October 17, 2019
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What If Things Go Right?

Todd Asset Management Q3 2019 International Market Commentary

	3Q 2019	YTD	1 Year	3 Year*	5 Year*	7 Year*	10 Year*
MSCI ACWI ex-US (Net)	-1.8%	11.6%	-1.2%	6.3%	2.9%	5.0%	4.5%
MSCI ACWI (Net)	-0.0%	16.2%	1.4%	9.7%	6.7%	8.8%	8.4%

** Annualized Total Returns.*

US Investors have shunned international markets this year. To be fair, the ACWI ex-US index is up more than 11.6% year to date, but that still pales when compared to the S&P returning over 20%. International indexes have underperformed the US since Q1 2018 as the uncertainties relating to trade wars, manufacturing slowdowns and Brexit weighed on confidence. The dollar has strengthened since then as well, exacerbating those concerns. This is in stark contrast to 2017, a period where we saw a reduction in anxiety about the economic outlook and investors focused on globally synchronized growth. International markets outperformed the S&P in 2017. Prevailing sentiment seems to worry about everything that can go wrong, but our question is what if things go right?

Brexit and the Trade Wars were the two largest wildcards in the quarter and were the principal drivers of most other developments. On the trade front, we entered 2019 with a ceasefire on implementing new tariffs. Frustrated with a lack of progress after China appeared to have backtracked on many elements of a draft trade bill, President Trump increased tariffs from 10% to 25% on $250B of Chinese imports in May. In June, agreements were made to restart the trade talks, though they did not result in any progress. In fact, by August, the US announced plans to tariff all Chinese products. The Chinese retaliated with tariffs of their own and by allowing their currency to weaken. The US ultimately reduced the scope of products they put tariffs on during September, but they also placed a number of restrictions on many of China's premier technology companies. Trade talks are continuing, and some tentative signs of progress are occurring.

Brexit was also a source of uncertainty during the quarter. As you probably recall, former British Prime Minister Theresa May resigned in May 2019, after unsuccessfully trying to push her negotiated Brexit through Parliament three times. Boris Johnson, an avowed Brexit supporter, was officially named Mrs. May's successor at the end of July. Since starting, PM Johnson has been thwarted at every turn by a Parliament that disagrees with him on many issues. He tried to call a general election, attempted to force Parliament to recess, and pushed for a no-deal Brexit, only to be rebuffed in Parliament and/or the courts each time. Negotiations with the European Union are ongoing and showing some progress, but the October 31 deadline is looming. Regardless of what the British Parliament wants, any extension has to be approved by the EU. We will have to wait and how that turns out.

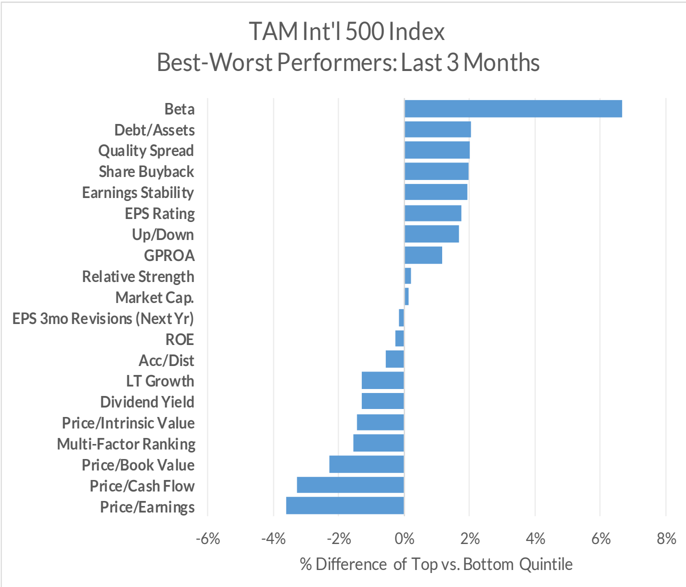
These uncertainties, coupled with a worldwide manufacturing slowdown have many investors worried about a recession. IMF Estimates of worldwide growth have declined for 2019, though they anticipate a recovery into 2020. The German Manufacturing Purchasing Managers Indexes (PMIs) are indicating contraction and at the lowest level since the Great Financial Crisis. China is also experiencing manufacturing weakness, with their PMI just crossing into contractionary territory in July.

