EAGLE GLOBAL ADVISORS

# Eagle International Equity

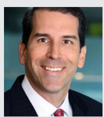
## ABOUT US

- Located in Houston, TX
- Founded in 1996
- $2.2B in AUM*
- 22 employees including 10 investment professionals

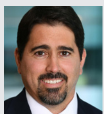
## INVESTMENT HIGHLIGHTS

- Focus on companies with global scale
- Industry leaders that possess sustainable competitive advantages
- Optimal combination of proprietary quantitative tools and fundamental research
- Sustainable Growth-oriented businesses trading at attractive valuations (SGARP)
- Allocations driven primarily by stock selection—45 to 60 high conviction holdings
- Flexibility to under/over-weight countries and sectors
- Benchmark sensitive—$R^2$ over 90%
- Low turnover—15% to 30% annually
- Long track record of competitive returns since inception

## PORTFOLIO MANAGEMENT



**John F. Gualy, CFA**
*Senior Partner,*
*Portfolio Manager*
*32 Years of Experience*



**Brian Quattrucci, CFA**
*Portfolio Manager*
*28 Years of Experience*

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**AUM data is inclusive of both discretionary and non-discretionary client assets.*

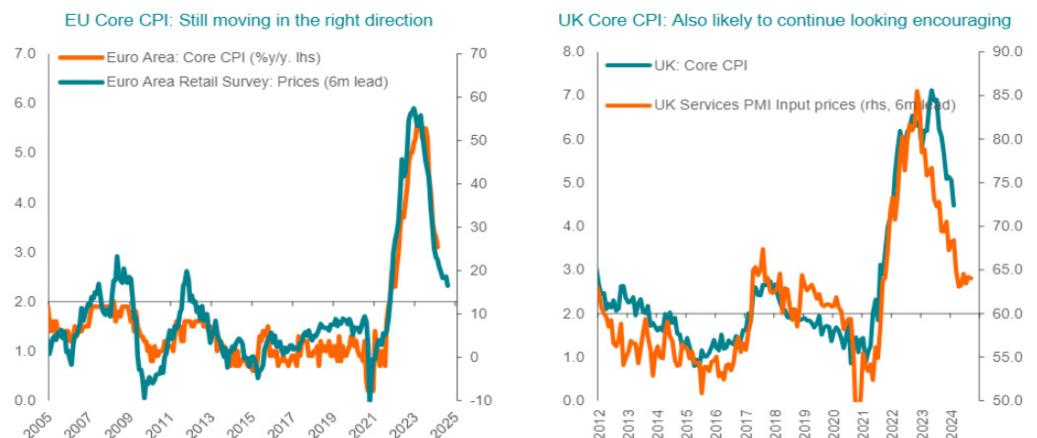
## Strong Start to the Year for Global Markets

Global markets continued their ascent in the new year as expectations of contained inflation, upcoming interest rate cuts, and strong earnings growth supported stock prices in the first quarter of 2024. The S&P 500 rallied 10.5% to start off the year while the MSCI EAFE Index in local currency terms rose a similar 9.8% but only 5.7% in U.S. Dollar terms as the dollar appreciated versus major currencies during the quarter.

Earnings for the fourth quarter of 2023 were mostly better than anticipated with expectations of continued growth into 2024 catapulting stocks in the first quarter of the year. While earnings growth is still expected to be double-digit for the S&P 500 in 2024, the MSCI EAFE is expecting growth of close to 6% after estimates have been revised down at the beginning of the year. Despite the negative earnings revisions, MSCI EAFE markets rose in the first quarter as Japan continued its corporate governance led rally and on expectations that European economies will gradually improve over the course of 2024.

Inflation continues to be a major priority for equity markets as investors anticipate global central banks to begin cutting rates this summer. Thus far, it appears the U.S., U.K., and the eurozone inflation figures suggest central banks can begin to cut rates soon. The declines in inflation seen in the later part of 2023 have leveled out as some inflationary pressure remains elevated but economists still believe inflation will decline, albeit more slowly in the coming quarters.

