International High Dividend ADR Equity Strategy

Q4 2018 Commentary

Market and Economic Review

Global equity markets experienced weakness across the board in Q4 2018, driven by a sell-off in highly-valued technology companies facing a moderating growth outlook and energy companies hurt by a steep decline in crude oil prices. In this environment of general risk aversion, fixed income outperformed equities, long-term interest rates fell, the US Dollar appreciated against most major international currencies and perceived safe havens, such as the Japanese Yen and Gold, outperformed. While international equities outperformed in the latest quarter, they have lagged in full year 2018. It is important to note that this more cyclical asset class tends to either strongly outperform or underperform in any one given year. When the latter occurs is usually a better-than-average time for patient, long-term investors to gain exposure here.

In the quarter, non-cyclical sectors such as Utilities, Real Estate, Consumer Staples, Communication Services and Healthcare outperformed, whereas cyclical sectors such as Energy, Information Technology, Materials, Consumer Discretionary, Industrials and Financials underperformed. By region, Developed Asia Pacific outperformed Western Europe and Emerging Markets outperformed Developed Markets. By style class, we experienced tailwinds as value outperformed growth and large caps outperformed small caps.

With momentum-based strategies having led markets higher on a multi-year basis, adhering to the price disciplines of low price earnings and high dividend yield has become all the more important in providing satisfactory absolute and risk-adjusted returns. We believe that our strategy of buying shares in strong companies, at attractive valuations and holding them for the long-term (i.e. 5 years) remains attractive in this environment. This is especially in light of the meaningful underperformance over several years of international value equities relative to other asset classes, which could now begin to normalize as international earnings and dividend growth continues.

Portfolio Performance

We outperformed our benchmarks MSCI EAFE and MSCI ACWI ex US this quarter as attractively valued non-cyclical companies, which we are overweight, outperformed. We continue to believe that our strategy, which invests in high-quality companies at reasonable valuations, is well positioned to outperform over a full market cycle while taking on less risk as measured by beta, standard deviation and/or down-market capture.

