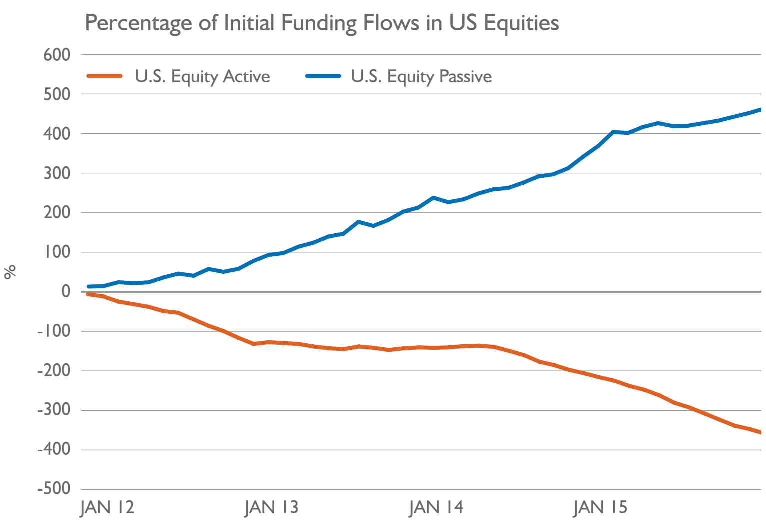
Opposing Forces: Active vs. Passive

> DECEMBER 2015 NEWSLETTER

Passive strategies have garnered an increasing share of institutional mandates within international equities.

Judging by the flows into passive strategies in recent years, some investors are abandoning active portfolio management with increasing intensity. Morningstar's round up of 2014 mutual fund flows found that active funds across all asset classes experienced $44 billion of net contributions while passive funds received inflows of $420 billion. Similarly, in the first half of 2015, data from Investment Metrics suggest that passive investing garnered 27% of initial international equity funding by U.S. tax-exempt institutions, up from 3% ten years ago (see Figure 1). Moreover, the Department of Labor's proposed fiduciary rule could be the catalyst for another sustained wave of passive equity investing. The new standards for financial advisors serving retirement accounts could send $1 trillion in new assets to

FIGURE 1: PASSIVE STRATEGIES HAVE GARNERED AN INCREASING SHARE OF INSTITUTIONAL MANDATES WITHIN DOMESTIC US EQUITIES



Source: Morningstar. Data applies to U.S. tax-exempt institutionalized assets.

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CONTACT INFORMATION

Sales and marketing
Paul O'Grady
email: ogrady@causewaycap.com
phone: 310-231-6143

Client service
Eric Crabtree
email: crabtree@causewaycap.com
phone: 310-231-6145

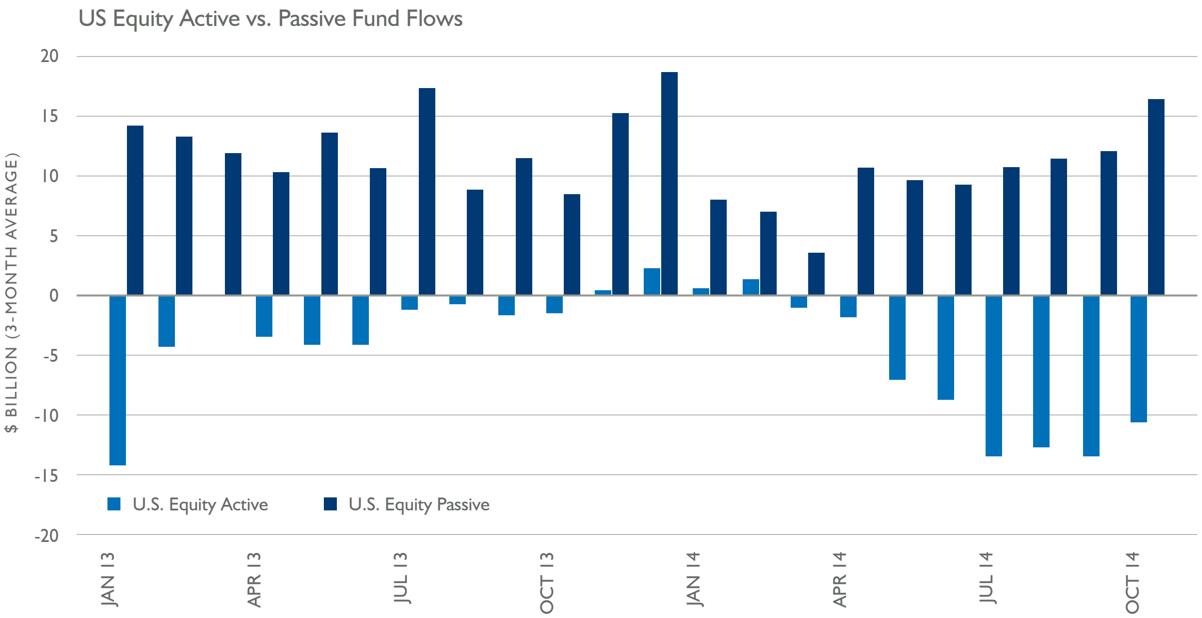
Opposing Forces: Active vs. Passive

Active management does have a proven track record of producing alpha in non-U.S. equities… As well as in Global Equities, where cumulative performance favors active management.

passive investment products, according to Morningstar (see Figure 2). The starting suppositions of any indexation strategy are, a) you are aware of the risk factors you are taking when establishing this exposure b) the index correctly captures the opportunity set of the asset class in which you are investing, and c) your timing of indexation is correct. Unfortunately, these suppositions are generally incorrect.

