October 16, 2020
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Todd Asset Management

The Bounce Begins…

Todd Asset Management Q3 2020 International Market Commentary

	3Q 2020	YTD	1 Year	3 Year*	5 Year*	7 Year*	10 Year*
MSCI ACWI ex-US (Net)	6.3%	-5.4%	3.0%	1.2%	6.2%	3.2%	4.0%
MSCI ACWI (Net)	8.1%	1.4%	10.4%	7.1%	10.3%	7.8%	8.5%
MSCI ACWI ex-US Value (Gross)	2.4%	-17.2%	-10.4%	-4.6%	2.7%	0.4%	2.2%

* *Annualized Total Returns.*

The Chinese economy has bounced back after the Pandemic. Other global economies are expecting a bounce back as well, but likely lagged from China's by 3 months. Looking at just the numbers, the Chinese economy grew 3% year over year in the second quarter. While this is less than half of the growth rate we saw prior to the Pandemic, it highlights how economies can recover from the depths of a recession when the stars align and conditions for a recovery are present. In contrast, the developed markets of Western Europe and Japan were in the midst of the pandemic slowdown during the second quarter and expecting a third quarter rebound. The bounce in GDP readings has begun, and should continue as stimulative measures take hold and expand.

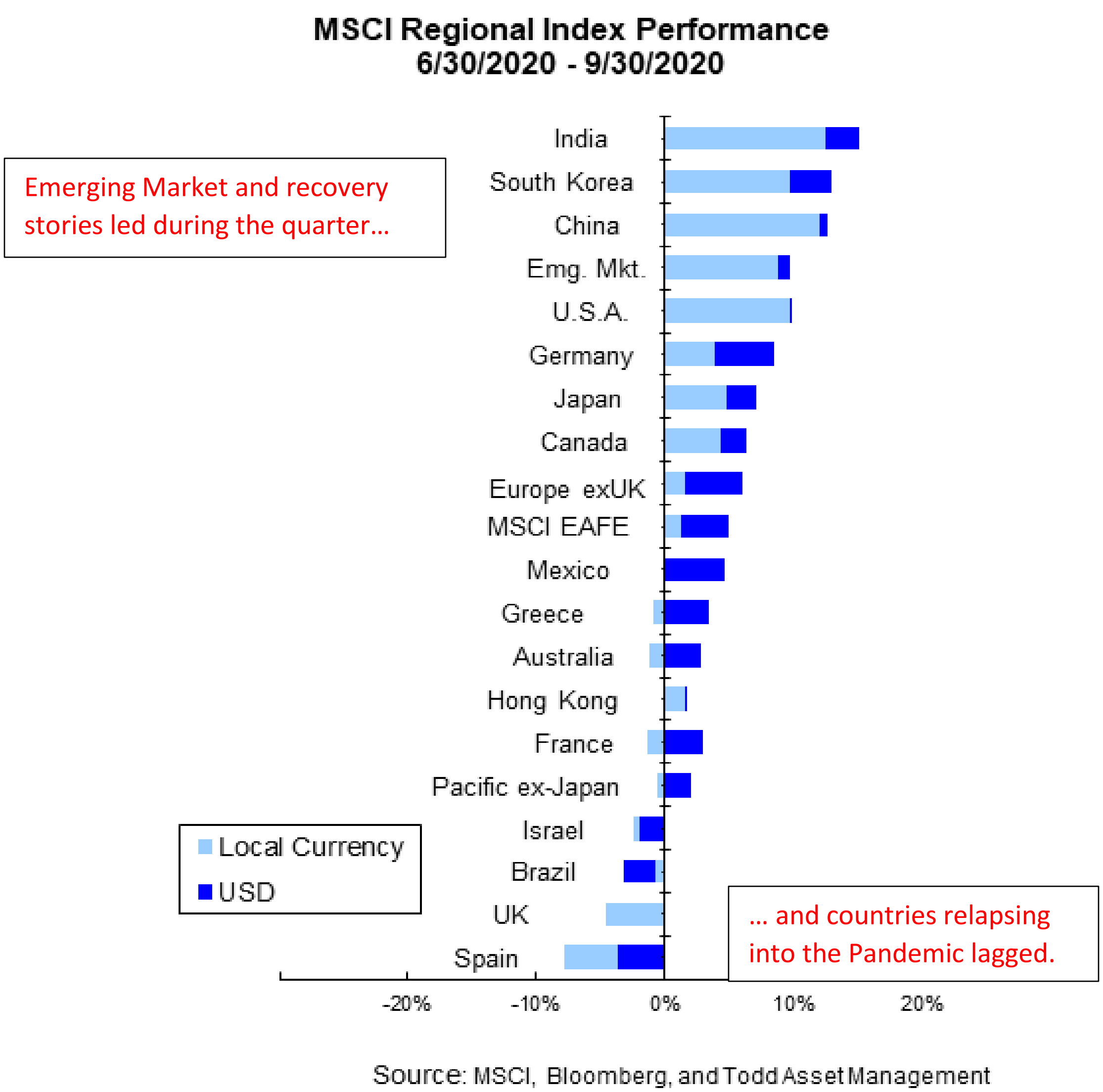
Major points we noted from the quarter were:

- The ACWI ex-US index returned 6.3%, lagging the S&P return of 8.9%. The ACWI ex-US Value Index lagged the overall index with returns of 2.4% versus the comparable growth index returning 10.2%. Emerging Markets outperformed Developed Markets with a return of 9.7%.
- The Pandemic outbreak continues, with some notable second waves in the US and much of Europe. China and much of Asia have not seen a second wave. Importantly, fatalities have not seen a commensurate increase with cases. Authorities worldwide are reluctant to institute lockdowns again. Progress continues on vaccines and treatments, and many medical leaders expect some breakthrough over the next few months.
- Government stimulus continues to flow. We await the final approval of the EU Recovery Fund while China is pursuing serious stimulus as well. The US is expected to follow suit post-election. This has historically had a multiplier effect on growth over the following two years. According to a recent IMF study, a 1% increase in public investment leads to nearly 3% higher growth and 10% higher private investment and a 1.2% higher employment over the following two years.
- Most international currencies have strengthened against the Dollar. While this is plateauing as US stimulus plans come into question, more US fiscal actions are expected regardless of who wins the election. This implies more deficit spending, and (in all likelihood) stronger international currencies versus the dollar.

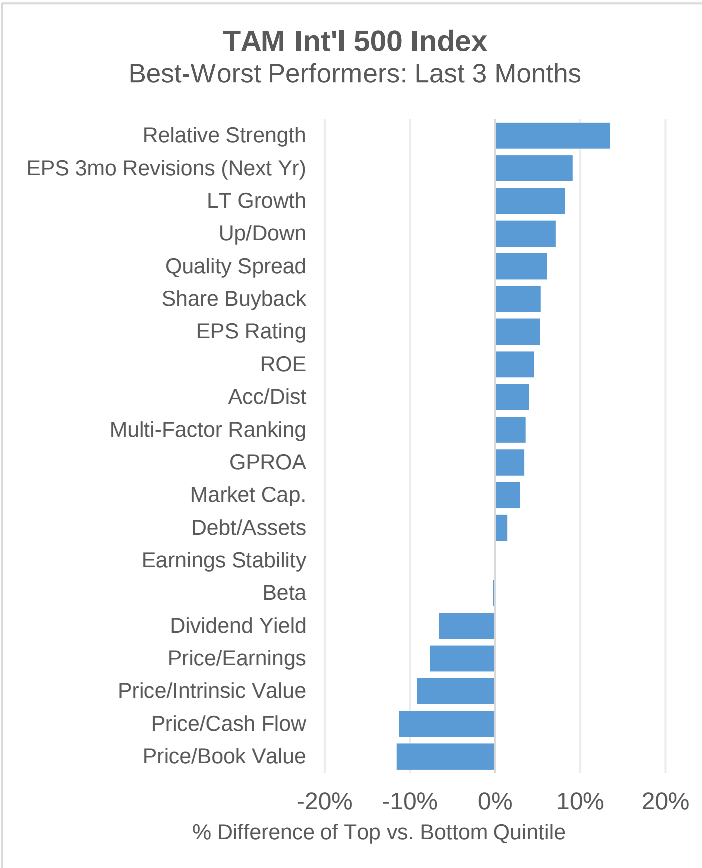
- Manufacturing and Services Purchasing Managers Surveys are both indicating we have entered a global economic expansion. Exports are recovering after the COVID related weakness. This is broad based and could be amplified if a medical breakthrough on vaccines or treatments occur.
- Brexit negotiations remain with us and the coming two months will determine whether they can get a trade deal with the EU or if they need to default to World Trade Organization rules. We believe a negotiated trade deal would be a better option.

