

Lazard Global Low Volatility Fund

Fund Commentary

The global developed equity markets finished 2016 with a strong fourth quarter as the surprise outcome to the U.S. election and positive economic news allowed for an easy absorption of the widely anticipated U.S. Federal Reserve interest rate hike in December. The strengthening U.S. economy, alleviation of deflationary pressures in China and signs of modest wage inflation bolstered investor and consumer confidence. Higher interest rates and depressed valuations benefitted financial stocks as they rallied 17% for the quarter. OPEC ministers were able to agree on production cuts which appear to place a floor on energy prices and sent energy stocks up over 9% in the quarter; they were the best performing sector for the year. By contrast, health care and consumer staple stocks continued to struggle and were the two worst sectors for the quarter and year. Valuation concerns along drug pricing pressures depressed returns for both sectors. The Canadian dollar, helped by higher interest rates, continued to strengthen in the quarter adversely impacting returns by 0.5%.

Factor performance for the quarter showed a strong preference for higher risk, small cap and value factors, themes which have dominated the market for the past six months. Conversely, sentiment and growth factors remain out of favor as companies with favorable price momentum and five-year sales growth lagged for six straight months. Regional factor performance showed little difference from these themes with the exception of quality measures. Companies with higher return on equity, operating margins and lower leverage were rewarded in the U.S. whereas investors in Europe and Japan showed an opposite preference.

Against this backdrop, the Lazard Global Low Volatility Fund underperformed its benchmark, the MSCI World index.

Positive Contributors

Stocks which provided the greatest contribution to the Fund's return for the quarter included Sysco, one of the major food suppliers to U.S. restaurants. The company has undergone a significant shift in management with a renewed focus on cost control and revenue management. A significant increase in their dividend also helped lift the

stock. Primerica, the U.S. insurer rallied as the company reported strong earnings from their life business and analysts have been upgrading the stock. They are expected to benefit from higher U.S. rates and the prospect of less government regulation. They reported earning ahead of expectations. Kroger rebounded after its recent selloff as potential food inflation and an improved valuation encouraged buyers. Same store sales continue to struggle but showed signs of improving the fourth quarter.

Performance Detractors

Sector positioning caused the quarter's underperformance, as stock selection added a small incremental return for the quarter. The overweight to consumer staples and utilities and corresponding underweight to financials and energy accounted for the quarter's shortfall. Stock selection was favorable in information technology, health care and consumer staples but weak in materials and financials. The risk control process attempts to minimize the sensitivity of the portfolio to changes in interest rates which worked to the disadvantage in those stocks which benefitted from the rise in rates.

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Detractors in the quarter included Tyson Foods which struggled as higher animal feed costs and lower prices combined for a negative earnings surprise. The company announced the need for a major capital investment which will depress earnings over the near-term dampening investor enthusiasm for the stock. Resolute Mining sold off by a third after its eight-fold rise in the first eight months of the year. Higher costs and production numbers which were lower than expected, disappointed investors. With a price earnings multiple of 6, and recent approvals for expansion of their major mine at Ravenswood, Lazard continues to find the stock attractive. CSL, the Australian biotech concern, fell, as the pricing pressures in the U.S. impacted the entire sector. New competition in the hemophilia field worried some investors as the medical community seeks to narrow the preferred treatments to 2-3 providers in a very crowded market.

Select Buy & Sell Activity

Purchases in the quarter included Sysco which Lazard brought to a full active position. The stock has an attractive risk profile with little economic sensitivity and is ranked favorably on all of our measures.

Lazard opened a new position in Waste Management, which also has a very attractive risk profile and ranks well

in terms of growth and sentiment. The Fund also initiated a position in GlaxoSmithKline which has declined sharply post the Brexit vote and looks attractive on a valuation and risk basis. While large pharma stocks continue to experience pricing pressures, the weak pound should provide them a competitive advantage. Sales in the quarter included a reduced exposure to Link Real Estate as the new stamp tax in Hong Kong has reduced the sentiment for the stock. Lazard still ranks the stock positively based on a strong quality and growth score.

The Fund also reduced its position in Clorox which missed its first quarter earnings despite an increase in sales. Sentiment has decreased as it is feared that they will have to cut prices to maintain market share. The Fund also sold half of its position in Dr. Pepper Snapple which has performed well. Sentiment has declined as analysts are concerned that the U.S.-centric company will be adversely impacted by the strong dollar with little ability to grow their brand globally.

Current Positioning

With economic indicators largely improving on all fronts, and markets past a number of political events that created much concern throughout 2016, 2017 might still present some challenges. There are some potential political

minefields for European markets in 2017, including general elections in France, Germany and the Netherlands. The concern is that political volatility and reduced faith in monetary policy stimulus will make for a risky combination at a time when the moderate stimulus provided by fiscal policy over the past two years might well come to an end. The other major source of uncertainty for Europe will be the U.K., which has promised to start the formal Article 50 process for leaving the European Union by the spring of 2017. Against this backdrop, market sentiment will likely alternate between an optimistic vision of higher global growth, driven by the combination of fiscal stimulus and a continuing program of quantitative easing, as well as by concerns that the recovery in the United States may be late cycle. The focus will likely be on the path of rate rises in 2017 from the U.S. Federal Reserve, and as these become a reality, this will likely be the next test of risk appetite among investors. The impact of the increasing cost of credit on the U.S. consumer and a still strengthening dollar present the most major risks to stock returns. Against this backdrop, Lazard would envisage active stock selection to offer up opportunities, but equally important will be to manage the risk in the Fund from any adverse macro events.

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