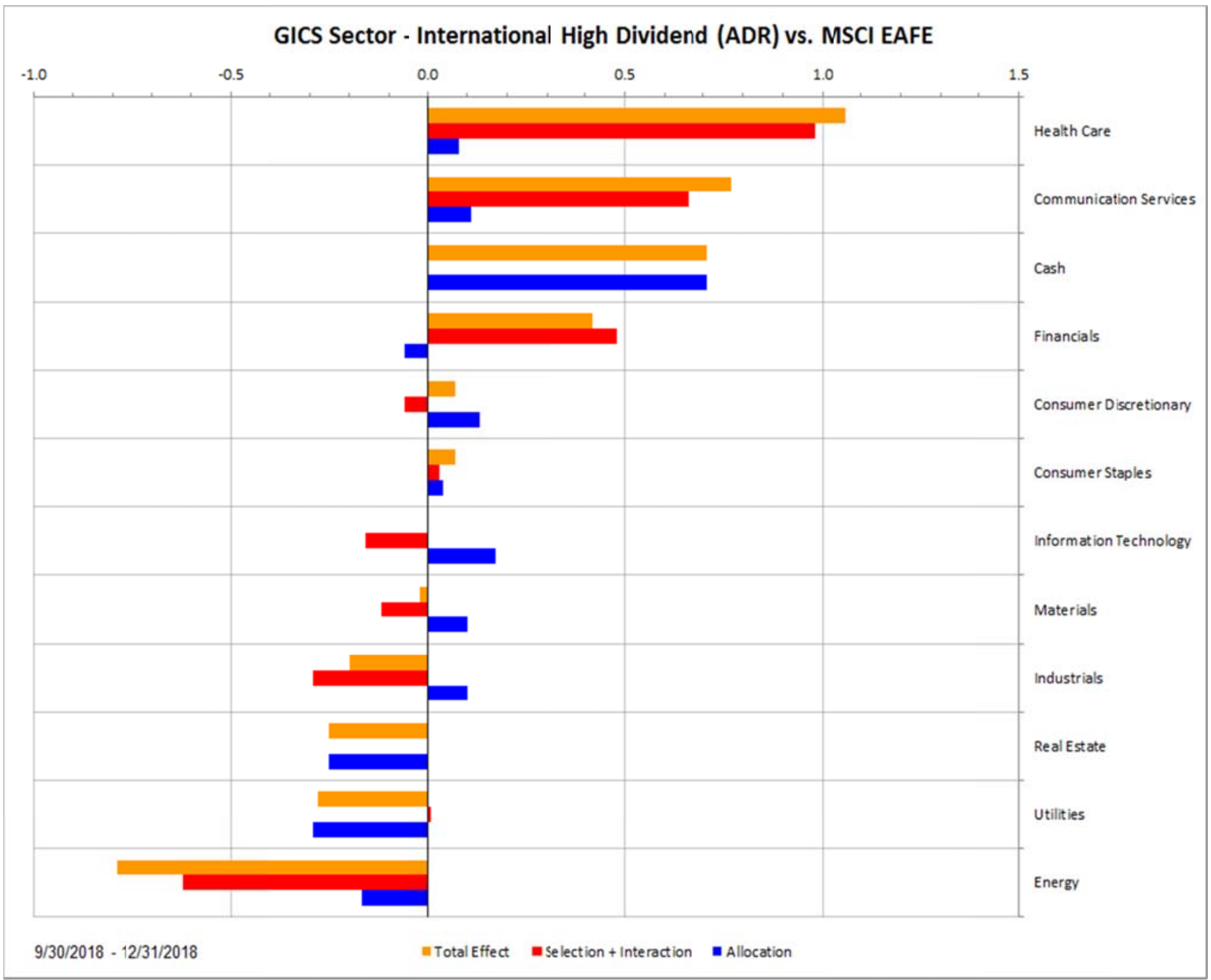
	Q4	YTD	1 Year	3 Year	5 Year	10 Year	Since Incept*
SCCM Intl High Div ADR (gross)	**-11.0**	**-14.5**	**-14.5**	**1.7**	**-0.3**	**5.8**	**4.7**
SCCM Intl High Div ADR (net)	**-11.1**	**-14.9**	**-14.9**	**1.3**	**-0.7**	**5.3**	**4.2**
MSCI EAFE	**-12.5**	**-13.8**	**-13.8**	**2.9**	**0.5**	**6.3**	**3.9**
MSCI ACWI ex US	**-11.5**	**-14.2**	**-14.2**	**4.5**	**0.7**	**6.6**	**4.3**

*As of 6/30/2005 through 12/31/2018. Performance for periods greater than 1 year is annualized.
Past performance is no guarantee of future results.

Sector Attribution

The largest contributor to relative performance was our overweight allocation to ***Communication Services, Healthcare*** and ***Consumer Staples*** and our underweight allocation to ***Information Technology, Consumer Discretionary, Materials*** and ***Industrials.*** We made these allocation decisions based on valuations and the visibility and sustainability of future dividend streams while looking to avoid companies with high levels of financial and/or operating leverage. Stock selection aided us in ***Healthcare***, ***Communication Services*** and ***Financials,*** where a diverse set of leading companies outperformed, including Roche, Novartis, Telefonica Brasil, Deutsche Telekom, Munich Re and Zurich Insurance. Cash aided performance during the quarter.

The largest detractor from relative performance was our stock selection in ***Energy***, ***Industrials***, ***Information Technology*** and ***Materials***. In many cases our portfolio companies in these sectors were held back by negative short-term factors though we see limited, if any, meaningful impact to the long-term earnings power of these companies. Our overweight allocation to ***Financials*** and ***Energy*** and our underweight to ***Utilities*** and ***Real Estate*** hurt performance.