The charts below show the eurozone inflation and U.K. core inflation which both continue to fall and are expected to fall towards central bank target levels. The latest March data for inflation in the eurozone showed headline inflation falling to 2.4% and core inflation falling to 2.9%, both below analyst expectations. Some leading indicators in the eurozone, such as the retail survey and in the U.K., the PMI input prices index both still point to downward pressure on inflation on the horizon for Europe. This trend would be supportive of equity prices in the region.




*Source: Datastream, BNP Paribas Exane estimates*

While most data points suggest inflation should moderate in the eurozone during 2024 giving the European Central Bank (ECB) plenty of reason to begin cutting rates, one area of concern is the recent rise of oil prices which bleeds into eurozone inflation faster than in most other developed areas. Brent Crude prices have now climbed to the high $80's after ending 2023 at around $77. Geopolitical tensions have escalated somewhat in recent months as Ukraine appears to be targeting Russian oil and refining capacity as they fight back against the Russian invasion. In addition, Middle East tensions have risen since Hamas attacked Israel and since Israel invaded Gaza as a response to the attack to try and eliminate the Hamas terrorist network. Other Iran-backed terrorist groups, including Hezbollah in Lebanon and the Houthis in Yemen have joined in disrupting the North of

Israel (Hezbollah) and Red Sea shipping lanes (Houthis). The shipping lanes are more important to Europe than they are to the U.S. but are not necessarily being crippled in any way, just a marginal increase in shipping times and costs which could bleed into certain parts of the supply chains globally.

Back to oil prices, as can be seen in the two year chart of Brent Crude prices, the year-over-year price comparison in the first quarter was quite muted as Brent prices in the first quarter of 2023 hovered in the $80's, on average slightly higher than in the first quarter of 2024. Hence, inflationary pressure compared to last year from oil prices were mostly muted for the first quarter of 2024.

*Source: FactSet*

However, once you compare the second quarter of 2023 to where prices are starting the second quarter 2024, there is greater scope for inflationary pressures on a year-over-year basis in the second quarter of 2024. While not ringing the alarm bells just yet, we are conscious of the fact that markets are expecting the ECB to begin cutting rates as early as their June policy rate setting meeting and any shift to that narrative caused by negative inflation surprises could disrupt equity markets in the near-term. That said, economic growth is expected to improve in the eurozone as the year progresses.

## DOLLAR STRENGTH CONTINUES, BUT FOR HOW LONG?

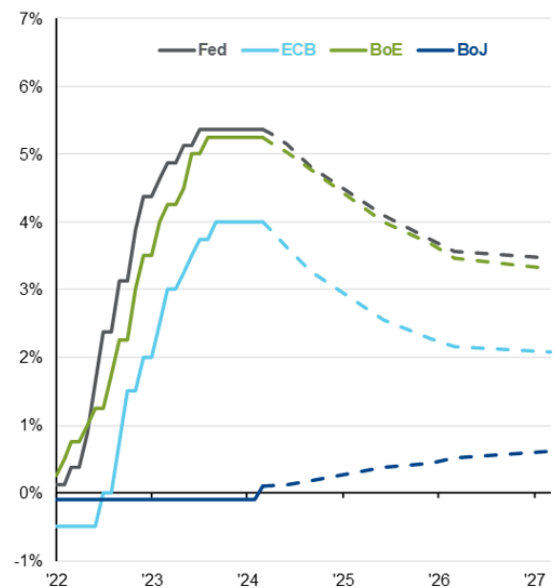
International equity prices for U.S. Dollar investors were held back again by the strength of the dollar. As mentioned above, the MSCI EAFE rose almost as much as the U.S. market in the first quarter in local terms but in dollar terms the returns were more muted as the dollar appreciated during the quarter. We have written in the recent past that given where the dollar is trading today, we expect over the next three years a higher probability that the dollar falls from here versus appreciating from here. But in the short-term, there is much uncertainty regarding central bank policy rates and strength in the dollar will be harder to predict.

