EAGLE GLOBAL ADVISORS

Quarterly Commentary
Q3 2020

EGA International Equity ADR
From the EGA Portfolio Management Team

3Q 2020: Mostly Sunny With A Few Clouds Brewing

International markets opened the second half of 2020 on a positive trajectory as economic activity continued to rebound, albeit on a jagged line. Returns across regions were positively impacted by the strength of local currencies and the decline of the U.S. Dollar. On the news front, the Shinzo Abe era of Japanese politics came to a sudden end in late August with the surprise announcement Japan's longest serving Prime Minister would resign for health reasons. Abe was succeeded by Yoshihide Suga, who has pledged his top priority is to revive the Japanese economy. While his tenure has been short, enthusiasm about the future is on the rise, which has been reflected in positive returns for the Japanese stock market since his arrival.

By quarter-end, volatility increased due to a resurgence in COVID-19 cases around the world, which caused fears of additional lockdowns and a more prolonged recovery. The outcome of Brexit, deal or no deal, was once again back in the spotlight with the EU accusing the U.K. of breaking international law by trying to override parts of the Brexit deal. Finally, the results of the upcoming U.S. election and the impact to relations between the U.S. and China/Europe as well as trade policy direction played a role in increased investor anxiety.

For 3Q 2020, the MSCI EAFE gained +4.80%, while in the U.S., the S&P 500 gained +8.93%. Regional and country specific indexes including, Europe, Japan and the Emerging Markets gained +4.50%, +6.94% and +9.56%, respectively. Year-to-date, MSCI EAFE, Europe, Japan and Emerging Markets lost -7.09%, -8.85%, -0.68% and -1.16% respectively, while the S&P 500 gained+5.57%.

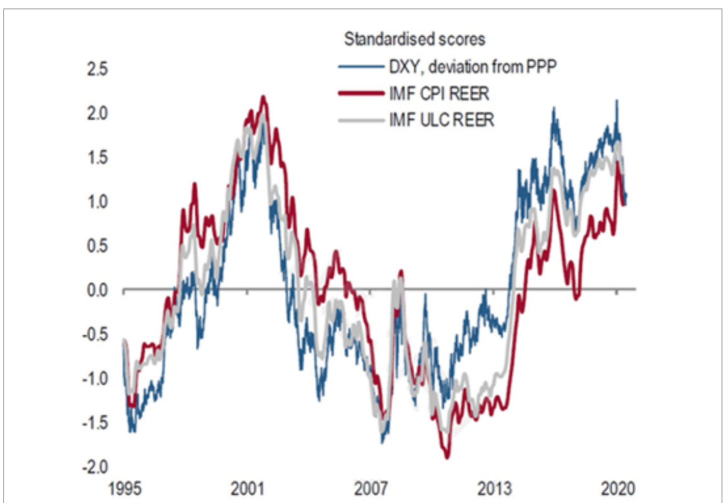
Brexit: It's Back

In the early days of 2020, there was renewed optimism in the U.K. following Boris Johnson's Conservative Party victory and the passing of the Brexit Withdrawal Bill through Parliament, which enabled the U.K. to officially exit the European Union on January 31st. This marked just the beginning of the end as intense trade negotiations began and continue to this day. The pandemic only added more complexity to the discussion as priorities changed on both sides. Fast forward to September and the ugliness got worse as it was revealed the U.K. government was planning new legislation to tear up key elements of the Brexit Withdrawal Bill including those impacting Northern Ireland customs and subsidies for companies. There appear to be two key issues: leveling the playing field rules regarding state aid and access to U.K. fishing waters. The EU wants a guarantee the U.K. will not increase the aid at their expense and the U.K. refuses to accept being under the heavy hand of the EU during the transition period. This is the latest version of the Brexit trade-off between sovereignty and welfare and the balance between taking back control at some cost to the economy and U.K. influence, while maintaining alignment to the EU to reduce the economic burden from Brexit. There are a range of possible outcomes with the most likely being the U.K. continuing negotiations, while maintaining a hardline stance with a defined walkaway position because they believe this will lead to the most favorable outcome.

Currency: A Tailwind Or A Headwind?

