October 19, 2021
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Todd Asset Management

Working Through Concerns

Todd Asset Management Q3 2021 International Market Review and Outlook

	3Q 2021	YTD	1 Year	3 Year*	5 Year*	7 Year*	10 Year*
MSCI ACWI ex-US (Net)	-3.0%	5.9%	23.9%	8.0%	8.9%	5.7%	7.5%
MSCI ACWI (Net)	-1.1%	11.1%	27.4%	12.6%	13.2%	10.0%	11.9%
MSCI ACWI ex-US Value (Net)	-2.3%	9.1%	31.4%	3.8%	6.4%	2.9%	5.5%

* *Annualized Total Returns.*

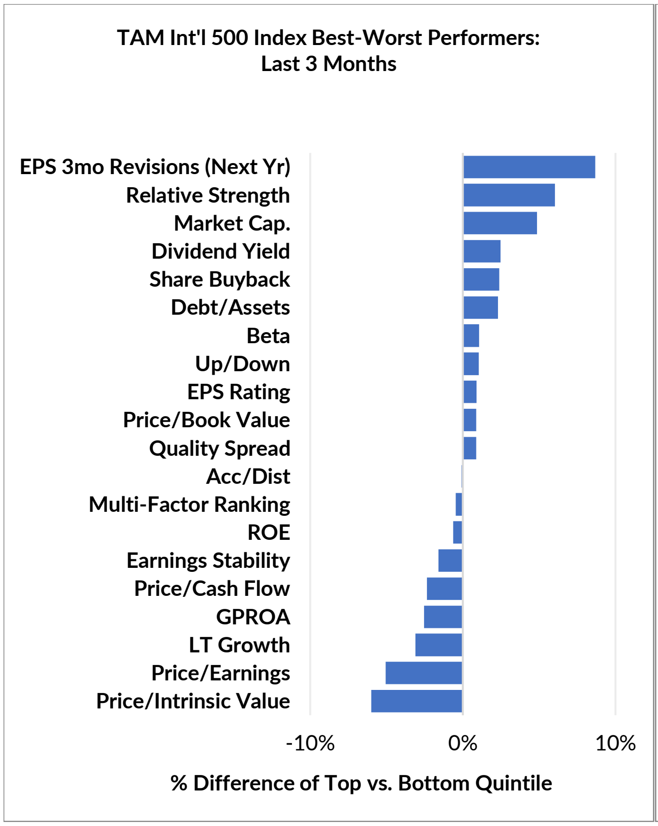
World markets sagged on several scares in September including Washington turmoil, Central Banks tapering, power shortages, potential financial crisis in China, Inflation worries, continued Covid concerns and general markdowns of expected economic growth on supply chain disruptions into year end. International markets underperformed the US for the quarter but outperformed during the September decline. ACWI ex-US declined -3.0% in Q3 compared to the ACWI (including US) return of -1.1%. Interest rates rose and yield curves steepened late in the quarter as inflation picked up, causing growth stocks to roll over. Higher rates do imply the growth scare of the summer is giving way to expectations of re-acceleration as international economies are working through their concerns. This should be supportive of stocks going forward.

