Eagle Quarterly Commentary

EAGLE Asset Management

International ADR

Fourth Quarter | 2022

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Market Overview[1,3]

There's no shortage of negative takeaways from 2022 as many equity indices ended the year with the worst annual performance since the financial crisis in 2008, and at the same time bonds had their worst year on record.

Unfortunately, the changing of the calendar doesn't automatically reset the fundamental challenges that investors will continue to face well into 2023. At risk of oversimplifying: Inflation remains elevated while the economy appears to be slowing.

The U.S. Federal Reserve (Fed) has battled inflation by raising its benchmark interest rate to the highest level in 15 years. The Fed raised rates seven times in 2022, up to a targeted range between 4.25% and 4.50%. Along with the increases came an indication that officials expect to keep rates higher through 2023, with no reductions until 2024.

"Despite the slowdown in growth, the labor market remains extremely tight, with the unemployment rate near a 50-year low, job vacancies still very high, and wage growth elevated," Fed Chairman Jerome Powell said in December, noting that the United States had added an average of 272,000 jobs per month over the last three months. "Although job vacancies have moved below their highs and the pace of job gains has slowed from earlier in the year, the labor market continues to be out of balance."

Multiple compression was another theme during 2022. In the U.S. large-cap space, the Russell 1000® Index started the year trading at 24 times trailing earnings, while as of Dec. 31, 2022, that number sat at 18. The same pattern occurred in U.S. small caps, as the Russell 2000® Index's trailing price to earnings (P/E) ratio fell from 16 to 11 during the year. Similarly, outside the United States, as measured by the MSCI EAFE® (Net) Index, P/E ratios declined from 17x to 12x.

Another significant driver of markets in 2022 was dispersion across sectors. For example, in the S&P 500 Index the energy sector was up more than 60%, while communication services was down 40%: a 100 percentage point spread! While not as extreme, dispersion across countries was also notable. For example, as measured by the MSCI EAFE Index, in developed markets the U.K. was down 5%, while much of Europe was down 20%. Similarly, in emerging markets Brazil was up 14% while China was down 20%. While we don't like dispersion just for the sake of volatility, we believe sometimes large market moves can create opportunity.

Deteriorating U.S. and China relations highlighted unfolding global shifts. Chinese President Xi Jinping appears to have solidified power; however, a survey in December found that China's business confidence had fallen to its lowest since January 2013. A mishandling of the restrictive "zero-COVID" policy and then a lack of preparation for re-opening raised serious questions for leadership. China's stumbles coupled with global supply chain issues create questions around economic integration going forward. In our opinion, the unwinding of the long-term trends toward globalization could be a key driver of success and failure across multiple sectors and countries.

According to the Wall Street Journal, "Almost everyone on Wall Street and Washington got 2022 wrong." The Federal Reserve expected 2021's inflation surge to be transitory, but it wasn't. Core inflation climbed to a four-decade high, nearly triple the Fed's forecast. Analysts predicted markets would have a so-so year. The extent to which so many were wrong-footed has left many with a sense of unease.

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Top 10 Holdings

Novo Nordisk
Nippon Telegraph & Telephone
HSBC Holdings
Toyota
Nestle
Mitsubishi UFJ Financial Group
Novartis
Sumitomo Mitsui Financial Group
ASML
Hermès International

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Portfolio Review[1,2,3]

During the fourth quarter of 2022, the International ADR portfolio outperformed its MSCI EAFE benchmark on a gross and net basis. In terms of sectors, stock selection helped, while sector allocation was negative. An underweight to real estate contributed to performance, while overweights to consumer staples and communication services detracted. Stock selection was positive in all sectors, with industrials and materials being the strongest. With regard to countries, stock selection was the main driver of outperformance while allocation was also positive. An overweight to Denmark and an underweight to Israel contributed positively, while an overweight to Japan and an underweight to Italy detracted from performance. Stock selection was strongest within Japan and the United Kingdom and was weakest within Finland and Australia.

At the start of the quarter, as compared to the MSCI EAFE Index, the International ADR portfolio was most overweight the consumer staples and communication services sectors, and most underweight the financials and real estate sectors. By the end of the quarter, the portfolio continued to be most overweight communication services and consumer staples and was most underweight real estate and materials. Among countries, at the start of the quarter, the portfolio was most overweight the Netherlands and Japan, and most underweight Australia and Hong Kong. By the end of the quarter, the portfolio remained most overweight the Netherlands and Japan and most underweight Australia and Hong Kong. All sectors in the MSCI EAFE Index were positive, with financials and materials performing the best. All countries were also positive with Denmark and Austria performing the best.

