Eagle Insight

EAGLE Asset Management
AN AFFILIATE OF CARILLON TOWER ADVISERS

International ADR

Second Quarter | 2019

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International investing presents specific risks, such as currency fluctuations, differences in financial accounting standards, and potential political and economic instability. These risks are further accentuated in emerging market countries, where risks can also include possible economic dependency on revenues from particular commodities or on international aid or development assistance, currency transfer restrictions, and liquidity risks related to lower trading volumes. The fund may invest in small- and mid-cap stocks, which may involve greater risks than investing in larger, more established companies. These companies often have narrow markets and more limited managerial and financial resources.

Market Overview[1]

During the second quarter of 2019, the optimism from the first quarter continued, and, for the most part, equities rallied (or climbed a wall of worry?) across the globe, albeit with a sharp selloff in May.

In some ways, the weakness in the fourth quarter of 2018 set the stage for the recovery in 2019. Confronted by the market selloff, weaker economic data, risks to the trade outlook and low inflation, the Federal Reserve (Fed) and the European Central Bank (ECB) indicated that their next moves would likely be further monetary stimulus. Because of central banks' reaction functions, this year's bad economic news has been "good news" for markets.

Most economic data has yet to reflect a significant impact from the U.S. trade war with China, but that is unlikely to last if the stalemate drags on, and/or if the next round of tariffs kick in. An important question is whether or not the Fed has sufficient ammunition to fight a trade-related slowdown. Chairman Jerome Powell said the Fed was weighing a rate cut because economic "cross currents" have led to "greater uncertainty," but Powell added that he was "mindful that monetary policy should not overreact to any individual data point or short-term swing in sentiment."

While global growth remains positive, on average, it has become more uneven, and many major economies appear to have moved later in their business cycles. The United States is firmly late in the economic cycle, and while valuations are stretched, there is likely only low near-term risk of recession. However, macro events could quickly change our opinion. Valuations are more reasonable outside the United States in both developed and emerging market economies.

China's growth recession weighed on its export partners, but policy stimulus appears to have begun stabilizing the world's second largest economy. That said, while China's policymakers stepped up the pace of stimulus this quarter, credit growth remains subdued,[i] and the policy actions' ability to reaccelerate China's economy remains in question, implying high debt levels may still be inhibiting the government's actions.

Oil prices have fluctuated lately over a variety of concerns, including slowing global growth, disruptions to supply because of attacks on tankers in the Gulf of Hormuz, and U.S. sanctions on Iran. In addition, the potential for military conflict between the United States and Iran has increased macro volatility. Over the past 12 months, Iranian oil exports have fallen by 90%, much of that coming in the past two months.[ii] Markets would be well served by a de-escalation in bluster and violence.

The Fed completed the second round of its annual stress tests, which assess the nation's 18 biggest banks. The tests were created as part of the Dodd-Frank Act implemented after the 2008 financial crisis. The Fed found all 18 banks able to withstand a financial crisis, allowing them the flexibility going forward to increase dividends and/or repurchase shares. This is positive news as the flatter yield curve has challenged banks' profitability by shrinking the gap between lending rates and funding costs.

Like the rest of the world, we have no idea what is happening with Brexit. The story changes daily and is more unpredictable than ever. In times of such macro uncertainty, maintaining balanced portfolio positioning to the alternate outcomes, and the associated alternate risks, remains paramount.

Portfolio Review[2,3]

During the second quarter of 2019, the International ADR portfolio outperformed its MSCI EAFE Net benchmark on a gross and net basis. Stock selection was the main driver of outperformance, while sector allocation was also positive. An underweight to real estate and an overweight to information technology contributed to performance, while underweights to industrials and consumer discretionary detracted. Stock selection was strongest within consumer discretionary and utilities and weakest within consumer staples and industrials. With regards to countries, an overweight to France and an underweight to Japan contributed positively, while an overweight to Israel and an underweight to Australia detracted from performance. Stock selection was strongest within Japan and Israel and was weakest within Switzerland and Finland.

At the start of the quarter, as compared to the MSCI EAFE Net Index, the International ADR portfolio was most overweight in the information technology and communication services sectors, and most underweight in the real estate and industrials sectors. By the end of the quarter, the portfolio continued to be most overweight information technology and communication services, and most underweight real estate and industrials. Among countries, at the start of the quarter, the portfolio was most overweight France and the Netherlands, and most underweight Australia and Japan. By the end of the quarter, the portfolio remained the most overweight in the Netherlands and France and most underweight Australia and Japan. The most positive sector returns in the MSCI EAFE Net Index were in information technology and industrials sectors, while the real estate sector lagged. For countries, Switzerland and Australia outperformed the other countries, while Israel underperformed.

NICE is an Israel-based enterprise software solutions and services provider. The company continues to see significant traction for its open cloud contact center platform and demonstrated a strong delivery across all products.

Nestle benefitted from better-than-expected organic sales growth and China's plan to restrict imports on infant formula.

Allianz, based in Germany, offers insurance and financial services through its subsidiaries. The company announced two small transactions to extend its U.K. insurance franchise, sending it into the ranks of the biggest U.K. providers of car, home, and business cover.

Nintendo, based in Japan, produces hardware and software for its interactive gaming systems. The company benefitted from the release of a hit Pokémon movie, as well as announcing that it is entering the Chinese gaming market and forming a partnership with Tencent.

LVMH Moet Hennessy Louis Vuitton is a diversified luxury goods group headquartered in France. The company experienced exceptional growth rates in China despite uncertainty linked to U.S.-China trade relations.

Imperial Brands, a British tobacco company, dropped as industry data showed a decline in cigarette volumes and sales of next generation products missed expectations.

