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**James P. Cullen**  
Chairman & CEO

### 2019 Market Outlook (Part II) International & Emerging Markets **Stay the Course**

**After a down year in most of the US & global markets there is always pressure for advisors and their clients to do something.** This year is no exception. At the end of 2018 a BlackRock survey showed that almost 70% of all institutional portfolio managers were cutting back on equities under the questionable guise of reducing risk. **This reaction plays into the trap of buying stocks when they are expensive and selling them when they are out of favor.**

**The famous Wall Street Quilt is an example of how this can play out.** Many investors started with the international/EM strategy between 2007 and 2013 when the strategies were popular. Now in the last few years, when EM and international are out of favor, investors are bailing out. **History would indicate that long term investors should be doing just the opposite.**

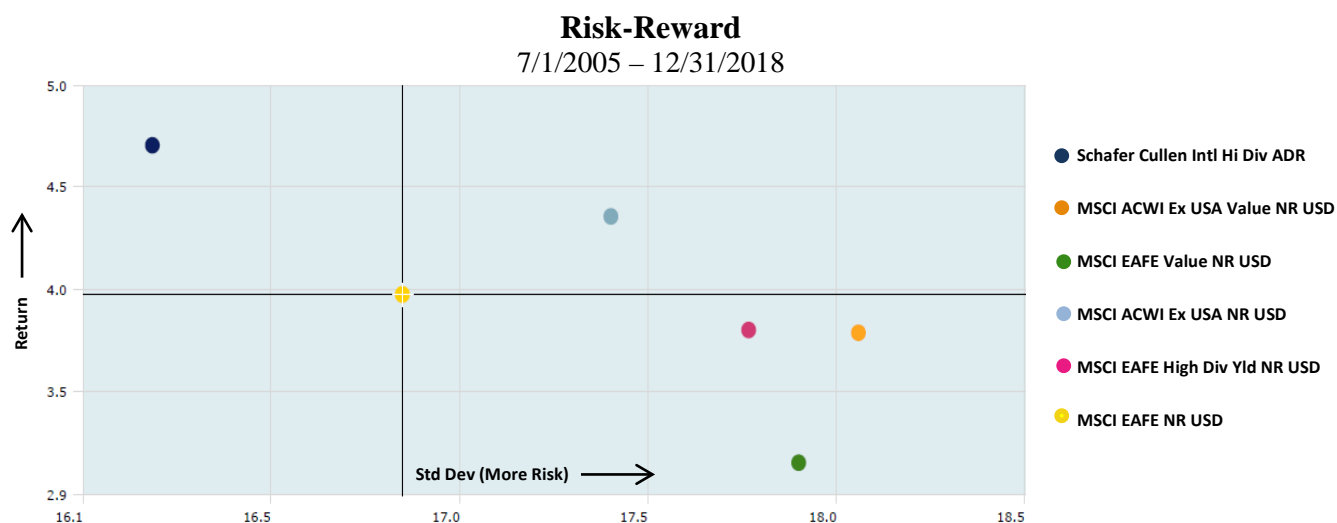
2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018 (YTD)
Bonds +11.0%	EM +55.82%	EM +25.55%	EM +34.00%	EM +32.17%	EM +39.38%	Bonds +5.24%	EM +78.51%	Small Cap +26.85%	Bonds +7.84%	EM +18.25%	Small Cap +38.82%	US Growth +14.89%	US Growth +5.52%	Small Cap +21.31%	EM +37.28%	US Growth +5.21%
EM -6.16%	Small Cap +47.25%	International +20.25%	International +13.54%	International +26.34%	International +11.17%	Small Cap -33.79%	International +31.78%	EM +18.88%	US Growth +4.65%	US Value +17.08%	US Growth +32.75%	US Value +12.36%	Bonds +0.55%	US Value +17.40%	US Growth +27.44%	Bonds -1.00%
International -15.94%	International +38.59%	Small Cap +18.33%	US Value +5.82%	US Value +20.81%	US Growth +9.13%	US Growth -34.92%	US Growth +31.57%	US Value +15.10%	US Value -0.48%	International +17.32%	US Value +31.99%	Bonds +5.97%	International -0.81%	EM +11.19%	International +25.03%	US Value -4.53%
Small Cap -20.48%	US Value +31.79%	US Value +15.71%	Small Cap +4.55%	Small Cap +18.37%	Bonds +6.97%	US Value -39.22%	Small Cap +27.17%	US Growth +15.05%	Small Cap -4.18%	Small Cap +16.35%	International +22.78%	Small Cap +4.85%	US Value -3.13%	US Growth +6.89%	US Value +15.36%	Small Cap -5.13%
US Value -20.85%	US Growth +25.66%	US Growth +6.13%	US Growth +4.00%	US Growth +11.01%	US Value +1.99%	International -43.38%	US Value +21.17%	International +7.75%	International -12.14%	US Growth +14.61%	Bonds -2.02%	EM -2.19%	Small Cap -4.41%	Bonds +2.65%	Small Cap +14.65%	International -12.86%
US Growth -23.59%	Bonds +4.10%	Bonds +4.34%	Bonds +2.43%	Bonds +4.33%	Small Cap -1.57%	EM -53.33%	Bonds +5.93%	Bonds +6.54%	EM -18.42%	Bonds +4.21%	EM -7.60%	International -4.90%	EM -14.92%	International +1.00%	Bonds +3.54%	EM -16.87%