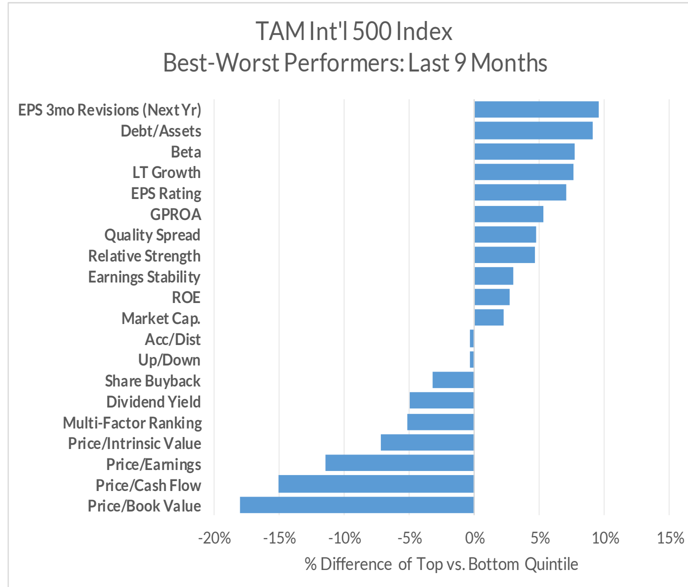
Countering these weaknesses, there are a few things that can go right:

- Manufacturing is a cyclical business. It runs in three year cycles. The last time we saw PMI decline like this, it rebounded strongly and within 12 months we were in the midst of globally synchronized growth. We think that can happen again.
- Services are larger than manufacturing in most economies, and those tend to be very resilient sources of growth.
- Central Banks are responding to the weakness and lowering rates to promote economic growth.
- Stimulative policies are being undertaken by China. Tax reductions, easing bank reserve requirements and other stimulative policies are being deployed to counteract manufacturing weakness.
- Many European countries are trying to stimulate growth. France recently lowered tax rates, and there is some talk of Germany pursuing higher government spending. The UK has proposed stimulus for the post Brexit environment as well. Italy is considering measures as well.

While there are many concerns now, we believe they should get resolved as we move forward. As that occurs, we believe that the economic outlook should probably brighten, and the risk premium that has been put into the dollar should come out. If these occur, we would expect a lower dollar, and the potential for International Markets to outpace US markets in dollar terms as they did in 2017.