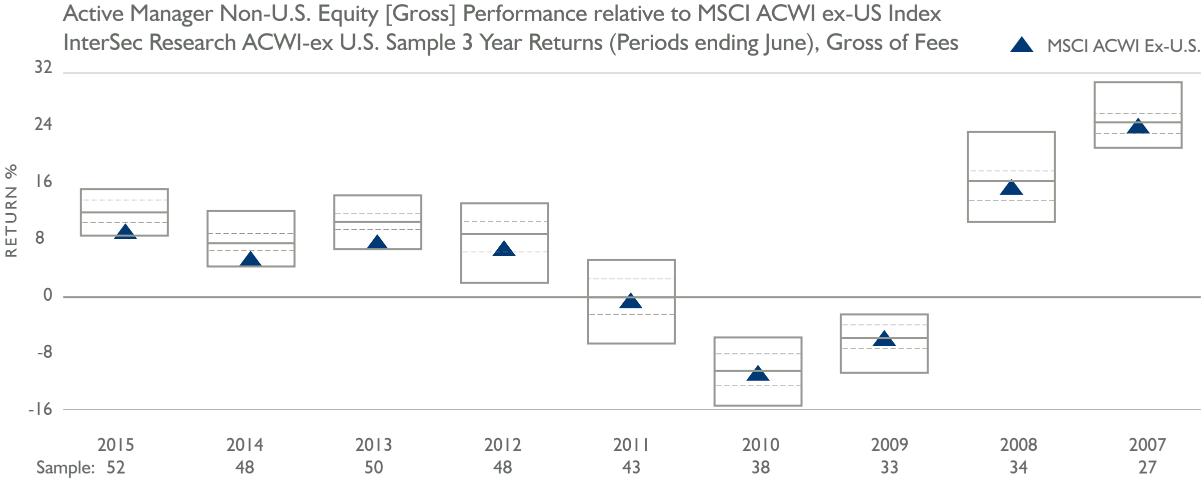
The typical academic argument for passive management goes something like this: It is a well-known truism that investing is a zero-sum game, in which the returns of all active participants, before fees, sum to the return of the market itself. Thus, an index tracking that market will deliver mean performance with some active managers beating it and others losing to it. The argument continues by introducing fees and demonstrating that the average active manager cannot consistently outperform the index, and active management is a fool's errand dependent on luck and not skill. Finally, since the market is efficient, you're better off simply investing in a low-cost passive alternative.

FIGURE 2: LATEST CHANGES MIGHT ACTUALLY EXACERBATE CURRENT TREND



Source: Morningstar Direct Asset Flows

FIGURE 3: ACTIVE MANAGEMENT DOES HAVE A TRACK RECORD OF PRODUCING ALPHA IN NON-US EQUITIES...



Relative Median Performance to Index

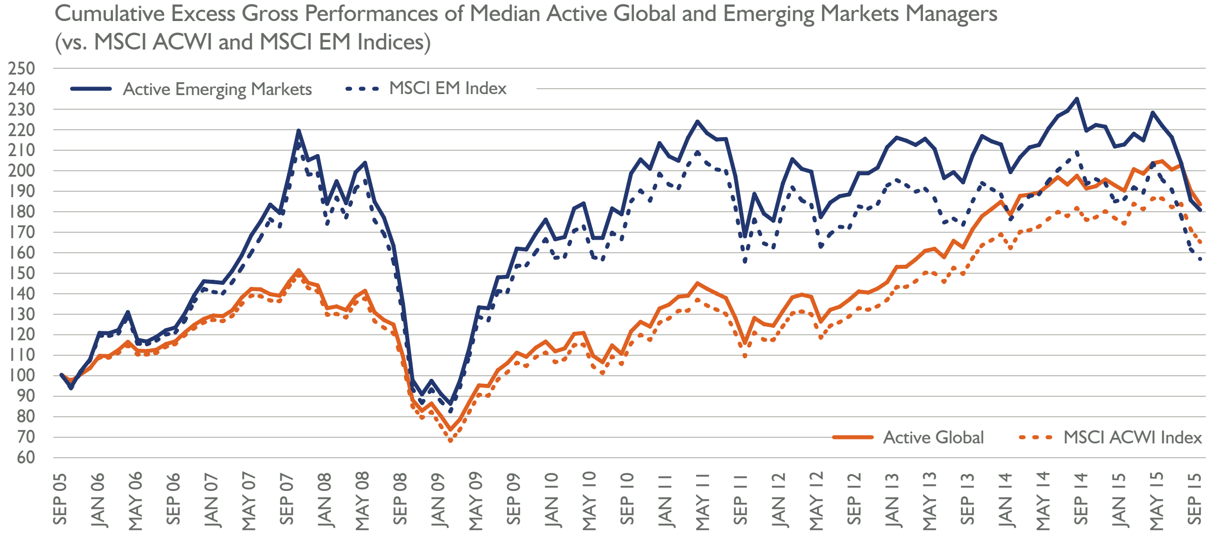
2015	2014	2013	2012	2011	2010	2009	2008	2007
2.75	2.07	2.78	2.12	0.59	0.27	0.22	0.74	0.33