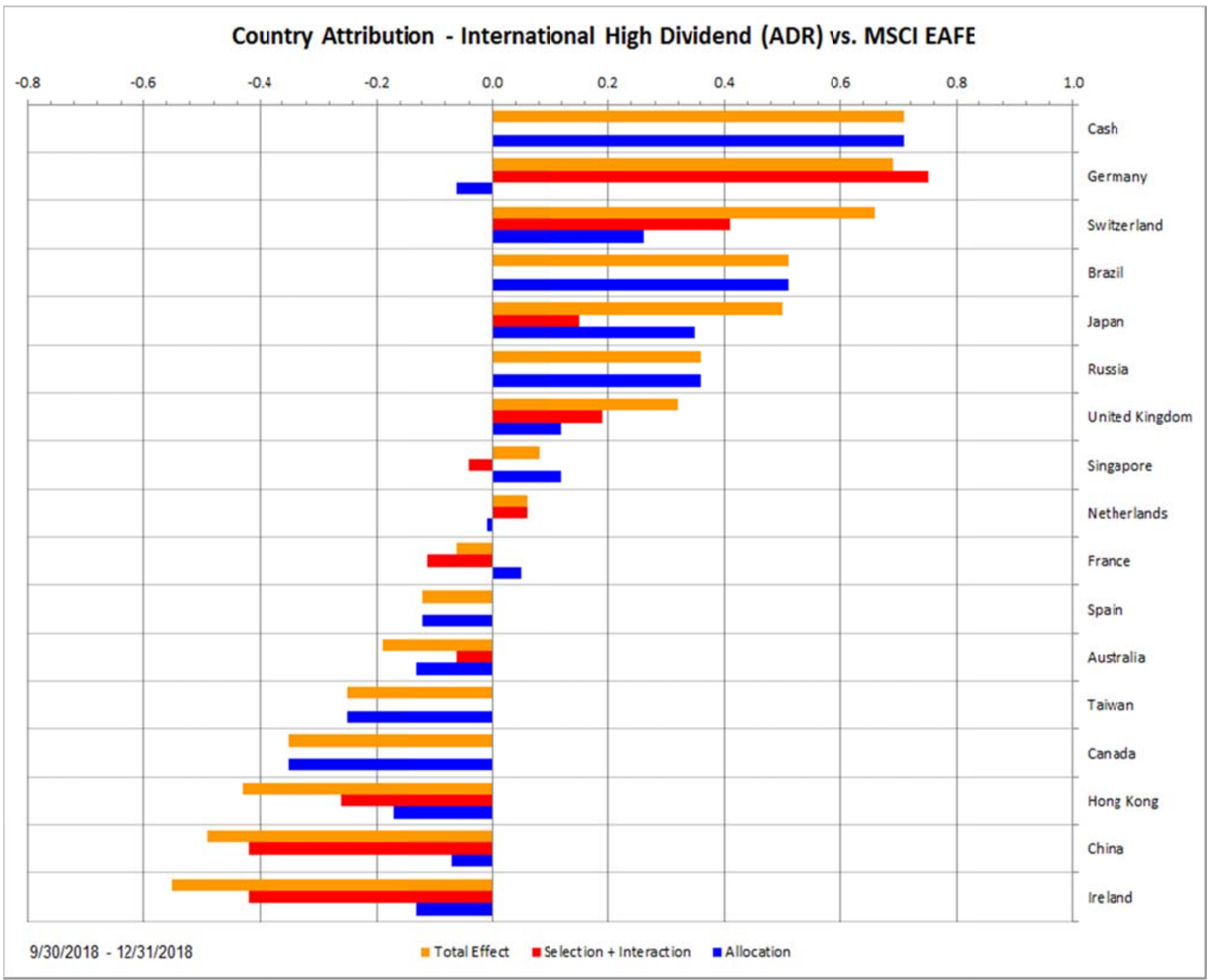


Source: Bloomberg, 12/31/2018

Country Attribution

The largest contributor to relative performance was our overweight allocation to Switzerland, United Kingdom, Singapore and our underweight allocation to Japan, Belgium, France and Finland. Stock selection aided us in Germany, Switzerland, Japan, United Kingdom and Netherlands. Across these countries, strong performers were high-quality companies with below-average cyclical risk trading at reasonable valuations including Munich Re, Deutsche Telekom, Roche, Novartis, Nippon Telegraph & Telephone, Diageo, Unilever and NN Group. Cash aided performance during the quarter.

The largest detractor from relative performance was our underweight allocation to Hong Kong, Australia and Spain and overweight allocation to Ireland, Germany and Netherlands. We retain confidence in our allocation decisions based on valuations and the long-term outlook of our portfolio companies. Stock selection hurt us in Ireland, Hong Kong, France, Australia and Singapore as some of our more cyclical holdings underperformed over the near-term, though we expect the affected companies to continue generating a stream of growing earnings and dividends over the long-term.



Source: Bloomberg, 12/31/2018

Purchases:

None.

Sales:

ING Groep N.V. Netherlands Financials

Our position in ING Groep was sold during the quarter following a few developments that constituted a change in our original investment thesis. Against the backdrop of an unexpected macroeconomic deterioration in Turkey, the rising costs of compliance and know-your-customer protocols and unanticipated technological challenges in transitioning towards a unified banking platform, we believe the company's earnings and dividend growth will be under pressure going forward. In light of these changes, we decided to reallocate capital among other portfolio holdings with similar exposures and stronger conviction levels.

Outlook

