EAGLE GLOBAL ADVISORS

Quarterly Commentary
Q2 2020

EGA International Equity ADR

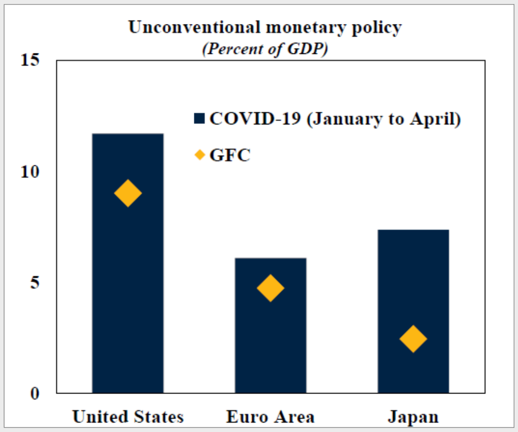
From the EGA Portfolio Management Team

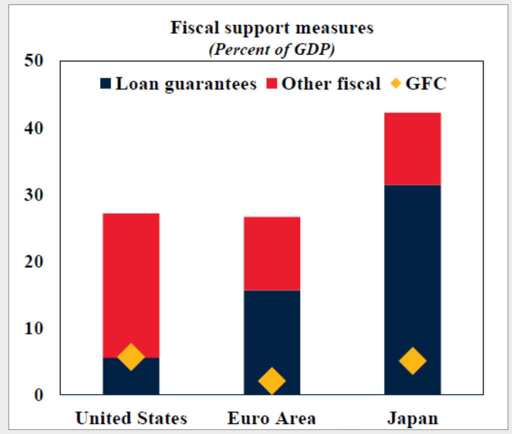
Q2 2020: A Welcome Reprieve

International equity investors were rewarded with a sharp rebound in stock prices during Q2 2020 as they looked beyond historically negative economic data in anticipation of a partial reopening of the global economy and progress on a vaccine. Improving sentiment led by FOMO (Fear of Missing Out) and less defensive positioning overshadowed skepticism about a V-shaped recovery and warnings from public health experts about a second wave of infections. Markets also shrugged off U.S./China tensions including the Senate passage of the Holding Foreign Companies Accountable Act, which requires foreign companies to provide financial transparency. Chinese stocks who fail to comply could be delisted from major U.S. exchanges. By quarter-end, returns moderated due to overbought conditions and concern about new virus cases threatening the economic recovery.

In an effort to promote economic growth, developed market policy makers made further stimulus announcements (see charts on the next page), which in total, dwarf the level of support provided during the 2008 Global Financial Crisis. In late May, the European Commission unveiled a €750B pandemic recovery plan, which was followed by bond buying programs by the ECB and the Bank of England. Of greatest surprise, however, was the kiss and make up between Germany and France for a pandemic rescue deal, a sign of a coordinated effort to lead the EU out of the biggest recession in 63 years. Angela Merkel led the way with the announcement of a €130B package to promote growth on more than 50 initiatives. Merkel also buried her grievances with French premier Emmanuel Macron to produce €500bn of grants (known as the Recovery Fund) for hard-pressed businesses across the EU, despite fierce opposition from countries known as the "frugal four"– the Netherlands, Sweden, Denmark and Austria. A final compromise should be resolved by the end of July and likely mark an inflection point for Europe as investors take advantage of the improving outlook. The European Central Bank also stirred the pot with a generous increase in lending to sovereign nations and the banking sector, joining the U.S. Federal Reserve, the Bank of Japan and the Bank of England in making sure the cost of borrowing remains at all-time lows for years to come. China also continued stimulus measures with a variety of rate cuts, and increased lending facilities to commercial banks. They also asked banks to cap interest rates on loans to selected firms.

