July 19, 2021
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Todd Asset Management

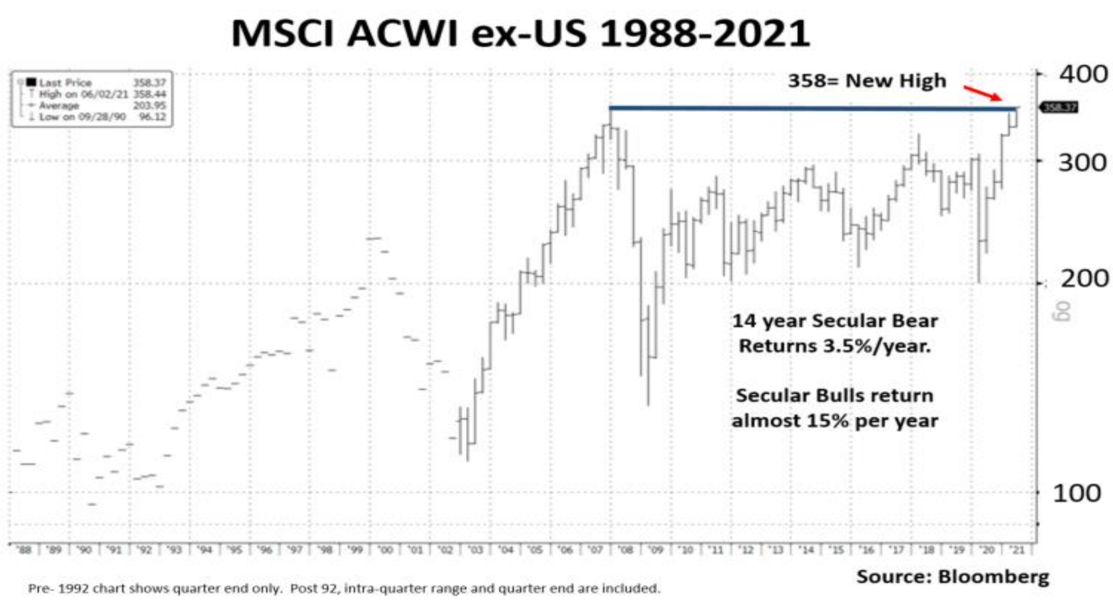
Investors Ignored New International Highs

Todd Asset Management Q2 2021 Review and Outlook for International Markets

	2Q 2021	YTD	1 Year	3 Year*	5 Year*	7 Year*	10 Year*
MSCI ACWI ex-US (Net)	5.5%	9.2%	35.7%	9.4%	11.1%	5.3%	5.5%
MSCI ACWI (Net)	7.4%	12.3%	39.3%	14.6%	14.6%	9.8%	9.9%
MSCI ACWI ex-US Value (Net)	4.3%	11.7%	37.6%	5.2%	8.6%	2.4%	3.5%

* *Annualized Total Returns.*

On June 1, the ACWI ex-US traded to a new high (the first since 2007) and stayed at new highs until June 15, before backing off a bit. This happened after nearly 14 years in a trading range. Google it… there are no news stories and the media ignored it. A sustainable breakout would suggest a shift to a secular bull market. The second half of June was difficult for the ACWI ex-US index, prompting a full month decline of -.65% versus the S&P 500 gain of +2.33%. It wrapped up a quarter where US stocks outperformed the ACWI ex-US, led by a rotation back into the growth stocks on declining bond yields. *As reopening continues, we think the paused rotation towards Value and International should resume.*

