

## International Value ADR

Marketing communication | As of 30 Sep 2025

- **During the third quarter, the International Value ADR strategy outperformed its primary benchmark, the MSCI EAFE Index, but underperformed the MSCI ACWI ex-U.S. Index.**
- **Relative to the EAFE benchmark, the strategy benefited from security selection in materials and Switzerland, along with an out-of-benchmark allocation to Canada, while security selection in information technology, Japan and France detracted.**
- **Despite threats of higher U.S. tariffs, our outlook for international equities remains positive as Europe infrastructure spending begins to ramp up and China shows signs of recovery.**

### Market review

While uncertainty continued to overhang the global markets during the third quarter, worst-case scenario fears regarding the impact of tariffs on economic growth and inflation were avoided. Monetary policy worldwide continued to diverge, with central banks balancing still-sticky inflation and economic growth concerns amid ongoing tariff uncertainty. After holding rates steady at its July meeting, the Federal Reserve (Fed) cut rates for the first time this year in September, bringing the target federal funds rate to a range of 4.00%-4.25%. While the Fed's updated economic projections in September showed few changes, the heavily scrutinized dot plot indicated two more rate cuts this year and one in 2026. The Bank of England (BOE) also cut rates once by 25 basis points in August, while the European Central Bank (ECB) and Bank of Japan (BoJ) held policy steady throughout the quarter.

Global stock markets rallied during the third quarter with major U.S., European and Japanese markets reaching new all-time highs. The risk-on sentiment was supported by the Fed's rate cut, the frenzy surrounding artificial intelligence (AI), easing tariff drag and solid earnings expectations, which offset European fiscal concerns and a softening U.S. labor market. The MSCI EAFE Index advanced 4.8% for the quarter, adding to its strong first-half results and ending September up 25.1% year to date. In developed markets outside the United States, returns were stronger in Japanese and Canadian stock markets, while European stocks lagged despite the onset of Germany's fiscal boost. The U.S. rally was led by quality and growth stocks; however, the EAFE Index was helped by stronger bank earnings and currency headwinds, leading EAFE Value to outperform EAFE Growth by around 5%.

Emerging market equities were the star performers, outpacing developed markets with a 10.6% quarterly return as measured by the MSCI Emerging Markets Index. Chinese equities were buoyed by AI-related momentum, signs of bottoming consumer spending that lifted Macau casinos, increased industrial-led capital expenditures and an improved outlook for financial companies with the steeper U.S. yield curve. Sentiment also improved because of the potential for a tariff truce between the United States and China and anti-involution measures to reduce factory overcapacity.



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Europe underperformed both the EAFE Index and the United States because of less exposure to AI and big tech companies, combined with fiscal and geopolitical concerns. Excitement about Europe faded during the summer following softer second-quarter earnings, a stronger euro and ongoing news articles regarding disagreements in Germany and France about future funding uses. Europe did recover somewhat at the end of the quarter as the currency and tariff uncertainty began to ease. However, political risks remain as exemplified by the resignation of Francois Bayrou as prime minister of France after his government lost a no-confidence vote.

Japan outperformed as the yen initially weakened because of fiscal deficit and debt sustainability issues and then slid further following upper house elections that led to the resignation of Prime Minister Shigeru Ishiba. We do not believe Japan's fiscal and monetary policy will meaningfully change under the new government, given the large coalition that will be required.

Precious and semi-precious metals showed strong performance as lower real rates, central bank buying and fiscal worries kept demand high, with gold prices rising approximately 17%, silver 29% and platinum 20%. The U.S. dollar, as measured by the DXY Index, stabilized in the third quarter but still underperformed as U.S. rate differentials declined based on expectations of rate cuts. Oil was generally weaker during the quarter with Brent crude oil prices falling around 4%, while natural gas prices fell 5%.

## Portfolio review

During the quarter, the International Value ADR strategy outperformed the MSCI EAFE Index on a gross and net of fees basis, but underperformed the MSCI ACWI ex-U.S. Index. Global sector leadership was cyclically driven during the period as AI-related and big technology stocks delivered the bulk of gains in the United States, while in other developed markets, financials outperformed followed by other cyclical sectors such as materials, industrials and consumer discretionary (helped by autos and luxury). From a sector perspective, the strategy's security selection in materials contributed to outperformance relative to the EAFE, while selection in information technology detracted. On a country basis, an out-of-benchmark allocation to Canada and security selection in Switzerland contributed the most to relative performance, while selection in Japan and France detracted.

## Contributors

Canadian mining company Agnico Eagle benefited from higher gold prices propelled by further dollar weakness, rate cuts and threats of a U.S. government shutdown looming. Gold stocks generally outperformed the physical price of gold this quarter, especially as energy prices, a large input cost for mining companies, continued to remain low. At quarter end, we still believed Agnico was trading at a 20% discount to physical gold, offering a continued positive risk/reward scenario.

