International Opportunities ADR

Marketing communication | As of 30 Jun 2024

- **During the second quarter, the International Opportunities ADR strategy underperformed its benchmark, the MSCI ACWI ex USA Index.**
- **The portfolio's underperformance was driven by unfavorable security selection in the financials sector and an overweight in the underperforming consumer discretionary sector.**
- **Our team continues to identify long-term structural growth opportunities in non-U.S. stocks despite forecasting a mixed equity market landscape outside the U.S.**

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Market review

Global equities posted mixed results in the second quarter. Emerging market (EM) stocks led the way after lagging in the prior quarter, followed closely by U.S. shares. In contrast, non-U.S. developed markets produced negative returns. Investors were cautious, looking for broader earnings growth and dovish cues from central banks. The European Central Bank (ECB) was the first to cut rates, while the Bank of England signaled easier monetary policy may be forthcoming later this summer. In the U.S., the Federal Reserve tempered expectations for lower rates, signaling just one likely cut in 2024. The Bank of Japan, which raised rates in March, continued to pursue tighter monetary policy, announcing plans to scale back its monthly bond buying program.

European markets battled disappointing economic data. On the continent, eurozone shares (-2.8%) lost ground amid May's soft expansion in the services sector and a more pronounced decrease in manufacturing production. But U.K. equities (+3.8%) got a lift from an improving economy, a revival of mergers & acquisition (M&A) activity and falling inflation. Japan's Nikkei 225 Index (-7.6%), one of the first quarter's top performers, suffered a notable reversal of fortune in the second. Although a weak yen boosted exports and tourism, businesses struggled to fill job openings, and rising costs hurt profit margins.

Elsewhere, emerging market shares were bolstered by a recovery in Chinese stocks (+7.1%). Manufacturing activity continued to expand, retail sales improved across a broad range of segments and consumer prices rose in May for the fourth consecutive month, offering hope that the country was making progress against deflation. And while the housing market remained in the doldrums, Chinese banks sought to bring relief to the sector by lowering mortgage rates and down payment requirements.

International Opportunities ADR

Portfolio review

During the second quarter, the International Opportunities ADR strategy underperformed its benchmark, the MSCI ACWI ex USA Index, on a gross and net of fees basis.

Value shares overall outperformed their growth counterparts, and the portfolio's underweight in stocks with high earnings yield — often characterized as value stocks— was a detractor. The portfolio's EM underweight also detracted, as EM equities outperformed developed non-U.S. markets. Regarding market capitalization, the strategy's underweight in large caps weighed on relative returns, as the segment handily outperformed small and mid caps.

In terms of sectors, the largest detractors from the portfolio's relative return for the quarter were financials, due to unfavorable stock selection, and an overweight in the lagging consumer discretionary sector. Meanwhile, information technology was the top contributor, reflecting strong stock selection. From a country perspective, the United Kingdom, Canada and Brazil detracted the most, the result of negative stock selection. On the plus side, Japan provided the biggest lift, bolstered by the good performance of our holdings there.

Contributors

Regarding individual names, the largest contributor to relative results was Taiwan Semiconductor Manufacturing Company (TSMC), which delivered consensus-topping revenue and earnings per share (EPS) and issued positive guidance. As a market leader among semiconductor foundries, TSMC's customers include artificial intelligence (AI) leaders NVIDIA, Apple and Broadcom.

Semiconductor and software firm ARM Holdings PLC also contributed, on the strength of a positive earnings report featuring better-than-forecast revenue and EPS. Similar to TSMC, ARM benefited from the AI and semiconductor boom, which fueled demand for its software services.

Also proving beneficial was a position in pharmaceutical company Novo Nordisk, which posted solid quarterly financial results and raised its 2024 outlook for both sales and operating profit growth — signaling optimism heading into the second half of the year.

Detractors

In terms of specific stocks, the top detractor was French luxury conglomerate LVMH, which struggled due to lagging revenue growth and uncertain demand in the U.S. for wines and spirits, two of LVMH's key markets. Furthermore, given the global nature of its business, LVMH has been exposed to macroeconomic factors — currency risk, in particular — which have undercut organic growth across nearly all of its product lines.

Canadian athletic apparel retailer lululemon athletica also detracted. Despite lululemon's solid first-quarter earnings, investors remained concerned about the company's slow start to the year and weak outlook in the face of a major leadership shakeup in May.

Another Canadian holding, e-commerce company Shopify, hampered relative performance as well. Its shares struggled after management acknowledged several headwinds, including softening demand in Europe, the challenges of a strong U.S. dollar and expectations for lower gross margins.

Portfolio positioning

Portfolio holdings remained well-diversified and growth-oriented. At quarter-end, the strategy's sector positioning was overweight consumer discretionary and energy, while underweight industrials, financials and utilities.

Geographically, the portfolio finished the period with overweight allocations to the Netherlands, Brazil and the United Kingdom. India, Australia and Germany were the three largest underweights.

We exited three positions during the quarter: Bank of Montreal, Brazil's Localiza Rent a Car and French customer relationship outsourcing firm Teleperformance. We did not initiate any new positions during the quarter, but used the proceeds from these sales to increase our overweights in 10 long-term, high-conviction names.

Over the course of the quarter, the strategy's exposures to energy, consumer discretionary, information technology and health care increased, while its weightings in financials and industrials decreased. On a country basis, allocations to Switzerland and Taiwan grew the most. In contrast, our exposure to France, Brazil, and Canada declined. Lastly, our EM allocation remained relatively stable, ending the period at 17% of the portfolio.

Outlook

With equity markets reaching new highs during the quarter, we remain concerned about how much of their ascent has already been priced into earnings and medium-term interest-rate trends. Despite this cautious stance, we don't believe a steep pullback is imminent, although periods of increased volatility and lower returns are possible.

While many investors are focused on the U.S. election in November, 2024 is also a banner year for political contests around the world, with billions of voters going to the polls by year-end. The outcomes of these elections will have a bearing not only on politics but also on trade, regulation, growth, inflation and other key market and economic issues. In our view, political uncertainty, driven by respective political platforms, could lead corporate leaders to slow capital expenditures until the election results have been determined.

In developed markets, the Japanese yen could stabilize as the Bank of Japan continues to normalize monetary policy and manage inflation. Corporations in Japan have shown signs of strength, with profits reaching an all-time high in the first quarter of 2024 (+15.1% year-over-year). Meanwhile, in the wake of China's third plenary session, which concluded on 18 July, we expect Beijing to provide more support for the country's capital markets, consumer and technology sectors, and struggling housing market.

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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. With 1,853 constituents, the index covers approximately 85% of the global equity opportunity set outside the US.**Volatility** is the fluctuations in market value of a portfolio or other security. The greater a portfolio's volatility, the wider the fluctuations between its high and low prices. **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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