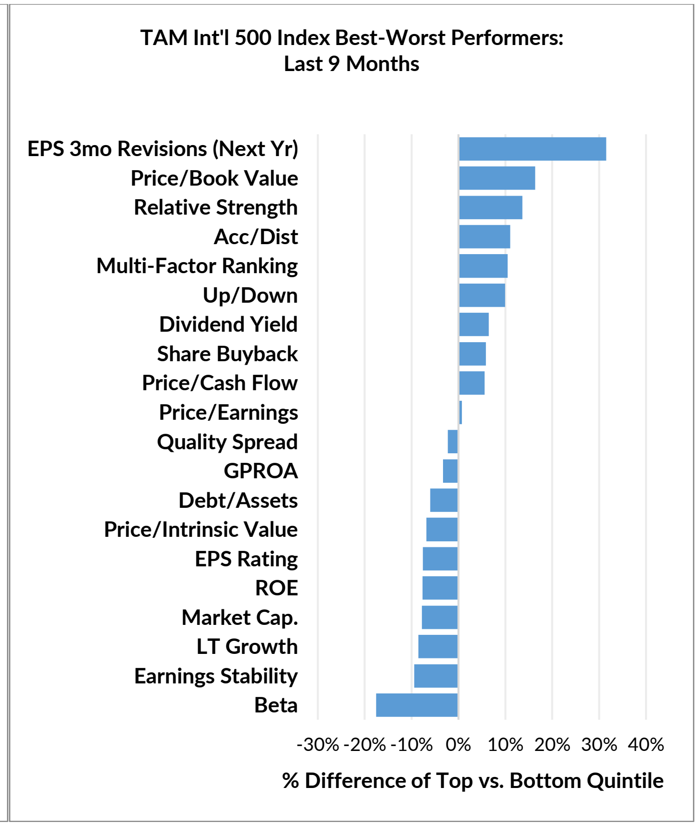
Items of note during the quarter included:

- **China remains a concern** as the Evergrande Crisis, regulation and energy shortages have investors worried about systemic challenges. Economic growth is slowing, but we anticipate renewed fiscal and monetary stimulus over the near term to counter this.
- **The ECB will trim emergency bond purchases** but won't call it tapering (even if it is.) Higher inflation rates and continued economic growth probably prompted this.
- Despite Washington's turmoil during the month, **the Fed opened the door for a November tapering,** and bond yields rose on that news.
- **Commodity prices have hit the highest levels since 2015** on re-opening demand and an energy surge. China, the UK and Europe have seen energy shortages for various reasons, driving oil and natural gas prices higher. As cold weather is just beginning, these higher prices are probably with us for some time. Inflation probably remains higher than many observers estimate.

Economic growth sagged during Q3 but should recover as Q4 progresses. Weaker indicators included retail sales worldwide over the summer and many PMIs in Asia. Lockdowns and supply chain disruption were at the core of these concerns. With the news last week of Merck's breakthrough Covid treatment, we believe markets may begin to react like they did after the announcement of the vaccine last November. Call it the Grand Re-opening 2.0 if you want, but the Delta Variant led to a markdown in growth estimates and an effective treatment could reverse that. We believe both the US and China are about to come through with significant stimulus which would bolster this case. If economic growth recovers and rates continue to rise, the recent rotation to value probably continues which should be good for international investments vs the US.