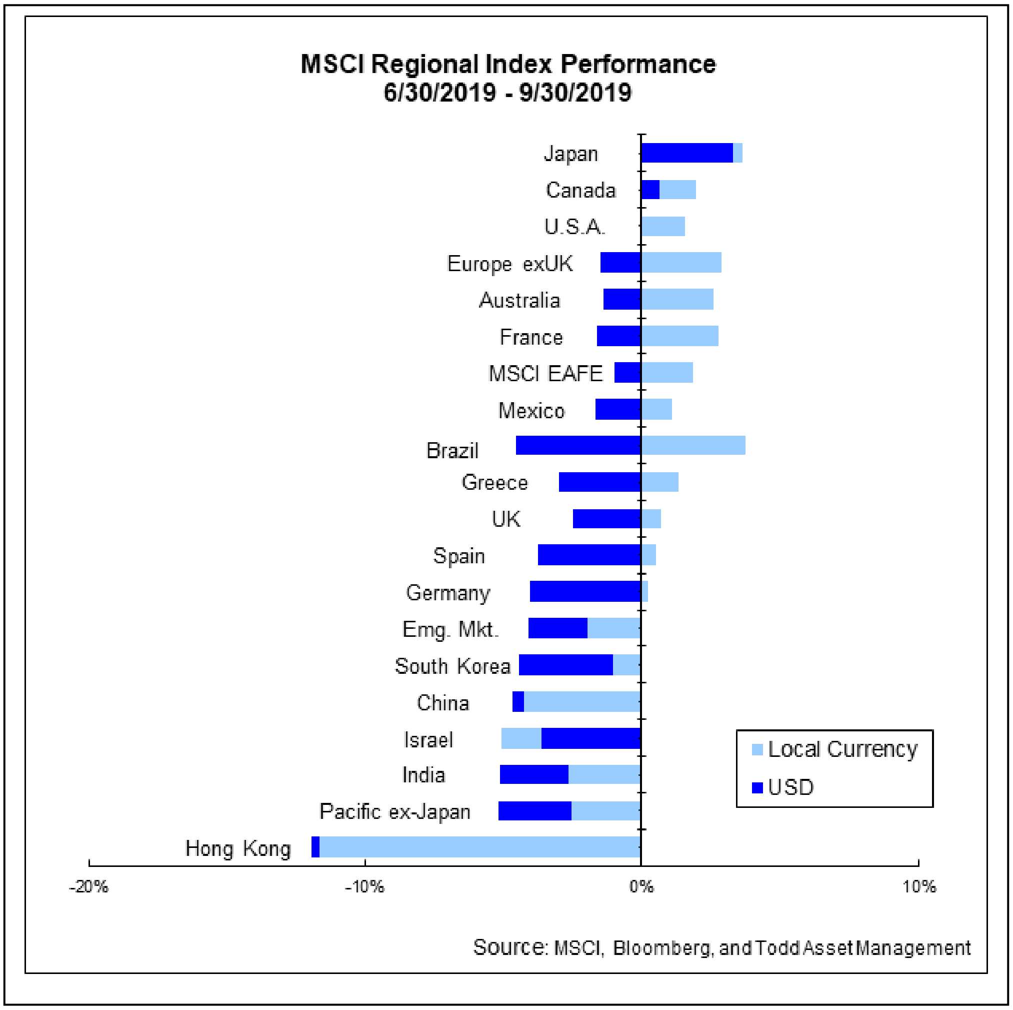
Factor Analysis





Source: Bloomberg, William O'Neil + Co and Todd Asset Management

The charts above present the customary factor analysis we prepare each quarter to see which characteristics the market was rewarding over various time frames. As a reminder, we use the largest US traded securities for internationally based companies as our universe, and compare the spread of returns of the top quintiles for each factor versus the bottom quintiles. During the most recent quarter, quality and financial strength were the factors adding the most value, while value factors were ignored. Trends for the year to date period were similar as well.



Regional market performances are presented in the chart above. For the quarter, a safety trade drove most of the regional differences. Economic and geopolitical concerns caused investors to focus on the safer markets of Japan, Canada and the US. With world central banks pursuing easier policies, the dollar has been strengthening. This led to many of the mid ranked countries showing gains in local currency, but lower returns in dollars. The countries that were near the bottom of the rankings were suffering geopolitical pressures. Hong Kong has had protests that are proving disruptive to their economy. India has been altering their stance towards a disputed region between them and Pakistan, leading to more tensions. South Korea and Japan are engaged in a trade dispute. Many of the other laggards are weighed down by the pressures on manufacturing we noted above. If world tensions on Trade and Brexit ease, and we get some pickup in manufacturing indexes, we would expect to see some of these laggards recover.

