April 19, 2021
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Todd Asset Management

A Delayed Boom

Todd Asset Management Q1 2021 International Market Commentary

	1Q 2021	1 Year	3 Year*	5 Year*	7 Year*	10 Year*
MSCI ACWI ex-US (Net)	3.5%	49.4%	6.5%	9.8%	5.3%	4.9%
MSCI ACWI (Net)	4.6%	54.6%	12.1%	13.2%	9.4%	9.1%
MSCI ACWI ex-US Value (Net)	7.1%	48.7%	2.4%	7.3%	2.6%	3.0%

* *Annualized Total Returns.*

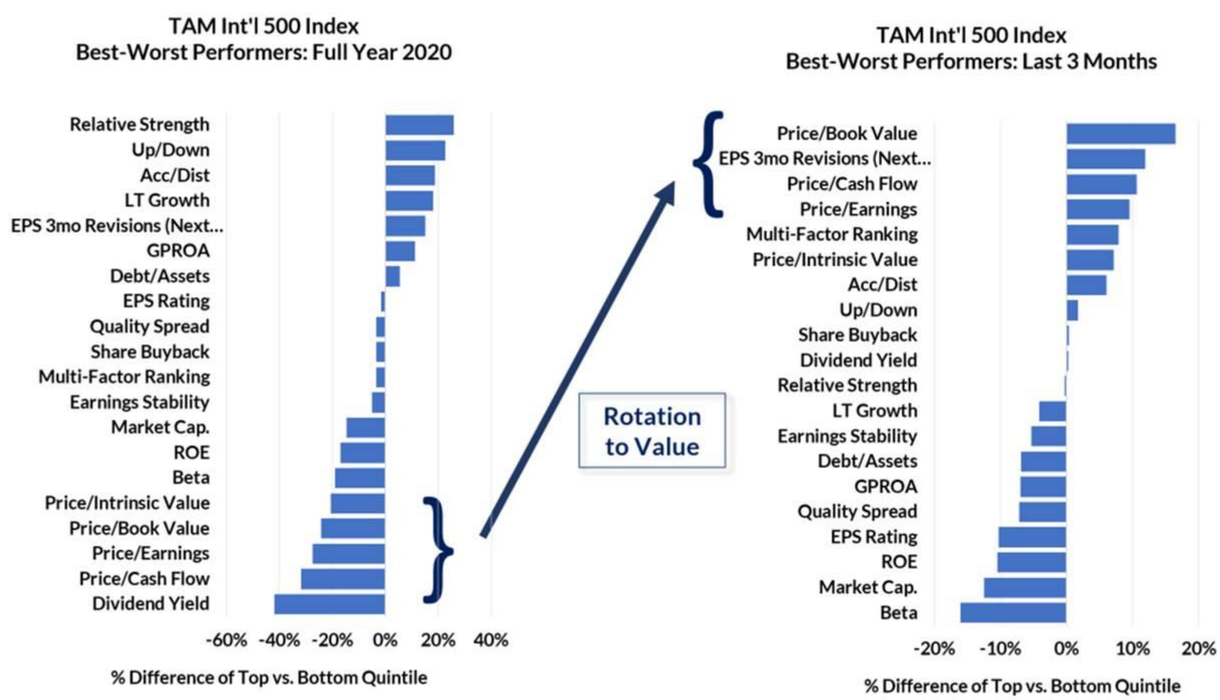
The global resurgence of COVID-19 cases during the first quarter has delayed the global economic boom we expect after the reopening fully occurs. Delayed… not cancelled. Globally synchronized growth is still the most likely outcome as vaccinations occur and economies re-open. We remain in the early portion of an economic recovery, a period that should reward value oriented investors, and international markets. The drivers of this reopening boom should become clearer as it develops, but we believe this is likely for the following reasons

