Eagle Global Advisors

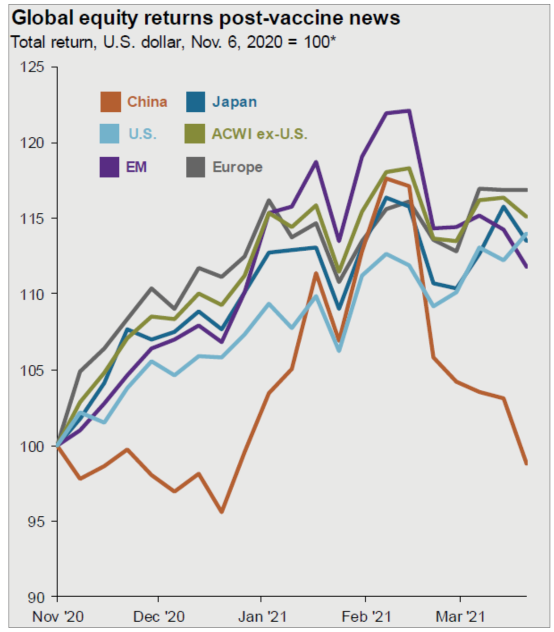
Quarterly Commentary
1Q 2021

EGA International Equity ADR

From the EGA Portfolio Management Team

Equity Markets Get a Shot in the Arm

Global equity markets received a boost with the November news of vaccine success and have continued to benefit from this optimism through the first quarter of 2021. The pace of vaccines has risen in the first months of the year and the market is looking through current variants' risk and the risk of new waves of the virus, specifically in Europe. Volatility has risen in the markets as a tug of war of market leadership ensues given market optimism for a strong cyclical recovery leading to strong returns for value sectors while the leadership in growthier sectors has seen some selling pressure, even though there is continued optimism for longer-term secular trends.



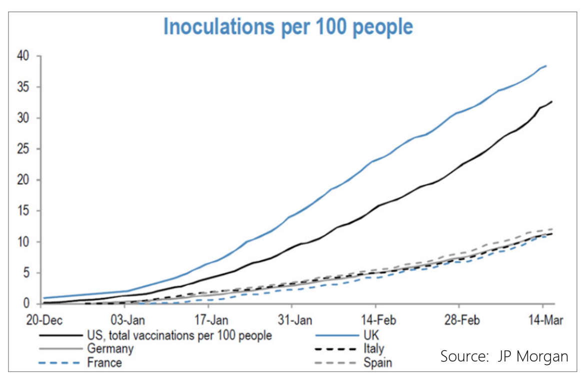
Source: JP Morgan

We expect a strong global cyclical rebound in 2021. The combination of aggressive fiscal and monetary policy as well as easy comparables to last year should provide a strong tailwind to corporate earnings for 2021 and into 2022. This optimism has translated to strong equity gains at the beginning of the year.

The S&P 500 Index is off to a strong 6.2% start for the year led by value/cyclical sectors such as Industrials, Financials, and Energy while the international MSCI EAFE Index is also up with a 3.5% return in USD terms (7.6% in local currency terms), also led by the same cyclical sectors as in the U.S. MSCI Europe is up over 4.0% in USD-terms for the quarter while Japan trails at 1.6% and the U.K. leads major MSCI EAFE markets at over 6.0% return for the first quarter.