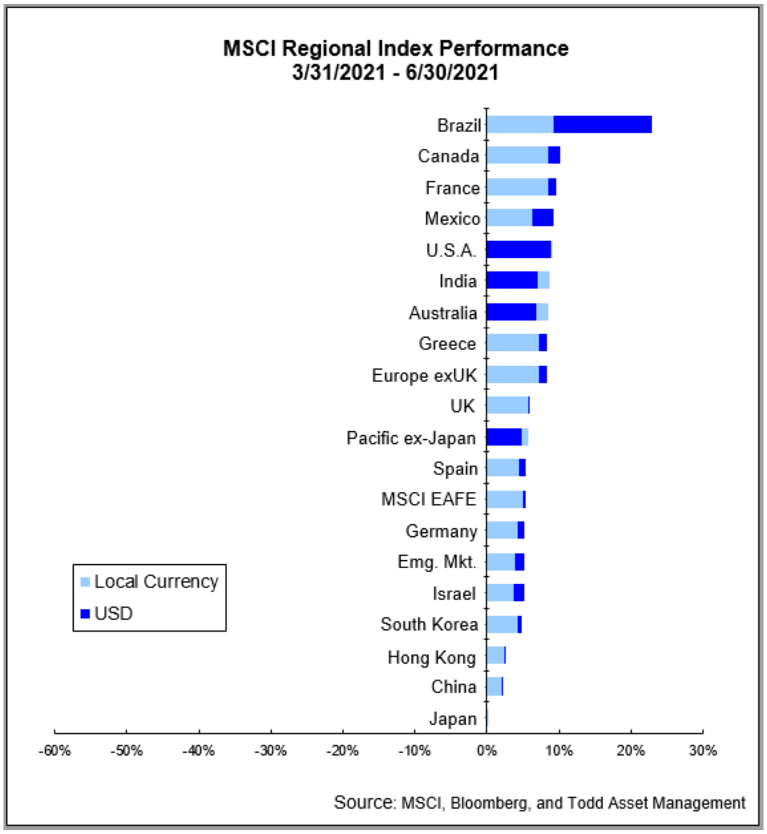


Four Bullets Summarizing the Quarter:

- The Covid-19 Delta variant has slowed re-opening efforts in Europe, and worried most governments. Countering this, vaccine rollouts are accelerating worldwide, and they work against this variant.

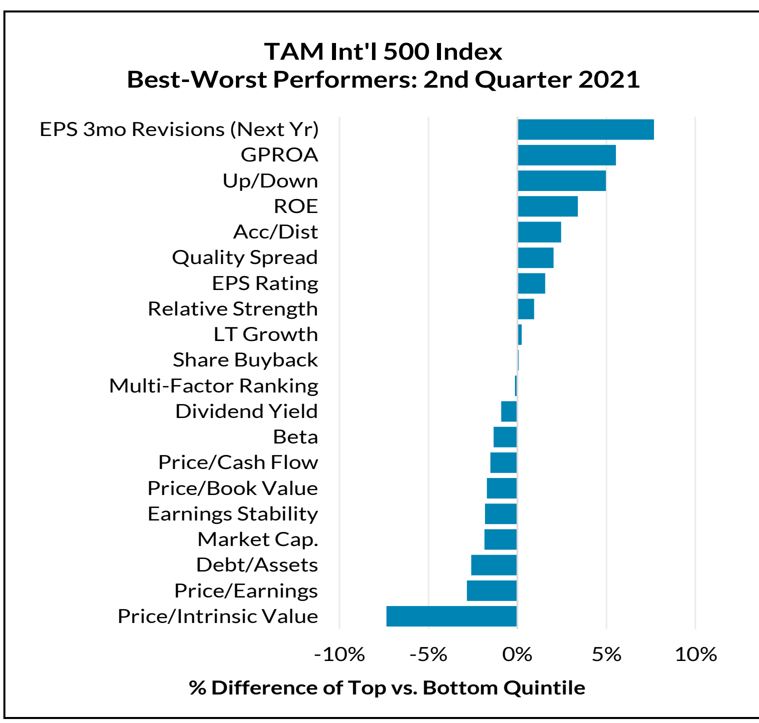
- Better economic results and early signs of inflation were abundant, and prompted talk of Fed Tapering and ECB action. Despite this, government yields declined and reopening trades weakened.
- China has dramatically ramped up regulation of companies recently, impacting many well-known stocks during June and the second quarter. We know this was painful for investors, but think it is transitory.
- Commodities remain strong, with oil and iron ore surging during the quarter, suggesting low inventory supplies and stronger demand from expected economic growth ahead.