- Vaccination efforts in many markets have been delayed but are starting to pick up. Vaccine shortages, uncertainty of side effects and general trepidation has led to the global resurgence of cases we noted above. This is despite the US and UK seeing dramatic improvements in their case counts. Case counts have risen in most of Europe and Asia, but the most alarming numbers are being seen in Brazil and India. Opinions vary, but many analysts predict the pace of vaccinations and infections should lead to herd immunity in those locations by the end of the summer and allow for renewed economic growth.
- Global Growth is being led by the US and China, though China is further along in their post pandemic boom. Global GDP estimates are rising and the next regions that should see the boom would include Europe and Japan. Those areas are already seeing manufacturing improve, and their service economies, while still depressed, are showing signs of an impending recovery.
- Long term interest rates increased worldwide, which should not be a surprise given the amount of fiscal stimulus now being applied. Our sense is that interest rates should have the potential to rise as the economic recovery continues to build. Inflation rates are rising too, especially in some of the Emerging Markets.
- The Dollar strengthened against most currencies during the quarter, which led international markets to lag the S&P YTD. We believe the Euro probably strengthens against the dollar through the end of the year, as their economic growth is expected to be better than the US during the second half of the year and into 2022. Structurally, higher US deficits and funding needs will probably pressure the dollar lower over the long term.

For the past 10 years, central banks worldwide have been working overtime implementing policies designed to keep rates low and provide support to the global economy. They have also begged central governments to pursue fiscal stimulus, though governments spent much of that time pursuing austerity and regulation instead of growth oriented policies. That started to change with the last US administration as they implemented supply side tax policies and deregulation, and economic growth was better than for the eight years following the Financial Crisis. With the Pandemic, this seems to be getting into high gear globally, with fiscal response amounting to approximately 25% of US GDP, and most other developed market governments offering 10 to 20% of GDP in fiscal stimulus being injected into the economy over a relatively short time frame. Manufacturing has already recovered, and we are seeing shortages of hard goods like computer chips, commodities, and shipping containers. The next leg of the recovery should be driven by services and should be well funded by consumers that have generally been shielded from pandemic related financial fallout. For the next two years, we expect economic growth is going to be robust. Vaccines should allow a reopening to satisfy pent up demand, while monetary and fiscal policies are being aimed to overshoot during the early part of this recovery. That's something we have not seen in a long time (perhaps ever?), and thus far most stock markets are liking it.

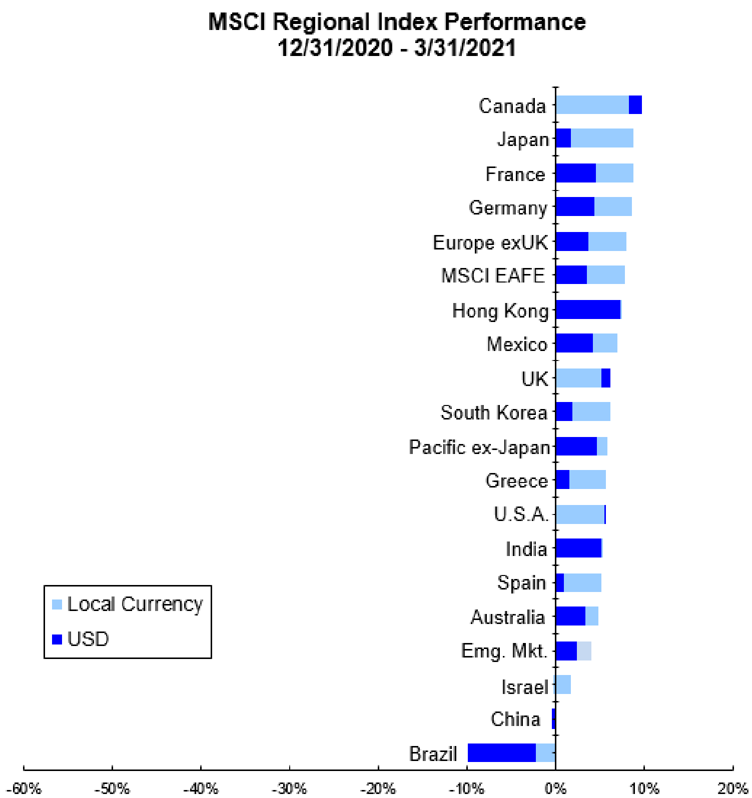
The ACWI Ex-US index has not seen a new high since 2007, a 14 year stretch that qualifies as a secular bear market. When the US broke out of the secular bear market (after about 13 years without a new high) it went on to nearly triple from that breakout in 2013 until now. As we look forward with a new economic cycle unfolding, our sense is that the International indexes will break out and start their own secular bull markets, similar to what the US has experienced, over the coming decade.