Novo Nordisk is a Danish company that develops, produces, and markets pharmaceuticals. The U.S. Food and Drug Administration cleared regulatory notices that it had issued after previous inspections of manufacturing sites in the United States and Brussels, bolstering confidence that Novo will be able to offer all strengths of its weight loss therapy Wegovy by the end of the year.

Mitsubishi UFJ Financial Group is a Japan-based financial services company. The planned sale of its Union Bank unit received approval from the Federal Reserve and Office of the Comptroller of the Currency.

Sumitomo Mitsui Financial Group provides commercial banking and a variety of financial services. The Japanese company announced a buyback that met market expectations and reported an earnings beat driven by core operations and currency impacts.

Hermès International is a France-based luxury goods producer. Luxury stocks rose as the easing of COVID controls in some parts of China boosted expectations that the nation's stringent zero-COVID policy would be relaxed.

Mitsui & Co., a general trading company headquartered in Japan, reported an earnings beat driven by its energy and machinery segments, which helped offset the impact from falling iron ore prices.

Ashtead Group is a U.K.-based equipment rental company. Larger than anticipated rate hikes across Europe and the United States weighed on Ashtead, among other interest rate-sensitive stocks.

Komatsu manufactures and sells construction and mining machinery. The Japanese company's

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	Top Securities	Average Weight (%)	Contribution to Return (%)	Bottom Securities	Average Weight (%)	Contribution to Return (%)
International ADR	Novo Nordisk	2.49	0.77	Ashtead Group	0.18	-0.08
	Mitsubishi UFJ Financial Group	1.47	0.64	Komatsu	0.21	-0.07
	Sumitomo Mitsui Financial Group	1.14	0.48	Cellnex Telecom	0.10	-0.04
	Hermès International	1.65	0.45	3i Group	0.14	-0.03
	Mitsui & Co.	1.36	0.44	Roche Holding	1.53	-0.02

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shares declined on concerns about cost inflation, competition, and the slowing U.S. housing market.

Cellnex Telecom is a Spanish company that operates wireless telecommunications and broadcasting infrastructures. The company's pivot away from mergers and acquisitions as well as a discounted share placement weighed on the stock.

3i Group is a U.K.-based private equity and venture capital company. We were underweight the stock when the share price rose as one of its portfolio companies performed well, with strong sales, good cost control, store expansion, and good cash generation, despite concerns about cost pressures and consumer demand weakening.

Roche Holding develops and manufactures pharmaceutical and diagnostic products and is based in Switzerland. Its much-awaited drug for Alzheimer's failed in a pair of large studies, a disappointment in a research field marred with failures.

Outlook[1,2,3]

The intersection of the inflation narrative and concerns over slowing economic growth will be a key focus for us, and most investors, in 2023. These market headwinds are well-documented, and it feels rare these days to engage in an investment discussion that doesn't focus on very real and worrisome risks. That said, 2023 could also surprise us on the upside, and we often remind ourselves that it is important to consider the various potential futures. This isn't intended to minimize any of the challenges, but given many predictions for a challenging first half of the year, there are certainly some right tail risks that we would do well not to forget.

The main economic storyline of 2022 was inflation. Despite hopes that it was transitory, it has remained high and has been damaging. We believe that broad macroeconomic forces like inflation can dominate sentiment and make everything feel negative despite pockets of good news. For example, wages are up, many jobs are available, and consumers, for much of the year, kept up spending. And with some positive signals like crude oil continuing to trade lower, it contributes to the notion that we might be past the point of peak inflation and central bank hawkishness.

We started 2022 with many companies, industries, and even sectors apparently priced for perfection, but after the serious multiple compression over the past 12 months there are many parts of the market that appear much more reasonably priced relative to fundamentals. Some are certain to be "falling knives," and some are likely going nowhere until the Fed ultimately pauses the rate hiking cycle, but we believe many have strong underlying businesses and have simply been thrown out with the bathwater. We are always on the lookout for companies whose strength is underappreciated by the market.

More than 15% of the constituents of the S&P 500 are trading with single digit P/E multiples, with that percentage having crossed 20% during the selloffs in the spring and late summer. The U.S. market as a whole is now much more reasonably priced than a year ago, and European markets are now trading below 17-year averages. The key question is whether valuations are now reasonable enough, especially as the Fed tightens further. And with elevated levels of cash sitting on the sidelines, investors could start putting money back to work in some of cheaper parts of the market

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Performance as of Dec. 31, 2022

		Fourth Quarter	Year to Date	One Year	Three Years	Five Years	Since Inception (Jan 1, 2013)
Eagle International ADR	Gross	19.15%	-12.26%	-12.26%	2.26%	2.40%	5.38%
Eagle International ADR	Net	18.40%	-14.97%	-14.97%	-0.78%	-0.63%	2.28%
MSCI EAFE® (Net) Index (Net of Dividend)		17.34%	-14.45%	-14.45%	0.87%	1.54%	4.67%

The performance data quoted represents past performance. Past performance does not guarantee future results. Investment return and principal value will fluctuate so that an investor's portfolio, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance information quoted. To obtain current month-end performance information, please call your financial professional or visit eagleasset.com.