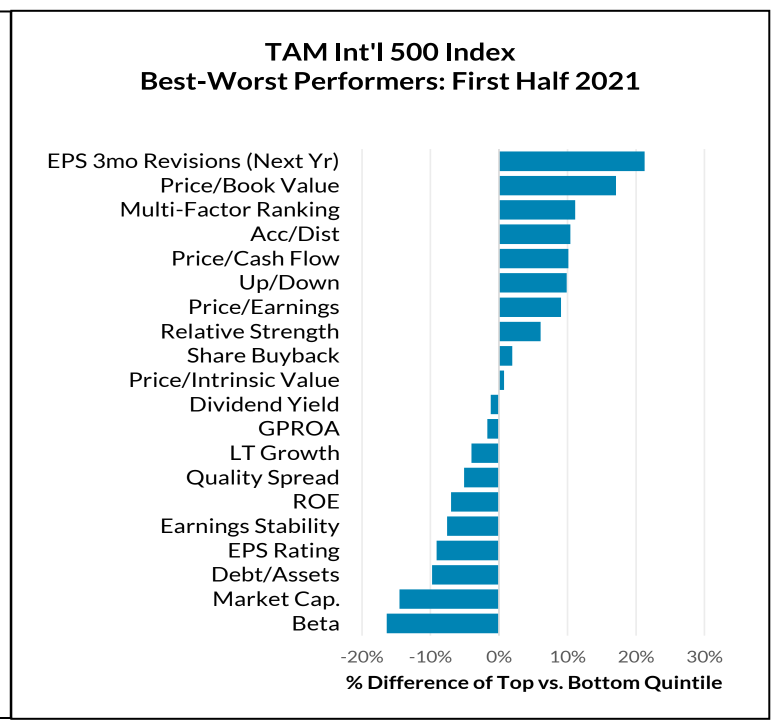
The recent rotation to bonds and the "safety" of growth stocks does not feel right to us as we look at anticipated economic growth rates. We think investor psychology is still scarred from the post-GFC decade of deleveraging induced subpar growth and the recent Covid-19 depression. We think second quarter earnings reports during July could change investors' perception and allow the economically sensitive sectors that we favor to get reinvigorated. While China was easing back on their monetary stimulus, Europe was ratifying the EU Recovery Fund at the end of May. That money reaches national governments in July. Experience says stimulus helps the economy, and the effects last for years. *This marks the first time in decades that European Governments have bound together to promote economic growth and it should provide support for the Euro area for some time to come.* The economic recovery is young, reopening is occurring and stimulus continues. International Investors should be viewing the recent pullback versus the US indexes as a good entry point. We think re-opening and renewed stimulus points to a resumption of gains for international equity markets later on this year. We believe the paused rotation to value and international should resume. Our time tested strategy that blends valuation, fundamental strength and market acceptance should be poised to do well in that environment.



Three of the top four country performers during the quarter have commodity production oriented economies. Commodities have strengthened as production cutbacks are meeting with higher demand, leading to higher prices. We believe the new economic cycle should help that trend and seems sustainable for some time, in our view. The laggards suffered from Covid resurgence fears as Japan has prohibited spectators at the Olympics, and South Korea just suspended their professional baseball season. China has increased regulation and cut back on stimulus just as they have had to re-impose quarantines in some cities as well. Asia is generally dealing with an uptick of Covid cases, which has weighed on markets.