Factors



Source: Bloomberg, William O'Neill + Co. and Todd Asset Management

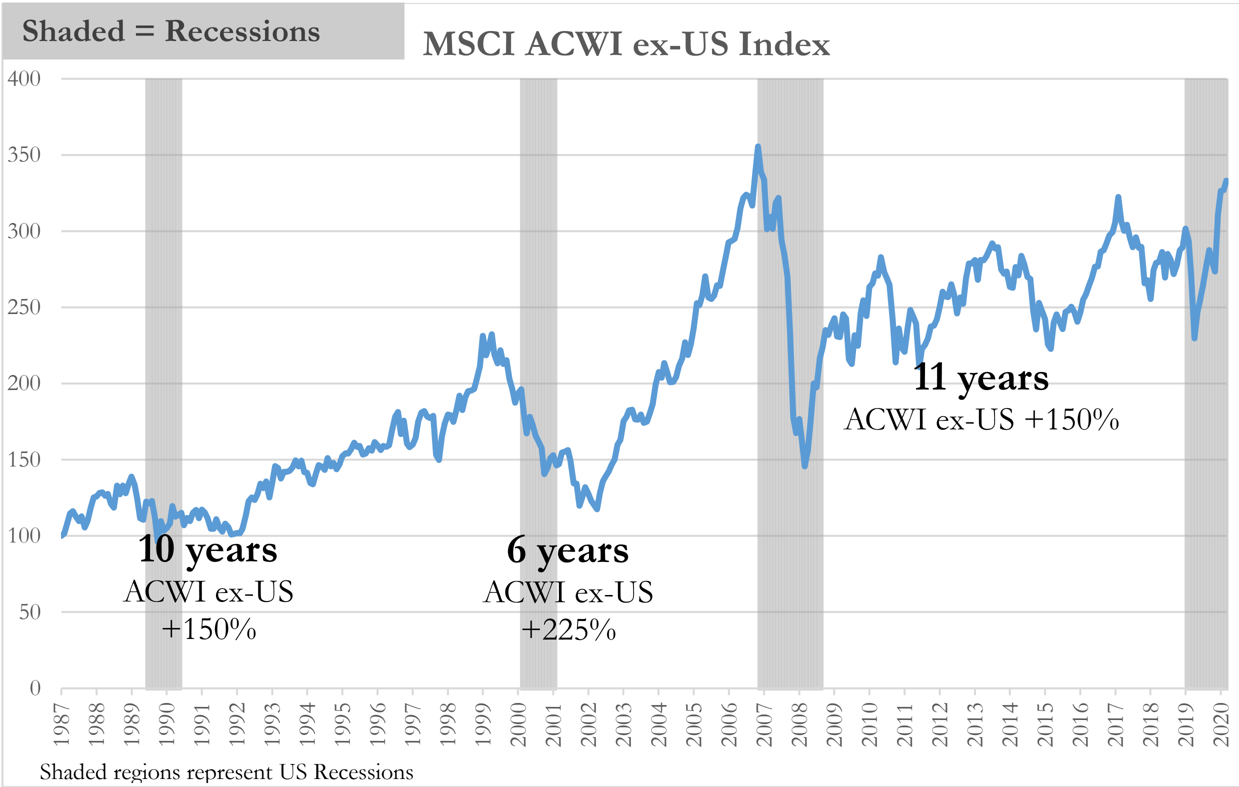
We present our customary factor analysis in the charts above. The right chart shows the first quarter results, while the left chart shows the results from the Full Year 2020. These charts have done a complete about face over the past few quarters. Through the pandemic, assured growth was all investors wanted, while Value factors were penalized, as can be seen in the full year 2020 results. Value has been pressured for over 5 years now as investors have been constantly worried about (and pricing in) the next recession. We believe this represents a significant rotation in the market that should last for quite some time. We are at the beginning of an economic expansion, so recession fears should not occur for years to come, especially with the stimulus being applied to economies. As investors seek to benefit from recovery induced earnings improvement, the rotation to value should continue.