Source: The Guardian; Photography: Axel Smith/Reuters





Source for both charts: World Bank Group

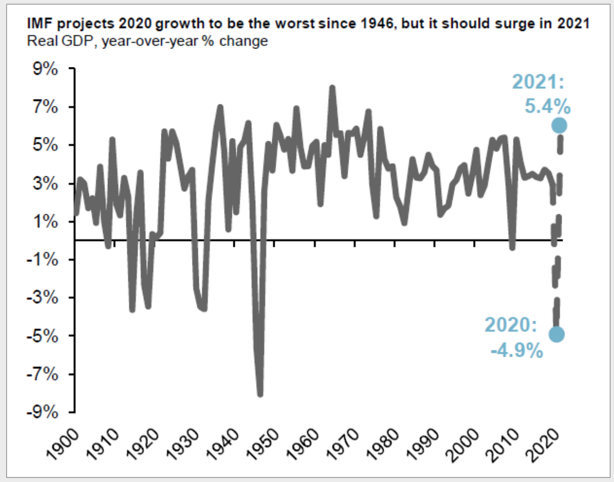
In sharp contrast to Q1 2020 performance, the MSCI EAFE Index gained 15.1% during Q2 2020, while in the U.S., the S&P 500 gained 20.5%. Regional and country specific indexes including Europe, Japan and the Emerging Markets gained 12.9%, 11.5% and 18.1%, respectively. Year-to-date, all regions remain in the red with MSCI EAFE losing 11.7%, the S&P 500 -3.1%, Europe -12.5%, Japan -7.7% and the Emerging Markets -9.8%.

Shape of Recovery: Alphabet Soup of V, U, W or Nike Swoosh?

With more than 90% of economies set to experience a recession this year, what does the shape of the recovery look like? Economists in the bullish, V-shaped recovery camp predict a sharp, but short recession with global GDP growth troughing at -8.6% YOY in the second quarter and economies returning to pre-pandemic levels of output by Q1 2021. March purchasing managers data in China provided the biggest hint yet that such an upbeat scenario remains possible as the second-biggest economy in the world re-starts its production engines. Optimists also predicate their view based on the fact

that the COVID-19 shock was not caused by large imbalances; the need to deleverage will be manageable; policy support has been sizable and will be effective in boosting the recovery and lastly, a vaccine should be available by summer of 2021. Obvious risks include the resurgence of COVID-19 in selected areas with the potential for strict lockdowns as well as the timing and efficacy of a vaccine.

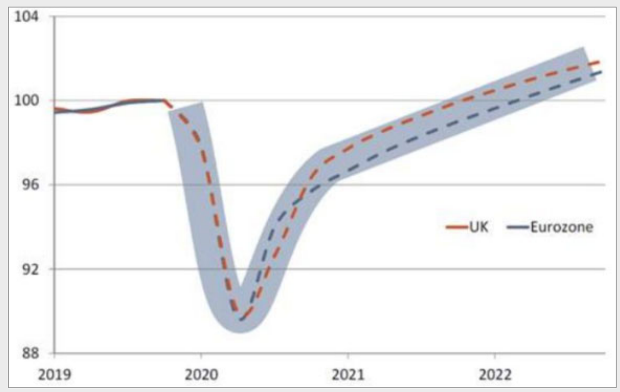
Economists in the less optimistic U and W camps take a much more cautious stance on the timing and strength of the rebound. In the case of a W-shaped recovery, Act II of COVID-19 threatens global growth for a prolonged period. According to a recent report from the International Monetary Fund, they view the global economy recovering more slowly than expected with 5.4% global growth in 2021 or 6.5% lower than their January 2020 pre-pandemic prediction. In addition to the potential for a resurgence of the pandemic, others have noted the risk of surging debt and deficits may force governments to dial back their massive fiscal stimulus.



IMF projects 2020 growth to be the worst since 1946, but it should surge in 2021
Real GDP, year-over-year % change

Source: IMF and JPAM

Finally, in the Nike Swoosh scenario, businesses and spending slowly resumes as limits are eased more carefully than they were introduced. The level of economic output stays beneath the level of its pre-crisis trend well into 2021. However, there is a lack of animal spirits as people remain cautious of over-spending or taking long-distance trips, especially if they have high personal debt levels to service or their employment is in question.



Source: Berenberg, Eurostat, ONS

Economics (Old News) vs. Equity Markets (Forward News)

The key question investors have been pondering is whether asset prices are too rich given underlying economic fundamentals. As previously noted, economies around the globe are experiencing the largest and deepest global recession in decades, with few expecting risky assets to be trading close to or at all-time highs. Major central banks may very well be trapped in a framework where low and possibly lower inflation could lock in highly accommodative fiscal and monetary policies for the foreseeable future, which would boost risky assets further. As shown to the right, G-4 central bankers have failed to meet their inflation target for the last decade. Time will tell if lessons learned from the Global Financial Crisis lead to a successful path of reflation or not.