Since the end of March, U.S. investors have enjoyed a currency tailwind from foreign investments as the U.S. Dollar Index/DXY (which measures the currency against a basket of peers) has declined ~9.0%. For the third quarter, this translates into a +3.6% gain for U.S. investors invested in EAFE relative to local currencies. A variety of factors suggest this currency tailwind is unlikely to abate. The late-July announcement of the €750B Recovery Fund through the issuance of common, not country specific debt, the ECB's aggressive balance sheet expansion and Germany easing its fiscal policy by 8.0% of GDP in local currency terms have led to the Euro being a more credible reserve currency at a time when central banks appear to be structurally underweight the Euro. This underweight is due to central banks having just 20% of their FX reserves in Euros versus 62% in U.S. Dollars. The Euro is also being supported by a U.S. Fed that is printing money at a rate commensurate with a budget deficit that is estimated to be 24% of GDP or double that of Europe. When the Fed increases its balance sheet by more than the ECB, the Euro tends to strengthen. The U.S. has also committed to open ended Quantitative Easing versus a €1.35T purchase limit by the ECB in June.

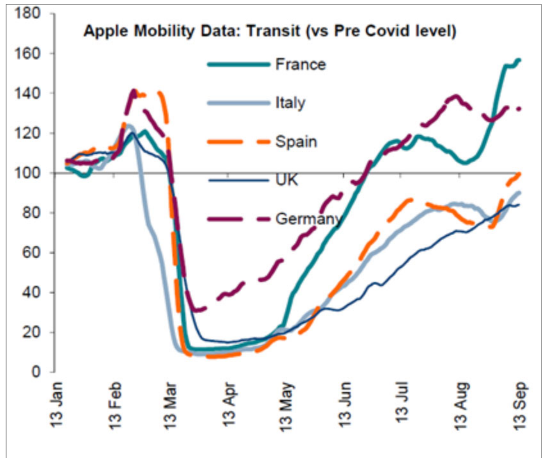
So, what could cause the U.S. Dollar to reverse course? On the valuation front, currencies usually trough when they are undervalued. This is not the case today. As shown in the chart below, the U.S. Dollar remains overvalued relative to purchasing power parity, inflation and unit labor costs. Despite a stronger U.S. Dollar, the trade balance is still deteriorating as it takes six to nine months for the volumes to adjust to the change in currency. The fall in the price of oil has also had an impact with the current price of oil relative to a shale breakeven price of $45 preventing the U.S. from becoming a major net oil exporter. Finally, both a lack of monetary policy response by either Europe or the U.S. as well as current fiscal policies are more supportive of a stronger Euro. It should be noted there was a short-term reversal of approximately 3.0% in U.S. Dollar strength near quarter-end as investors flocked to safer assets on fears of a second wave of COVID-19, additional lockdowns and a contentious U.S. Election.



Source: Refinitiv, Credit Suisse research

Recovery Update

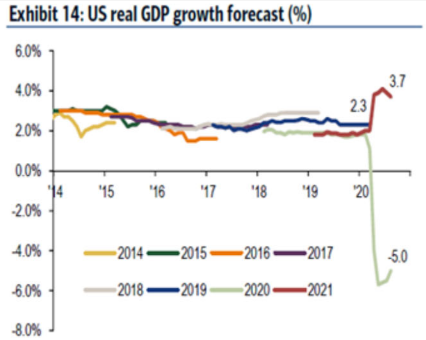
While the global economy bounced back strongly from the collapse it suffered in the Spring, more recent data suggests the early gains from the lifting of coronavirus lockdowns are showing some signs of exhaustion, adding to evidence the recovery back to pre-COVID levels could be prolonged. Case in point, late September PMI data from the Eurozone shows growth halting to a grind during the month with diverging trends between manufacturing and services as well as by country. Manufacturing data improved, while on the other hand, services contracted again amid rising COVID-19 infections. As of this writing, virus cases are making new highs in the U.K., yet the fatality rate continues to fall. Japan experienced the same scenario last month with no new lockdowns and the crisis passed. Interestingly enough, mobility data (as shown to the right) has not reversed course even in countries like the U.K. and Spain, which have seen a spike in new cases. Time will tell how the recovery process evolves, but going back to our comments from last quarter discussing the alphabet soup of outcomes, it appears less likely we experience a sharp, V-shaped recovery and more along the lines of the Nike Swoosh, U or W recovery paths.