Source: MSCI, Bloomberg, and Todd Asset Management

The dollar gained nearly 4% during the quarter masking strong underlying performance of most stock markets worldwide when measured in dollars. Developed nations that are starting to roll out their vaccination efforts are leading, while Emerging Markets wound up under some pressure with the rise in rates and the Dollar strength. We already noted that Brazil has some COVID 19 challenges. Chinese stocks came under pressure as they are starting to back away from stimulus efforts and politics (both external and internal) hurt sentiment. Oddly, Israel, who may have had the best vaccination rollout worldwide, also underperformed.

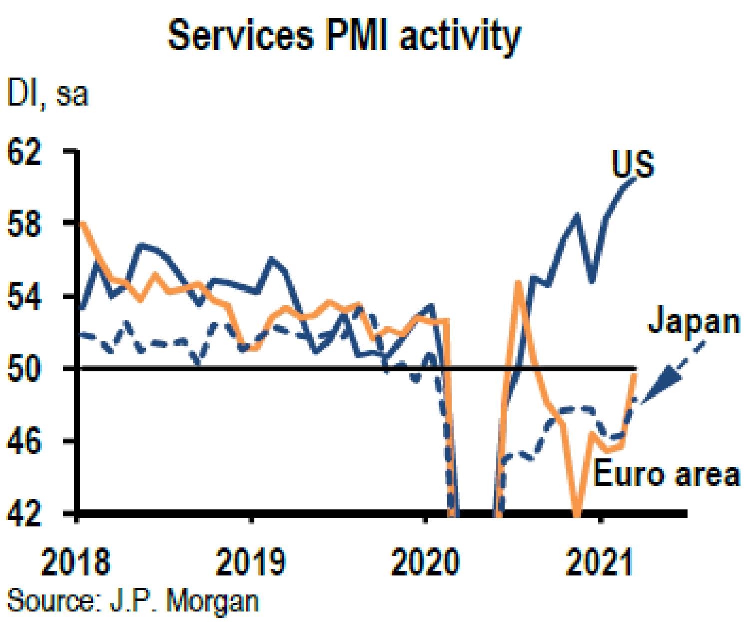
Interesting Charts We Saw This Quarter



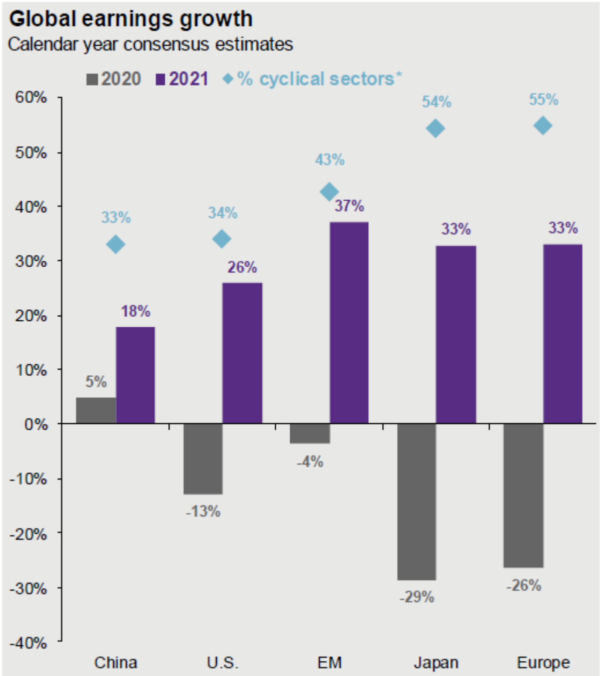
Source: Todd Asset Management, Bloomberg and MSCI as of 3/31/2021 [1]

We are in a very rare circumstance right now. We're exiting recession and at the beginning of a recovery. That only happens every 10 years or so, and normally results in a 9 year expansion accompanied by a nearly 200% rise in the market, as you can see in the chart above. Also, after there is a US yield curve inversion (and usually recession) the market cycle shifts to favor International or US investing. We believe this recovery should result in International outperformance, as the cycle chart below suggests.