Factors

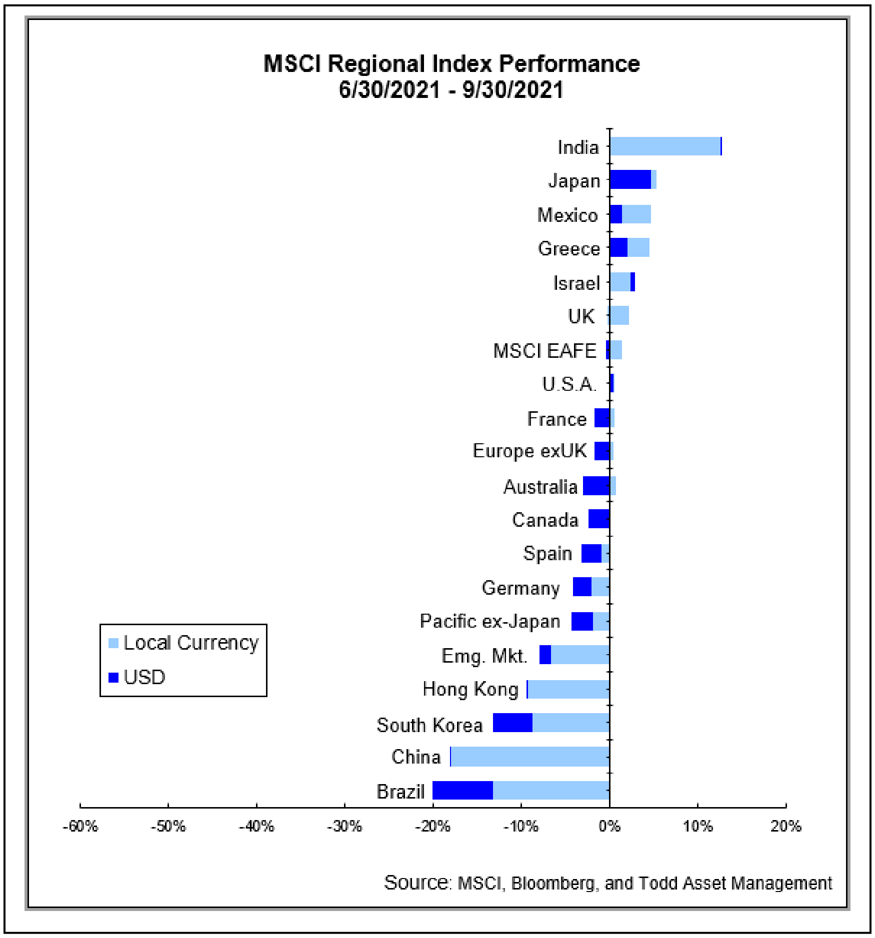




Source: Bloomberg, William O'Neill + Co. and Todd Asset Management

Our customary factor analysis is presented above, which compares performance between the best and worst 20% of the largest 500 securities in our international universe based on the respective factors. Data for the quarter are presented on the left, and for the YTD period are on the right. Quality and visibility led for the quarter, as well as the year-to-date period. This probably should not surprise us, as tensions have been heightened by the Chinese uncertainties. Offsetting that, as the ECB begins to taper, we would expect them to note a better tone of economic growth as the current Covid concerns ease up. As conviction in the recovery grows, value factors should improve in these rankings.

Regional Performance

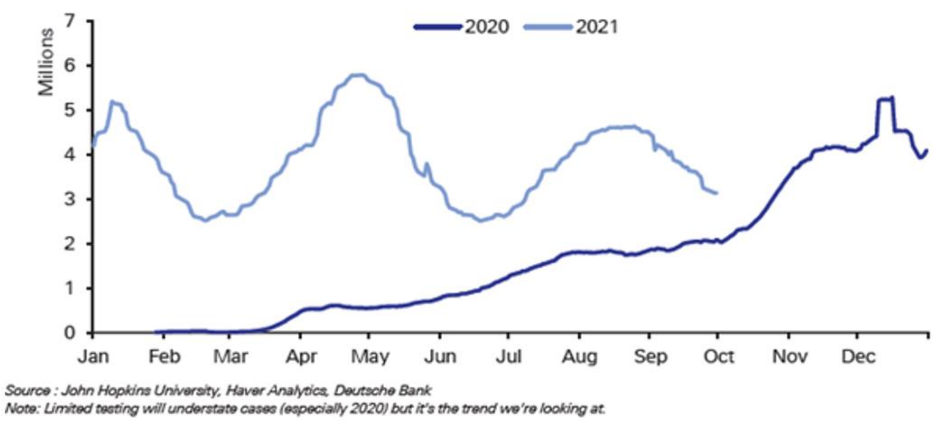


The chart to the left illustrates the leading and lagging markets in both local currency and dollar-based returns. The best performers during the quarter have been those recovering from Covid Shutdowns. India was recently highlighted as having the strongest GDP growth outlook in Asia for 2021. Japan is restarting after a prolonged lockdown, and Mexico has benefitted from rising oil prices.