Alibaba benefited from the growth of AI investment in China, an improving Chinese macro recovery and signs the company is successfully using its cloud and e-commerce business to boost its commercial position. The company reported solid first quarter 2026 results where both cloud revenues (growing 26%) and capital expenditures (up 2x) were ahead of expectations. AI contributed to more than 20% of cloud revenue, which is among the highest globally. Moreover, Alibaba recorded a better-than-feared drag from food delivery/instant commerce investment as several delivery companies are fighting a price war to grow market share. Despite the strong performance during the quarter, the company is still trading at a reasonable multiple, given the Chinese AI growth opportunity, as well as having around 17% of its market capitalization in cash for supporting shareholder returns.

European financial shares outperformed the MSCI EAFE Index during the quarter and Dutch banking and financial firm ING Groep meaningfully outperformed both, posting stronger-than-expected second quarter 2025 results. European banks continue to trade at around a 30% discount to other sectors and enjoy strong quality capital positions with an average common equity tier 1 (CET1) ratio, a buffer to absorb potential losses, of more than 14%. ING Groep specifically is experiencing strong customer growth, higher fee income and outperforming volumes with costs under control and rising capital deployment. The company is trading at a 15% discount to the European bank sector while offering better-than-average shareholder returns.

## Detractors

French advertising and public relations firm Publicis Groupe was hurt by persistent concerns about the negative impact from generative AI for the advertising agency sector as a whole and a potential organic sales slowdown in the second half of the year. The company enjoyed stronger-than-expected second quarter fiscal 2025 results with 5.9% in organic sales and a more than 8% improvement above its

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peers. Management also guided to higher full-year guidance upgrades on the back of the first-half results; however, the upgrade implies a second-half organic growth increase of around 4.5%, which is slightly below consensus estimates. Publicis has commented that slowing consumer spending has caused its clients to become more cautious. While we acknowledge a slowing economic environment, we believe this is fully discounted in the company's low price-to-earnings multiple of 11x fiscal-year 2025 estimates, 10% free cash flow yield and 4.5% expected dividend yield.

Swiss nutrition, health and beauty company DSM-Firmenich was hurt by a softening demand environment for flavors and fragrance as well as cost headwinds from U.S. import tariffs. Moreover, while the sale of the company's animal health and nutrition division (ANH) is said to be progressing well, the company may not receive as high a valuation as initially expected and may be forced to retain a percentage, reducing expected shareholder returns. Finally, vitamin prices are normalizing at a lower price as German company BASF ramps up capacity again following its factory closure earlier this year. While DSM's share price has fallen in line with earnings expectations, we believe the market will appreciate the cleaner, more streamlined business model once the ANH business is fully divested, with the potential for higher future returns.

Shares of U.S. specialty insurance and reinsurance firm Axis Capital were pressured by fears that weaker reinsurance rates would negatively impact future earnings. While the company continues to reiterate confidence in underwriting, aided by lower general and administrative costs and adequate pricing in property and casualty insurance, investors fear that falling property rates could hurt its future combined ratio. In its second quarter 2025 results, Axis Capital reported that property rates fell 11% and showed little sign of improvement with irrational pricing behavior by market participants. On the other hand, U.S. primary rates were said to be up 12.5% and casualty up 14% during the quarter. Assuming no major claims in the second half, the company continues to guide to achieving mid- to high-single digit premium growth and potentially increased shareholder returns.

### Portfolio positioning

During the quarter, we initiated a new position in SMC in Japan, the largest manufacturer of pneumatic equipment with about 30-35% global market share and over 60% of Japanese share. Pneumatic equipment – such as actuators, valves, fittings, tubings and vacuum components – are used to reduce the energy consumed in factories and is a crucial

step toward achieving carbon neutrality. Compressing air uses a large amount of energy, so improving the efficiency of this process reduces factory costs. SMC's stock is trading at a 10-year low based on enterprise value-to-sales and price-to-earnings ratio, and at an all-time low price-to-book ratio of 1.4x, compared with an 8% return on equity (ROE) and 23% operating profit margins. However, the company has traded up to 13% ROE in the past and 32% pre-Covid. We believe a recovery in factory automation, machine tools, semiconductors and other equipment would help boost sales and margins in the future. The company currently has about 30% of its market capitalization in cash and has been buying back shares given the weaker share price, providing some downside protection.

We eliminated Yamaha to initiate the new position in SMC. Our original thesis for owning Yamaha was that the company would be able to reduce inventory and experience a strong recovery in earnings once the demand for musical instruments recovered. However, increased tariffs and slow demand in Japan, North America, China and Europe have led us to believe the recovery may come later than expected. We believe SMC offers the strategy a better risk/reward scenario.

We also eliminated Japanese firm NTT based on fears the company could experience a slower-than-expected earnings recovery due to weakness in consumer communications, higher upfront costs in the smart life business (NTT Docomo) and sluggish demand for overseas IT services. The company has made several expensive acquisitions such as SBI Sumishin and Carta Holdings, which have increased its leverage and may lead to reduced shareholder returns in the near future. We believed other names offered better risk/reward scenarios.

The portfolio ended the period with overweights in the materials, financials, energy and industrials sectors while remaining predominantly underweight in the defensive sectors of the market such as health care, utilities, consumer staples and real estate, as well as information technology, consumer discretionary and communication services.