Source: Exane BNP Paribas estimates

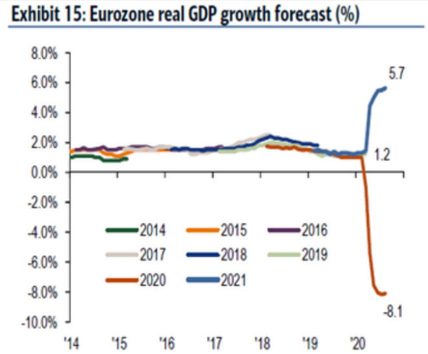
As shown in the charts below, expectations for growth around the globe remain on a positive trajectory as we move closer to 2021 and beyond; however, given the historic level of collapse in activity, a sustained period of robust economic growth will be necessary to achieve pre-COVID 19 levels. Proactive fiscal and monetary policy actions have played a substantial role in the recovery process. What to watch from here? The race towards a vaccine is on and when successful, will provide an enormous catalyst for economic growth and investor sentiment. There are currently several Phase 3 vaccine trials underway. Usually there is an 85% likelihood of a Phase 3 vaccine trial being approved. The caveat is Phase 3 trials generally last several years, not several months. Nevertheless, even a lower probability of success compounded over several trials, suggests the likelihood of an approval is quite high. On the final day of the quarter, game changing news was announced about approval given in Europe for a 15-minute COVID-19 test. This is significant news given the recent uptick in daily cases. In the meantime, infection rates, mobility restrictions and daily cases can be monitored for signs of improvement or deterioration of the recovery process. Unemployment, although a lagging indicator, is another factor to monitor because it could still rise due to bankruptcies and the eventual end of government support. Sentiment levels both for businesses (PMI) and consumers are also indications of the pace of recovery.

Exhibit 14: US real GDP growth forecast (%)



Source: BofA Global Markets, Datastream, IBES, MSCI

Exhibit 15: Eurozone real GDP growth forecast (%)



Source: BofA Global Markets, Datastream, IBES, MSCI

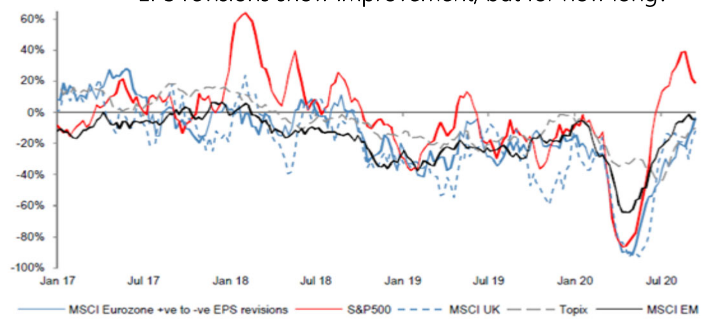
Exhibit 16: China real GDP forecast (%)

Source: BofA Global Markets, Datastream, IBES, MSCI

Earnings/Valuation: A Game Of Tug Of War

Equity market valuations around the globe continue to be elevated due to multiple expansion, despite double-digit declines in forward EPS forecasts for the first half of the year and modest improvement for the balance of the year. As hurdle rates for earnings comparisons come off very low levels, the trajectory of the earnings recovery will likely play an increasingly larger role in equity market valuations, particularly if earnings don't meet expectations. While there has been some upward movement more recently in the U.S. and Europe is on the cusp of recovery, it is likely to stall as a gap has opened between earnings revisions and PMIs where the level of activity is too weak to sustain improvement barring a strong rally in PMIs, oil prices and consumer confidence. A PMI reading of 54 and above is typically required for EPS revisions to be sustainably positive; however, August PMI for Europe lost momentum as it declined to 51.6 before climbing back to 53.7 in September.

EPS revisions show improvement, but for how long?



Source: JP Morgan

Valuations have been a mixed bag with NTM (Next Twelve Month) P/E ratios increasing to 22.4x for the S&P 500, declining slightly to 17.6x for MSCI EAFE, and unchanged at 14.7x for MSCI EM. On the earnings front, S&P 500 EPS growth of -19% is expected in 2020 before rebounding 26% in 2021. MSCI EAFE EPS is estimated to decline 17% in 2020 before rebounding 22% in 2021, while MSCI Emerging Markets EPS is expected to decrease 9.3% for 2020 and increase 32.2% in 2021.