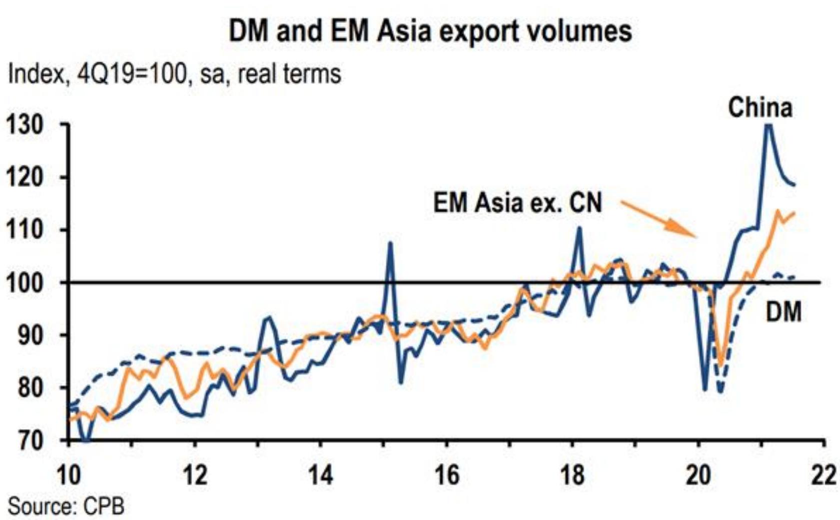
On the other end of the spectrum, Brazil remains pressured as growth slows and inflation surges. Chinese markets suffered from the regulatory concerns noted earlier. South Korea continues to work through a Covid flare-up as well.

Charts we Found Interesting

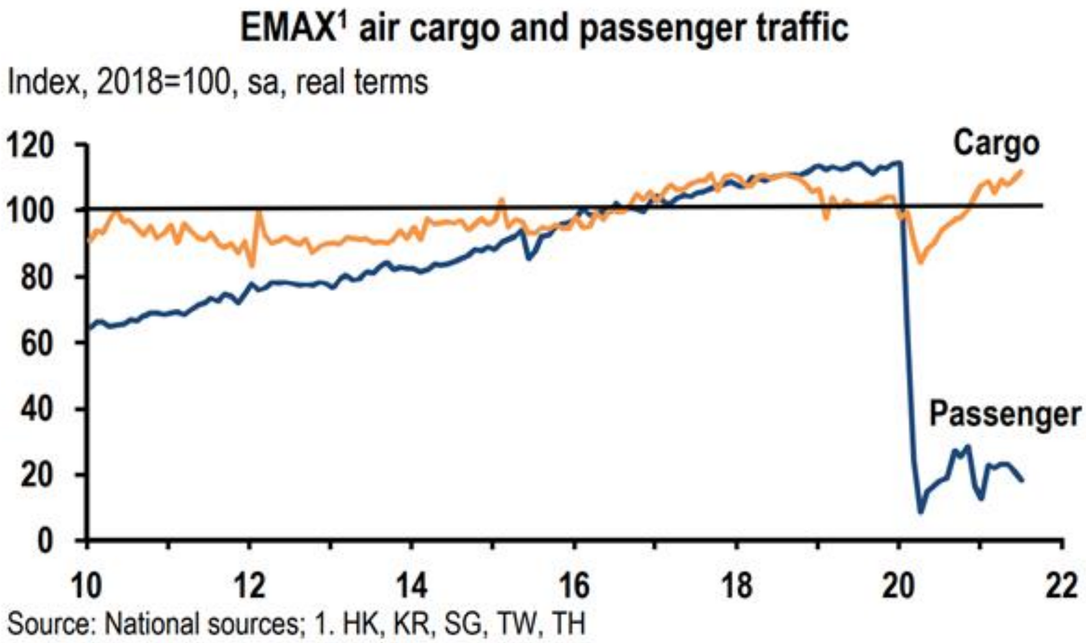
Weekly Global Covid Cases, Delta Appears to be Easing.



