style. While the market registered slightly down for the year, it gave the outward appearance of relatively good behavior. However, below the surface, there were far more stocks down than up. Breadth has consolidated, and most stocks are down far more than the benchmark suggests.

Commodities of all sorts and flavors suffered for most of the year. The strong dollar was a key driver, causing pain for any U.S. company with international business and any countries with economies dominated by commodities. Add to the mix, slowing economies in China and emerging markets, and a lack of growth from Europe and Asia, and suddenly commodities became the poster child for what not to own.

Other sectors declined along with commodities. Industrials and materials—which are also acutely affected by the strong dollar and weak commodities complex—were also impacted negatively. Essentially, down pricing in commodities is having a ripple effect throughout the industrial sector. For instance, a heavy equipment manufacturer—the largest as defined by revenues—has not had three years of down revenues since the 1930s. If revenues contract again in 2016, it will mark the first time in its history that this manufacturer has posted declining revenues for four consecutive years.

For the fourth quarter, the Brandywine Global Small Cap Value Equity strategy composite returned -1.31% for the quarter on a gross-of-fees basis (-2.04% net), while the benchmark returned 2.88%. When we look back at the fourth quarter of 2015—and the year for that matter—much of the decline in performance is due to this direct or indirect exposure to commodities. When we examine the causes of the underperformance for the quarter, and ultimately the year, it comes down to four stocks: an energy services company, a retailer, a packaging company, and a technology company. We no longer hold the energy and technology companies, and we reduced allocations to the packing company and retailer to more appropriate weightings given the risks we see in their businesses. The natural next questions are: what happened and why are we selling these now?

Our process has been and remains grounded in our proprietary research and stock selection process. We focus on businesses with strong cash flow generation and balance sheets that can weather any storm. The energy services company is a business with real assets, but a capital structure that is ultimately dependent upon the willingness of the capital markets to fund their business. With high yield and equity funding closed to many businesses involved with energy this quarter, the weakness of this business model became apparent. When the company unexpectedly cut its dividend—which was being funded by indirect equity issuances at their subsidiaries—the stock fell 60% in a single day, closing down 75% for the quarter. Unfortunately, without improved capital markets to fund their operations, the equity value is uncertain.

Our collaborative, transparent process that challenges security research and buy/sell decisions is core to what has worked well in this strategy's past, and is employed successfully in other equity strategies at the firm today. With renewed focus on our communication and decision-making, the portfolio managers have made strategy adjustments, including selling or reducing these four names—not because they were poor performers—but rather because we did not believe the potential reward, even at lower prices, outweighed the risk. The packaging company and retailer remain in the accounts simply because their prices have fallen to a level that their valuations are now appealing, but at much smaller weights.

As we look ahead, the market appears to be nervous, and there are forecasters who are calling for a recession. We do not believe that we can forecast correctly all of the time—or even some of the time— so we will leave that to others. However, we now see stocks priced as if we are already in a recession. Without a doubt, negative sentiment abounds. But the fact remains that markets have fallen 20% or more from highs of the recent past—a typical bear market definition—without the economy hitting a recession. Moreover, if there is indeed a recession, it will not be identified until well after the fact. If we are in a slowdown, what if it is similar to 1990-91, which set up the best buying opportunity for the next decade? Fortunately for our clients, we believe this scenario is exactly the type of environment where we do our best work. We are trained to look at a business not over the next quarter, but over the next few years. By expanding the scope beyond the near term, the value of a

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business looks much different, and short-term price declines suddenly become obvious long-term buying opportunities. That is where we are today.

It may not surprise you that we are actively buying stocks today that are down 70% from their peak. Aside from attractive valuations, the other characteristics that our recent additions have in common are strong balance sheets and companies that produce cash, even in a downturn. We do not seek to manage risk by being better forecasters than the next manager. We manage risk by being very diligent with respect to the balance sheet and thoroughly understanding the cash flows of the business we are acquiring.