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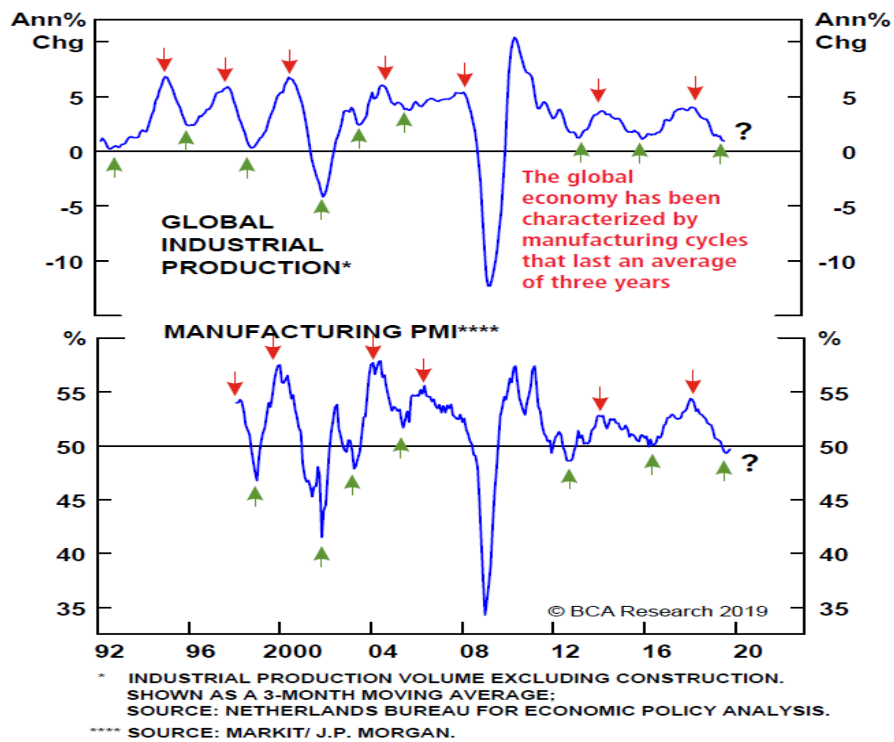
<u>Interesting Charts We saw this quarter</u>

<u>Manufacturing Moves in 3 Year Cycles</u>



Global Industrial production has slowed and Manufacturing PMIs have weakened worldwide, causing recessionary concern lately.

The chart above, from BCA Research, highlights that these are cyclical concerns and the cycles last 3 years.

If they are correct, this downturn has almost run its course and a recovery driven by lower rates, resurging auto sales and global stimulus should prompt better action in these statistics.

This would suggest Bond Yields have nearly bottomed as well.