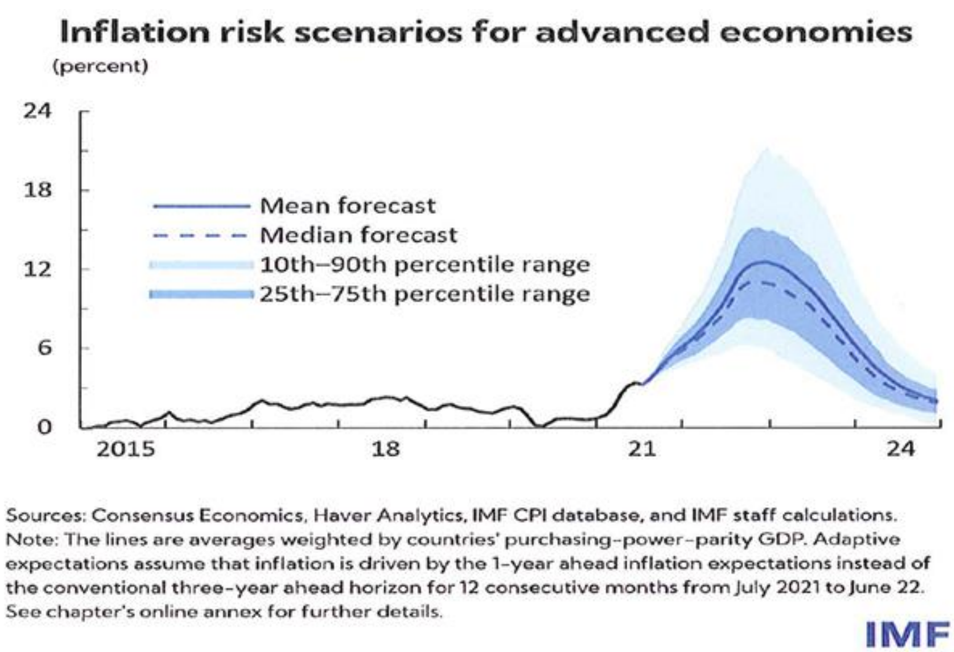
This chart, from Deutsche Bank, is good to keep an eye on. It shows the progression of the pandemic through weekly new case counts for 2020 (dark blue) and 2021 (light blue). New cases have rolled over and fear of covid seems to be waning. New treatments have been announced, namely a pill from Merck that treats mild to moderate covid and appears to help patients avoid hospital time. This could be a game changer as an effective treatment would allow a fuller Grand Re-opening 2.0.