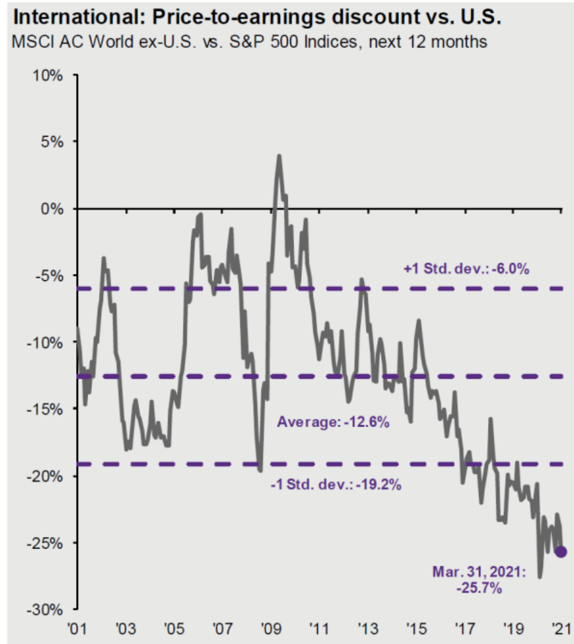
Source: Todd Asset Management [2]



Services PMI levels indicate whether services are growing or shrinking. Above 50 indicates expansion, and below it indicates shrinkage. US Services are growing strongly as vaccination efforts have led to reopening and growth. Japan and the Euro area have had a delayed recovery in this measure, though as you can see in the chart, they are about to move into expansion. We expect a boom from these economies later this year.



Source: FactSet, MSCI, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management.

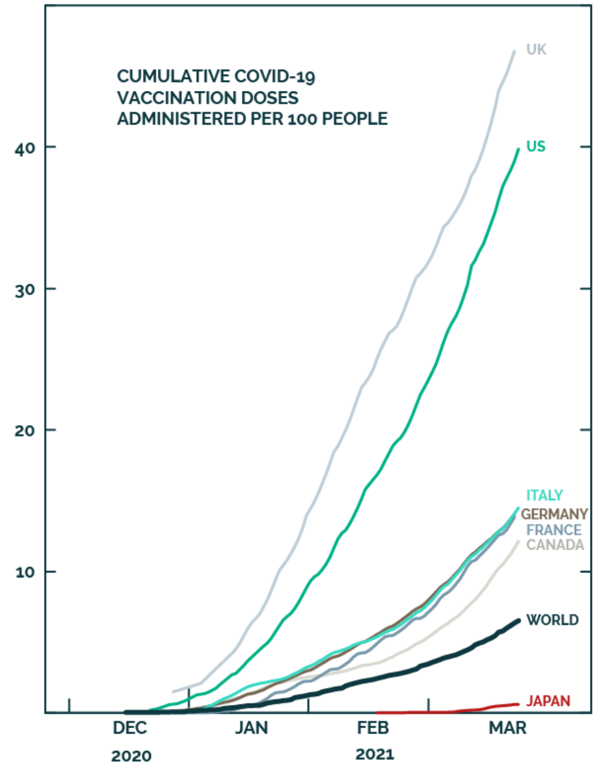


Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management.
Guide to the Markets – U.S. Data are as of March 31, 2021.

This growth is expected to show up in earnings, especially those of the more cyclical sectors. The chart on the left shows expected earnings growth for global regions. Note that the ones with higher cyclical representation are expected to show the best comparisons later this year. Meanwhile the chart to the right shows valuation differentials between international and US markets. International indexes are at record discounts to the US, despite anticipated better growth later this year.

