Clark Capital Management Group

# Portfolio Commentary

## Navigator® International Equity/ADR


Author

**Tony Soslow, CFA®**
*Senior Portfolio Manager*


Navigate Your Future. Enjoy the Journey.

# The News Diet

With everything going on in today's world, the 24-hour news cycle can feel relentless and overwhelming—especially as we move closer to the upcoming election. I recently watched the Netflix documentary "The Social Dilemma," which highlights a lot of these same feelings.

After talking about this with my partner Maira Thompson, we agreed that maybe taking a break from the noise wouldn't be such a bad idea. For this quarter's commentary, I am doubling down on my efforts to focus exclusively on the data, and not the noise.

Fortunately, our investment approach, which is a disciplined application of a quantitative investment process, helps keep our focus on the proper investing criteria and not get distracted by the noise. Right on cue, the U.S. Economy has followed the same V-shaped recovery as the stock market – just two months behind. The stock market began its advance during the extraordinary two-month lockdown recession from March to April, which saw payrolls decline by 22 million and the unemployment rate soar from 3.5% to 15.1%.

Through September, nearly half of jobs lost have been recovered and the unemployment rate has fallen to 7.8%. Clearly, the economy is not yet back to pre-pandemic levels and human and economic hardship, especially among the most vulnerable, is high. The economy's improvement in backward looking data like the Atlanta Fed's GDPNow tracking model shows Q3 real GDP up over 30%. More anticipatory or coincident data like mobility, airlines miles traveled, OpenTable reservations and the ISM Non-Manufacturing Index (NMI), which rose in September to 57.8, shows expansion for the fourth month in a row. All of these statistics corroborate the V-shape advance.

## The Path Forward

As noted above, near-term earnings and economic growth for many parts of the economy appear on firm footing. S&P 500 Q3 earnings exceeded estimates at a record pace and service industries in which workers can stay-at-home or manufacturers who can undertake health protocol adjustments are doing quite well. Conversely, air travel, hotels, restaurants, in-person education and socially dense leisure and entertainment activities continue to suffer as the persistence of the 7-day average of new COVID cases and the lack of a COVID vaccine limits re-opening.

Some portion of the improvement in economic activity can be attributed to the CARES Act's federal stimulus payments, expanded unemployment benefits and the Fed's use of emergency lending tools to support credit markets. In lieu of a generally available vaccine, we believe that a continued successful path forward will require additional government support as the expiration of PPP loans may push temporary layoffs to permanent ones and cause consumer demand to sputter as supplemental unemployment insurance benefits expire. Unfortunately, political wrangling has delayed the passing of an COVID support package.

## To Lend, but Not Spend

The biggest recent cheerleader for additional fiscal stimulus has been Fed Chairman Jerome Powell. Committed to using his emergency lending powers to support credit markets until maximum employment is reestablished, it appears as though monetary policy will remain accommodative, keeping short-term interest rates near zero till 2023. Powell has repeatedly emphasized that the Fed has the limited power to lend, but not the power to spend. This authority to spend rests with Congress. Essentially, the Fed is eager to buy (lend) what the Treasury sells (to fund government stimulus), but it cannot make direct expenditures.

Prior to the pandemic, the Fed followed its dual mandate of full employment and target inflation of 2% by providing an upward bound. Breaking the upper bound was introduced by prior Fed Chair Janet Yellen, as she discussed the concept of hysteresis or letting the economy "run hot". Last month, Chairman Powell added flexibility to this objective by "seeking to achieve inflation that averages 2% over time, and therefore judges that, following periods when inflation has been running persistently below 2%, appropriate monetary policy will likely aim to achieve inflation moderately above 2% for some time." Taken in sum, clear Fed guidance, depressed inventories, low long-term interest rates, strong ISM Export Activity and residential housing construction on the verge of exploding, should keep a fragile, bifurcated economy moving higher into Q4 and the beginning of 2021.