Interest rate differentials are one area that continues to support the dollar versus global currencies with the Federal Reserve having raised rates aggressively. While the Bank of England (BoE) followed suit, the ECB raised rates but peaked well below Fed fund rates and the Bank of Japan (BoJ) did not budge as Japan welcomed inflation.

The chart below shows the recent spike in central bank policy rates starting in 2022 all the way to their peak levels where we sit today. Rate differentials have favored the U.S. and hence helped the dollar stay strong. Differentials are expected to stay at similar levels versus the U.K. and eurozone as the chart shows that those regions are projected to cut rates at a similar pace as the Fed is expected to over the coming years. One difference is in Japan. The country just announced its first rate hike in many years and its exit from negative interest rate policy (NIRP). Expectations are for the BoJ to very gradually increase rates over the coming years and hence the rate differential between the U.S. and Japan will compress as the Fed cuts and the BoJ potentially hikes. This should lend to some pressure on the dollar that could be one of the reasons the dollar ceases to appreciate versus the yen and the trade-weighted index.

**HISTORICAL POLICY RATES AND FORWARD CURVES**

Target policy rates and market implied forward rates




*Source: BIS, Bloomberg, FactSet, JPAM*

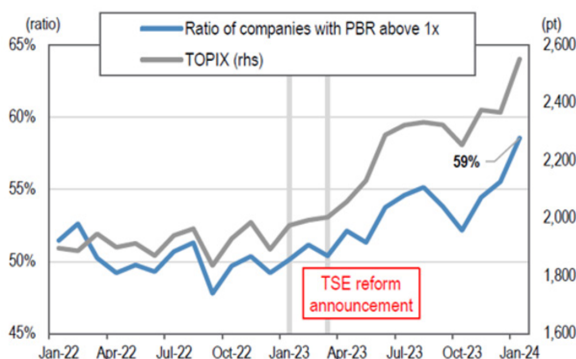
The dollar has also benefitted from better economic growth in the U.S. versus other developed markets and we believe that growth differential is also likely to narrow somewhat in the coming years as Japan and European growth rates bounce back from depressed levels and as U.S. economic growth moderates.

## JAPAN'S POSITIVE MOMENTUM

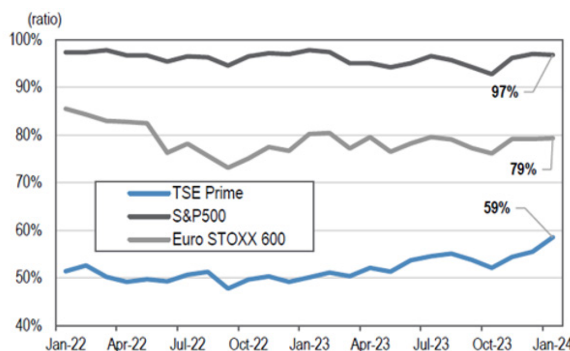
Although Japan's governance culture began to change slightly as early as 10 years ago with Prime Minister Shinzo Abe's "Abenomics" plan and talking up the importance of ROE for Japanese corporates, it wasn't really until what is being called the "P/B reform" by international investors that significant change has been noticed. Around one year ago, the Tokyo Stock Exchange (TSE) put out an ultimatum to Japanese corporates that they needed to focus on returns on equity and look for ways to increase their stock prices as many corporates were trading below book value. The threat that Japanese management teams would be shamed for not adhering to governance reform and economic changes has driven positive change.

We have seen a dramatic shift in the focus of several Japanese companies talking about selling off non-core assets, dismantling inefficient cross shareholdings, increasing dividends, announcing new share buybacks, and other areas of reform to improve ROE.