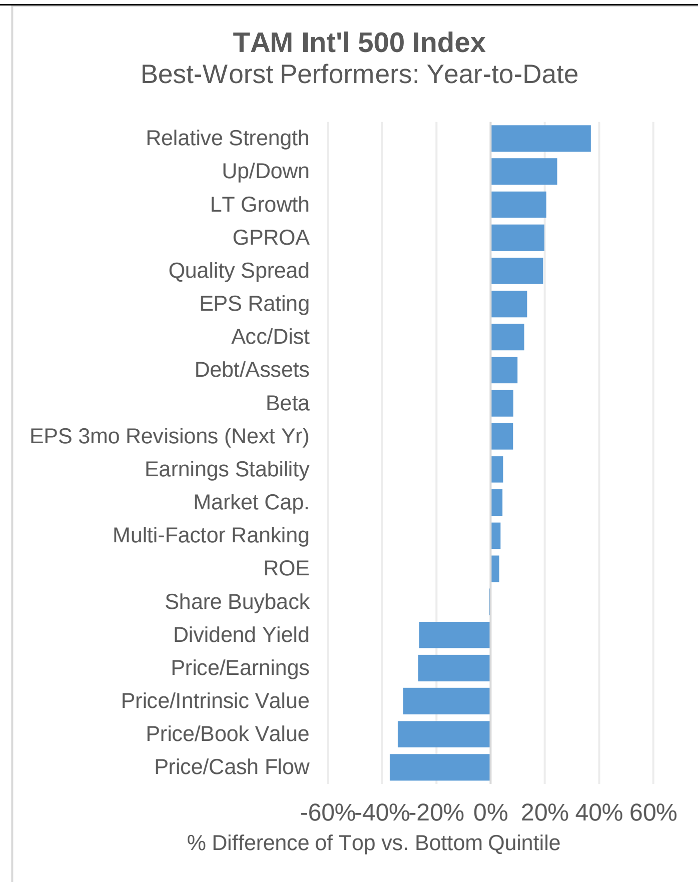
We still think the economic recovery has years to run, and do not believe a double dip recession is likely. We would not be surprised if growth takes on a stair step shape over the short term depending on the course of the pandemic. History suggests rates rise during recoveries and cyclical stocks outperform. This has been the case (with ebbs and flows) since the market bottom on March 23, and we think it is a trend that should continue for some time to come. If rates rise, the relentless push into growth stocks probably eases up, allowing Value and International stocks to outperform.