Source: Investment Metrics / Intersec Research

These arguments, however, ignore three critical facts. First, after fees, index funds have underperformed the index virtually 100% of the time. Second, most of the famous academic studies focus on the U.S. market. Recent data suggest that, for international (and global) equity funds, active managers consistently have beaten the index (see Figures 3 and 4). Third, and most importantly, markets are not efficient and therefore, an index will reflect a myriad of biases at any point in time. Since the factors that drive the returns for any index are not constant, it's hardly surprising that disciplined active managers experience periods of underperformance. However, even when the annualized excess return to a benchmark, or "alpha," delivered by an active manager appears to be modest, compounding excess returns over a period of years can add up to significant gains.

Passive investing may have a role in a broad portfolio. However, excluding active management is akin to suggesting that a team that goes 50-50 during a season can never improve on its record and it's futile to even try. As numerous studies in behavioral science have shown, investors are far from rational. Market participants are prone to deep-rooted psychological predispositions that often cause asset

FIGURE 4: ... AS WELL AS IN GLOBAL EQUITIES, WHERE CUMULATIVE GROSS PERFORMANCE HAS FAVORED ACTIVE MANAGEMENT

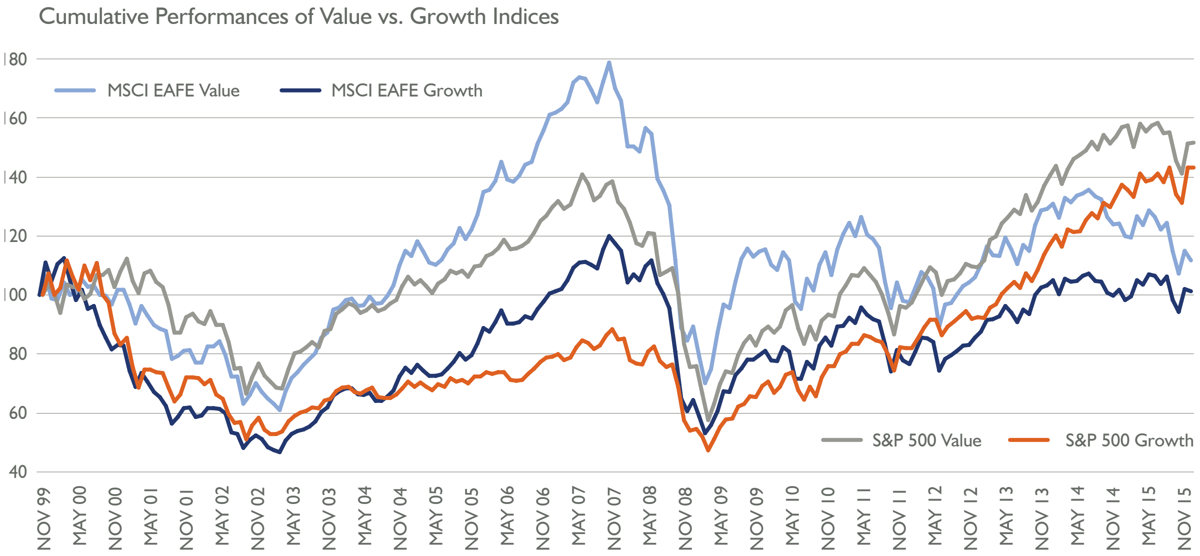


Note: Analysis uses median manager return (gross) on a monthly basis within the eVestment Global Equity manager and Emerging Markets manager universe and the MSCI ACWI and MSCI Emerging Markets Indices (gross dividends). Source: eVestment, MSCI

price anomalies. Since these asset price anomalies are always present, the market and representative indices will always reflect a host of inefficiencies. Chief among these are a short-term focus, indifference toward valuation, and disregard for risk.

Since current prices are driven by marginal buyers and sellers, an index's composition is defined by those short-term influences. Capitalization-weighted indices, which dominate the performance measurement industry, therefore become vulnerable to extreme allocations at certain points in time. In March 2000, for instance, the technology sector represented 65% of the weight in the NASDAQ Composite Index and 33% of the S&P 500 Index. We all know how technology stocks fared over the next couple of years. A decision to index the MSCI EAFE Index in December 1989 when Japanese stocks were at their most expensive (and comprised 60% of the weight in the EAFE Index) would have led to years of poor performance relative to other markets. And finally, financial stocks as a proportion of the S&P 500 Index nearly doubled from the mid-1990's to 20% by mid-2007. By the end of 2008, they had shrunk to about 11%. Active managers, by contrast, can resist and even exploit these extreme index allocations.