The U.S. and U.K. Lead the Way in Vaccines to Date

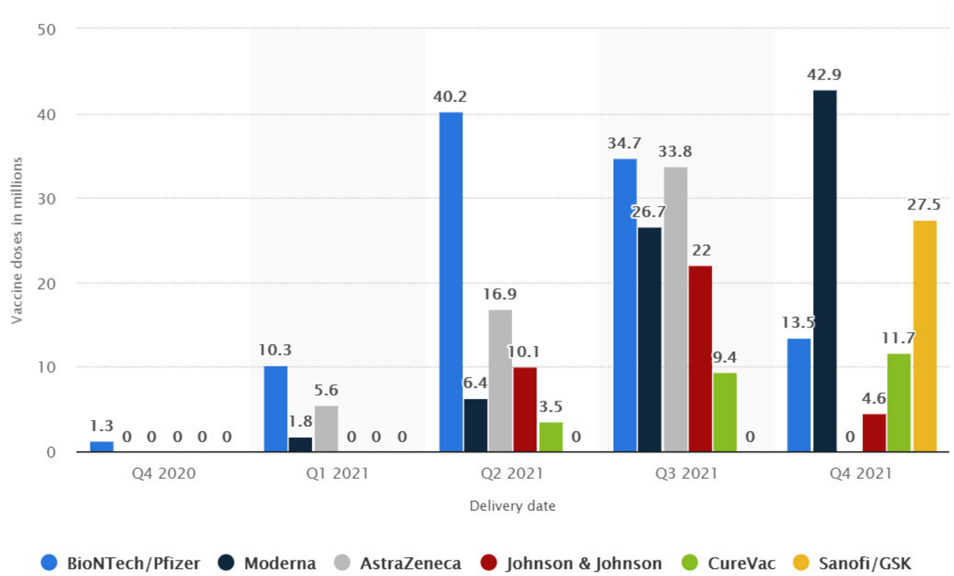
The rollout of coronavirus vaccines across the globe has been choppy. Although it is truly a miracle how quickly the medical community was able to formulate a vaccine for the virus, test it, and put it into production and begin inoculating the population. Yet, the delivery of the vaccines and inoculations has not been consistent across regions and countries.



Source: JP Morgan

While Israel appears to be far ahead in the vaccine rollout across all countries, the U.K. and the U.S. are leading the way in major economies. The U.S. and U.K. appear to have had the worst virus outcomes of major economies but are also ahead in vaccinations. Other European countries are lagging 2-3 months behind as vaccine availability was very limited in the region as well as issues reported with the AstraZeneca vaccine. But all is not lost, and Europe will begin to catch up quickly beginning in the second quarter. As the chart on p. 2 shows, deliveries of the vaccine to Germany are expected to increase substantially starting in the second quarter, providing the market's room to continue pricing in a recovery in the region. However, the slow rollout of the vaccine in Europe has slowed the earnings and economic upgrades for the region. Yet, we still expect a robust earnings rebound in Europe for 2021, albeit with a couple of months lag to the U.S. and U.K. recovery.

Confirmed COVID-19 Vaccine Expected Deliveries for 2021 - Germany



Source: Statista

Yield Curves Steepen as Light is Seen at the End of the Tunnel

Bond yields rose sharply in most areas of the world following a combination of increasing inflation worries and optimism over the reopening of economic activity across the globe.

	10-Yr Yield March 31, 2021	Change since Dec. 31, 2020
US 10-Yr Bond	1.74%	+82 bps
German 10-Yr Bond	-0.30%	+27 bps
French 10-Yr Bond	-0.05%	+29 bps
British 10-Yr Bond	0.83%	+63 bps
Japanese 10-Yr Bond	0.09%	+7 bps

Yield curves steepened across the world, led by the U.S. curve as U.S. rates rose faster than most other major economies. While short-term interest rates remain anchored close to zero, longer maturities began rising on inflation worries and economic recovery. Inflationary expectations have risen in the last couple of months, first on easy comparables to last year's recessionary impacts from closing economies but also on worries over the massive fiscal stimulus packages around the world having unintended inflationary consequences. Even the Fed has joined the conversation in agreeing that inflation is likely to tick up in 2021 but they expect it to be transient and not a secular shift to higher inflationary pressures. Most economists expect higher inflation in the developed world in 2021 but moderating some in 2022. Interest rates are likely to continue rising as economic conditions normalize and improve over the coming quarters. There is light at the end of the tunnel in reopening of economies, rising vaccination numbers, and corporate earnings. Let's just hope that light is not an inflation train.

