Eagle Insight

EAGLE Asset Management
AN AFFILIATE OF CARILLON TOWER ADVISERS

International ADR

Fourth Quarter | 2017

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Market Overview

Most equity markets worldwide 2017 will go down as a remarkable year for global equity markets. Few investors expected gains of 20 percent-plus across the globe with near-record low volatility, all while enduring geopolitical tensions, natural disasters and a tighter monetary policy.

2017 demonstrated why forecasting is difficult and market timing is dangerous. The year showed that elevated valuations and low volatility (cyber-currencies aside) can be sustained for longer than many expect, especially when growth delivers.

The International Monetary Fund upgraded its global economic growth forecast for 2017 and 2018 to 3.6 percent and 3.7 percent, respectively, driven by a pickup in trade, investment and consumer confidence. Forecasts for the Eurozone, Japan, China, emerging-market Europe and Russia were also all revised upward.

The year also demonstrated the capacity for equity markets to climb a “wall of worry.” Investors began the year uncertain about the new President Donald Trump administration, the potential for trade protectionism and escalating geopolitical tensions. In addition, there was an anti-Euro election scare in France, nervousness about the Fed’s balance-sheet reduction plans and worries about North Korean aggression. The events many worried about in early 2017 didn’t materialize and markets responded very positively.

Portfolio Review[1,2]

Eagle’s International ADR portfolios underperformed the benchmark MSCI EAFE Index. An underweight position in utilities and an overweight position in information technology (IT) contributed to performance while an overweight position in telecommunication services and an underweight position in real estate hurt performance. Stock selection was strongest within industrials and IT, and weakest within healthcare and materials. Country selection was positive: Overweight positions in China and South Korea helped performance while an underweight position in Australia and an overweight position in the Netherlands hurt performance. Stock selection was strong within Hong Kong and Israel but weak within the United Kingdom and France.

Sony reported strong earnings due in part to increased demand for high-end 4K televisions and wider use of camera chips.

Mining and machinery company Komatsu reported stronger-than-expected quarterly results due to demand from China and Indonesia.

Tencent, a Chinese IT company, beat earnings expectations with growth in online games such as League of Legends and Clash of Clans.

Robot manufacturer Fanuc reported strong quarterly earnings driven by improved margins and strong demand in its Robomachine segment.

Royal Dutch Shell beat earnings expectations helped by stronger refining and chemicals industry conditions. The company also initiated a share buyback.

French pharmaceutical company Sanofi saw its Dengue vaccine program suspended in the Philippines. Increasing competition and falling profit margins also hurt its core diabetes-treatment business.

adidas reported a slowdown of sales growth and concerns over increased promotional spending in North America.

GlaxoSmithKline declined on weak pharmaceutical sales and growing uncertainty about margin pressures.

Healthcare company Bayer reported disappointing drug sales; further, the company cut its stake in its plastics unit, which hurt the share price.

Subdued demand for derivatives products hurt Societe Generale, a French financial-services provider. Lower market share in the equities segment also dragged down demand.

Outlook[1]

MarketsThe synchronized global expansion has room to run as strong corporate earnings and steady global growth support equity markets. However, geopolitical risks, inflation and other factors could make 2018 challenging. That said, we are also skeptical of the typical Wall Street exercise of publishing year-end stock market outlooks because what we don't know today frequently overwhelms what we do know.

One candidate for a non-U.S. shock is China. We're not expecting a crisis but high debt levels may be a risk. The recent Communist Party National Congress solidified the power of President Xi Jinping, giving him the authority to pursue his agenda during a second five-year term. Near the top of his list is gradually deflating the debt bubble. Chinese central bankers have more levers than their counterparts in developed markets so it is likely they will be able to engineer a managed deleveraging. That said, tightening credit in a high-debt economy historically has been a dangerous exercise.

Growth in Japan has improved with business surveys pointing to an increasingly confident business sector. Additionally, the 2020 Tokyo Olympics is expected to inject further stimulus into the economy. We expect the Bank of Japan to maintain an accommodative policy, even in the face of tightening elsewhere. That could have a two-pronged benefit: It should continue to pump liquidity into the Japanese economy and also put downward pressure on the yen.

Currently, we are worried about political risk in the Eurozone given both the state of the Brexit negotiations and numerous elections in 2018. Regarding the former, many still expect an agreement will be reached to implement a two-year status-quo transition period which should help minimize the economic fallout. However, a complete breakdown in talks cannot be dismissed as a possibility and severe trade disruptions could wreak havoc on the region's economic growth. With respect to the upcoming Italian elections, the largest risk is an anti-Euro bloc taking power. However, anti-Euro has not been a winning strategy in recent elections and is notably in decline in Italy.

Elsewhere in the world, investors will have to maneuver around elections. Tight contests are expected for important markets such as Brazil and Mexico but results in countries like Russia should be predictable.

Investors should be careful – in our view – not to extrapolate 2017's performance into 2018. The global bull market is intact, supported by solid global growth and strong corporate earnings; however, we anticipate more frequent bouts of volatility. Pullbacks are increasingly possible given that expectations are now set quite high. If inflation stays low, high valuations can continue to be supported. Low inflation and low rates have been key pillars of equity-market support, reducing the cost of capital and enhancing earnings yields. However, if this assumption proves wrong, multiple compression and a spike in volatility are likely. As always, investment discipline is critical when looking ahead into an unknowable future.

[1] 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

Top 10 Holdings

Royal Dutch Shell
Canon
Novartis
Sony
FANUC
Nestle
BP
Tencent
HSBC
Unilever

The information provided above should not be construed as a recommendation to buy, sell or hold any particular security. The data is shown for informational purposes only and is 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.

International ADR

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	Best Securities	Average Weight (%)	Security Contribution to Portfolio Return	Worst Securities	Average Weight (%)	Security Contribution to Portfolio Return
International ADR	Sony	2.02	0.41	Sanofi	1.78	-0.26
	Komatsu	1.51	0.37	adidas	1.24	-0.15
	Tencent	1.90	0.36	GlaxoSmithKline	0.72	-0.11
	Fanuc	1.88	0.29	Bayer	1.11	-0.10
	Royal Dutch Shell	2.28	0.28	Societe Generale	0.70	-0.10

* as of Sept. 30. 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.

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[2] Source: FactSet