Sector Spotlight: Is The Technology Sector In A Bubble?

The MSCI Global Technology Index has strongly outperformed global markets this year returning 80% from its March 2020 trough to its early September peak, which excludes the ~7.0% September pullback. The sector remains the winner of the COVID-19 disruption shifting the way we work, shop and entertain ourselves. Technology is also the beneficiary of the shift to Artificial Intelligence and increased penetration of Electric Vehicles. Amazingly enough, the $9.3 Trillion market cap of the US Technology sector is greater than the market cap of Europe's entire stock market, perhaps highlighting the value proposition of the region. While some of the excesses in technology like revenue and earnings, valuation and speculative positioning are high, in most instances, they are not at extreme levels. Additionally, there has not been a decoupling of stock price performance from earnings revisions, which would indicate the probability of a reversal on the horizon. Finally, while valuations are extended on a trailing year over year basis, they are much less so on a forward one-year basis, the P/E relative to the market excluding the performance of TMT (Telecom, Media & Technology). With respect to sentiment, we point to the U.S. market as a proxy where inflows have not been noteworthy and speculative positioning is not extended.

Risks to be cognizant of for the sector are the increasing stock market concentration in terms of market capitalization and number of stocks driving index performance. While this loss of market breadth is significantly less than what we experienced during the TMT bubble in 2000, it is a warning signal to monitor. However, in contrast to 2000, resilient earnings growth, strong free cash flow generation and healthy balance sheets support the sector as do stock buybacks. Increased regulation continues to be a threat depending on the outcome of the U.S. election. Finally, the approval of a vaccine could also have a dampening effect on the sector as the tailwind technology stocks have enjoyed will likely decelerate depending on the pace of the reversal of the trend toward being online. Because of the risks noted, we believe selectivity in terms of stock selection will be a key driver of performance going forward.

Portfolio And Stock Highlights

Last quarter's market cap and style performance trends continued in the third quarter with EAFE small cap outperforming both EAFE large and mid caps, while Growth outperformed Value by over 7%. The best performing MSCI EAFE countries for the quarter were Denmark, Sweden and Finland, while the worst performing MSCI EAFE countries for the quarter were the Austria, Spain and Israel.

Outperformers: Our portfolio generated strong absolute and relative results versus the MSCI EAFE benchmark for the third quarter with outperformance of nearly 2.7%/2.5% on a gross/net of fees basis. From a longer-term perspective, strategy returns for the one and three-year annualized periods continue to exceed the MSCI EAFE benchmark on a net of fees basis.

Stock selection by sector and country 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), Alibaba (China) and Yandex NV (Russia). Our overweight to Consumer Discretionary and underweight position to the Energy sector also added value. From a country perspective, our stock selection in Hong Kong, China and Russia drove performance as well as overweight positions to China and Russia.

Disappointments: Stock selection in the Energy and Consumer Staples sectors modestly detracted from performance for the quarter due to our holdings in Royal Dutch Shell, Total and Imperial Brands. From an allocation perspective, our underweight to the Materials sector and our Cash allocation detracted from performance. Finally, our underweight position to Japan and overweight to Belgium also detracted from returns.

Opportunity Set / Portfolio Positioning

Our international strategy continues to generate strong absolute and relative results as we were well-positioned to participate in the extension of the 2Q 2020 rally with modest defense during the September weakness. Our team continues to identify opportunities in long-term structural growth stories with solid fundamentals trading at attractive valuations. HDFC Bank in India is one example where we took advantage of a valuation opportunity in a high-quality bank with attractive growth prospects as the effect of the pandemic passes and economic activity returns. We also took advantage of opportunities in individual Japanese names to eliminate our passive exposure.

As we expected, market performance continues to be in a choppy, back and forth pattern, particularly between growth and value stocks. We expect this trend to last through the balance of the year as the shape of the recovery remains difficult to predict. We don't expect any significant changes to our portfolio structure and expect to maintain our bias toward structural growth stories with long-term growth potential. Earnings results will play an important role in company valuations as investors navigate the uncertain economic and political landscape. 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 to balance the risks and rewards through the remainder of the year.