## International Equity Continues to Shine in Third Quarter

The Navigator® ADR/International Equity remains positioned in approximately 17.4% in emerging markets with the balance in developed economies. Our weight in Japan has been reduced to 11.5% from ~20% at the height of the pandemic as we exited Nippon Telegraph as pressure mounts to reduce subscriber fees among the telephone oligopoly there, thus hurting likely future cash flows.

During the quarter, the portfolio added Canadian trucking company TFFI, Garmin and building materials company Masonite (DOOR) as economic prospects, mobility and home investment trends improve. In addition to Nippon Telegraph, ADR exited VIPS Shops, Essent, and Royal Bank of Canada during the quarter as either business momentum slowed, or credit conditions remained a concern.

Financials and Technology remain our largest sector weights with Japan, Switzerland, Britain, and Canada our largest country weights. While US security selection has been concentrated in the large-cap growth area this year, performance is broadening internationally. The portfolio's quality characteristics, as measured by earnings variability and gross and net margins, have now tilted towards a barbell of what we believe are high quality, high margin and high yielding companies. We believe that the strong antifragility characteristics score of its holdings will help keep portfolio volatility low.

The Navigator® International Equity/ADR strategy delivered annualized gains of 8.08% gross (4.90% net) vs. the gains of 4.00% for the MSCI All Country World ex-USA Index over ten years ending September 30, 2020. For the third quarter of 2020, the strategy had a gain of 6.22% gross (5.44% net) versus the 6.25% gain in the MSCI All Country World ex-USA Index. For the 10 years ending June 2020, International Equity/ADR is in the top 3% of Morningstar peer group managers in the Foreign Large Blend category. Additionally, since inception, the strategy is in the top 2% of the same Morningstar peer group.

Our positioning in Information Technology and Healthcare helped relative performance while positioning in Consumer Discretionary and communication services acted as a drag. Our holdings in SolarEdge Technologies and Taiwan Semiconductor helped performance in the quarter while positions in KDDI Corporation and CNOOC dampened performance.

From a country perspective, the portfolio benefited from strong performance in our positions in Israel and Taiwan while performance in China and France lagged. The value characteristics of the strategy remain compelling compared to both its U.S. and international bench¬marks as the current P/E of 20.7 is less than that of the S&P 500 (26.0) and in-line with EAFE (20.2) with similar quality and business growth characteristics.

*Past performance is not indicative of future results.*
*This is not a recommendation to buy or sell a particular security. Please see attached disclosures.*
*Returns are presented gross and net of investment advisory fees and include the reinvestment of all income.*

| Ticker | Quarter Ending September 30, 2020 | Average Weight (%) | Contribution to Return (%) |
|---|---|---|---|
| **Top 5 Contributors** | | | |
| SEDG | SolarEdge Technologies, Inc. | 2.19 | 1.36 |
| TSM | Taiwan Semiconductor Manufacturing Co., Ltd. Sponsored ADR | 2.95 | 0.99 |
| INFY | Infosys Limited Sponsored ADR | 2.84 | 0.98 |
| CNI | Canadian National Railway Company | 2.05 | 0.38 |
| SNE | Sony Corporation Sponsored ADR | 3.19 | 0.33 |
| **Top 5 Detractors** | | | |
| KDDIY | KDDI Corporation Unsponsored ADR | 2.17 | -0.37 |
| LUKOY | Oil company LUKOIL PJSC Sponsored ADR | 1.86 | -0.32 |
| BNPQY | BNP Paribas SA Sponsored ADR | 0.44 | -0.30 |
| CEO | CNOOC Limited Sponsored ADR | 2.26 | -0.29 |
| VIPS | Vipshop Holdings Ltd Sponsored ADR | 1.50 | -0.26 |

*Source: Factset. For illustrative purposes only. Past performance does not guarantee future results. The holdings identified do not represent all of the securities purchased, sold or recommended for advisory clients. In the chart above, "weight" is the average percentage weight of the holding during the period, and "contribution" is the contribution to overall performance during the period. To obtain the calculation methodology and a list showing every holding's contribution to the overall composite during the period, contact: PortfolioAnalytics@ccmg.com.*