Source: SCCM, December, 2018

## Addressing Risk

We started managing international/EM portfolios in 2005 for US investors who were looking to get some international exposure. We cautioned at the time that while these markets had phenomenal long term potential, they also tended to be much more volatile. **Therefore, having a dividend discipline was going to be especially important, even more important than for our US portfolios.**

The below chart on risk/reward, since the inception in 2005, shows how our international portfolios have done compared to all the international indexes on a risk adjusted basis. The reason for this is the dividend discipline, which we discuss in the next paragraph.



Source: Morningstar Direct, January, 2019 \*All charts and tables are available for both EM and international. EM omitted in the chart above as it would be too cluttered.

## Dividend Discipline

The below table, which we have shown in the past, points out how dividends have grown for ten of the largest stocks in the int'l portfolio. As of the end of the year (2018), the yield on the portfolio was 5.4% and the year over year dividend growth was 11.7%. **On a short term basis, while dividend yield is not much of a factor, over the long term it is the key to performance.**

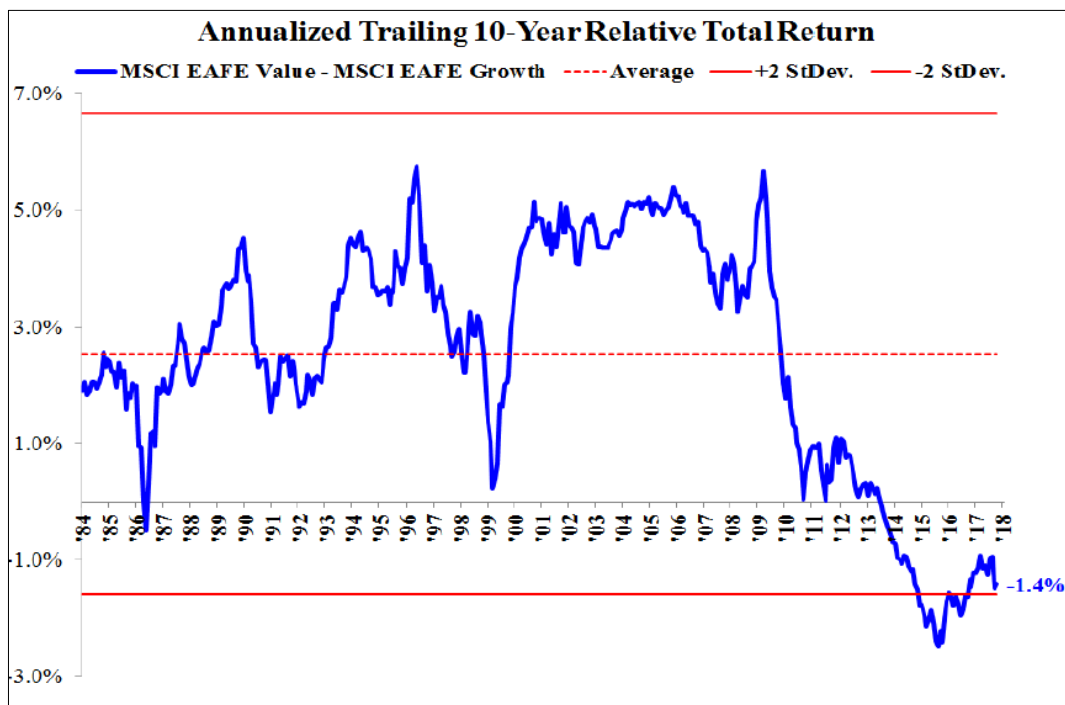
Stock	Dividend Currency	DPS Paid in 2007	DPS Paid in 2017	Percent Gain
British American Tobacco	British Pound	0.59	2.18	+271%
ABB	Swiss Franc	0.24	0.76	+217%
Siemens	Euro	1.45	3.60	+148%
Roche	Swiss Franc	3.40	8.20	+141%
Nestle	Swiss Franc	1.04	2.30	+121%
Daimler	Euro	1.50	3.25	+117%
Novartis	Swiss Franc	1.35	2.75	+104%
Allianz	Euro	3.80	7.60	+100%
Unilever	Euro	0.72	1.40	+94%
Diageo	British Pound	0.33	0.62	+90%