### PERCENTAGE OF COMPANIES WITH P/B ABOVE 1X




*Source: Bloomberg Finance L.P., J.P. Morgan*



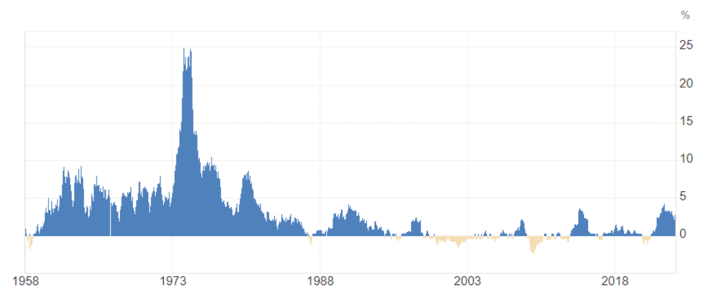

*Source: Bloomberg Finance L.P., J.P. Morgan*

Momentum in this reform process has seen equity prices rally in Japan. The Nikkei 225 reached a new high during the quarter in local currency terms, passing its last peak which was at the peak of the Japan bubble in late 1989. While global markets have appreciated nicely since then, Japan has been in a trading range and deflationary spiral that we are hopeful is now behind them.

The markets have applauded Japan's new focus on returns. Since the TSE reform announcement, the ratio of companies trading above P/BV of 1x has risen from about 50% of companies to 59% of companies. While a huge shift for Japanese markets, the charts also show that the 59% is still well below where the U.S. (97%) and Europe (79%) are today. There is plenty of opportunity for Japanese corporates to continue this momentum and for markets to give credit to those companies truly changing their focus towards shareholder friendly governance and a more returns focused management.

Another welcomed development in Japan has been inflation. While inflation is uninvited in most other places, over the course of the last 25 years, Japan has been in and out of deflation and stagnant growth, dampening opportunities for corporate revenue growth and consumer spending and investment.

### JAPAN'S INFLATION RATE




*Source: Tradingeconomics.com, Ministry of Internal Affairs & Communications*

But now over the last couple of years, inflation is back in Japan. This is the main reason the BoJ has held rates low for an overly extended period of time and why the BoJ never raised rates like other major central banks. Yet, Japan's monetary policy has now shifted as the BoJ just exited its Negative Interest Rate Plan (NIRP) even though it is likely to keep rates well below other major developed market policy rates.

Also welcomed as part of this newfound inflation is that real wages are bouncing back in Japan. The spring labor union wage negotiations have gone better than expected with high profile headlines such as Toyota Motor agreeing to the biggest wage hike in 25 years. Other major corporates have followed. This is of major interest as consumer spending has remained depressed in Japan for many years as wage growth was low and as deflation disincentivized consumers and corporates from spending or investing. While the recent labor union wage negotiations are a major positive momentum boost, only 16% of workers in Japan, according to a recent Nikkei Asia report, are members of a labor union. The rest of the population is not yet seeing the big hikes in wages that unions have seen this year. The hope is that a trickle effect will occur and a shift in thinking, spending, and investing will welcome a new era in Japan.

A deflationary mindset will be very hard to get out of but this is the cleanest path we have seen over the last 25 years for Japan to exit its deflationary and stagnant path and enter into a new more prosperous one. If that is the case, the runway for Japanese corporates to improve their profitability and returns is long and money flows into the market could remain strong for the foreseeable future as positive momentum awakens animal spirits in Japan and support for a market that most international investors are underweight. This of course would be very supportive for international equity performance.

## INTERNATIONAL MARKET HIGHLIGHTS

The markets continued to focus on a soft landing, a goldilocks-scenario per se, of low to moderate economic growth and falling inflation underpinned by strong optimism in equity markets for the quarter. Global markets continued their recent ascent which saw Japan's market reach new highs not seen since its peak in 1989. While economic growth and PMIs in Japan and much of Europe have been muted in recent quarters, expectations are for a gradual improvement in these over the course of 2024. Corporate and consumer balance sheets are strong, and both will be able to take advantage of improving fundamentals.