FIGURE 5: VALUE HAS OUTPERFORMED GROWTH OVER LONG PERIODS OF TIME IN INTERNATIONAL EQUITIES



Source: FactSet

By extension, most indices are indifferent to valuation. Capitalization-based weighting ensures that the largest, most overvalued stocks receive the largest weights. Since an index is dismissive of valuation, it is reasonable to ask what role, if any, valuation plays in the investment decision. All active managers employ some valuation methodologies in their decision making process and, as such, any decision to apply a passive approach to investing is the antithesis of active investing. Note that value style investing over full market cycles has outperformed conventional market capitalization indices. By default, investors in passive funds endorse the current valuation of all stocks in the index. Active managers can build portfolios that take contrarian points of view with regard to valuation.

Ignoring valuation is certainly one of the bigger risks embedded in passive investing. But valuation isn't the only systemic risk to consider. As we have demonstrated in our recent whitepaper on Causeway's Risk Lens, country, currency, sector, and style factor risks must all be considered to avoid the potential for excessive factor concentration or unintended factor dependence that may subsequently lead to underperformance. Style investing is cyclical in nature and, coupled

Focusing exclusively on the risk of underperformance versus a benchmark will, in all likelihood, expose the portfolio to a myriad of other risks and unintended consequences.

with the zero-sum law of investing, can often lead investors to gain exposure to the wrong type of factors at a point in time. The greater an index's imbalance to one or several of these risk factors, the more concentrated the impact of changes in prices and therefore, the greater the potential volatility. Investors need to know the overall portfolio exposure to such factors. Focusing exclusively on the risk of underperformance versus a benchmark will, in all likelihood, expose the portfolio to a myriad of other risks and unintended consequences. Active managers can control their exposure to specific factors. Causeway, for instance, uses a proprietary risk model which aggregates stock-level factor exposures to the portfolio level. Prospective holdings are rewarded if they diversify the existing portfolio with regard to factor concentrations, and ultimately, our portfolio consists of those stocks with higher expected return relative to each stock's marginal contribution to risk (or "MCTR"). This enables us to take an objective approach to risk, with no direct reference to the risk factors currently embedded in market indices.

The timing of a decision to abandon active management in favor of a passive strategy faces a number of hurdles. Often investors decide to index after a manager has underperformed. This may be precisely the wrong time if the factors that have driven short-term performance of the index are unsustainable (e.g. overvaluation or excessive country or sector concentration). If an investor decides to invest passively, the choice of which index to mimic becomes critically important and any decision to change managers, or even to change the allocation, should be based on the same criteria and judgement used to select them.

In assessing the relative merits of active versus passive management, it's essential to remember that good active managers earn their fees by resisting the inherent biases of markets and indices. These contrarian decisions will inherently involve periodic underperformance versus market indices. In the long run, however, these contrarian decisions can pay off, particularly in international, emerging, and global equity markets where active managers have a consistently positive record of outperforming the relevant index before fees. Causeway prides itself on always retaining a long-term, value-focused, risk-conscious approach as stewards of our clients' capital.

Causeway Global Value Equity

STRATEGY HIGHLIGHTS

Philosophy

- Active, bottom-up stock selection
- Fundamental research
- Focus on managing risk – defined as volatility of returns
- Team approach

Process Highlights

- 24 developed markets (United States, EAFE, Canada, South Korea)
- 3,000 stock universe
- Screen by country and industry
- Fundamental analysis
- Validate price target
- Rank stocks by risk/return profile

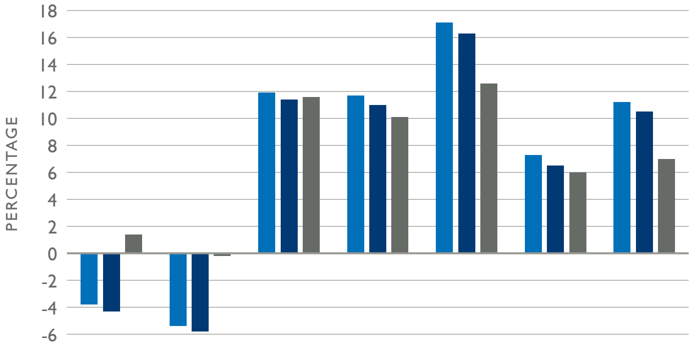
Portfolio Managers

- Sarah Ketterer, Harry Hartford, James Doyle, Jonathan Eng, Conor Muldoon, Foster Corwith, Alessandro Valentini, Ellen Lee

PERFORMANCE *(as of 11/30/2015)*

Annualized for periods greater than one year

GLOBAL VALUE EQUITY COMPOSITE



	YTD	1 YEAR	3 YEARS	5 YEARS	7 YEARS	10 YEARS	INCEPTION*
Gross of Fees	-3.8	-5.4	11.9	11.7	17.1	7.3	11.2
Net of Fees	-4.3	-5.8	11.4	11.0	16.3	6.5	10.5
MSCI World	1.4	-0.2	11.6	10.1	12.6	6.0	7.0

*Inception: September 30, 2001

Data is preliminary.