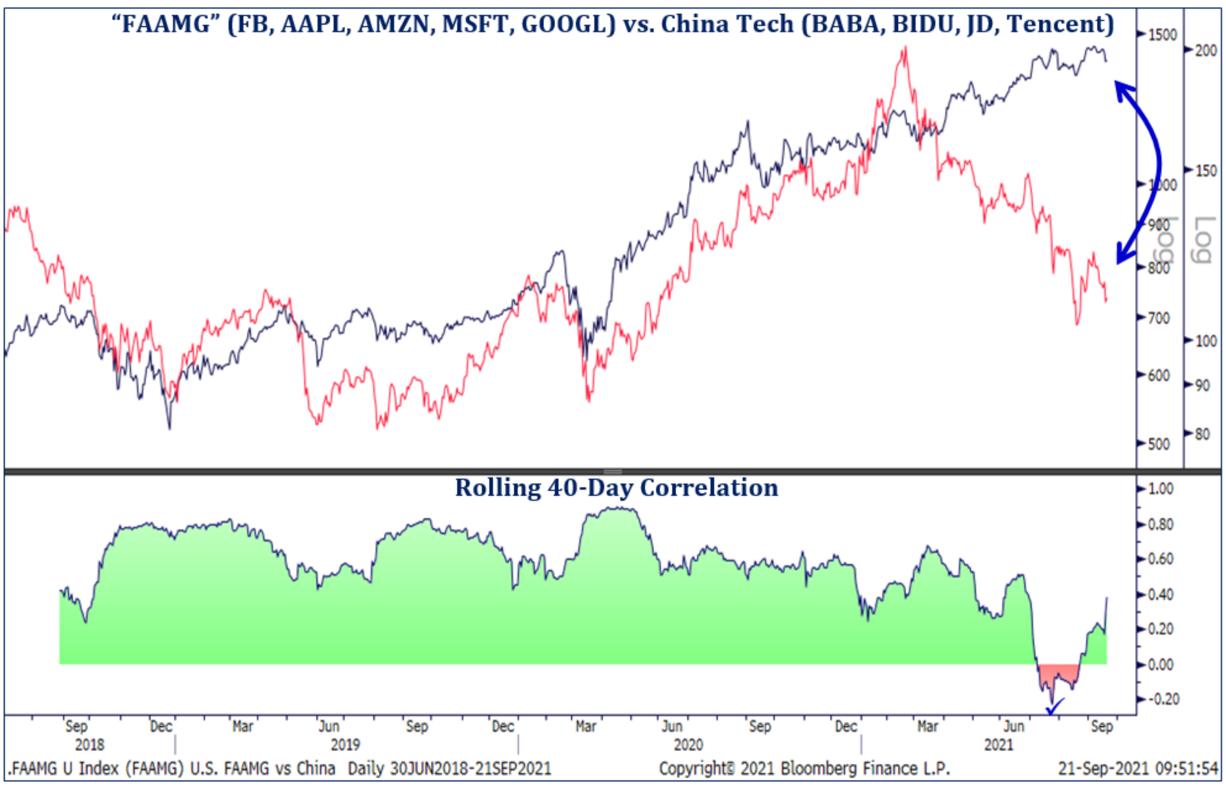
The chart to the left (from JPM) shows the recovery in export volumes from China, Emerging Market ex-China and the Developed Markets. Despite recurring Covid-19 lockdowns, China and the Emerging Markets have seen export volumes reach new records as re-opening demand is being satisfied. Worldwide growth is still strong.



This chart, from JP Morgan, illustrates the steady demand in Asia for air cargo as compared to passenger traffic. We take a couple of observations from this, first, a lot of air cargo is transported in the belly of passenger planes. Lack of that capacity has driven pricing up while the demand remains very firm. The second takeaway is that as Covid fades, there is still a lot of room for passenger airlines and other service sectors to recover.