Economy Roars Back, Dollar Bounces, and Value Outperforms Growth

Source: Haver, Morgan Stanley Research

The global economy is roaring back in 2021 full throttle on the fiscal and monetary pedal. This combined with accelerated vaccinations across the globe is leading to expectations of some of the hottest economic growth in the developed world in decades. While the U.S. appears to be leading the charge with greater fiscal push and more successful inoculation efforts, other major economies will not be far behind. Europe is hurting in the near-term from the slower rollout of the vaccine and additional lockdowns announced in recent weeks amid another virus wave. Yet, with vaccinations accelerating in the second quarter and more fiscal support from the European Recovery Fund into the second half of this year and 2022, the European economy will not be far behind. Global PMIs should continue to show significant strength in the coming months even though they have already risen meaningfully. The key question for equity markets in 2021 will be how much of this improvement has already been priced into equity prices.

The higher expected growth in the U.S. and quicker pace of interest rate rises also led to a small rebound in the US Dollar at a time that markets were pressing hard on the dollar depreciation story. Investor positioning in the USD since the fall had been bearish and caught off guard by the strong momentum in US growth and steeper rise in the yield curve versus major currencies. The US Dollar Index appreciated by over 3.0% in the first quarter, hurting international equity returns for US Dollar investors.

Talk of reflation and strength in the economic recovery gave way to a style rotation after the vaccine news in early November that continued into the first quarter of the year. While growth and quality equities had been leading for some time, cyclical and value sectors took leadership for the near-term as accelerating economic conditions led to sharp positive revisions to earnings estimates of cyclical/value sectors. Since the vaccine announcement last November, EAFE Value has outperformed EAFE Growth by 14.0% and outperformed MSCI EAFE by 7.0%, both trends continued in the first quarter of 2021. We expect this tug of war between value and growth to remain in place in the next few months as the economic cycle takes shape and earnings revisions in cyclical and value sectors continues to beat those of growth and quality sectors.

MSCI EAFE Value (Blue) vs. MSCI EAFE Growth ETF (Red)

November 6, 2020 to March 31, 2021

Source: Factset

Portfolio And Stock Highlights

In the first quarter of 2021, EAFE small caps outperformed both EAFE large and mid-caps, while EAFE Value outperformed EAFE Growth by over 8%. The best performing MSCI EAFE countries for the quarter were Sweden, the Netherlands, and Norway, while the worst performing MSCI EAFE countries were New Zealand, Portugal, and Denmark.

Outperformers: Despite the small cap and value headwinds, Eagle portfolios continued their outperformance trend versus the MSCI EAFE benchmark this quarter. Stock selection and sector allocation were both positive. Stock selection was led by the Industrials sector with standout names Techtronic Industries (Hong Kong), Ashtead Group (U.K.), and Recruit Holdings (Japan). Country allocation was also positive but was held back some from our allocation to emerging market holdings in Russia (Yandex) and LATAM (MercadoLibre). Country allocation and selection was best in Canada, Hong Kong, the Netherlands, and the United Kingdom.

Disappointments: Stock selection in Germany, Switzerland, and Israel were detrimental to the portfolio's relative performance. From a sector standpoint, stock selection was least favorable in the quarter in Consumer Discretionary, Health Care, and the Information Technology sectors with weak performances from Nice Ltd. (Information Technology-Israel) and Lonza Group (Health Care-Information Technology).

Purchases / Additions The Quarter

BASF AG (BAFY) SECTOR: Materials, COUNTRY: Germany. The largest diversified chemicals group in Europe should benefit from the upturn in the global economy as well as higher commodity prices. The supply/demand of BASF's key upstream chemicals likely troughed in 2020 and should see tighter conditions over the coming years as the cycle recovers. In addition, the company is undergoing a self-help strategy with a major cost-cutting program that should lead to increasing margins over the medium-term. The Ag solutions business, close to 25% of group EBIT, should also see an uplift this year as agricultural commodity prices have rallied as well. The company's oil & gas division is now a much smaller part of the overall picture and rising oil prices could help the company exit this business at an attractive price.

