A Supply Shock on Top of a Supply Shock

Todd Asset Management Q1 2022 International Market Commentary

	1Q 2022	1 Year	3 Year*	5 Year*	7 Year*	10 Year*
MSCI ACWI ex-US (Net)	-5.4%	-1.5%	7.5%	6.8%	5.2%	5.6%
MSCI ACWI (Net)	-5.4%	7.3%	13.8%	11.6%	9.7%	10.0%
MSCI ACWI ex-US Value (Net)	0.1%	3.3%	5.4%	4.7%	3.7%	4.2%

** Annualized Total Returns.*

Market tumbled in the first quarter as Russia invaded the Ukraine, and the world realized that you cannot take peace in Europe for granted. With the invasion, the existing global supply chain problems for manufactured goods were compounded by war related commodity supply chains disruptions. China's zero covid policy is also impacting availability of some manufactured goods, and likely to lead to slower economic growth in China than had previously been anticipated. No matter which way you look, Wall Street strategists seem to be trying to outdo each other with dire predictions of how nothing looks attractive. If there's one thing we've learned over the years, when all of Wall Street is looking at what can go wrong, it often pays to ask yourself what is going right. Something that has been working this year is the Value rotation. This is the first time the Value index has outperformed in a down quarter since the last Value cycle. Our sense is this recent turn marks the beginning of a multi-year trend change favoring Value indexes.

ACWI ex-US Value minus ACWI ex-US Growth 3/2002 to 4/2022

Points to note from the quarter:

- GDP growth is likely to slow, as the commodity shock in Europe and the Covid lockdowns in China impact growth rates. Will this result in recession? Probably not unless Russia expands the war or entirely cuts off energy exports. Also, China is still pursuing zero-Covid, which is putting a dent in their output. We believe when it is under control, more aggressive stimulus follows.
- Inflation rates are up worldwide as commodity prices are spiking. China, Europe, and Japan have less of a wage inflation problem than the US. They offered less pandemic stimulus, so fewer

excess funds are burning a hole in consumers pockets. Also, fewer workers left their labor forces during the pandemic, so they are not competing as fiercely as US firms must to hire for re-opening. Market based factors suggest commodity prices may be peaking.

- War in Europe is leading to more government spending in Europe and probably worldwide. Defense spending as well as increased investment in alternative energy are likely to spur capital investment.
- Long term interest rates in Europe are on the rise, as sovereign bonds have moved in anticipation of central banks removing some of their QE oriented policies. We believe developed market central banks are likely to be forced to tighten. Meanwhile, China is already easing to counter economic weakness.

Markets are likely to remain volatile as policymakers attempt to address problems of supply-oriented inflation and the economic concerns regarding reduced demand from concerned consumers. Many investors worry about what breaks if the central banks start normalizing (raise) rates? There are concerns that levered trades may have built up during the low rate period and could cause a financial crisis as rates rise. Yield curves and other indicators we monitor are not indicating problems yet.

Ultimately, re-opening is still occurring, and most consumers are in better economic shape than before the pandemic. Markets do tend to bottom during invasions, with quick recoveries. Potential supports for the global economy are likely to come from capital spending. The pandemic exposed weaknesses in supply chains and some observers believe globalization is pausing or potentially reversing. This will require additional plants and equipment closer to home in some developed markets. Additional support probably comes from increased Defense spending, as most of NATO has been undershooting their 2% of GDP target for many years. Tensions are rising in Asia that could lead to more defense spending as well. Volatility is likely, but economies probably avoid recession. If worldwide tensions simmer down later in 2022, that could provide the impetus for a weaker dollar and better markets.