From a country perspective, the portfolio maintained an overweight in France through several holdings that included Thales and Societe Generale, and the Netherlands via several securities, including ING Groep and Technip Energies. The portfolio also kept out-of-benchmark positions in the emerging market of Brazil through positions in Embraer and Itau Unibanco, and Canada through Agnico Eagle Mines and Nutrien. Meanwhile, the portfolio's most

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notable country underweights at quarter end were in Japan and Australia.

## Outlook

While many bulls highlight the large capital expenditures needed to build out AI and high-tech infrastructure, we remain relatively sanguine about the assumptions for future global growth heading into winter and early 2026. Having said that, U.S. stagflation combined with further risks of a weaker dollar and slowing earnings could offset the ongoing political volatility in France and Japan.

The United States has one of the largest current account and trade deficits, so we are not convinced that interest rates will meaningfully decline further this year, especially since it has the largest fiscal deficit among OECD countries. U.S. interest costs are now more than 3% of the country's GDP, while tax cuts probably won't help the economy until 2026 at the earliest. Given this environment, non-U.S. investments look relatively more attractive to us.

While non-U.S. markets outperformed the United States in the first half of the year, the current quarter saw a meaningful rally in Nasdaq and smaller cap U.S. stocks. Non-U.S. markets continue to trade at some of the largest discounts to the United States in decades. The MSCI EAFE Index's PBR is 2x and PER is 15.8x, compared to the S&P 500 Index at 5.1x and 23.4x, respectively. Moreover, given low earnings expectations, non-U.S. markets are catalyst rich for change.

Sentiment surrounding Europe has weakened since July, despite hopes of German stimulus next year, as tariffs and the stronger euro have hurt expectations for exporters over domestic names. Our portfolio is generally underweight in Europe, but has benefited from the expected recovery in European defense, financials and energy. We see some attractive deep value stocks like European autos and houseware companies, where we continue to balance the very low valuations with structure challenges from China.

Our portfolio is overweight in China/Hong Kong at around 4.2% versus the index at 2.0%. So far, the market has benefited from a recovery in sectors such as financials, property and a handful of technology stocks, but this could broaden out even further to more consumer-oriented areas, especially considering their low valuations. China's 4th plenary session will meet in October and most experts believe it will lead to calls for reducing regional debt and

moving consumers from savings to spending. China's household savings rate is about 35% today, one of the highest in the world, due to an insufficient social welfare system and shocks such as trade, Covid and the property crisis. According to several news articles, the country has around \$4 trillion held in time deposits and excess savings. The drip of "right direction" policies since the September 2024 pivot has helped revive market confidence, but remains insufficient to reflate the economy, enabling only a small household deposit shift into equities led by wealthy individuals. If the country was able to reform its cadre evaluation, tax and social welfare systems, it may help anchor inflation expectations and gradually draw down the excess savings.

While Japanese stocks were pressured in the first half of the year by tariff fears and the stronger yen, the market recovered nicely this quarter. The election of Sanae Takaichi as the next prime minister may send Japan on a more expansive fiscal and monetary path, despite above-target inflation. A weaker yen and steeper yield curve might be the catalyst for expected ROE improvement into 2026. The case for Japan remains the improvement in corporate governance as shareholder returns have hit new highs this year.

As we construct the portfolio from the bottom up, we remain comfortable with our overweight positions in sectors such as financials and industries. For banks, we are excited by low valuations and high CET-1 ratios, which give them the ability to increase buybacks despite lower rates. Moreover, we expect to see consolidation in the European financial industry to be a long-term catalyst. Our portfolio is more overweight in the insurance industry, a more defensive sector where pricing has been rising with inflation.

The strategy's industrial names are largely long-dated types of business, including Alstom with a €90 billion (or five-year) backlog, Komatsu with several years of backlog for mining equipment and Mitsubishi Electric with Japanese defense and power equipment. In Europe, the portfolio has about 5% in defense-related stocks, including leading cybersecurity company Thales. In an era of heightened uncertainty, we continue to focus on companies with good free cash flow growth as well as improving shareholder value.



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Minimum investment is \$100,000.

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## Glossary

The **MSCI ACWI ex USA Index** captures large and mid cap representation across 22 of 23 Developed Markets (DM) countries (excluding the US) and 23 Emerging Markets (EM) countries. The **MSCI EAFE Index** (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the United States and Canada. The **MSCI Emerging Markets Index** is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. The **MSCI Europe Index** captures large- and mid-cap representation across 15 developed markets countries in Europe. The **MSCI China Index** is designed to capture large- and mid-cap segments with H shares, B shares, red chips, P chips and foreign listings (e.g., ADRs) of Chinese stocks. The MSCI China Index represents approximately 85% of China free float-adjusted market capitalization and evolves to reflect the changing equity market. The **S&P 500® Index** is widely regarded as the best single gauge of large-cap U.S. equities. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization. **It is not possible to invest directly in an index.** Clients should consult their financial professional regarding unknown financial terms and concepts.

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