Factor Review for Quarter and YTD

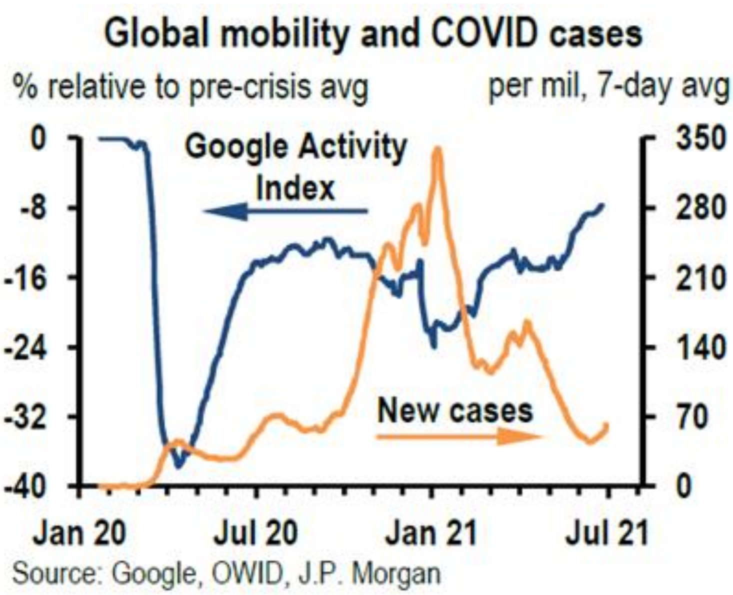




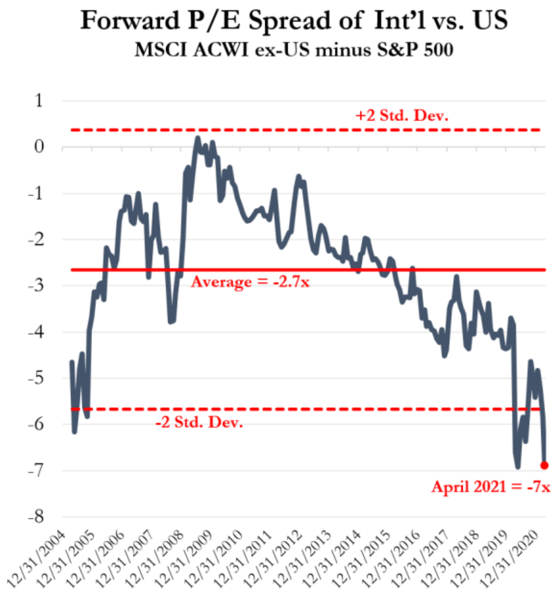
Source: Bloomberg, William O'Neill + Co. and Todd Asset Management

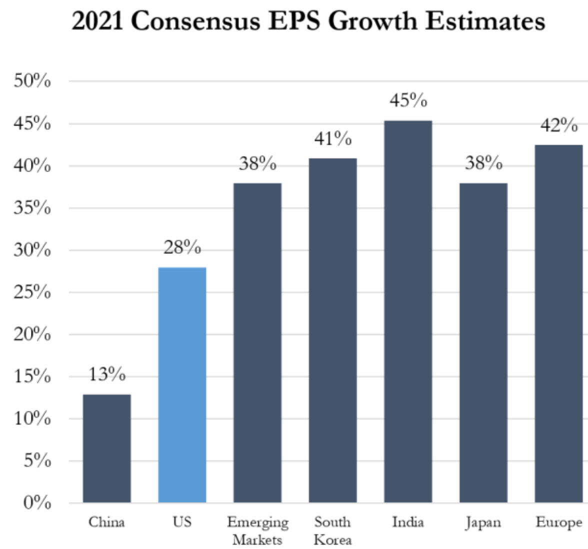
We present our customary factor charts for the second quarter (chart left) and YTD (chart right) periods. As a reminder, these charts evaluate the top 500 stocks in our International Universe, and compare the performance between the 100 best ranked stocks versus the 100 lowest ranked stocks on these measures. The second quarter favored quality and visibility, while many valuation measures languished. In contrast, the first quarter was good for most value factors, so they show up better in the year to date period. Value needs better visibility of the recovery to catch a bid, and we believe that clarity is coming. Rates are generally increasing in Europe, signaling a stronger outlook. China has been somewhat tighter in recent quarters, but is now pursuing monetary easing. Indicators of financial stress like credit spreads are not indicating underlying problems. We believe as the recovery matures, a rotation towards less expensive stocks is likely.

