Eagle Insight

EAGLE | Asset Management
AN AFFILIATE OF CARILLON TOWER ADVISERS

International ADR

Third Quarter | 2018

David Vaughn, CFA
Lead Portfolio Manager

Alex Turner, CFA
Portfolio Manager

Priyanshu Mutreja, CFA
Assistant Portfolio Manager

Stacey Nutt, PhD
Lead Portfolio Manager

Robert Zimmer, CFA
Client Portfolio Manager

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

United States equity markets were generally positive in the third quarter of 2018; however, globally, returns were mixed.

After eight years of modest growth in the U.S., some investors may be concerned about the late-stage economic cycle, especially as valuations become increasingly stretched. Further, President Trump's actions compound some investor worries. In the most recent trade war escalation with China, the United States imposed tariffs on another $200 billion in goods. This is another big step toward a broader conflict that may become difficult to reverse and could weigh greatly on the global economy.

Chinese equities sold off significantly during the third quarter on concerns of a GDP slowdown or debt crisis. The Chinese government seemingly failed to settle nerves when reporting 6.7 percent economic growth in the second quarter, comfortably above their 6.5 percent GDP growth target for 2018[i]. According to a Reuters' poll, analysts expect the People's Bank of China (PBOC) to keep its benchmark lending rate unchanged at 4.35 percent through at least the end of 2019.

The Federal Reserve (Fed) again raised the Fed funds rate by 0.25 percent in September to a target range of 2.00-2.25 percent. It represents the eighth rate hike since 2015, and now investors are looking for clues about next steps given low inflation and low growth. Federal Reserve Chair Jerome "Jay" Powell noted the economy is strong enough that low rates are no longer necessary – a shift the Fed marked by ending its description of its policy as "accommodative". Mr. Powell warned that a permanent shift to a "more protectionist world" would hurt the United States and global economies, but added that for now, he expects the overall economic impact to remain relatively modest.

The global benchmark for oil, Brent Crude, is up over 20 percent this year, closing September at $82, the highest level since 2014[ii]. Prices are up partly because of the sanctions imposed on Iran, due to take effect in November but already leading to a decrease into that nation's oil output[iii]. In addition, the collapse in Venezuela's output, caused by political instability and infrastructure failure[iv], certainly figures into the equation. Higher oil prices can act as a drag on global growth, with particular impact on the manufacturing and transportation sectors.

Portfolio Review[1,2]

During the third quarter of 2018, the International ADR portfolio outperformed its MSCI EAFE benchmark on both a gross and net basis. While stock selection was the main driver of performance, allocation was also positive. An overweight position to Energy and an underweight position to Real Estate contributed to performance, while an overweight to Consumer Discretionary and an underweight to Health Care detracted. Stock selection was strongest within Financials and Consumer Discretionary and weakest within Materials and Information Technology. With regards to countries, an underweight to Belgium and an overweight to Norway contributed positively, while an overweight to China and an underweight to Sweden detracted from performance. Stock selection was strongest within Germany and the Netherlands and was weakest within Spain and France.

At the start of the quarter, as compared to the MSCI EAFE Index, the International ADR portfolio was most overweight the Information Technology and Consumer Discretionary sectors, and most underweight the Consumer Staples and Industrials sectors. By the end of the quarter, the portfolio was most overweight Telecommunication Services and Energy, and most underweight Industrials and Real Estate. Among countries, at the start of the quarter, the portfolio was most overweight China and South Korea, and most underweight Australia and Sweden. By the end of the quarter, the portfolio was most overweight Israel and South Korea and remained most underweight Australia and Sweden. The highest sector returns in the MSCI EAFE Index were in the Telecomm and Health Care sectors, while the Real Estate and Utilities sectors fared worst. For countries, Sweden and Switzerland outperformed, while Belgium and Ireland lagged.

Sony Corporation is a Japanese consumer electronics and media company. Contributing to better-than-expected earnings were robust sales of the PlayStation console due to the popularity of new game launches, and strength in the company's image-sensing division.

SoftBank Group is a telecommunications provider and technology investment company based in Japan. Positive drivers for the stock included better-than-expected profits driven by valuation gains in its investment portfolio, and investor optimism regarding the potential listing of its domestic telecommunications business.

Novartis AG is a Swedish manufacturer of pharmaceutical and consumer healthcare products. Increased confidence in its product pipeline and the company's successful defense of a key drug from generic competition were among the positive drivers over the quarter.

SK Telecom Co. Ltd. is a Korean mobile and telecommunications operator. Effective cost control helped improve investor confidence in the company's earnings recovery, while positive sentiment surrounding next generation technology was an additional boost to the share price.

Nintendo is a Japanese manufacturer of video games. The company reported quarterly earnings that topped profit estimates, as higher software sales online more than offset weaker shipments of their new Switch console.

STMicroelectronics NV is a provider of semiconductor solutions based in the Netherlands. While earnings reported during the quarter were positive, concerns about a peaking industry cycle and deteriorating global trade relations had a negative impact on the share price.

Tokyo Electron is a producer of semiconductors and flat panel displays based in Japan. Cyclical risks in the semiconductor space continue to put pressure on the group as a whole.

Infineon Technologies AG is a semiconductor manufacturer based in Germany. The company reported strong earnings and guidance, however, its shares declined alongside industry peers due to peak cycle concerns and the negative impact of a trade war.