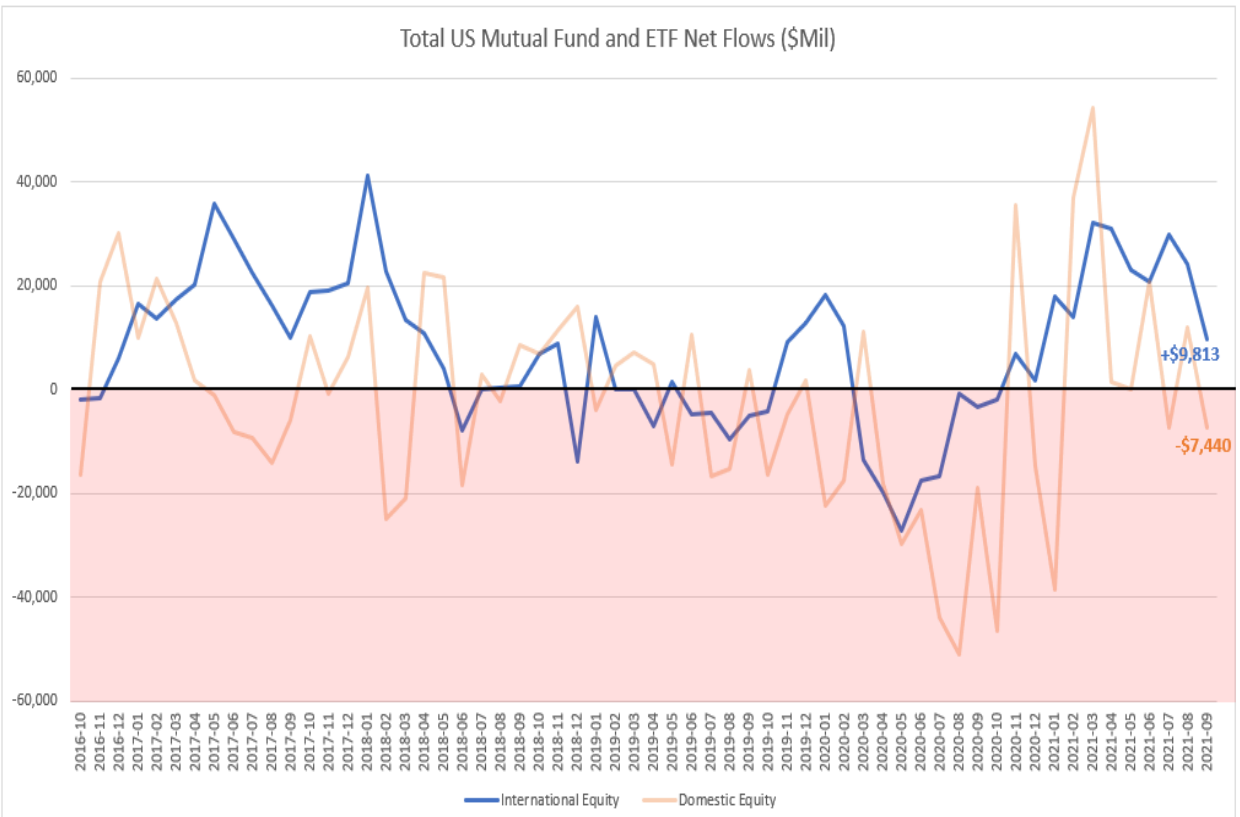
According to the IMF, higher inflation is likely to be with us through the beginning of 2023 and then start to ease up. Commodity prices are where we are seeing this most vividly, but shipping and other costs are seeing a boost as well. Consumers appear willing to accept higher prices according to the research we are seeing. Higher energy prices are going to be an issue for European and Chinese growth over the winter. It's not even cold out yet, and both regions are encountering energy shortages. Part of this is demand, but there have also been moves to move towards sustainable energy sources that have seen the supply of energy fall short of goals. We are monitoring this to see how the increased cost of energy is impacting corporate earnings and end demand.



Source: Strategas

US (blue line) and Chinese (red line) tech leaders used to trade in lockstep. Now with a Chinese regulatory crackdown, they have diverged. As reopening occurs (and non-tech names see good fundamentals), we would not be surprised for these two sectors to converge again.

One chart that may surprise you is presented below. Fund flows into international funds and ETFs in the US have been better than domestic ones lately. Since late last year, investors have been steadily allocating to international investments (blue line). We are encouraged that US Investors are re-allocating towards international stocks and believe the cycle is likely to continue shifting that way.



Source: Todd Asset Management and Morningstar

Summary

In summary, the economic recovery is continuing and should benefit from the Grand Re-opening v.2.0 we have highlighted in this report. Consumer demand remains firm, capital spending is starting to recover, and manufacturing is catching up. There are some issues slowing the recovery, notably a lack of workers, inflation concerns and supply chain breakdowns. The good news is that most of these issues are addressable and should contribute to a longer economic recovery as demand has been deferred not destroyed. There are likely to be bumps along the way as world economies begin moving towards a post pandemic world, but the new treatment announced by Merck could be a game changer that allows faster progress on that front. China has been a source of concern, making belligerent moves in the South China sea. We believe as we move through year end towards the February Olympics in Beijing, that these situations should cool. As we see the economic recovery continue, driving an earnings advance, we are close to seeing the ACWI ex-US Index break out of the trading range it has been in for 14 years. When that occurs, it will be a strong signal that those markets are in a secular bull market which should last for years. We believe that development is likely in the coming quarters.

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

10/19/2021
MSCI ACWI ex-US (Net) – 349
MSCI ACWI (Net) – 739
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.

The TAM International 500 consists of the largest 500 securities by market capitalization within the universe of securities we consider for investment.