Moreover, with inflation falling in most parts of the world, real wage growth is becoming more of a reality in Europe and Japan as we start the new year which would be supportive for consumer spending and the services economy. There are of course some supply disruptions caused by the attacks on Red Sea shipments as well as elevated geopolitical risks in the Middle East and with the Russia-Ukraine War but markets appear focused more on what could go right in 2024 instead of what could go wrong. It has been some time since the market took a normal pause and we would not be surprised to see some increased volatility in the near-term especially after a quarter that saw strong gains and low volatility.

That said, international equity valuations are still very attractive, sitting at two standard deviations below the average discount to the U.S. markets. This valuation discrepancy as well as the extended dollar tends to favor international equities from a risk-reward standpoint, at least in the medium-term.

MSCI EAFE large caps outperformed mid and small caps for the quarter. Growth came back during the quarter beating value after having lagged value in 2023. The best performing MSCI EAFE markets for the quarter were Ireland, the Netherlands, and Denmark while the worst were Portugal, Hong Kong, and Norway. The best performing MSCI EAFE sectors for the quarter were Information Technology, Consumer Discretionary, and Financials while the worst performing were Utilities, Materials, and Consumer Staples.

## QUARTERLY PORTFOLIO ANALYSIS

**Outperformers:** Eagle portfolios performed very well for the quarter on an absolute basis and on a relative basis outperformed the MSCI EAFE Index. Both sector allocation and stock selection were additive to the positive alpha in the quarter. An overweight to Information Technology and underweight to Materials and Consumer Staples was positive for returns. From a stock selection standpoint, Information Technology, Health Care, Materials, and Energy had good positive attribution, more than offsetting poor selection in Consumer Discretionary and Financials. Top positive attributors for the quarter included Novo Nordisk (Health Care-Denmark), Tokyo Electron (Information Technology-Japan), and Lonza Group (Health Care-Switzerland).

**Disappointments:** The small exposure to emerging markets in the portfolio was disappointing this quarter as weakness in China and India affected returns. In addition, other China-exposed portfolio companies underperformed given weak Chinese sentiment in the quarter. From a stock selection standpoint, the most disappointing sectors were Consumer Discretionary, Financials, and Communications Services. From a country standpoint, our underweight to Japan and stock selection there was negative as well as stock selection in Spain and Italy. Negative attributors this quarter included Amadeus IT Group (Consumer Discretionary-Spain), HDFC Bank (Financials-India), and Sony Group (Consumer Discretionary-Japan).

## PURCHASES/ADDITIONS IN THE QUARTER

**ASTRAZENECA (AZN):** SECTOR: Health Care, COUNTRY: United Kingdom. We added to our position in Astrazeneca as we see the company as having one of the best pipelines in the global pharma industry and a proven R&D track record and we believe its current valuation does not properly give it credit for these growth prospects. Astrazeneca has leading products and pipelines in oncology, biopharmaceuticals, and rare diseases.

**L'OREAL (LRLCY):** SECTOR: Consumer Staples, COUNTRY: France. L'Oreal is the largest beauty product maker in the world with top selling brands including L'Oreal Paris, Lancôme and Garnier. Europe and the U.S. make up about 30% of sales each and China 25%. Ecommerce sales are 30% and growing. L'Oréal holds the top market share in the skincare and makeup categories. The premium segment for L'Oreal contributes about half of company sales. The global beauty market, which is closing in on $400B in sales, is expected to grow mid-single digits in the foreseeable future on the back of rising disposable incomes in emerging markets and a move to premium products with skincare the largest subcategory to be the growth driver.