Teva Pharmaceutical, based in Israel, struggled as analysts slashed price targets in the wake of lawsuits surrounding the company's sales of opioid painkillers.

Royal Ahold Delhaize, the Netherlands-based food retail company, surprised investors with a larger-than-expected cut to its full-year guidance following an 11-day strike at Stop & Shop, the company's U.S. grocery store chain.

China Southern Airlines fell due to uncertainty

Top 10 Holdings

Nestle
Novartis
Allianz
NICE
Telefonaktiebolaget
Toyota
Roche Holding
Royal Dutch Shell
BHP Group
Airbus

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	Top Securities	Average Weight (%)	Security Contribution to Portfolio Return	Bottom Securities	Average Weight (%)	Security Contribution to Portfolio Return
International ADR	NICE	2.23	0.33	Imperial Brands	0.82	-0.30
	Nestle	2.75	0.32	Teva Pharmaceutical	0.48	-0.24
	Allianz	2.27	0.29	Royal Ahold Delhaize	1.09	-0.15
	Nintendo	0.93	0.25	China Southern Airlines	0.49	-0.12
	LMVH Moet Hennessy Louis Vuitton	1.45	0.24	Infineon Technologies	0.84	-0.10

* as of June 28, 2019. The information provided above should not be construed as a recommendation to buy, sell or hold any particular security. The data are shown for informational purposes only and are not indicative of future portfolio characteristics or returns. Portfolio holdings are not stagnant and may change over time without prior notice. Past performance does not guarantee future results. Please note that the holdings identified do not represent all of the securities purchased, sold or recommended for the composite. They are provided for informational purposes only. Eagle, its affiliates or their respective employees may have a position in the securities listed. Please contact your financial advisor to obtain the calculation's methodology and/or a list showing every holding's contribution to the overall composite's performance during the measurement period.

associated with trade tensions between United States and China, and increased currency volatility. In addition, the airline reported slightly disappointing results due to yield weakness and higher unit costs excluding fuel.

Infineon Technologies designs, manufactures and markets semiconductors. The stock was down as trade war worries drove decline in semiconductors, overall.

Outlook[2]

Stock investors have been on a wild ride the past year: Markets have gone from record highs, to being on the cusp of a bear market, to returning to recent peaks. This has left some investors feeling defensive as valuations appear stretched by some metrics. Conversely, many also worry about missing the next leg up in the now decade-long bull market.

U.S. stocks are hovering around all-time highs, kept afloat by hopes that the Fed will begin cutting rates as soon as their July meeting. Investors are questioning whether or not rate cuts will be sufficient to help what is ailing the economy. Absent a comprehensive trade deal, it's difficult to imagine that many companies will be confident enough to expand capital spending, one of the primary reasons given for the 2018 corporate tax cut.

According to a June report from the World Bank, global economic growth is forecast to ease to a weaker-than-expected 2.6% in 2019 before inching up to 2.7% in 2020. Growth in emerging markets and developing economies is expected to stabilize next year, as some countries move past periods of financial strain, but economic momentum remains weak.[iii]

Similarly, the Congressional Budget Office (CBO) forecasts U.S. economic growth will slow to 2.3% for 2019 from 3.1% in 2018, as the effects of President Donald Trump's tax cuts fade and the federal budget deficit climbs to nearly $900 billion. The government's latest estimate for first-quarter GDP was unchanged at 3.1%. While any extremely long-term forecasts are to be taken with a large grain of salt, the CBO predicts that persistently large deficits will push federal debt to 93% of GDP in 2029, its highest level since immediately after World War II, and to about 150% of GDP by 2049.

In the United Kingdom, odds suggest that Boris Johnson is a strong favorite to be the next prime minister. Regardless, parliament is still likely to prevent a no-deal Brexit, unless a general election or referendum takes place and provides a strong mandate from the population. At the moment, polls suggest only about 30% of U.K. voters want to leave the EU without a deal.[iv] Whoever it is, how the next prime minister hopes to solve the Brexit debacle remains to be seen.

The G20 meeting in June resulted in the United States and China agreeing to keep talking about trade, with no escalation in tariffs, but also without significant signs of progress. While the lack of further escalation avoids the worst-case scenario for the moment, the ongoing uncertainty and potential for a further breakdown in negotiations will continue to weigh on business sentiment. In addition, we've seen that new trade uncertainties can flare up at a moment's notice, including Mexico, Canada, India, and the

EU. To date, the effects appear to have been relatively muted; however, the upcoming earnings season will provide new information.

Based on the 2019 rally, the fourth-quarter dip in stocks did little to dent investor confidence. Continued trade uncertainty and the potential for a limited Fed reaction could weigh on stocks in the near term, while an easing of trade tensions could keep the rally alive. Given an inverted yield curve, trade uncertainty, Brexit, and slowing economic growth, we believe investors need to remain disciplined and diversified and, as always, continue to avoid trying to time volatile markets.

1. The MSCI EAFE® Net Index measures the performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada. The MSCI EAFE® Net Index subtracts any foreign taxes applicable to U.S. citizens but not applicable to citizens in the overseas country.

2. References to specific securities are intended to illustrate the types of securities Eagle may hold in this portfolio. They are not intended as representations of specific investment recommendations that would have been profitable to an investor. Past performance is not a guarantee of future results. Opinions and estimates offered constitute Eagle's judgment and are subject to change without notice as are statements of financial-market trends, which are based on current market conditions. Investing involves risk, including the possible loss of principal.

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3. Source: FactSet.

i Source: Reuters
ii Source: Reuters
iii Source: Bloomberg
iv Source: Bloomberg