Regional Performance



Factor Charts

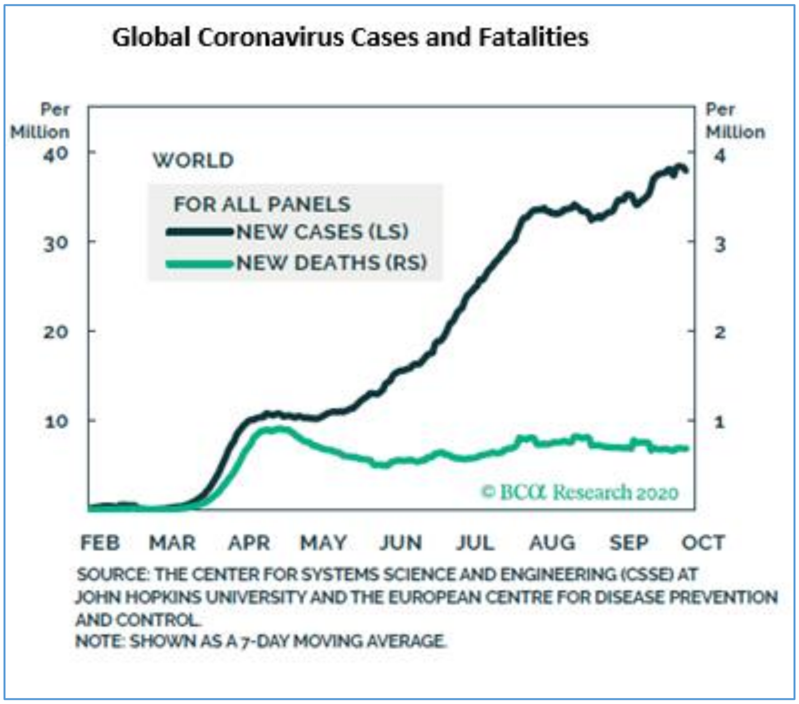




Source: Bloomberg, William O'Neill + Co. and Todd Asset Management

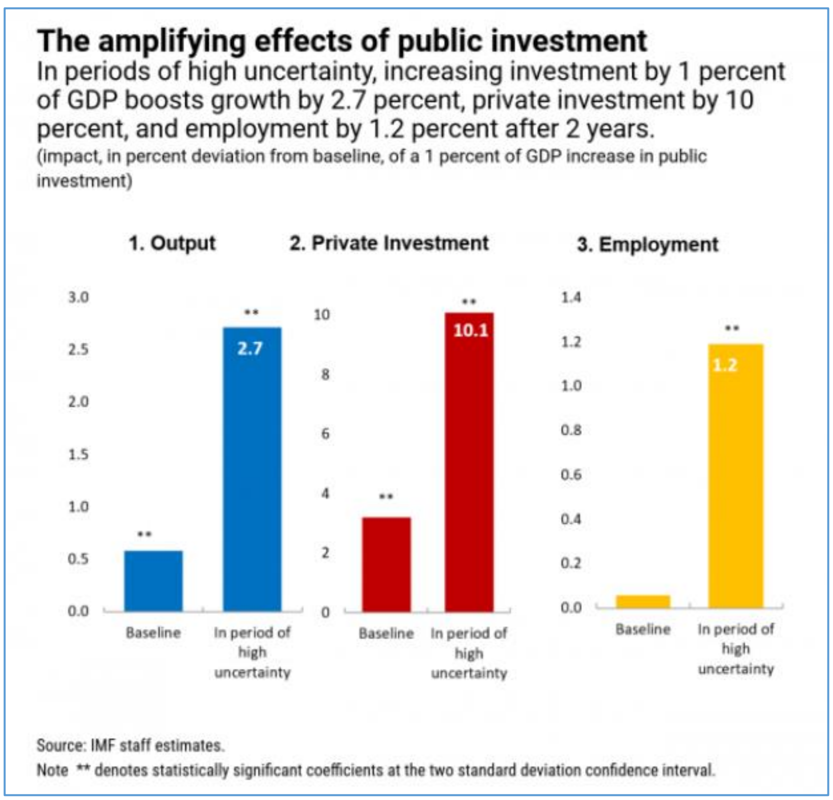
As was the case in the US, investors favored Visibility, Momentum and Growth over the past 3 months and YTD. They did not reward Value factors or Shareholder Returns (i.e. Dividends and Share Repurchase).