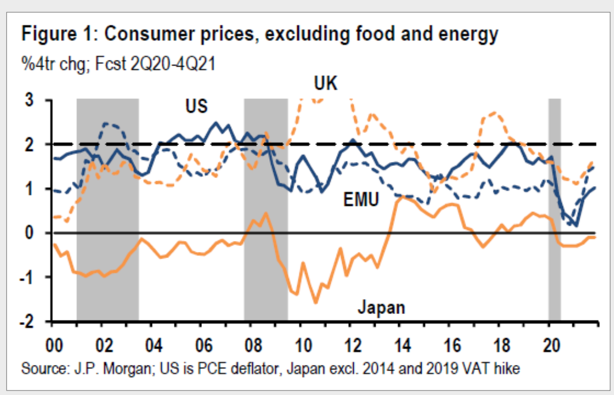


Figure 1: Consumer prices, excluding food and energy
%4tr chg; Fcst 2Q20-4Q21

Source: J.P. Morgan; US is PCE deflator, Japan excl. 2014 and 2019 VAT hike

All this being said, economic data is old news and markets are a forward-looking mechanism. Stocks have been on a tear since the end of the first quarter as economies slowly began to re-open and demand resumed. Valuations have re-rated higher with NTM (Next Twelve Month) P/E ratios at 21.3x for the S&P 500, 17.1x for MSCI EAFE, and 14.1x for MSCI EM. On the earnings front, S&P 500 EPS of -22% is expected in 2020 before rebounding 28% in 2021. MSCI EAFE EPS is estimated to decline -26% in 2020 before rebounding 28% in 2021, while MSCI Emerging Markets EPS is expected to decline -6.5% and -3.6% for 2020 and 2021, respectively. Valuations for companies who can embrace change and thrive in a post-pandemic world will likely hit uncomfortable levels relative to low margin, slow to adapt businesses whose earnings growth potential eventually falls short of their valuation.

Trends In A Post-Pandemic World

The silver lining of COVID-19 is the glimpse into future winning and losing investments, an environment active managers have long awaited. Investors have been provided a rare opportunity to step back and re-evaluate the future shape of the world as it relates to global security, international relations, trade policy, economic models and corporate/individual behavior. Bottom-up stock opportunities are emerging as countervailing forces are likely to offset the damage from job loss, lower consumption and other drags to the global economy.

Key trends that will likely accelerate going forward include the following:

- Digital Drivers: More remote working, more smart systems, more 5G and more IT services
- Decentralization: Working from home will drive decentralization with autos, real estate and transport being the most affected
- Domestic Resilience: A slow and selective reversing of globalization will affect supply chains, infrastructure and markets for years to come
- Health & Wealth: Investment in healthcare will be on the rise as consumers demand higher quality infrastructure
- New Energies: Acceleration in the move toward value over volume in hydrocarbons and the divergence between the U.S. in consolidation mode vs. Europe in new energy growth strategies
- Breaking Banks: Future trends include digitalization, consolidation and corporate re-equitization

Portfolio And Stock Highlights

In a reversal from last quarter, EAFE small cap outperformed both EAFE large and mid caps, while Growth again outperformed Value by over 4%. The best performing MSCI EAFE countries for the quarter were Australia, New Zealand and Germany, while the worst performing MSCI EAFE countries for the quarter were the United Kingdom, Spain and Switzerland.

Outperformers: Our portfolio generated strong absolute and relative results versus the MSCI EAFE Index with outperformance of 6.2% gross of fees and 5.9% net of fees. Superior stock selection drove the bulk of our outperformance for the quarter. Holdings in the Industrials, Consumer Discretionary and Communication Services sectors were among the top performers. Standout names included Techtronic Industries Co., Ltd. (Hong Kong), Mercadolibre, Inc. (Argentina) and Yandex (Russia). Our lack of exposure to Real Estate and overweight position to the Information Technology sector also added value. From a country perspective, our stock selection in Hong Kong, France and the United Kingdom drove performance as well as overweight positions to Canada and Russia.