The chart to the right shows vaccination progress in selected markets worldwide. The UK and US have had good success procuring and administering them, while most other countries have struggled. As vaccine supplies are increasing and these other countries are administering more vaccines, we believe the worldwide recovery should roll into those markets.

The chart below illustrates the magnitude of fiscal stimulus most major economies are pursuing, While the US is spending 25% of GDP, most other developed markets are somewhere between 10% and 20%. US spending should spill over into other markets as well, since most export to the US. All of these efforts dwarf the response to the Global Financial Crisis. Stimulus helps growth for years to come after the initial spending.



SOURCE: OUR WORLD IN DATA.

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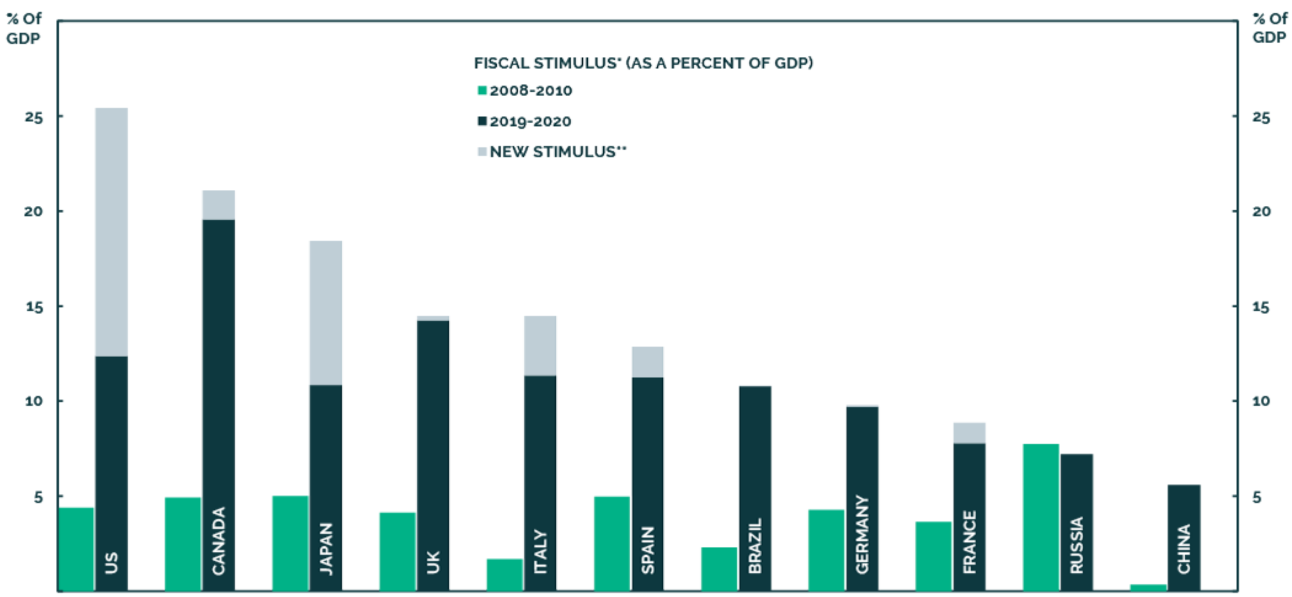

* CALCULATED AS THE ABSOLUTE VALUE OF THE CHANGE IN OVERALL BALANCE (NET LENDING/BORROWING AS % OF GDP). EXCLUDED LOAN GUARANTEES AND QUASI-FISCAL STIMULUS.