Causeway International Value Equity

STRATEGY HIGHLIGHTS

Philosophy

- Active, bottom-up stock selection
- Fundamental research
- Focus on managing risk – defined as volatility of returns
- Team approach

Process Highlights

- 23 developed markets (EAFE, Canada, South Korea)
- 1,500 stock universe
- Screen by country and industry
- Fundamental analysis
- Validate price target
- Rank stocks by risk/return profile

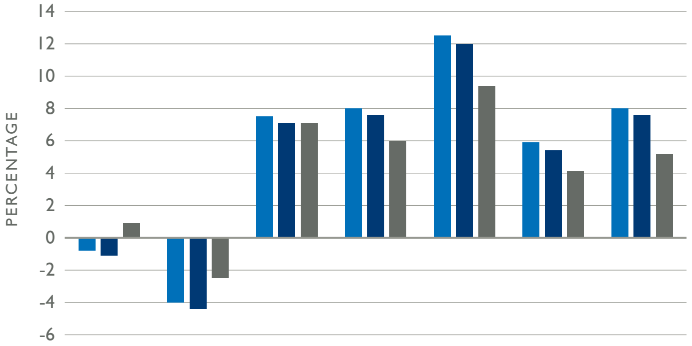
Portfolio Managers

- Sarah Ketterer, Harry Hartford, James Doyle, Jonathan Eng, Conor Muldoon, Foster Corwith, Alessandro Valentini, Ellen Lee

PERFORMANCE *(as of 11/30/2015)*

Annualized for periods greater than one year

INTERNATIONAL VALUE EQUITY COMPOSITE



	YTD	1 YEAR	3 YEARS	5 YEARS	7 YEARS	10 YEARS	INCEPTION*
Gross of Fees	-0.8	-4.0	7.5	8.0	12.5	5.9	8.0
Net of Fees	-1.1	-4.4	7.1	7.6	12.0	5.4	7.6
MSCI EAFE	0.9	-2.5	7.1	6.0	9.4	4.1	5.2

*Inception: June 11, 2001

Data is preliminary.

Causeway International Value Select

STRATEGY HIGHLIGHTS

Philosophy

- Active, bottom-up stock selection
- Fundamental research
- Focus on controlling risk – defined as volatility of returns
- Team approach

Process Highlights

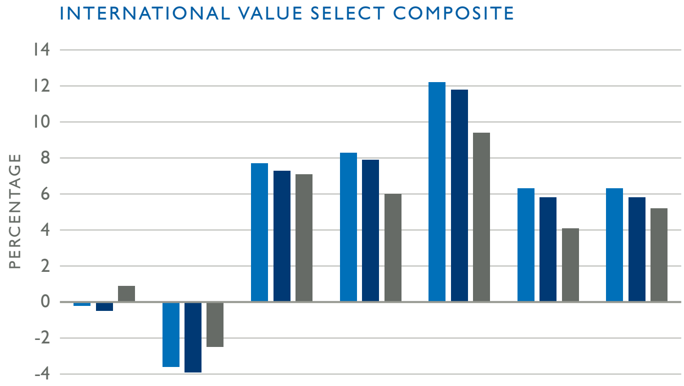
- 23 developed markets (EAFE, Canada, South Korea) 3,000 stock universe, $5B minimum market cap
- Screen by country and industry
- Fundamental analysis
- Validate price target
- Rank stocks by risk/return profile

Portfolio Managers

- Sarah Ketterer, Harry Hartford, James Doyle, Jonathan Eng, Conor Muldoon, Foster Corwith, Alessandro Valentini, Ellen Lee

PERFORMANCE *(as of 11/30/2015)*

Annualized for periods greater than one year



	YTD	1 YEAR	3 YEARS	5 YEARS	7 YEARS	10 YEARS	INCEPTION*
Gross of Fees	-0.2	-3.6	7.7	8.3	12.2	6.3	6.3
Net of Fees	-0.5	-3.9	7.3	7.9	11.8	5.8	5.8
MSCI EAFE	0.9	-2.5	7.1	6.0	9.4	4.1	5.2

*Inception: April 30, 2005

Data is preliminary.

Causeway Emerging Markets Equity

STRATEGY HIGHLIGHTS

Philosophy

- Actively managed, tracking-error oriented, quantitative emerging markets strategy
- Combines bottom-up and top down factors in security selection
- Risk management:
  - Constrain country/sector weights versus benchmark
  - Use proprietary quantitative tools

Process Highlights

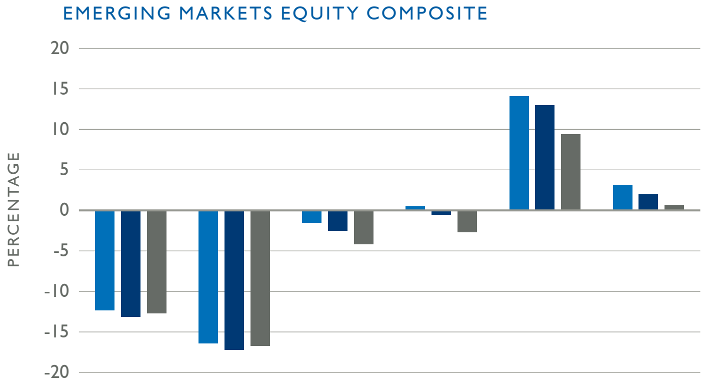
- 23 emerging markets
- 1,200 stock universe
- Employ stock ranking and risk models designed for emerging markets
- Use optimization to seek to maximize expected return per unit of risk