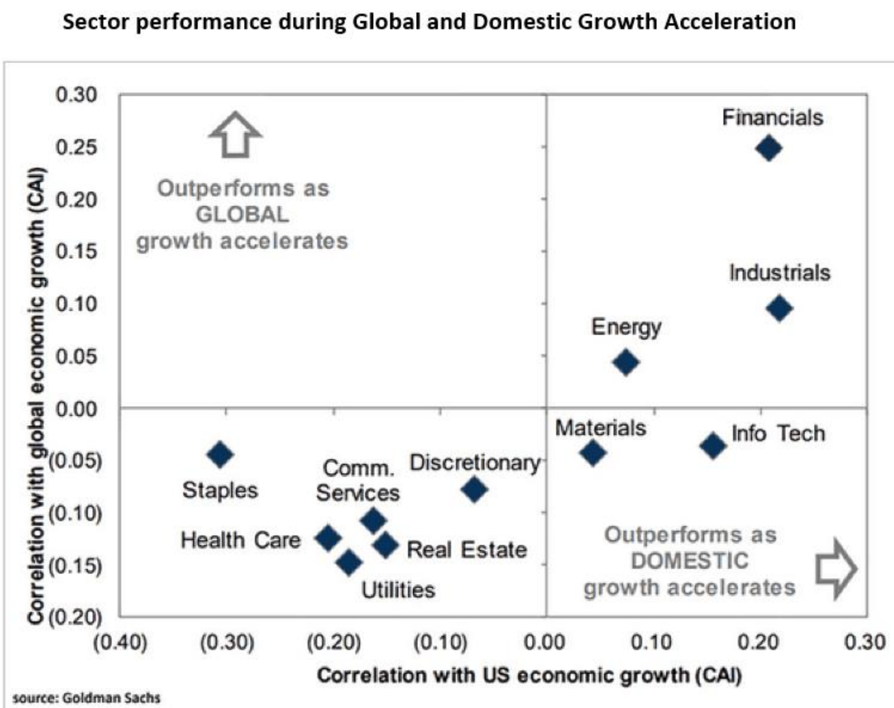
Interesting Charts we saw this Quarter



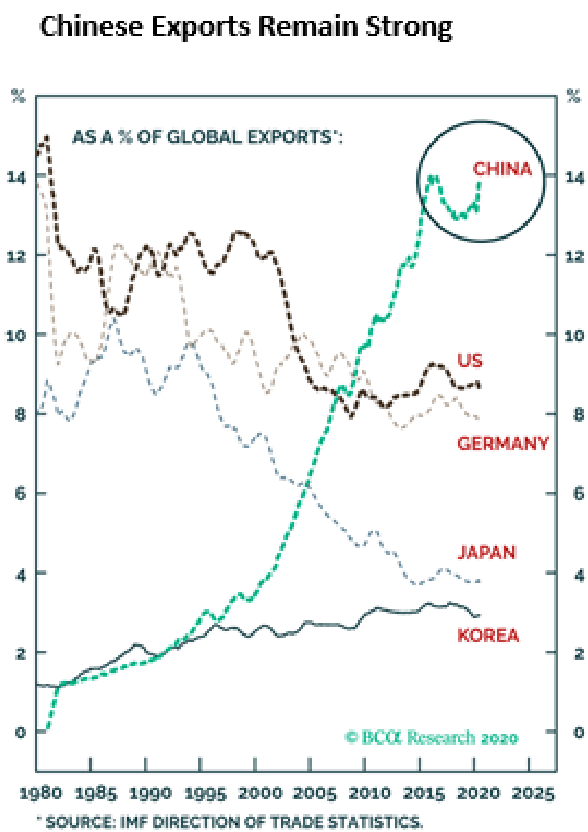
Global COVID-19 statistics have shown increases in the rate of new cases since a lull in the infection rate from April to June. With many economies reopening, infection rates have nearly quadrupled from those levels. Fatalities have remained constant per million population, as treatments have improved. Medical professionals sound optimistic that progress is being made in the search for a vaccine.