Purchases / Additions This Quarter

HDFC Bank LTD ADR (HDB) SECTOR: Financials, COUNTRY: India. HDFC is one of India's leading private banks with strong brand recognition and dominant market share in retail lending. They also benefit from their digital offering and consolidation in the industry. HDFC has a deposit franchise of retail customers who typically have long-term banking relationships. Growth is expected to be healthy for the next two years as HDB benefits from a "flight to quality" as well as from low funding costs. We expect loan growth to be slow this year due to a weaker economy, but will gradually recover over time. The stock is attractively valued given the potential for 20% revenue growth as they are gaining share combined with high profitability.

Hoya Corporation ADR (HOCPY) SECTOR: Health Care, COUNTRY: Japan. Hoya Corporation is a global med-tech company and the leading supplier of innovative products for the Health Care and Technology sectors including eyeglasses, medical endoscopes, intraocular lenses, optical lenses as well as key components for semiconductor devices, LCD panels and Hard Disc Drives ("HDD"). The company has a leading market share in next generation EUV blanks, which are higher priced with higher margins and supply two of the three major foundries, TSMC and Samsung. On the healthcare side of the business, the impact to demand from COVID-19 has been better than expected with eyeglass and contact lens sales rebounding strongly in part due to customers going online while cities were under lockdown. We believe the current valuation is warranted due to EUV blanks supply growth, increased adoption by customers of glass substrates for HDD and input cost declines with a depreciating yen.

Safran S.A. (SAFRY) SECTOR: Industrials, COUNTRY: France. Safran, through its CFM joint venture with GE, is a leading producer of aircraft engines for commercial and military airplanes. As one of a few major players, Safran operates in an oligopolistic industry typically characterized by attractive levels of profitability. Fueled by the development of emerging economies, air traffic – the key driver of Safran's business – has grown faster than global GDP. Over the medium to long-term, we expect a continued increase in air traffic per capita to allow the commercial aerospace industry to sustain GDP-plus levels of growth. This industry growth should bode well for both Safran's engine sales and the profitable aftermarket opportunities associated with Safran engines-in-service. In the near-term, COVID-19 has decimated air travel, leading to a significant and potentially excessive decline in earnings expectations for Safran. We believe these diminished expectations, as reflected in Safran's current share price, have opened an opportunity to own a world-class value creator at an attractive price.

Sony Corporation (SNE) SECTOR: Consumer Discretionary, COUNTRY: Japan. We increased our position to Sony because we expect their game business to remain resilient before entering its next leg of growth with the launch of PlayStation 5 (PS5) during the 2020 holiday season. In addition, we expect a greater fusion between games, music and movies. Although image sensors have been hurt by weak smartphones sales and technology export restrictions, we await recovery in momentum from rebuilding of customer base, market penetration of 5G smartphones and a recovery in demand for high-end smartphones.

Sells / Trims This Quarter

Wisdom Tree Japan Hedged (DXY) SECTOR: Industrials, COUNTRY: Japan. We exited this passive investment for better opportunities in individual Japanese companies.

Imperi.al Brands (IMBBY) SECTOR: Consumer Staples, COUNTRY: United Kingdom. Imperial Brands was eliminated from the portfolio in favor of new opportunities due a new CEO, as well as a widely expected dividend cut, which was not well-received coming off a 13% yield. Returns on the company's heavy investment in their Next Generation Products portfolio, which are products that are potentially less harmful than combustible cigarettes, were disappointing. This was a function of the slower than expected growth, management mistakes and product launches that were scaled up without sufficient consumer research in an attempt not to miss the wave.

Yandex (YNDX) SECTOR: Communications Services COUNTRY: Russia. We reduced our exposure to Yandex due to the valuation becoming extended given the company will likely face short-term headwinds due to a pronounced decline of Russia GDP. However, we think the structural shift toward online advertising spend will continue, so we expect the digital segment to still grow this year. Yandex should be a long-term beneficiary from this trend given its strong market positioning. Yandex also has exposure to other growth drivers including the rapidly evolving Russian online taxi, food takeaway and e-grocery markets.

Vanguard FTSE Emerging Market ETF (VWO) Index: We exited this passive investment for better opportunities in individual companies.