Portfolio Managers

- Arjun Jayaraman, MacDuff Kuhnert, Joe Gubler

PERFORMANCE *(as of 11/30/2015)*

Annualized for periods greater than one year



	YTD	1 YEAR	3 YEARS	5 YEARS	7 YEARS	INCEPTION*
Gross of Fees	-12.3	-16.4	-1.5	0.5	14.1	3.1
Net of Fees	-13.1	-17.2	-2.5	-0.5	13.0	2.0
MSCI EM	-12.7	-16.7	-4.2	-2.7	9.4	0.7

*Inception: April 30, 2007

Data is preliminary.

Causeway International Opportunities

STRATEGY HIGHLIGHTS

Philosophy

- Combines active fundamental international developed markets strategy with active quantitative emerging markets strategy

Process Highlights

- Uses a quantitative asset allocation strategy to determine exposures to developed and emerging markets
- Fundamental research
- Active, bottom-up stock selection
- Disciplined quantitative approach with fundamental underpinnings
- Proprietary risk models developed in-house

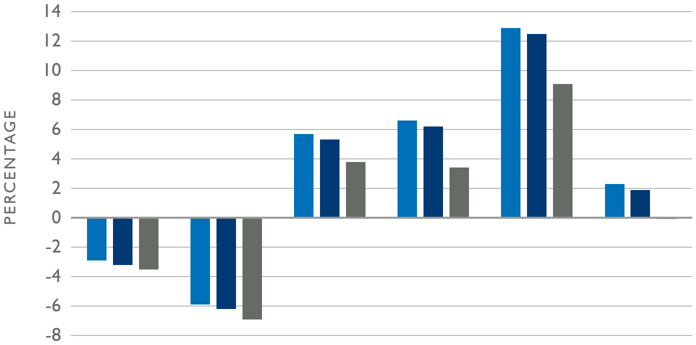
Portfolio Managers

- Sarah Ketterer, Harry Hartford, James Doyle, Jonathan Eng, Conor Muldoon, Foster Corwith, Alessandro Valentini, Ellen Lee, Arjun Jayaraman, MacDuff Kuhnert, Joe Gubler

PERFORMANCE *(as of 11/30/2015)*

Annualized for periods greater than one year

INTERNATIONAL OPPORTUNITIES COMPOSITE



	YTD	1 YEAR	3 YEARS	5 YEARS	7 YEARS	INCEPTION*
Gross of Fees	-2.9	-5.9	5.7	6.6	12.9	2.3
Net of Fees	-3.2	-6.2	5.3	6.2	12.5	1.9
MSCI ACWI Ex US	-3.5	-6.9	3.8	3.4	9.1	-0.1

*Inception: June 30, 2007

Data is preliminary.

Causeway Global Absolute Return

STRATEGY HIGHLIGHTS

Philosophy

- Combines separate investment processes: fundamental (long) and quantitative (short) sources of alpha

Process Highlights

- Global developed market value equity (long/short)
- Fundamental long (typically 35-55 exposures), 2-3 year time horizon
- Quantitative short (typically 50-125 exposures), 3-6 month time horizon
- Dollar value of longs approximately equals dollar value of shorts
- Typically low or no correlation to the MSCI World Index

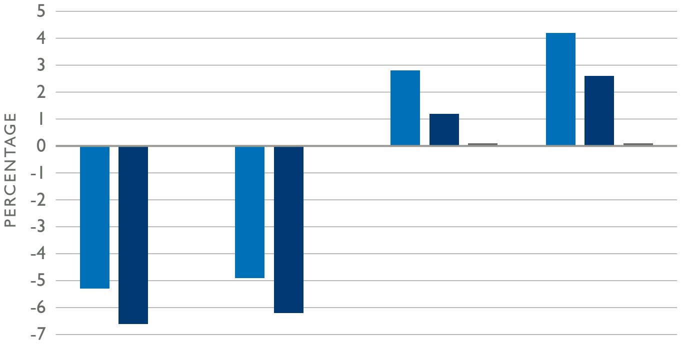
Portfolio Managers

- Sarah Ketterer, Harry Hartford, James Doyle, Jonathan Eng, Conor Muldoon, Foster Corwith, Alessandro Valentini, Ellen Lee, Arjun Jayaraman, MacDuff Kuhnert, Joe Gubler

PERFORMANCE *(as of 11/30/2015)*

Annualized for periods greater than one year

GLOBAL ABSOLUTE RETURN COMPOSITE



	YTD	1 YEAR	3 YEARS	INCEPTION*
Gross of Fees	-5.3	-4.9	2.8	4.2
Net of Fees	-6.6	-6.2	1.2	2.6
BofA/ML 90 T-Bills	0.0	0.0	0.1	0.1

*Inception: February 28, 2011

Data is preliminary.