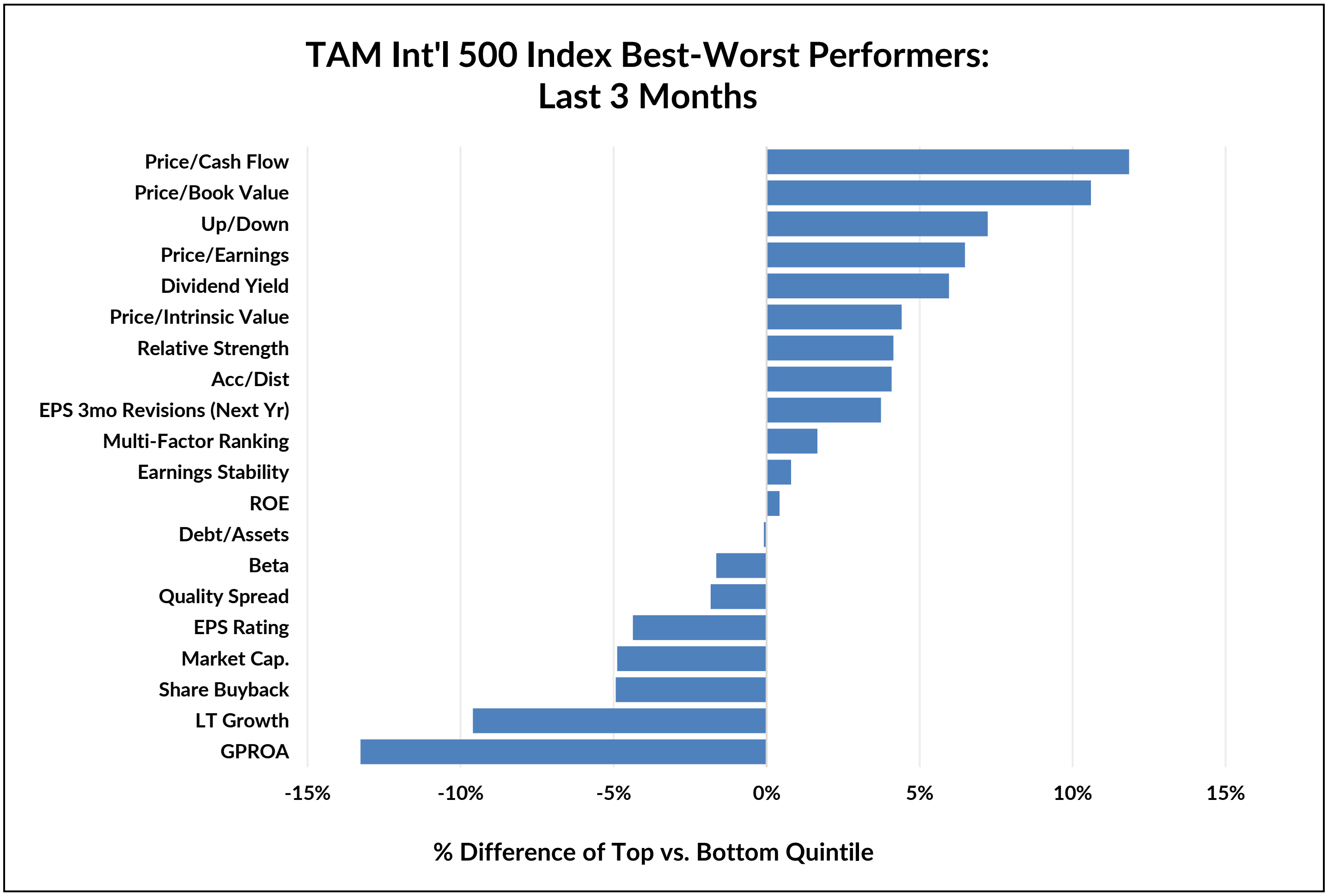
Global Markets 1938-2022 with Conflicts Noted

Growth of $100 invested since 1940

Markets usually recover quickly after conflicts. Since WWII, markets were up in 75% of instances one year post conflict. Three years post conflict, they were up 80% of the time.