We continue to believe that our strategy is well positioned from a long-term perspective given the strong outperformance potential from a reversal of the historically extreme multi-year underperformance of 1) international versus US equities and 2) value versus growth equities. In this regard, international equities currently have among the lowest weight in the MSCI World Index in 40 years, at 38.3% versus their long-term average weight of 51.5%, as the performance of world equities is being dominated by a narrow group of US-domiciled large capitalization growth stocks. Further, value as a style remains the most out of favor since the Tech Bubble, following which MSCI World Value returned 75% over the next 7 years (March 2000 – Feb 2007) while MSCI World Growth posted negative returns. Thus, our international value strategy offers the patient long-term investor with the ability to benefit from the normalization of two major discounts of meaningful proportion, all the while collecting an attractive near 5.5% dividend payment.

Given the generally more volatile nature of international markets, maintaining a long-term horizon becomes key in achieving satisfactory investment results. Below in a study from 1997 to present, annual returns for six major assets classes are ranked from best performing (top) to worst (bottom). What we find is that international equities (red) and emerging market equities (orange) are almost always either the best or worst performing asset class in any single given year. While there is an element of randomness to this return ranking profile over the short-term, what we find is that over a forward five year basis, international equities have performed strongest (+100.9%) following a year of poor performance and conversely have performed weakest (+3.8%) following a year of strong performance. Thus, it is best to ignore short-term performance when it comes to international equities and instead to focus on a disciplined approach to investing over the long-term.