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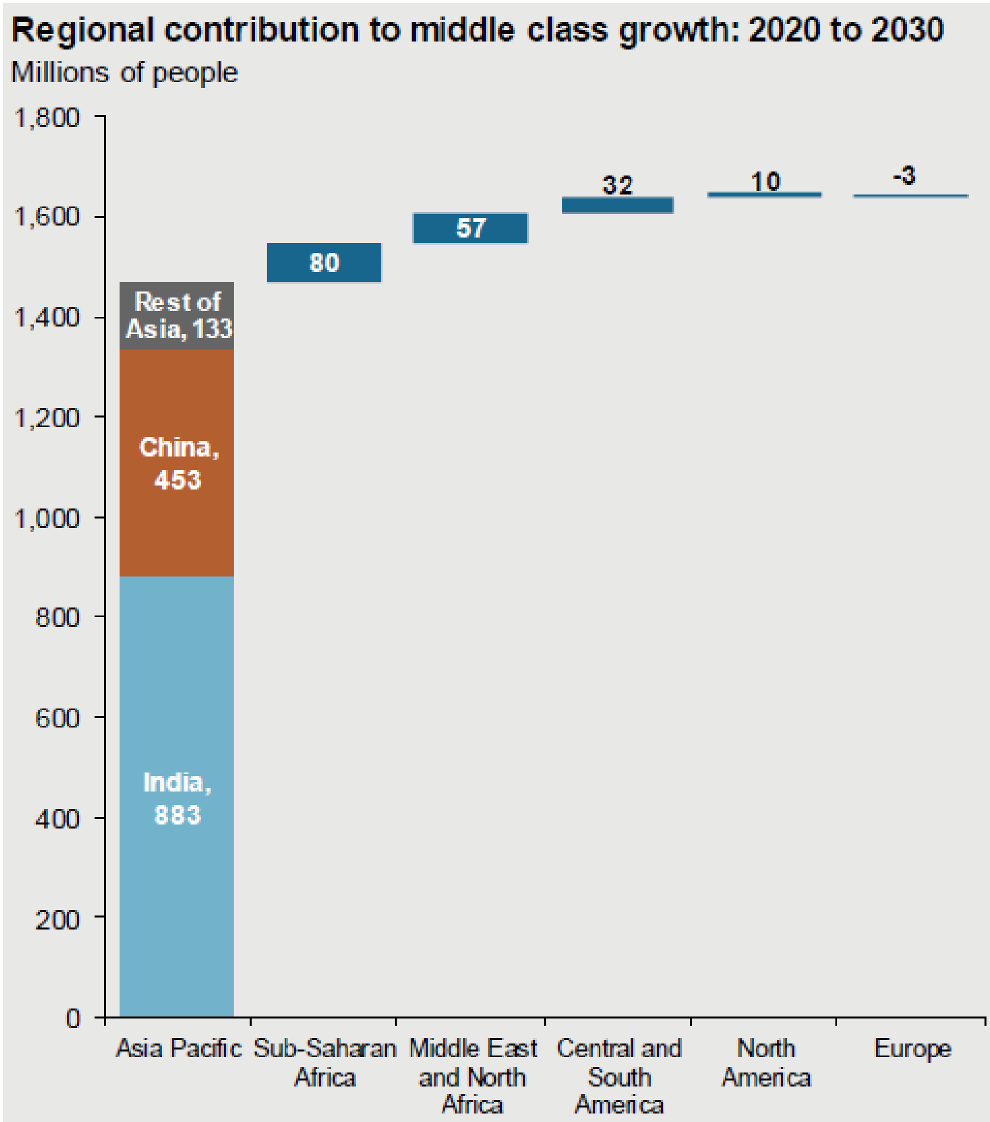
** NEW STIMULUS PLANS REVEALED AFTER OCTOBER 2020, INCLUDING: THE US' $2800 BN OMINIBUS BILL & BIDEN RESCUE PLAN, JAPAN'S THIRD RELIEF PACKAGE WITH $385 BN IN DIRECT FISCAL SPENDING, CANADA'S PROPOSED $78 BN STIMULUS PLAN OVER THE NEXT THREE YEARS (ASSUMING SPEND EVENLY), UK'S $6.2 BN NEW LOCKDOWN STIMULUS, ITALY'S $53.9 BN BUSINESS AID & STIMULUS, SPAIN'S $13 BN SMALL BUISNESSES AID, BRAZIL'S $ 8 BN EXTENDED FEDERAL CASH TRANSFER PROGRAM, AND FRANCE'S $24.3 BN BUSINESS AID PLAN. ADDITIONALLY, ITALY, SPAIN, GERMANY AND FRANCE'S NEW STIMULUS ALSO INCLUDE COMMITMENTS FROM THE EU RECOVERY GRANTS (EXCLUDING LOANS).