Disappointments: Stock selection in the Consumer Staples and Healthcare sectors modestly detracted from performance for the quarter due to companies we did not own in both sectors outperforming our holdings. From an allocation perspective, our underweight to the Materials sector and our Cash allocation detracted from performance. Finally, our underweight positions to Australia and Germany were small detractors from returns.

Opportunity Set / Portfolio Positioning

Our international strategy generated strong relative results as we were well-positioned to participate in the Q2 2020 rally. We took advantage of opportunities in long-term structural growth stories with solid fundamentals trading at attractive valuations during the first quarter dislocation, which boosted our performance. We also benefited by not shifting the portfolio to more defensive holdings. As expected, portfolio turnover returned to its historical level. From a longer-term perspective, strategy returns for the one and three-year annualized periods also exceed the MSCI EAFE Index.

As we have already witnessed in the final trading days of Q2 2020, market performance has returned to a choppy, back and forth pattern, particularly between growth and value stocks. We expect this trend to continue through the balance of the year as the shape of the recovery remains difficult to predict. Investors will sharpen their pencils in their evaluation of Q2 2020 earnings results relative to the hall pass given in Q1 2020, yet they will also have an eye toward improving results in 2021. The winner of the upcoming U.S. election presents another wildcard with potential risks for global stocks. As such, we are cognizant of maintaining an appropriate level of market risk in our portfolio in an effort to balance the risks and rewards through the balance of the year.

Purchases / Additions This Quarter

Adidas AG (ADDYY): SECTOR: Consumer Discretionary, COUNTRY: Germany. We initiated a new position in Adidas, the second-largest athletic apparel company in the world behind Nike. Its size and scale provides the company the financial resources and worldwide appeal to sign sponsorships with leading athletes, teams and leagues in the world to elevate its brand equity once we move past the COVID-19 restrictions on professional sports. Adidas has greater control over its brand and pricing due to e-commerce. The firm has increased its digital capabilities and introduced a membership program. Their e-commerce sales increased 34% to nearly EUR 3 billion in 2019. We view this trend as favorable, as Adidas sells much of its products through digital channels at full price and likely achieves a better margin by shifting some sales from wholesale channels. We also believe their digital business improves customer engagement and enhances the value of its brand intangible asset. Adidas also has 20% market share in China, the fastest-growing athletic apparel market, and will benefit from the growth of athletics.

Amadeus IT Group (AMADYI): SECTOR: Information Technology, COUNTRY: Spain. We reduced cash to add exposure to our position in Amadeus because we believe the stock price did not reflect a likely resumption, albeit slow, of air travel. Amadeus offers travel providers a portfolio of continuously updated technology solutions to automate critical business processes, which we believe is key component to their staying power in the post-pandemic world. Amadeus has also taken advantage of the capital markets, so they have sufficient liquidity unlike their large peer Sabre, who has a debt burden and will most like have to cut R&D and take other measures to weather the storm.

ING Groep NV (ING): SECTOR: Financials, COUNTRY: Netherlands. We opportunistically added to our position in ING Groep early in the second quarter due to its very attractive valuation relative to growth profile. We believe the stock price already priced in potential provisions for bad loans and low interest rates. ING Groep also stands to benefit from the digitization trend in the post-pandemic world as they are well-positioned in mobile banking.

Sells / Trims This Quarter

Melco Resorts Entertainment (MLCO): SECTOR: Consumer Discretionary, COUNTRY: Hong Kong. The sale of Melco was motivated by two factors: to reduce portfolio risk due to (1) US-China geopolitical tensions, which could result in actions leading to a macroeconomic slowdown in China; and (2) the possibility of a second wave of COVID-19. On the latter point, it is important to note Macau Casinos have seen a precipitous decline in traffic since the pandemic began. Initially the Casinos were required to shut operations. Shortly after they re-opened, new quarantine measures were introduced that discouraged people to visit Macau.

iShares MSCI EAFE ETF (EFA): COUNTRY: United States. We eliminated our position in the iShares MSCI EAFE ETF due to the strength of the rally during the second quarter and our desire to have dry powder for more attractively valued opportunities during the balance of the year given our expectation for choppier market conditions.