Low Government Bond Yields Force Investors into Equities

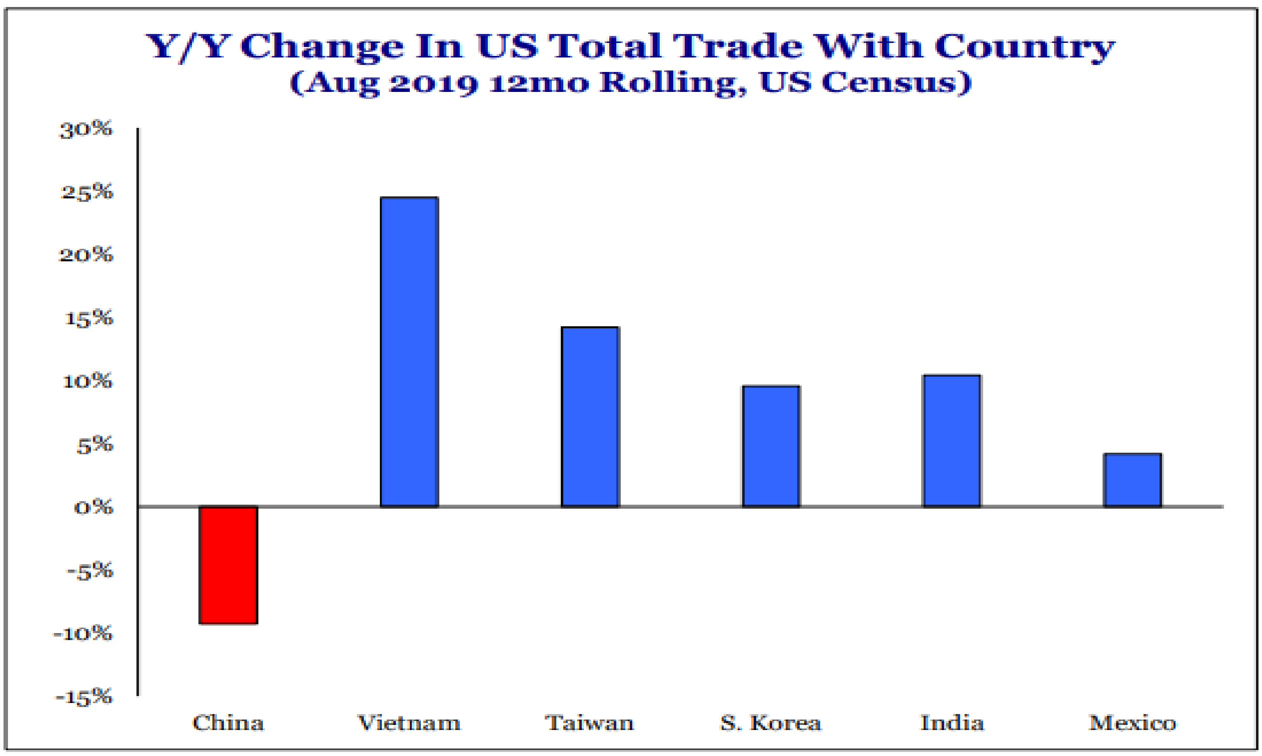
"T I N A"- There is No Alternative

Country	10 Year Government Bond Yield	Dividend Yield
Germany	-0.59%	2.29%
United Kingdom	0.48%	3.88%
Japan	-0.20%	1.80%
France	-0.32%	2.42%
Italy	1.42%	3.27%
Spain	0.16%	2.76%
Netherlands	-0.48%	2.01%
Switzerland	-0.99%	1.76%
Australia	0.95%	3.84%
United States	1.71%	1.88%

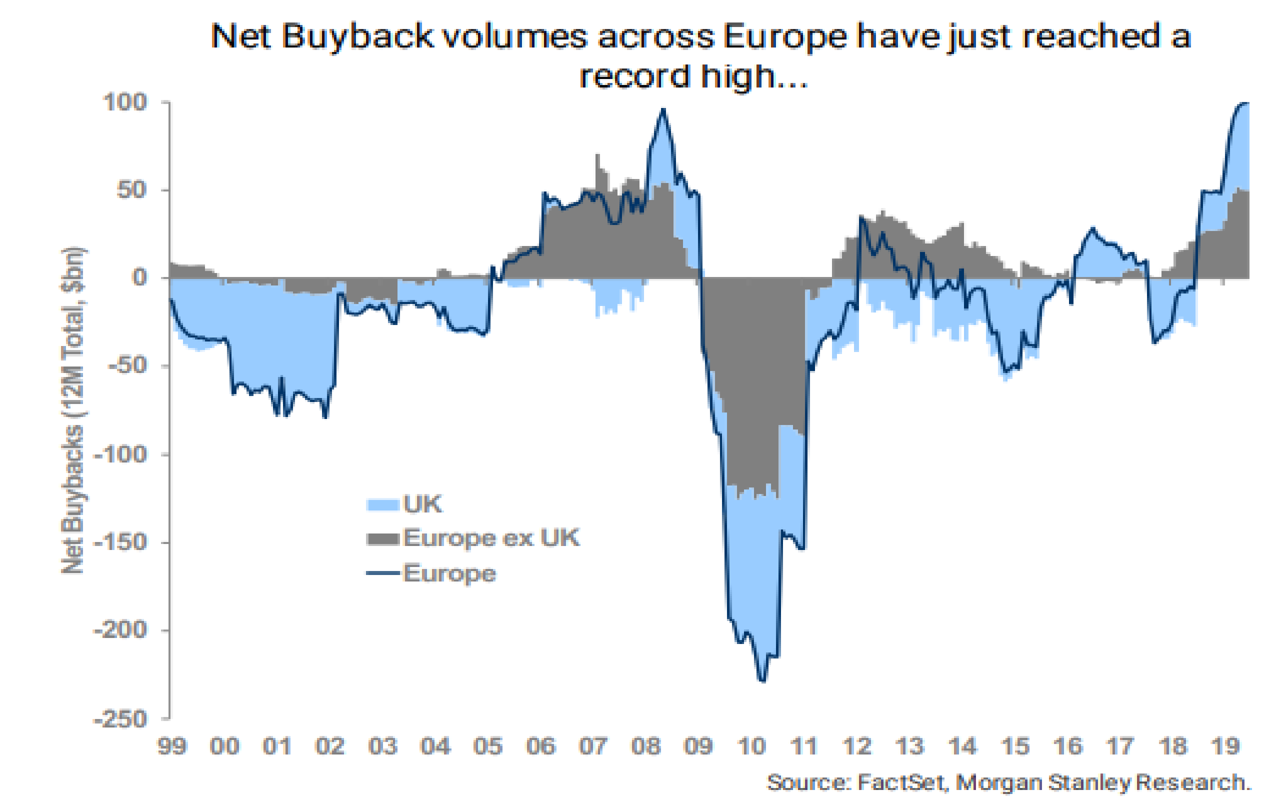
Sources: Bloomberg, iShares
Data as of Aug. 7, 2019