__Interesting Charts We Saw This Quarter__



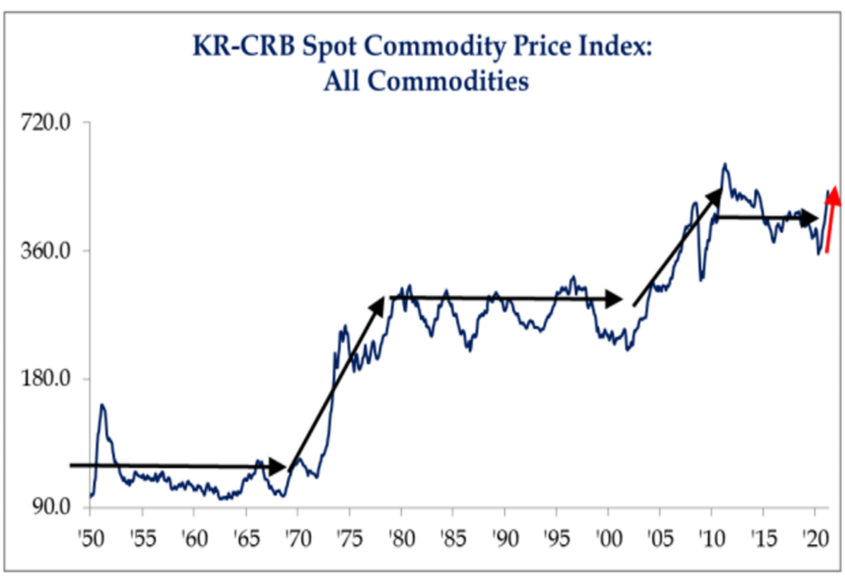
The Google activity index monitors consumers' everyday mobility, i.e. leaving the house for shopping or dining out. As new cases receded from the January peak, mobility picked up globally, though it is still not at pre-pandemic levels. Assuming new cases remain constrained as vaccinations roll out, this activity should bode well for the service sectors of economies that have been lagging in the overall recovery. We are seeing an uptick in cases recently (led by Asia) but most countries are aggressively ramping up vaccine distribution.





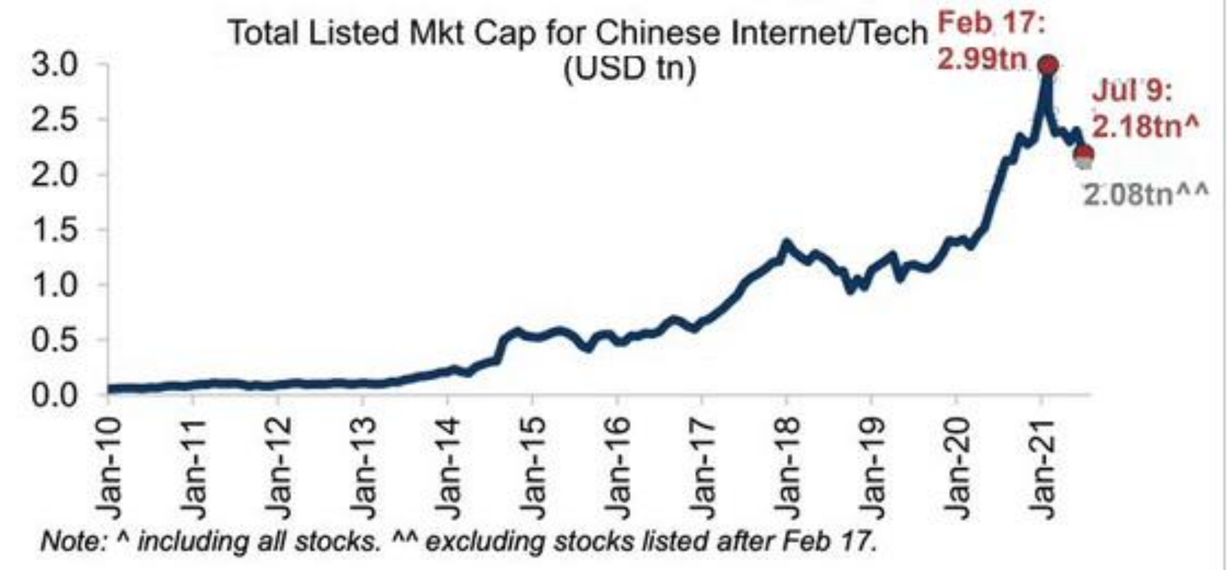
Source- TAM, Bloomberg

Earnings growth is expected to be robust globally on the back of the re-opening trade. The chart to the left compares the forward P/E multiple spread between international markets and the US. That measure is at a record discount now despite the better EPS comparisons expected as illustrated by the chart on the right. International markets are much cheaper than the US, and the economic outlook is clearly better from what we see. This should help investors justify investing more in these regions.