Because we have no view on when oil prices may rise—or the prices of other commodities for that matter—we want to make sure we invest in companies that we believe are likely to be survivors regardless of commodity price movements. This is how we manage risk. When you have companies all around you in your particular industry that are over-leveraged, losing money, and barely maintaining solvency, the best thing you can do is control costs and focus on cash generation. Not having to worry about interest expenses, debt payments, or refinancing debt provides the potential for a significant financial advantage over competitors. Companies with no debt rarely go bankrupt. In situations like this, we are quite comfortable with the macro pressures, as this environment will give the businesses that we invest in an opportunity to gain market share. We are not investing today for returns tomorrow. We are investing today for returns 2-3 years from today.

We are excited by what we see. Many stocks are on sale, especially businesses with economic cyclicality. We are focusing on new ideas that we believe have good potential upside based on a conservative estimate of earnings power, balance sheets that can withstand a downturn, and a significant margin of safety in their share price.

A quick examination of a couple of the top 10 holdings in the strategy highlights why we are so enthusiastic about the opportunities provided by the market today.

A company that sells equipment in what is considered the back end of a semi-cap equipment process is currently the top holding in the strategy. Its product is a wire bonder that binds a semiconductor chip produced at its foundry to the base of a device. This business has every characteristic we hold dear: strong cash generation, a leading competitive position, double-digit returns on capital in good times, and a rock solid balance sheet with over $7/share of cash and zero debt. At $10, the market is barely putting a value on the business. In the next replacement cycle, we believe the company should achieve anywhere from $1 to $2 per share in earnings. Unless a business is burning through cash, it is irrational for its stock to trade below the cash it has in the bank. Assuming fundamentals do not erode—which is something we do not expect—$7 is what our analysis concludes our downside limit to be. The stock should move higher when the cycle turns favorable again and the company becomes active deploying its excess capital to shareholders in the form of a dividend or buyback, or if someone buys the business at a notable premium. We believe the asset value plus earnings potential warrant a share price significantly higher than $10.

A department store chain with 275 stores located primarily in the Midwest and the South is trading at a very attractive valuation, largely due to the macro retail environment and the company's exposure to Texas, which is feeling pressure from low oil prices. Revenues are approximately $7 billion and the company has a small amount of debt to cover inventory for the holiday season, but otherwise operates debt free. The retailer owns a vast majority of its real estate, has large insider ownership, and thinks like rational owners. Importantly, it generates a lot of free cash flow that it uses to buy back stock. Over the last six years, the company has repurchased $2.1 billion worth of stock. The current market cap is $2.2 billion, which we believe is exceptionally attractive given the company's cash flow characteristics and safe balance sheet.

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ANNUALIZED RETURNS (%) (Results shown in USD)

	Gross	Net	R2000V	R2000
QTD	- 1.28	- 1.52	2.88	3.59
YTD	- 12.06	- 12.95	- 7.47	- 4.41
1 Year	- 12.06	- 12.95	- 7.47	- 4.41
3 Year	6.30	5.25	9.06	11.65
5 Year	7.30	6.24	7.67	9.18
7 Year	13.94	12.82	11.72	14.00
10 Year	6.68	5.62	5.57	6.80
Since Inception	11.89	10.79	9.08	7.77

Inception Date: 10/1/1996

GIPS INFORMATION (%, Unless Otherwise Noted) (Results shown in USD)

	Gross	Net	R2000V	R2000	# of Accounts	Market Value (M)	Total Firm Assets (M)	Composite Dispersion	Composite Rolling 3Y SD	R2000V Rolling 3Y SD	R2000 Rolling 3Y SD
2015	- 12.06	- 12.95	- 7.47	- 4.41	19	566	68,819	0.17	12.30	13.46	13.96
2014	2.29	1.27	4.22	4.89	19	695	63,375	0.09	11.04	12.79	13.12
2013	33.52	32.23	34.52	38.82	13	468	50,050	0.25	13.31	15.82	16.45
2012	18.21	17.05	18.05	16.35	13	492	42,894	0.13	15.82	19.89	20.20
2011	0.22	- 0.78	- 5.50	- 4.18	12	372	33,122	0.19	20.03	26.05	24.99
2010	23.82	22.62	24.50	26.86	14	572	31,996	0.27	24.08	28.37	27.69
2009	41.56	40.20	20.58	27.16	14	516	29,199	0.40	22.86	25.62	24.83
2008	- 29.51	- 30.23	- 28.93	- 33.79	14	378	32,755	0.67	18.74	19.14	19.85
2007	- 9.66	- 10.56	- 9.78	- 1.57	15	565	49,208	0.38	12.84	12.59	13.16
2006	20.18	19.00	23.48	18.36	12	497	39,241	0.41	11.83	12.33	13.75
2005	5.18	4.14	4.71	4.56	13	495	26,332	0.59	13.40	14.09	15.09