In prior publications, we have highlighted that governments are very stimulative, with the US, Germany and Japan all providing support of 12-16% of their annual GDP to their respective economies. If you dovetail that with this analysis from the International Monetary Fund, it leads us to expect that the stimulus should provide at least a two year tailwind for Output, Investment and Employment. As the markets have lacked this type of visibility for 5 years, we think it benefits some of the areas that have lagged over that time frame.

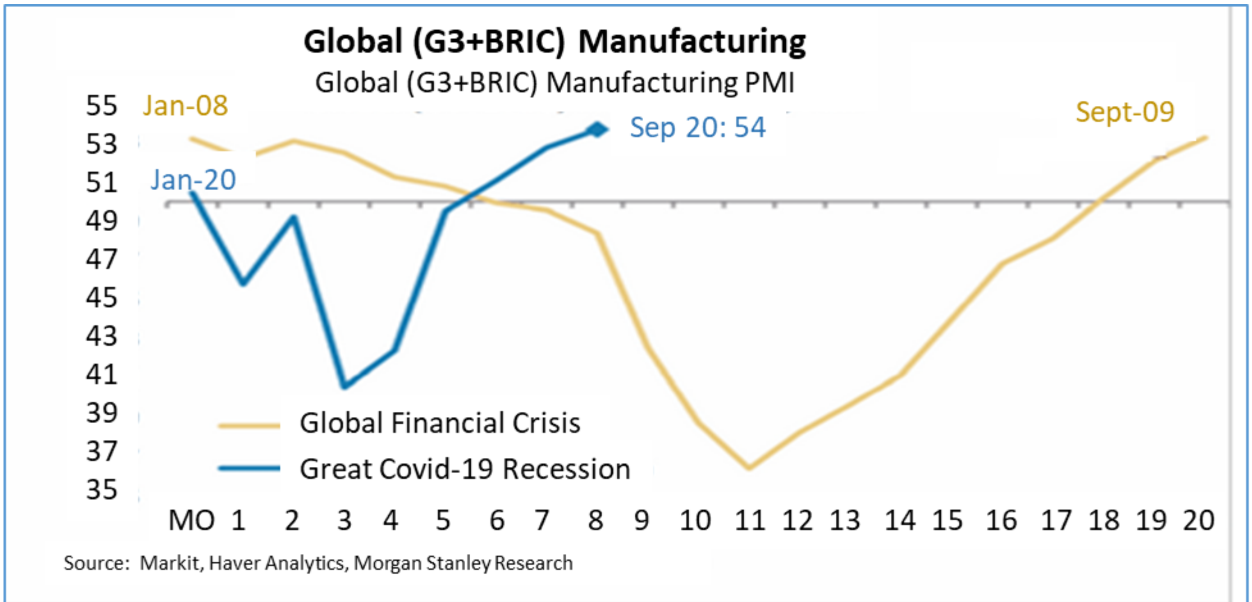


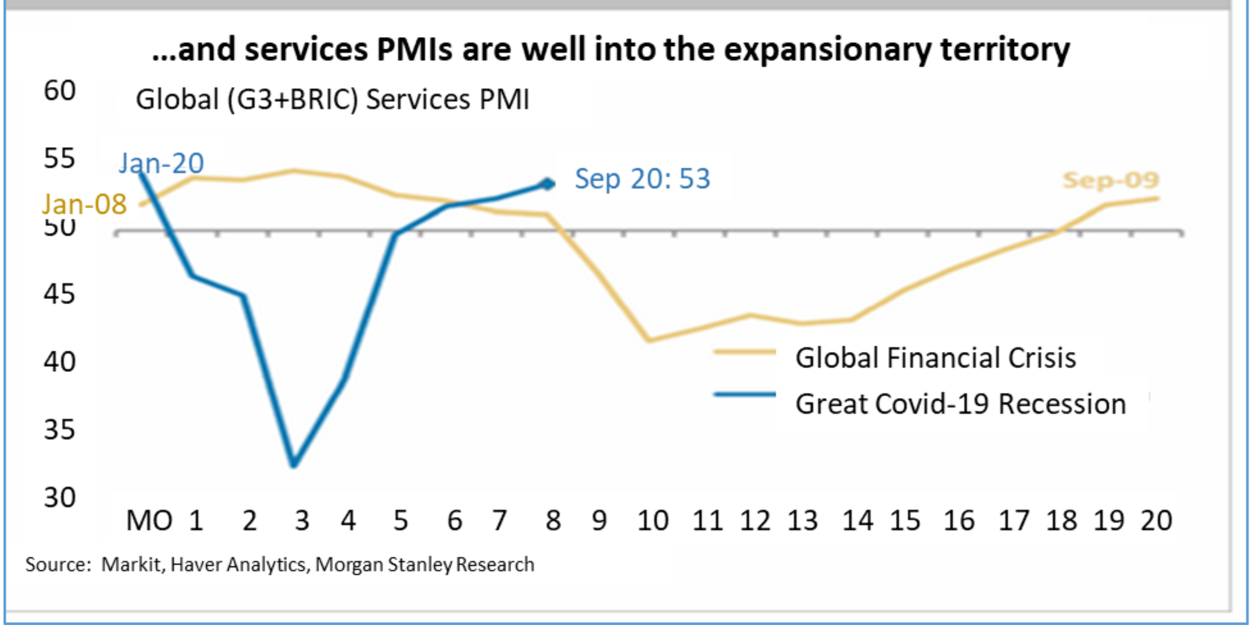


Global GDP growth is accelerating. This chart, from Goldman Sachs, shows how sectors performed when Global and Domestic growth accelerated. The Financials, Industrials and Energy stocks were best correlated to outperform when both Domestic and Global growth accelerated, while the Materials and Technology groups outperformed when Domestic growth accelerated. Other groups tended to underperform when global and domestic growth was accelerating.