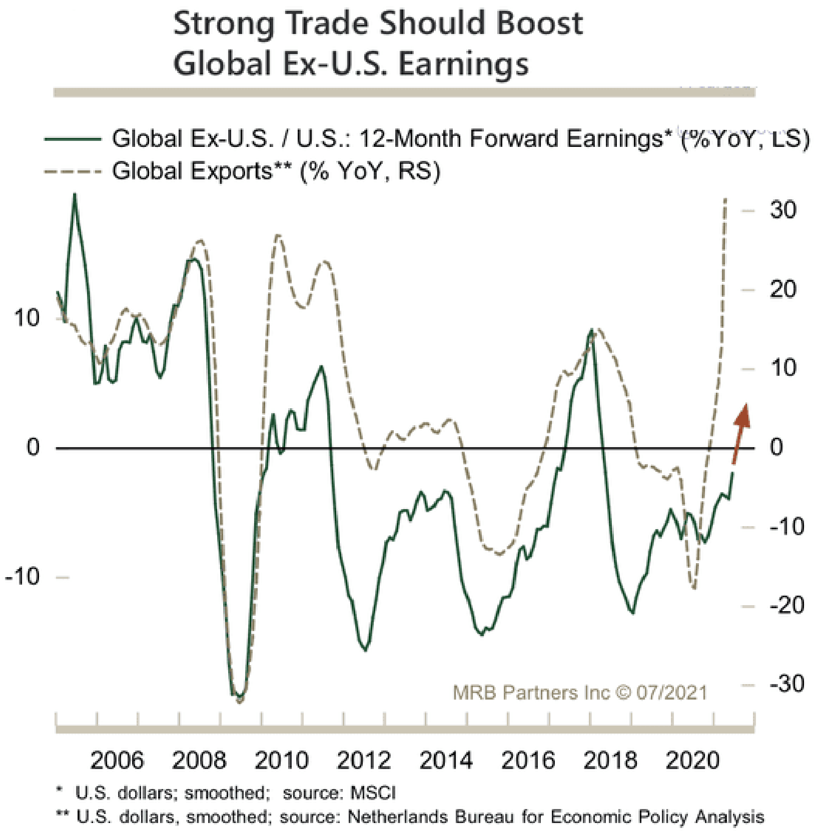
Source: Strategas

Commodities tend to run in long cycles, and have been lackluster performers (until recently) since the Global Financial Crisis. At that time, overspending to open new production facilities and oversupply led to weak pricing. These trends appear to be reversing now as production expansion is generally not occurring. If this discipline holds up, commodities producers should see better times ahead.



Source: FactSet, MSCI, Bloomberg

One weak spot in the quarter occurred when Chinese Internet companies were singled out by the authorities for new regulations mostly designed to ensure data protections. This has been a costly endeavor, reducing their market capitalizations by almost a third while their US counterparts (FANGMA stocks) have seen a resurgence in their shares. We believe most of the price adjustment is already reflected in the shares, and our sense is as the Communist Party is celebrating their 100th year, they are likely to promote a stronger economy and market. This should help these stocks.



Global exports are recovering, after a multi-year period when trade wars and the Pandemic caused dramatic declines and slowing of trade. Inventories remain low, which bolsters the outlook for trade continuing to improve as re-opening progresses. As trade improves, countries outside the US tend to be the beneficiaries of it. As you can see from the chart, international earnings have lagged the US since 2017, a trend that appears to be reversing.

Summary

There were a number of positive developments in the second quarter, despite the fact that International Stocks underperformed their US counterparts. The most recent global wave of Covid cases peaked in April and went on to decline by about half through mid-June. Earnings came in well ahead of consensus expectations which lifted full year estimates by another +8% during the quarter. All of this pushed the ACWI ex-US to new all-time highs in early-June (it's first in over 13 years). Despite this, concerns over the spread of the Delta variant brought the reopening trade into question in recent weeks. Outbreaks and extended lockdowns in several countries in May and June led to risk off positioning. German bond yields, which looked like they were working their way out of negative territory through the first part of the quarter, moved lower as concerns around the Delta variant weighed on global reopening expectations. This sentiment carried over to most markets with the US Dollar strengthening and most commodities consolidating or correcting over the past few months. Brent crude oil was an outlier here, continuing to make new post-pandemic highs as OPEC failed to agree to new production levels. Outside of Covid-related news, the Chinese government continued to roll out regulatory changes that targeted a number of large consumer-facing services companies. We anticipate that these issues are largely transitory as vaccines continue to show high levels of protection against emerging variants and administration ramps globally.

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

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07/19/2021
MSCI ACWI ex-US (Net) – 342
MSCI ACWI (Net) – 707
MSCI ACWI ex-US Value (Net) – 182

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.