Government bond yields are negative in much of the world, and low in an absolute sense almost everywhere. Stocks on the other hand, offer yield and growth of yield compared to bonds.

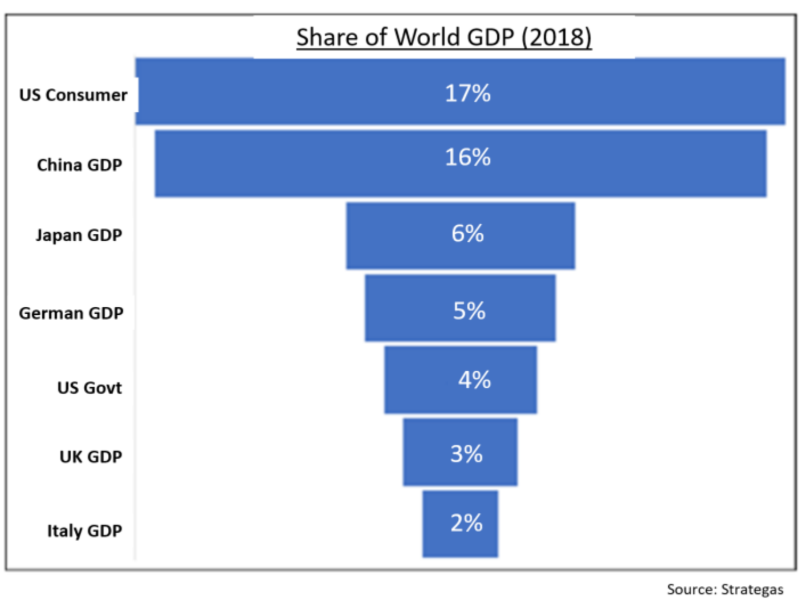
Meet TINA- "There is no alternative". Investors with actuarial return assumptions, liquidity needs, transparency requirements and needing understandable strategies are likely to view stocks as the best alternative to meet investment goals.



Economies are dynamic, and supply chains are shifting. The table above, from Strategas Research Partners, highlights the Y/Y change in US imports from our trading partners. Investors worry about Chinese exports to us declining, but we would point out that a number of alternate suppliers are doing well. The trade dispute may be the best thing to happen for other emerging market exporters.