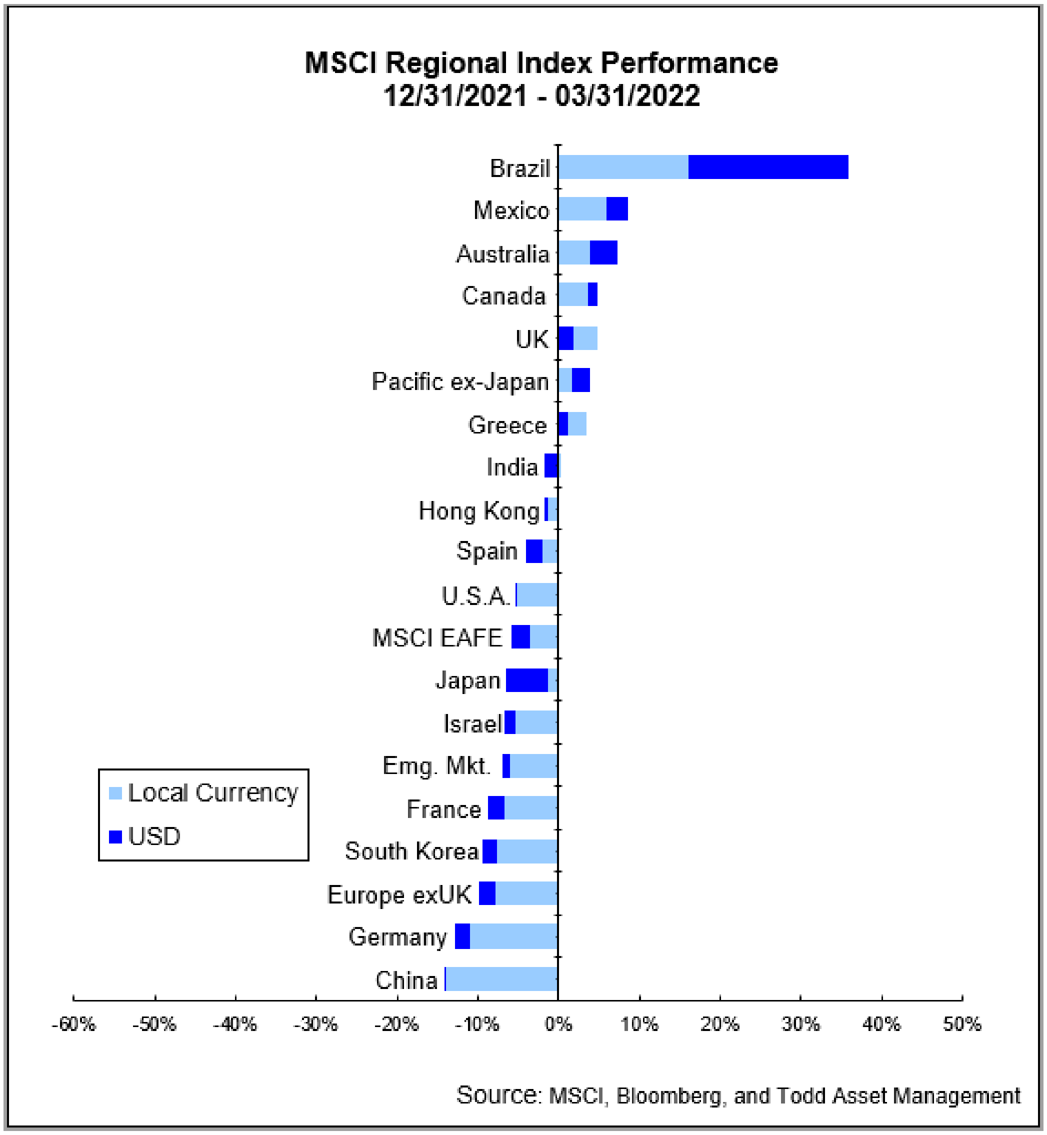
Source: Bloomberg, MSCI, S&P and Todd Asset Management. Series is indexed to 100 on 12/30/1938 through 3-31-22. To show a longer time frame, the MSCI ACWI (Gross) was chained with the S&P 500 (Gross) to represent Global Equities. The ACWI is used from inception at 3/31/1988 since it includes both US and International Markets, and the S&P prior to that.