HSBC Holdings is a banking and financial services company based in the U.K. The stock declined after reporting an increase in costs that overshadowed their revenue growth.

Tencent Holdings Ltd is China's largest social media service company. The stock pulled back after government curbs on new game approvals contributed to the company's first profit drop in over a decade, and renewed concerns regarding regulatory risk.

Outlook[1]

Domestic stocks have been able to climb a wall of worry, and remain near historic highs, despite the escalating trade wars. Outside the United

Top 10 Holdings

Royal Dutch Shell Plc Sponsored ADR
Sony Corporation Sponsored ADR
LVMH Moet Hennessy Unsponsored ADR
Novartis AG Sponsored ADR
BP p.l.c. Sponsored ADR
Toyota Motor Corp. Sponsored ADR
Nestle S.A. Sponsored ADR
Equinor ASA Sponsored ADR
BHP Billiton Limited Sponsored ADR
CSL Limited Unsponsored ADR

International ADR

Third Quarter | 2018

	Top Securities	Average Weight (%)	Security Contribution to Portfolio Return	Bottom Securities	Average Weight (%)	Security Contribution to Portfolio Return
International ADR	Sony Corporation	2.63	0.51	STMicroelectronics NV	1.01	-0.19
	SoftBank Group Corp.	1.37	0.47	Tokyo Electron Ltd.	0.62	-0.13
	Novartis AG	2.51	0.34	Infineon Technologies AG	1.03	-0.12
	SK Telecom Co., Ltd.	0.92	0.19	HSBC Holdings Plc	1.83	-0.11
	Nintendo Co., Ltd.	1.49	0.18	Tencent Holdings Ltd.	0.44	-0.11

* as of September 28. 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.

States, the potential for tighter monetary policy and the prospect for a reversal in the trend towards globalization rattled investors. While positive news on many of the macro fronts continues, as always, stocks face some hurdles in the short term.

Current estimates for S&P 500 year-over-year earnings growth stand at approximately +21%[v]; it could be difficult for the majority of companies to beat those elevated expectations. For now, earnings growth remains a key support for domestic stocks, and the healthy corporate picture is boosting the consumer via job growth and confidence.

Many surveys of U.S. investors still suggest plenty of optimism. The U.S. aside, much of the rest of the world remains in the early stages of recovery. Overall, the International Monetary Fund (IMF) expects global Gross Domestic Product (GDP) to increase 3.9 percent in 2018 and 2019, from 3.6 percent in 2017, with each of the world's major economies firmly positive. However, the IMF warned that the expansion is becoming less even, as the rate of growth appears to have peaked in some major economies and higher oil prices and currency pressures have caused downward revisions to some emerging market projections.

With Congress slated to inject significant fiscal stimulus over the next two years, the Fed will aim to avoid economic overheating. This late-cycle tug of war between fiscal policy and monetary policy is unusual, and potentially dangerous. Futures markets now anticipate the Fed will raise rates once more this year, three times in 2019 and once in 2020. As rates rise, pressure will increase on the already frothy housing market, a key driver for the U.S. economy.

In the short-term, the new tax cuts will benefit many Americans, and the spending bill should add to economic growth. In the long-term, while worrisome, it is difficult to forecast the impact of larger deficits. Adding to the already complicated picture, the government has enacted substantial fiscal stimulus at a time when the economy is at essentially full employment.

The intensifying trade battles could potentially disrupt the world's economies, as U.S. businesses source roughly 40 percent of their revenues from overseas[vi]; therefore, any disruption to global trade could be very damaging. Meanwhile, the ability of corporate management to be decisive in planning for the future may be compromised by the unsteady environment, impacting business confidence and capital expenditures.

Key elections in Mexico, Turkey, and Italy added volatility across global financial markets this year, amid a rising trend in populism. Looking forward, the run-up to Brazil's election on October 7 has been especially polarizing, including an assassination attempt on one of the candidates. In the United States, the November 6 midterm elections will be closely watched as Democrats seek to gain seats (and possibly a majority) in both the House and Senate.

Investors have a variety of issues to fret over, including ongoing political turmoil, tariff announcements, numerous contentious elections, etc. Sticking with a long-term investment approach is certainly more difficult to do when markets aren't going straight up; however, selloffs and volatility indicate a healthier investing environment, which could help extend the current growth cycle. Our outlook for the remainder of 2018, and into 2019, remains guardedly optimistic. That said, we would be wise to expect more bumps in the road along the way.

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 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 principle.

This information is not intended to serve as investment, tax, legal or accounting advice. It should not be considered a recommendation to engage in or refrain from taking a particular course of action and is not an endorsement, recommendation or sponsorship of any securities, services or other investment property. It has been prepared for informational purposes only and you should consult your own investment, tax, legal and/or accounting advisors before engaging in any transaction. Any discussion of tax matters contained herein is not intended or written to be used, and cannot be used, for the purpose of avoiding any penalties that may be imposed under federal tax laws. The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients or any of its or their respective affiliates. Views expressed are as of the date indicated and may change based on market and other conditions. The accuracy of the content and its relevance to your particular circumstances is not guaranteed.

2. Source: FactSet.

[i] Source: Reuters

[ii] Source: Bloomberg

[iii] Source: Reuters

[iv] Source: Bloomberg

[v] Source: FactSet

[vi] Source: Bloomberg