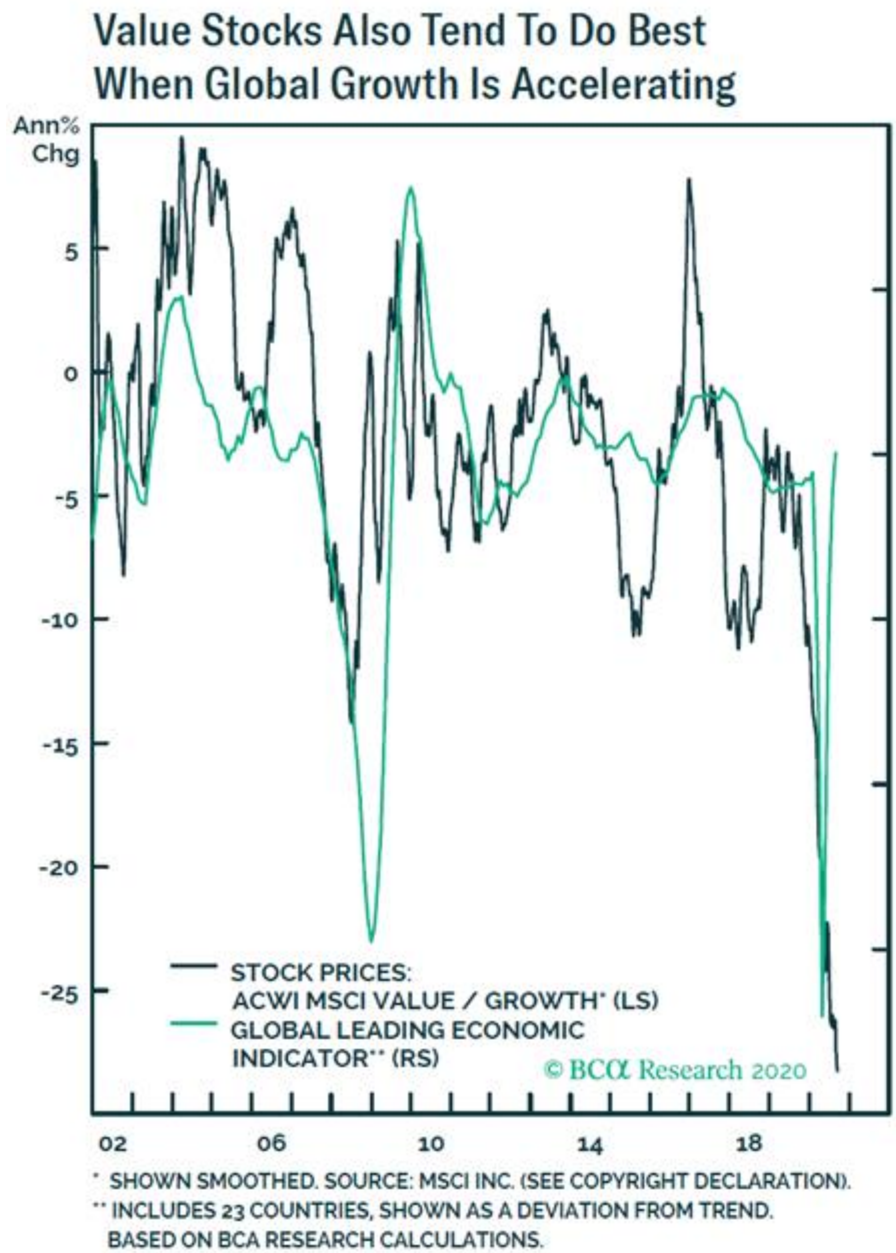


China has developed a strong manufacturing base, and a good reputation for being the best quality Global manufacturing outsourcer. The US instituted Tariffs to try and reclaim manufacturing, but Chinese exports recovered from a short lull in 2018-19 to nearly their old highs in market share. Japan and Germany have lost share since 2010, while the US share is up modestly since the Great Financial Crisis. China is automating and manufacturing more complex goods, increasing their productivity. This also allows them to let many labor intensive goods shift to be manufactured by other emerging countries like Vietnam or Mexico.





Purchasing managers' indexes are reinforcing what other high frequency indicators tell us. These charts, from Morgan Stanley, show that both Manufacturing and Services are above the 50 level, indicating expansions. The world economy is reopening, with both manufacturing and services growing again. This does not mean that the world has fully recovered from the COVID crisis, but it does indicate that the decline in output for both manufacturing and services have bottomed, and are turning up. The world has a lot of runway left before the COVID shortfall is completely recovered, which should allow for good GDP growth for some time to come.



Leading Indicators offer a good snapshot of economic confidence. The black line above shows the ratio of ACWI Value to ACWI Growth (declining = growth outperformance and vice versa) compared to the trend of Global Leading Economic indicators. When LEIs improve, Value tends to outperform. Coming off the recent market bottom, this should bode well for Value stocks when investors gain conviction that the economic expansion is durable.

Summary

Investors are probably going to be edgy and volatility is likely to be high until we get a resolution to Brexit, US Election results, progress on the Pandemic and better clarity on future stimulus plans. Fortunately, Brexit and the US Elections should be completed by year end. Regardless of which way those are decided, Investors may just be happy to get them both clarified so they can start looking forward again. We expect that more Fiscal stimulus is forthcoming. As the EU works towards approval of their Recovery program, we are seeing that other global initiatives continue. Japan, China, the US and many other countries are working to support economies during the pandemic. These actions tend to have impacts that are felt for years to come. Our sense is that an economic recovery probably benefits some of the out of favor segments of the world market, which should lead to better results for International stocks compared to US stocks. If you couple that with the potential for a weaker dollar, it could be the impetus needed to "turn the page" to favor international stocks for a change.

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

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10/16/20
MSCI ACWI ex-US (Net) – 242
MSCI ACWI (Net) – 295
MSCI ACWI ex-US Value - 143

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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 (gross) 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.

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