Source: SCCM, December, 2018

## Timing

As we have seen, the timing for int'l/value and EM/value has been challenging because not only have those styles been out of favor relative to US, but int'l/value and EM/value has also been out of favor relative to international and EM growth. **The below chart shows how the relative performance – value vs. growth – has reached a level where, the last time we were at these levels, the recovery was dramatic and lasted for many years. We have highlighted the recovery in the table below the chart.**

### Oversold Chart



Source: SCCM Research, September 30, 2018

### Recovery from Oversold

Year	Total return for MSCI EM	Total return for S&P 500	Difference
2001	-2.4%	-11.9%	+9.5%
2002	-5.9%	-22.1%	+16.2%
2003	+55.8%	+28.7%	+27.2%
2004	+26.0%	+10.9%	+15.1%
2005	+34.3%	+4.9%	+29.4%
2006	+32.5%	+15.8%	+16.7%
2007	+39.7%	+5.6%	+34.1%

Source: SCCM, December, 2011

## Dividend Support in Tough Markets

Prior to this period, the worst period for international was the 1995-2000 market. The buildup to that period was highly inflated and the most popular area was the mini-bubble for the international “Tiger Funds”. In 1995 these markets rolled over and performance was terrible for the next five years. **However, a research study covering that period by Merrill Lynch pointed out that in this terrible market the high dividend stocks actually did quite well.**

In this study, Merrill Lynch took a weighted basket of the 15 highest yielding stocks in each emerging market country at the beginning of each year, rebalancing the basket at the end of each year. What the study showed was that while many of these emerging market countries had a negative return over the five year period, the highest dividend yielding stocks in those markets were up and some substantially.

### Asia Pacific ex-Japan

Country	Country Index	High Dividend Yield Basket	Difference
Taiwan	-30.8%	127.4%	158.2%
Thailand	34.7%	142.3%	107.6%
Singapore	-20.0%	37.9%	57.9%
Malaysia	5.2%	47.2%	42.0%
India	10.5%	135.4%	124.9%
Indonesia	21.2%	589.1%	567.9%
China	129.8%	357.7%	227.9%
Philippines	-17.2%	-5.0%	12.20%
Hong Kong	-23.8%	186.4%	210.2%
<b>Average</b>	<b>12.2%</b>	<b>179.8%</b>	<b>167.6%</b>

Source: Merrill Lynch, December, 2011

## Summary

**For long term investors, it would seem that international and emerging markets are at a level where their accumulation makes more sense than their liquidation.**

Jim Cullen, CEO

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