Factors



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

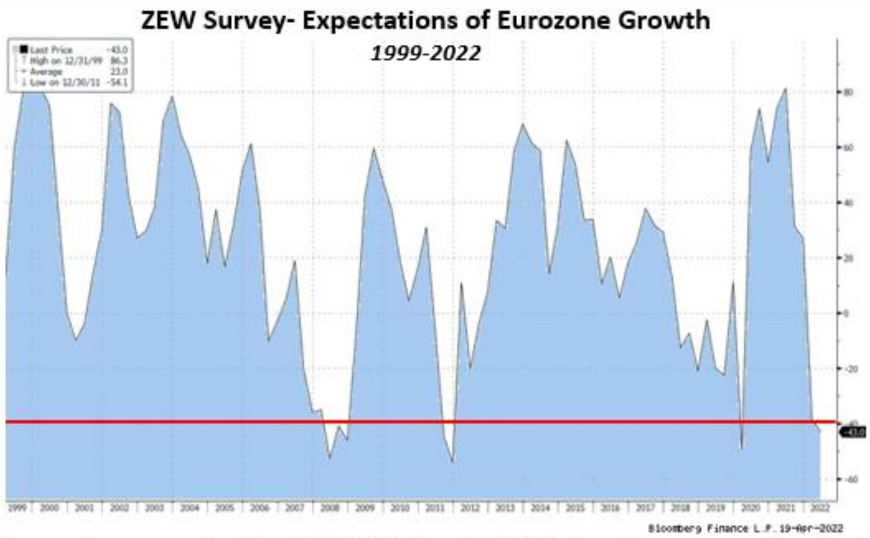
Our factor analysis chart for the past quarter is presented above. This chart measures the performance of the best 100 stocks versus the least attractive 100 stocks within our 500-stock TAM International Index, ranked by factor over the past quarter. While Value has led internationally since vaccines were introduced, for much of the past year this analysis showed leaders and laggards were a mix of value, growth, and quality factors without one group dominating the other. Over the most recent quarter, that changed, and we saw a clear bias towards value and away from growth. One explanation for this is the increase in rates experienced in most developed markets. As rates increase, stock multiples tend to decline, and that was the case during the first quarter. Multiple compression hurts more expensive stocks, which are usually the growth stocks. We think interest rates are probably going to remain higher for longer, and as such, the headwinds for growth stocks will probably be with us for some time to come.



The regional leaders and laggards for the quarter are presented above, and the evidence is pretty clear that a commodity cycle is impacting these results. The leadership for the quarter consisted of commodity producers. The laggards of the quarter were the commodity consumers. We believe a new commodity cycle is unfolding. Investment in production of most natural resources has been curtailed over the past 10 years, as ESG concerns, and shareholder activism has many companies in the sectors reluctant to invest in production. Until more investment is made in production, commodities probably get a stronger bid in the future.

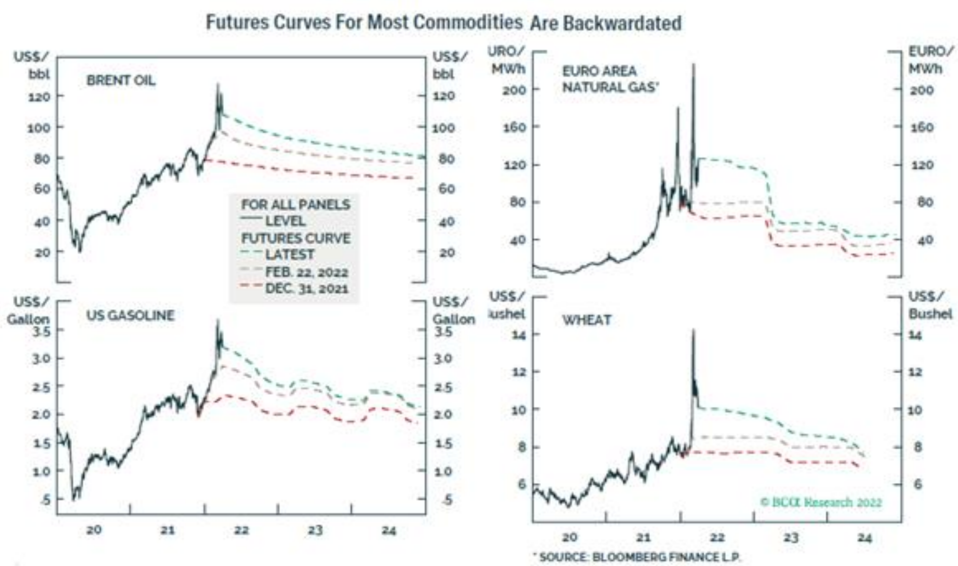
Charts we are sharing with our clients:

Sentiment is Poor in Europe



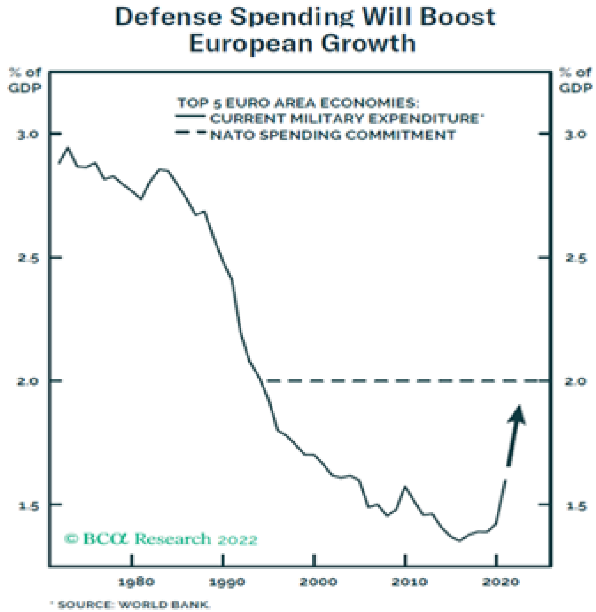
Sentiment is near lows reached in 2008, 2011 and 2020. In prior cases, after the index recovered to above -40, ACWI ex-US returns were +42.3%, +17.3% and +50.2% in the following year.

Are Commodity Prices Peaking?



Commodities futures indicate lower prices for next year.

A Long-Term Spending Support for Europe and Others



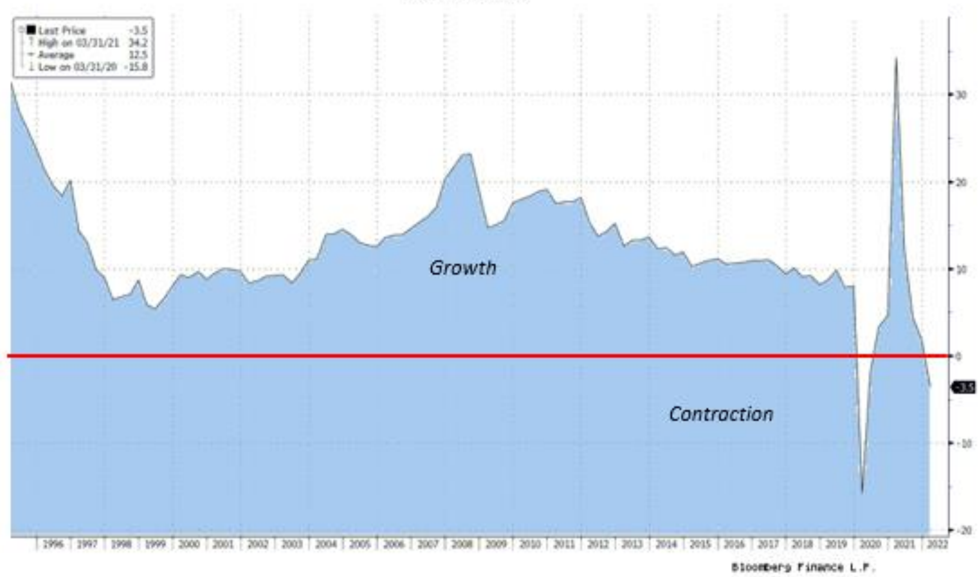
Heightened geopolitical uncertainty is likely to lead to higher Defense spending in both Europe and Asia.

European NATO members used to spend nearly double their current defense budgets during the Cold War. This is a regime change for them, and probably for Japan, South Korea and Taiwan as well.