**MITSUBISHI UFJ FINANCIAL GROUP (MUFG):** SECTOR: Financials, COUNTRY: Japan. MUFG is Japan's largest bank by profits and assets and highest market share in terms of loans and deposits. They also own a 20% stake in Morgan Stanley. We believe MUFG will benefit from the Bank of Japan rates policy changes as well as the push for Governance improvement which has accelerated with the Tokyo Stock Exchange's policy initiative over the past year. Given its diversified revenue stream, it benefits from an improving macro, higher rates, a recovery of capital market, loan growth, and benign asset quality. Revenue growth combined with costs discipline would boost EPS growth and ROE toward the 9%-10% range.

**SONY GROUP (SONY):** SECTOR: Consumer Discretionary, COUNTRY: Japan. We added to Sony after the stock corrected to a more attractive valuation. We believe Sony is a long-term compounder with leadership position in key categories such as gaming, image sensors, music and pictures. Its various segments (games, pictures and music) support one another creating revenue synergies while its leadership in image sensing can expand into new large end markets such as autos and robotics.

## SELLS/TRIMS IN THE QUARTER

**AIA GROUP (AAGIY):** SECTOR: Financials, COUNTRY: Hong Kong. We trimmed our position in AIA, the largest independent pan-Asian life insurance group, given weaker than expected top line growth due to slower post-Covid recovery in mainland Chinese visitor (MCV) sales in Hong Kong as well as a challenging investment environment in mainland China, such as lower yields, a volatile equity market, real estate, and local government financing vehicles (LGFVs).

**DBS GROUP HOILDINGS (DBSDY):** SECTOR: Financials, COUNTRY: Singapore. We trimmed our position in DBS, Singapore's largest bank with a presence in China, considering the uncertain environment, the weak outlook for loan growth, NIM pressure and higher costs. Some of the revenue pressure is offset by double digit fee growth outlook and benign asset quality.

**DIAGEO PLC (DEO):** SECTOR: Consumer Staples, COUNTRY: United Kingdom. We trimmed our position in Diageo as destocking issues in Latin America as well as some surprising weakness in U.S. spirits are likely to remain issues in 2024. While tequila could perform better, overall spirits trends are weak after strong periods of demand during the pandemic years. Competition has increased in several brand categories and the introduction of GLP-1 obesity drugs also adds a longer-term concern of muted demand for alcoholic beverages while the company is not committing to its mid-term organic sales growth target range for the next two fiscal years.

**NESTLE SA (NSRGY):** SECTOR: Consumer Staples, COUNTRY: Switzerland. We trimmed our position in Nestle as weak organic sales growth and lower than expected margins is causing a reset to expectations. While pricing is still holding in okay, volumes and mix are struggling as some consumers trade down given persistent inflationary pressures. The company is also having to increase marketing/growth investments to defend categories.

**NOVO NORDISK (NVO):** SECTOR: Health Care, COUNTRY: Denmark. Novo's stock has appreciated precipitously with the success of their weight loss drugs and is now our largest position in the portfolio. Although we believe the penetration of the drugs are still in the early stages, the valuation is now at historic highs. Additionally, there are always unforeseen risks from government pricing pressure, competition, and or potential adverse reaction to the drugs. We decided to take some profits and reduce our single security risk.

**TOKYO ELECTRON LTD (TOELY):** SECTOR: Information Technology, COUNTRY: Japan. We trimmed our position in Tokyo Electron to lock in a portion of the significant gains from our investment in the company. We believe current market expectations adequately reflect the near-term growth opportunities in semiconductor capital expenditure, a recovery in memory spending for DRAM and NAND, driven by new investments in generative AI.

## DISCLOSURES

The indices shown are for informational purposes only and are not reflective of any investment. They are unmanaged and shown for illustrative purposes only. The volatility of the indices are likely materially different than the strategy depicted. Eagle Global's International Equity ADR strategy includes buying and selling various international equity companies. Holdings will vary from period to period and international equity companies can have a material impact on the performance.

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