Causeway International Small Cap

STRATEGY HIGHLIGHTS

Philosophy

- Actively managed, tracking-error oriented, quantitative small cap equity strategy
- Combines value, earnings growth, technical, and quality factors in security selection
- Risk management:
  - Constrain country/currency/ sector weights versus benchmark
  - Proprietary cross-sectional risk model

Process Highlights

- Developed and emerging markets
- 2,800 stock universe
- Employ stock ranking and risk models designed for small cap equities
- Use optimization to seek to maximize expected return per unit of risk

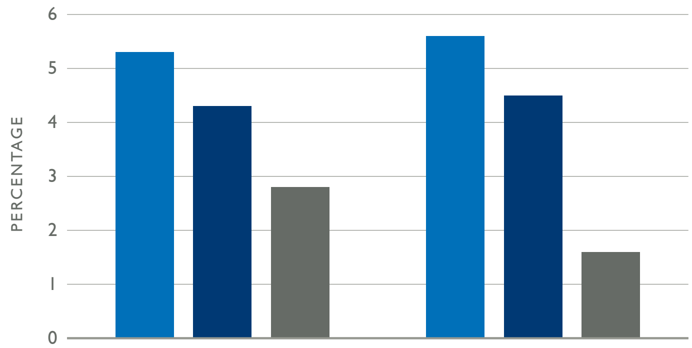
Portfolio Managers

- Arjun Jayaraman, MacDuff Kuhnert, Joe Gubler

PERFORMANCE *(as of 11/30/2015)*

Annualized for periods greater than one year

INTERNATIONAL SMALL CAP COMPOSITE



	YTD	INCEPTION*
Gross of Fees	**5.3**	**5.6**
Net of Fees	**4.3**	**4.5**
MSCI ACWI ex US Small Cap	**2.8**	**1.6**

*Inception: November 30, 2014

Data is preliminary.

Important Disclosures

The Firm, Causeway Capital Management LLC ("Causeway"), is organized as a Delaware limited liability company and began operations in June 2001. It is registered as an investment adviser with the U.S. Securities and Exchange Commission under the Investment Advisers Act of 1940. Causeway manages international, global, and emerging markets equity assets for corporations, pension plans, public retirement plans, sovereign wealth funds, superannuation funds, Taft-Hartley pension plans, endowments and foundations, mutual funds and other collective investment vehicles, charities, private trusts and funds, wrap fee programs, and other institutions. The firm includes all discretionary and non-discretionary accounts managed by Causeway.

Causeway claims compliance with the Global Investment Performance Standards (GIPS®).

The International Value Equity Composite ("International Composite") includes all U.S. dollar denominated, discretionary accounts in the international value equity strategy, which do not apply a minimum market capitalization requirement of $2.5 billion or higher ($5 billion or higher prior to November 2008), permit investments in South Korean companies after October 2003, do not regularly experience daily external cash flows, and are not constrained by socially responsible investment restrictions. The international value equity strategy seeks long-term growth of capital and income through investment primarily in equity securities of companies in developed countries located outside the U.S. From June 2001 through November 2001, the International Composite included a non-fee-paying account with total assets of approximately $2 million. This was the sole account in the International Composite from June through September 2001. The account was included in the International Composite at account inception because it was fully invested at inception. The benchmark is the MSCI EAFE Index.

The Global Value Equity Composite ("Global Composite") includes all U.S. dollar denominated, discretionary accounts in the global value equity strategy which are not constrained by socially responsible investment restrictions. Through March 30, 2007, Causeway managed the Global Composite using research and recommendations regarding U.S. value stocks from an unaffiliated investment advisory firm under a research services agreement for an asset-based fee. The global value equity strategy seeks long-term growth of capital and income through investment primarily in equity securities of companies in developed countries located outside the U.S. and of companies located in the U.S. The benchmark is the MSCI World Index.

The International Value Select Composite includes all U.S. dollar denominated, discretionary accounts in the international value equity strategy which apply a minimum market capitalization requirement of $2.5 billion or higher at the time of initial investment ($5 billion or higher prior to November 2008). The international value equity strategy seeks long-term growth of capital and income through investment primarily in equity securities of companies in developed countries located outside the U.S. The benchmark is the MSCI EAFE Index.

The Emerging Markets Equity Composite includes all U.S. dollar denominated, discretionary accounts in the emerging markets equity strategy. The emerging markets equity strategy seeks long-term growth of capital through investment primarily in equity securities of companies in emerging markets using a quantitative investment approach. The benchmark is the MSCI Emerging Markets Index.

The International Opportunities Composite includes all U.S. dollar denominated, discretionary accounts in the international opportunities strategy that are not constrained by socially responsible investment restrictions. The international opportunities strategy seeks long-term growth of capital through investment primarily in equity securities of companies in developed and emerging markets outside the U.S. using Causeway's asset allocation methodology to determine developed and emerging weightings, and using Causeway's international value equity strategy or Causeway International Value Fund for the developed portion of the portfolio and Causeway's emerging markets strategy or Causeway Emerging Markets Fund for the emerging markets portion of the portfolio. The benchmark is the MSCI All Country World Index ex U.S.