Performance Disclosures

The calculation of the performance data includes reinvestment of all income and gains and is depicted on a time-weighted and size-weighted average for the entire period. Performance is shown after deduction of transaction costs and both "gross" (before the deduction of management fees) and "net" (after the deduction of management fees). Performance figures include all internal, retail International ADR accounts of Eagle Asset Management, a St. Petersburg, Florida-based firm. Eagle Asset Management, Inc. claims compliance with the Global Investment Performance Standards (GIPS®). GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. Eagle Asset Management, Inc. has received a firm-wide verification for the periods January 1, 1982 through December 31, 2021. Performance data for 2022 and the current year may be revised, and Eagle will publish any revised performance data. No inference should be drawn by present or prospective clients that managed accounts will achieve similar investment performance in the future. Because accounts are individually managed, returns for separate accounts may be higher or lower than the performance figures stated above. Investing in equities may result in a loss of capital. Past performance is not a guarantee of future results.

where fundamentals are possibly disconnected from valuations.

Like all investors, we will be watching inflation, yields, and jobs as some of the key indicators that could signal a bottoming process in financial markets. Nonetheless, we would expect any sustainable market recovery to take time as we unwind some of the dislocations from the pandemic. Monetary policy works with a lag; therefore, changes in interest rates don't immediately have a significant impact on the economy. This has been the fastest rate hiking cycle in decades, and it may take some time to work its way through the economy. For long-term investors, this bottoming process may present an opportunity to diversify, rebalance, or put new capital to work at potentially better prices ahead of what we hope is a robust recovery.

1. The MSCI EAFE® (Net) Index, the strategy's benchmark 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 United States. 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.

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 portfolio 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.

Definitions

A multiple, sometimes referred as the price multiple or earnings multiple, is a measure of a company's value based on the ratio of its current share price to its earnings per share. This ratio is known as the price-to-earnings ratio, or P/E.

Multiple compression is an effect that takes place when a company's earnings rise, but its stock price does not move in response. This decreases the company's financial multiple, and this often reflects a change in investor expectations. In the case of a company that posts flat earnings, a multiple compression could see the stock price fall or, in the event that the company reports falling earnings, the stock price could fall faster than the earnings.

A trailing indicator, also known as a lagging indicator, is an observable or measurable factor that changes some time after the economic, financial, or business variable that it is correlated with changes.

The price/earnings or price to earnings ratio (P/E) measures a company's current share price relative to its per-share earnings.

Core inflation is measured by the Personal Consumption Expenditures (PCE) excluding Food and Energy, Price Index, also known as the core PCE price index, is a measure of the prices that U.S. consumers pay for goods and services, not including two categories – food and energy – where prices tend to swing up and down more dramatically and more often than other prices. The core PCE price index, released monthly by the U.S. Department of Commerce Bureau of Economic Analysis, measures inflation trends and is watched closely by the U.S. Federal Reserve as it conducts monetary policy.

A consensus estimate is a forecast of a public company's projected earnings or the expected findings of a macroeconomic report based on the combined estimates of analysts and other market observers that track the stock or the data in question.

Tail risk describes a form of portfolio risk associated with the increased possibility that an investment will move more than three standard deviations from the mean in a normal distribution. Left tail risks refer to unusually large losses. Right tail risks refer to unusually large gains.

Hawkish, dovish, and centrist are terms used to describe the monetary policy preferences of central bankers and others. Hawks prioritize controlling inflation and may favor raising interest rates to reduce it or keep it in check. Doves tend to support maintaining lower interest rates, often in support of stimulating job growth and the economy more generally. Centrists tend to occupy the middle of the continuum between tight (hawkish) and loose (dovish) monetary policy.

A falling knife is a saying used in investing to describe a rapid drop in the price or value of a security. The admonition against trying to catch a falling knife is a way of saying that an investor should wait for a price to bottom before buying a security that could either rebound or lose all of its value if the company issuing it goes into bankruptcy.

Indices

The S&P 500 Index measures change in stock market conditions based on the average performance of 500 widely held common stocks. It is a market-weighted index calculated on a total return basis with dividend reinvested. The S&P 500 represents approximately 75% of the investable U.S. equity market.

The Russell 1000® Index measures the performance of the 1,000 largest companies in the Russell 3000® Index, which represents approximately 93% of the total market capitalization of the Russell 3000® Index.

The Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 7% of the total market capitalization of the Russell 3000® Index.

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