ALIBABA GROUP (BABA) SECTOR: Consumer Discretionary, COUNTRY: China. We attribute Alibaba's share price weakness since October (-26.0% vs. MSCI China +8.0%) to concerns on regulatory risks, particularly the ongoing anti-trust investigation and the risk of the US banning Americans from investing in Chinese tech giants. On the former, we expect single digit percent potential earnings impact in CY2022. The current share price only implies 10x 2022 P/E multiple on Alibaba's core commerce, assuming 10% of Tmall's Gross Merchandise Value (GMV) will be lost to competitors in the first full year of impact. On the latter, recent news about the U.S. no longer planning to add Chinese tech giants to the Defense Department list of firms deemed to support China's military, intelligence and security services, calls for a moderation of geo-political risk premium attributed to Alibaba's valuation. We like the relative valuation and the timing of cloud and logistics networks turning profitable soon.

HOYA CORP (HOCPY) SECTOR: Health Care, COUNTRY: Japan. After recent weakness in the share price we added to our position as we believe the company trades at an attractive valuation compared to its growth potential in the IT business of Extreme Ultraviolet Lithography (EUV) mask blanks and Hard Disk Drive (HDD) substrates driven by secular trends in semiconductor EUV adoption and continued data center growth. Its life care division has been impacted by the shutdowns during the pandemic and recent extensions of lockdowns in Europe will not help. Yet, we believe it is a matter of time in 2021 when we will start to see a recovery in their eyeglass lens business that will provide an additional boost to earnings.

SONY CORP (SONY) SECTOR: Consumer Discretionary, COUNTRY: Japan. We added to our position in Sony as we expect a rerating of Sony shares. Strong growth from game and network services (GNS) on a strong pipeline of first-and third-party games and shift toward subscription model and recovery in recording music market to pre-pandemic levels with a rebound in ad-supported streaming services and expected publishing recovery by the end of the year. Moreover, a recovery in media network ad revenues and further strength in TV production with an aggressive shift from linear networks to streaming networks as well as recovery of the smartphone market in China and adoption of Time of Flight (ToF) sensor technology in the Android supply chain following the adoption in iPhone 12 all should lead to better times ahead.

Sells / Trims This Quarter

NICE LTD (NICE) SECTOR: Information Technology, COUNTRY: Israel. We took some profits in NICE based on valuation. We like the secular growth story driven by the shift to the cloud in the High-growth SaaS category of Software stocks. The company had reached a milestone with the cloud at 50% of revenues. It is well positioned to capture new demand as it is an established leader within the customer engagement and CCaaS space and is also the leader in financial services where its Actimize platform has become a de facto standard for Compliance & Financial Crime prevention.

NESTLE SA (NSRGY) SECTOR: Consumer Staples, COUNTRY: Switzerland. While Nestle is likely to remain a long-term core holding for the portfolio, we trimmed our position to provide room for more attractive opportunities at this part of the business cycle. There are risks in the coming couple of years around margins not growing as quickly as they have in the last four years and as the company has guided in desired M&A that could carry valuation risk. While disposals have been group margin positive, risks of an M&A strategy could hold back its sales growth in the medium term. With interest rates increasing and U.S. corporate taxes possibly on the way back up, this could also hurt valuation multiples and earnings in the near-term.

KAO CORP (KAOOY) SECTOR: Consumer Staples, COUNTRY: Japan. Kao's business has suffered during the pandemic as people used less cosmetics while wearing masks in addition to the impact in sales felt from the hit in tourism. Although these impacts should be short-term in nature as economies open up, increased competition is leading to higher investment and has cast a cloud on future earnings. In addition, Kao's diapers business in the Chinese market (which was an area of growth for the group) is also facing increased competition. We decided to sell and redeploy into other opportunities.