SOURCE: IMF FISCAL MONITOR (OCTOBER 2020) AND BCA CALCULATIONS.



Source: JP Morgan

Anyone who has spoken with us knows we are very excited about the prospects for the expansion of the middle class in Emerging Markets. In our opinion, this will be the single largest tailwind for global economies for decades to come. The chart above illustrates where the middle class should be expanding between 2020 and 2030. Interestingly, this is the first time we've seen these estimates favor India over China! We think India is primed for growth in the post pandemic world, and are excited to see how this develops over the coming decades.

Summary

Unprecedented levels of government spending are being complemented by record low rates and resulting in an economic boom for 2021. Following the recession, we are at the beginning of a new economic cycle that should last for years, and result in value stocks leading markets for some time to come. Markets do not go up in a straight line though, and that is what they feel like they have done since last year. International Markets have not seen a new high since 2007, but they are at the cusp of posting new highs at this writing. Given that we are only beginning the economic cycle, we believe they will. After the US market posted a new high in 2013 (after 13 years of waiting) the stock market tripled over the following 8 years. Our sense is International markets are probably going to experience something similar to that after the breakout.

The shift to favor value stocks should be durable, as fears of recession over the past 5 years are what has driven the insatiable grab for growth stocks at any price. Our sense is that a broader group of stocks should participate in the second half of the bull market. We believe many of the more economically sensitive sectors should be the beneficiaries of this trend. Energy, Financial, Industrial and Material stocks have been the leadership during the first quarter. We think they are likely to be mentioned much more frequently over the next five years as the economic expansion plays out.

As always, if you need any additional information, please feel free to contact any of us.

Curt Scott, CFA
Jack White, CFA
Jack Holden CFA
Shaun Siers, CFA

04/19/2021
MSCI ACWI ex-US (Net) – 298 (Intraday)
MSCI ACWI (Net) – 360 (Intraday)
MSCI ACWI ex-US Value (Net) – 183 (Intraday)

Refer to the following page for more information on the commentary presented. This is pertinent to this letter and should not be reproduced or duplicated without this disclosure.

The indexes are unmanaged, and not available for direct investment; they include reinvestment of dividends; they do not reflect management fees or transaction costs.

MSCI ACWI ex-U.S. (net) Index is a float-adjusted market capitalization index that is designed to measure the combined equity market performance of developed and emerging market countries excluding the United States. The ACWI ex-U.S. includes both developed and emerging markets. For investors who benchmark their U.S. and international stocks separately, this index provides a way to monitor international exposure apart from U.S. investments. The Net Index takes into account the impact of foreign tax withholdings on dividend income.

MSCI ACWI (net) Index is a float-adjusted market capitalization index that is designed to measure the equity market performance of developed and emerging markets.

The MSCI ACWI ex-U.S. Value (net) Index captures large and mid-cap securities exhibiting overall value style characteristics across 22 Developed and 26 Emerging Markets countries. The value investment style characteristics for index construction are defined using three variables: book value to price, 12-month forward earnings to price and dividend yield.

1. Past performance does not provide any guarantee of future performance and one should not rely on performance as an indication of future performance. Indexes are unmanaged and not available for direct investment. They include reinvestment of dividends; they do not reflect management fees or transaction costs. Commentary may contain subjective judgements and assumptions subject to change without notice. There can be no assurance that developments will transpire as forecast. See Performance Disclosure and Additional Disclosures for more information about benchmarks presented.

2. The indexes used in the chart are unmanaged, and not available for direct investment. They do not include the reinvestment of dividends, nor do they reflect management fees or transaction costs. The S&P 500 is a widely recognized index of market activity based on the performance of common stocks within the S&P 500 Index. The MSCI ACWI ex-US is a widely recognized index of market activity based on the performance of common stocks within the MSCI ACWI ex-US Index. The MSCI EAFE is a widely recognized index of market activity based on the performance of common stocks within the MSCI EAFE Index.