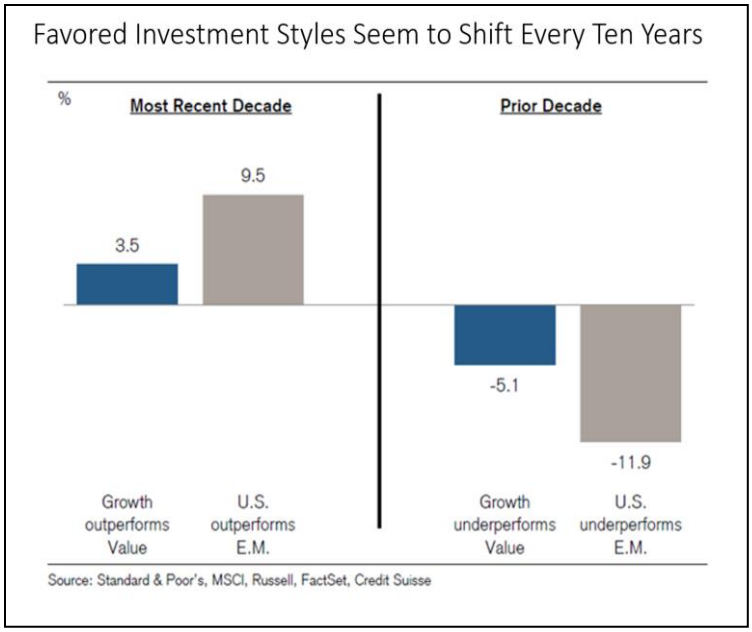
European Companies have traditionally not been large purchasers of their own stock, unlike their US counterparts. This trend seems to be changing, which we would view as shareholder friendly. We hear anecdotal evidence that Japanese companies are also looking to be more shareholder friendly, and would expect them to adopt these policies as well.



The chart to the left shows the relative sizes of different segments of the world economy. The reason many pundits spend so much time examining the health of the US consumer and the Chinese Economy is that together, they represent approximately one third of global GDP.

We have recently heard people say Value and International Investing will never work again. We would caution against this conclusion. Ten years ago, investors said Growth and US investing would never work again. Twenty years ago they said Value and International would never work again.

Investing is cyclical, and cycles turn on a regular basis. While Value and International are out of vogue now, our sense is that lower rates, some clarification on the world growth outlook and a weaker dollar could cause both of these cycles to turn again.



Summary

Investors are focused on manufacturing weakness, Brexit uncertainty and the US/China trade dispute. As a result of these concerns, the US dollar has risen and most international markets have weakened compared to the US. We believe the outlook may be better than most investors expect for international economies. Manufacturing is cyclical and we expect a recovery. Brexit is still uncertain, but the US and China appear to be de-escalating their trade war. We expect to see manufacturing start to recover and think trade tensions are easing. Those developments suggest the most likely direction of the dollar would be to weaken versus other currencies. A weaker dollar and brighter international outlook should lead to better relative performance for the International markets.

As always, if you need any additional information, please feel free to contact any of us.

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10/16/19
MSCI ACWI ex-US (Net) – 234
MSCI ACWI (Net) - 262

Refer to Performance Disclosure on the following page for more information on the performance numbers presented. These notes are an integral part of this letter and should not be reproduced or duplicated without these notes.

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MSCI ACWI ex-U.S. (net) Index is a float-adjusted market capitalization index that is designed to measure the combined equity market performance of developed and emerging market countries excluding the United States. The ACWI ex-U.S. includes both developed and emerging markets. For investors who benchmark their U.S. and international stocks separately, this index provides a way to monitor international exposure apart from U.S. investments. The Net Index takes into account the impact of foreign tax withholdings on dividend income.

MSCI ACWI (net) Index is a float-adjusted market capitalization index that is designed to measure the equity market performance of developed and emerging markets.