Covid-Zero Taking a Toll on Chinese Growth

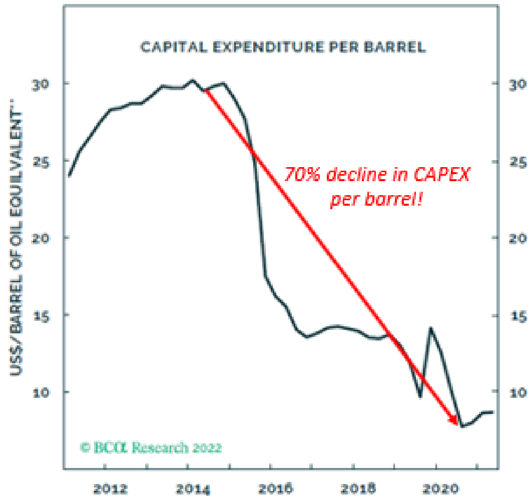
Chinese Y/Y Retail Sales Growth

1995-2022



Covid lockdowns have retail sales declining -3.5% Y/Y. Recovery is likely.

An Example of Dis-Investment in Natural Resources



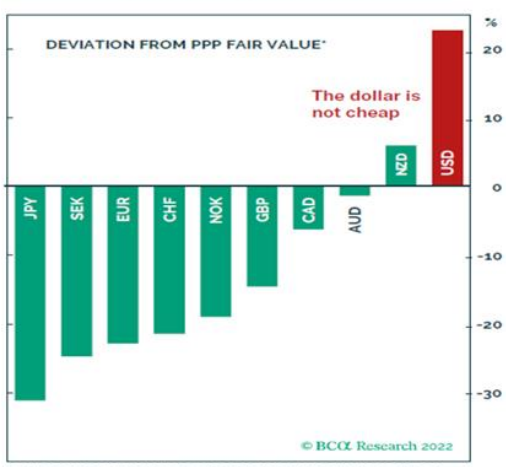
* EXCLUDES THE ADDITIONAL 1 - 1.3 MMB/D OF OIL SUPPLY FROM IRAN FOR THE FORECAST PERIOD.
**IN 2015 US DOLLARS. SOURCE: US EIA. BASED ON PUBLIC FINANCIAL STATEMENTS FROM GLOBAL OIL AND NATURAL GAS COMPANIES. THE VALUE FOR Q4 2015 HAS BEEN INTERPOLATED.
NOTE: SHADED AREA DENOTES BCA FORECASTS.

Capital spending is the driver of production growth for most natural resource companies. As can be seen in the chart to the left, capital investment per barrel of oil equivalent peaked in 2014 at $30 per barrel. It is currently below $10 per barrel. This rhymes with investment programs for many other commodities as well.

Higher commodity prices are going to be with us until investment picks up.

The Dollar Should Weaken If Any Concerns Ease

USD Remains Overvalued



* OUR FOREIGN EXCHANGE STRATEGY PPP MODEL IS BASED ON RELATIVE PRICE RATIOS AGGREGATED USING FIVE GROUPS IN THE CPI BASKET WITH CUSTOM WEIGHTS. PLEASE REFER TO THE FOREIGN EXCHANGE STRATEGY AUGUST 23, 2019 SPECIAL REPORT TITLED "A FRESH LOOK AT PURCHASING POWER PARITY," FOR FURTHER DETAILS.

Models described are from BCA Research

- Heightened Geopolitical concerns have caused recent dollar strength as a haven currency.
- Several signs point to eventual weakness, including
  - ✓ PPP favors others (chart left)
  - ✓ Dollar usually weakens after first Fed tightening
  - ✓ Dollar usually weakens when twin deficits rise

Summary

There is a lot of bad news to digest currently. War, Central Banks raising rates, high Inflation, constrained consumers, and Covid lockdowns leave investors with a nagging feeling that something bad is likely to happen. The bad news… it probably takes a few months to work through these developments, given geopolitics do not deteriorate further. The good news… once situations become clearer, investors are likely to enjoy better sentiment, economic re-opening can continue, and economies can avoid recession. The latter scenario is going to take time to develop, but what we are looking for are indicators that things are "less bad". If ZEW surveys rebound, commodity prices stabilize, Covid subsides, and general angst levels come down, markets can enjoy better results. We are also watching Q1 earnings results and guidance from corporations on what they expect to happen. We believe more positive developments can come to pass but will take time. Until then, we will take solace in the fact that markets historically bottom during invasions and move on to recover quickly following them.

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

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04/00/2022
MSCI ACWI ex-US (Net) – 274
MSCI ACWI (Net) – 357
MSCI ACWI ex-US Value (Net) – 270

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.