R2000V = Russell 2000® Value Index R2000 = Russell 2000® Index

Organization: Brandywine Global Investment Management, LLC (the "Firm") is a wholly owned, independently operated, subsidiary of Legg Mason, Inc. The Firm has prepared and presented this report in compliance with the Global Investment Performance Standards (GIPS). For the periods July 1, 2000 through June 30, 2014, the Firm has been verified by Kreischer Miller. A verification includes assessing whether the Firm (1) complied with the composite construction requirements of the GIPS standards on a firm-wide basis, and (2) designed its processes and procedures to calculate and present performance results in compliance with the GIPS standards. A copy of the verification report is available upon request. Disclosed total firm assets represent the total market value of all discretionary and nondiscretionary, fee-paying and non-fee-paying assets under the Firm's management. Composite Description: The Institutional Small Cap Value Equity Composite (the "Composite") inception date is October 1, 1996 and the Composite creation date is October 1, 1996. The Composite includes separate, fully discretionary, fee-paying accounts with no minimum value requirement and no investment restrictions invested in the firm's Small Cap Value Equity strategy. The strategy invests in small capitalization stocks (typically consistent with the capitalization range of the Russell 2000 Index) that are, in the portfolio team's opinion, inexpensive relative to the company's intrinsic value and results in approximately 60 - 90 positions. Benchmark: The Russell 2000 Value Index measures the performance of those Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values.The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index Performance Calculation: Preliminary data, if so noted, reflects unreconciled data for the most recent reporting period. Portfolios are valued daily on a trade date basis and include dividends and interest as well as all realized and unrealized capital gains and losses. Return calculations at the portfolio level are time-weighted to account for periodic contributions and withdrawals. Performance results are calculated on a before tax, total return basis. Prior to July 1, 2007, portfolios were included in the Composite beginning with the first full quarter of performance through the last full quarter of performance. After July 1, 2007, portfolios are included in the Composite beginning with the first full month of performance through the last full month of performance. Composite returns are reported on quarterly basis. The Composite returns consist of size-weighted portfolio returns using beginning of period values to weight the portfolio returns. Monthly linking of interim performance results is used to calculate quarterly and annual returns. Composite's valuations and returns are computed in U.S. Dollars ("USD"). The results are presented in USD or in other currencies (to accommodate overseas investors), the latter by converting monthly USD returns into other currency returns using the appropriate currency exchange rate returns. Gross returns reflect the deduction of trading expenses. Net of fee returns reflect the deduction of trading expenses and the highest investment management fees charged within the composite membership as stated in the fee schedule below. Composite dispersion is calculated using the asset-weighted standard deviation method for all portfolios that were in the Composite for the entire year. Composite dispersion is not presented for periods with five or fewer portfolios. The number of accounts and market values are as of the end of the period. The three-year annualized standard deviation measures the variability of the composite and the benchmark returns over the preceding 36-month period. Past performance is no guarantee of future results. A complete list describing the Firm's composites as well as any additional information regarding the Firm's policies for calculating and reporting performance results is available upon request. Fee Schedule: Institutional Client Separate Account Management Fee Schedule (minimum investment $10 million) states 0.900% on the first $20 million; 0.850% on the next $30 million; 0.750% on the next $50 million; 0.700% on any portion of assets in excess of $100 million. Additional information on the Firm's fee schedule can be found in Form ADV Part 2A which is available upon request.

Past performance is no guarantee of future results.

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