The Global Absolute Return Composite includes all discretionary accounts in the global absolute return ("GAR") strategy. The GAR strategy seeks long-term growth of capital with low or no correlation to the MSCI World Index through investment in long and short exposures to common and preferred stocks of companies in developed countries located outside the U.S. and of companies located in the U.S. The benchmark is the BofA Merrill Lynch 3-Month U.S. Treasury Bill Index. The GAR strategy takes long and short positions in securities directly and/or using swap agreements. The strategy will use leverage up to four times total assets. The use of leverage is speculative and will magnify any losses. Short positions will lose money if the price of the underlying security increases, and losses on shorts are therefore potentially unlimited. The strategy involves significant expenses including financing charges and transaction costs which will reduce investment returns and increase investment losses. To the extent swap agreements are used, the strategy risks loss of the amount due under a swap agreement if the counterparty defaults or becomes insolvent. To the extent assets are held by a prime broker, recovery will be limited in the event of the prime broker's insolvency. The strategy involves liquidity risks since a portfolio may not be able to exit security exposures immediately, particularly during periods of market turmoil.

The International Small Cap Equity Composite includes all U.S. dollar denominated, discretionary accounts in the international small cap equity strategy. The international small cap equity strategy seeks long-term growth of capital through investment primarily in common stocks of companies with small market capitalizations located in developed and emerging markets outside the U.S. The benchmark is the MSCI ACWI ex USA Small Cap Index.

New accounts are included in the Composites after the first full month under management, except as noted for the International Composite above. Terminated accounts are included in the Composites through the last full month under management. Account returns are calculated daily. Monthly account returns are calculated by geometrically linking the daily returns. The returns of the Composites are calculated monthly by weighting monthly account returns by the beginning market values. Valuations and returns are computed and stated in U.S. dollars. Returns include the reinvestment of interest, dividends, and any capital gains. Returns are calculated gross of withholding taxes on dividends, interest income, and capital gains, except returns of Causeway-sponsored mutual funds are net of such withholding taxes and reflect accrued tax treaty reclaims. The firm's policies for valuing portfolios, calculating performance, and comparing compliant presentations are available upon request. Gross-of-fees returns are presented before management, performance-based and custody fees, but after trading expenses. Net-of-fees returns are presented after the deduction of actual management fees, performance-based fees and all trading expenses, but before custody fees. Causeway's basic management fee schedules are described in its firm brochure pursuant to Part 2 of Form ADV.

Past performance is no guarantee of future performance. In addition to the normal risks associated with investing, international investments may involve risk of capital loss from unfavorable fluctuation in currency values, from differences in generally accepted accounting principles or from economic or political instability in other nations. Emerging markets involve heightened risks related to the same factors as well as increased volatility and lower trading volume. Investments in smaller companies involve additional risks and typically exhibit higher volatility.

The MSCI EAFE Index is a free float-adjusted market capitalization weighted index, designed to measure developed market equity performance excluding the U.S. and Canada, consisting of 21 stock markets in Europe, Australasia, and the Far East. The MSCI World Index is a free float-adjusted market capitalization weighted index, designed to measure developed market equity performance, consisting of 23 developed country indices, including the U.S. The MSCI Emerging Markets Index is a free float-adjusted market capitalization index, designed to measure equity market performance of emerging markets, consisting of 23 emerging country indices. The MSCI All Country World Index ex U.S. is a free float-adjusted market capitalization weighted index, designed to measure the equity market performance of developed and emerging markets excluding the U.S. consisting of 45 country indices. The BofA Merrill Lynch 3-Month U.S. Treasury Bill Index is comprised of a single issue purchased at the beginning of the month and held for a full month. Each month the index is rebalanced and the issue selected is the outstanding Treasury Bill that matures closest to, but not beyond 3 months from, the rebalancing date. The Treasury Bills comprising the Index are guaranteed by the U.S. government as to the timely payment of interest and principal. Accounts in the GAR strategy will primarily be exposed to securities that will not be similarly guaranteed by the U.S. government. The MSCI ACWI ex USA Small Cap Index is a free float-adjusted market capitalization weighted index, designed to measure the equity market performance of smaller capitalization stocks in developed and emerging markets excluding the U.S. market, consisting of 45 country indices. The MSCI ACWI ex USA Small Cap Index covers approximately 14% of the free float-adjusted market capitalization in each country. The Indices are gross of withholding taxes, assume reinvestment of dividends and capital gains, and assume no management, custody, transaction or other expenses. It is not possible to invest directly in these indices. Accounts in the Composites may invest in countries not included in their benchmark indices.

Contact Sarah Van Ness at 310-231-6127 or vanness@causewaycap.com to request a complete list and description of firm composites and/or a presentation that adheres to the GIPS® standards.

Market Commentary

The newsletter expresses the authors' views as of 11/30/2015 and should not be relied on as research or investment advice regarding any stock. These views and portfolio holdings and characteristics are subject to change. There is no guarantee that any forecasts made will come to pass.