Annual Returns for Key Indices Ranked In Order of Performance (1997 - 2018)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Best	US Growth +36.52%	US Growth +42.16%	EM +66.84%	Bonds +11.63%	Bonds +8.43%	Bonds +10.26%	EM +55.82%	EM +25.55%	EM +34.00%	EM +32.17%	EM +39.38%
	US Value +29.98%	Int'l +20.00%	US Growth +28.24%	US Value +6.08%	Small Cap +2.49%	EM -6.15%	Small Cap +47.25%	Int'l +20.25%	Int'l +13.54%	Int'l +26.34%	Int'l +11.17%
	Small Cap +22.36%	US Value +14.68%	Int'l +26.96%	Small Cap -3.02%	EM -2.61%	Int'l -15.94%	Int'l +38.59%	Small Cap +18.33%	US Value +5.82%	US Value +20.81%	US Growth +9.13%
	Bonds +9.64%	Bonds +8.67%	Small Cap +21.26%	Int'l -14.17%	US Value -11.71%	Small Cap -20.48%	US Value +31.79%	US Value +15.71%	Small Cap +4.55%	Small Cap +18.37%	Bonds +6.97%
	Int'l +1.78%	Small Cap -2.55%	US Value +12.73%	US Growth -22.08%	US Growth -12.73%	US Value -20.85%	US Growth +25.66%	US Growth +6.13%	US Growth +4.00%	US Growth +11.01%	US Value +1.99%
Worst	EM -11.59%	EM -25.34%	Bonds -0.83%	EM -30.71%	Int'l -21.44%	US Growth -23.59%	Bonds +4.10%	Bonds +4.34%	Bonds +2.43%	Bonds +4.33%	Small Cap -1.57%

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Avg. 5 Year Int'l Total Return
Best	Bonds +5.24%	EM +78.51%	Small Cap +26.85%	Bonds +7.84%	EM +18.23%	Small Cap +38.82%	US Growth +14.89%	US Growth +5.52%	Small Cap +21.31%	EM +37.28%	Bonds 0.01%	N/A
	Small Cap -33.79%	Int'l +31.78%	EM +18.88%	US Growth +4.65%	US Value +17.68%	US Growth +32.75%	US Value +12.36%	Bonds +0.55%	US Value +17.40%	US Growth +27.44%	US Growth -0.01%	3.8%
	US Growth -34.92%	US Growth +31.57%	US Value +15.10%	US Value -0.48%	Int'l +17.32%	US Value +31.99%	Bonds +5.97%	Int'l -0.81%	EM +11.19%	Int'l +25.03%	US Value -8.97%	53.8%
	US Value -39.22%	Small Cap +27.17%	US Growth +15.05%	Small Cap -4.18%	Small Cap +16.35%	Int'l +22.78%	Small Cap +4.89%	US Value -3.13%	US Growth +6.89%	US Value +15.36%	Small Cap -11.03%	13.8%
	Int'l -43.38%	US Value +21.17%	Int'l +7.75%	Int'l -12.14%	US Growth +14.61%	Bonds -2.02%	EM -2.19%	Small Cap -4.41%	Bonds +2.65%	Small Cap +14.65%	Int'l -13.79%	30.7%
Worst	EM -53.33%	Bonds +5.93%	Bonds +6.54%	EM -18.42%	Bonds +4.21%	EM -2.60%	Int'l -4.90%	EM -14.92%	Int'l +1.00%	Bonds +3.54%	EM -14.58%	100.9%

Source: SCCM Research; 12/31/2018*

While fears of a slowing global economy and tightening central bank liquidity have contributed to the recent correction in asset prices, our portfolio of companies is still forecasted to deliver healthy growth in earnings and dividends in 2019. Corrections and/or bear markets which are not accompanied by a major decline in earnings tend to be shallower in both intensity and duration. Tail risks which would interfere with this more reasonable outlook include a worsening of trade tensions, a disorderly Brexit and a worsening of financial conditions given the increase in corporate leverage, especially at US companies. While we are not entirely immune from any of these issues, we have worked hard to position ourselves well across a number of these more adverse scenarios. For instance, across our portfolio holdings, we remain underweight the manufacturers and retailers of industrial and consumer goods, which may be vulnerable to trade disruptions. We have avoided going overweight domestic UK exposure, which would be hurt by a disorderly Brexit. Further, we continue to retain our non-cyclical bias, though somewhat less so than in the past given valuation considerations and would note that our portfolio holdings, on average, have meaningfully stronger balance sheets and credit ratings relative to the broad market.

Following several years of rising asset prices and accommodative monetary policies, investors need to carefully balance the requirements of risk and reward in making prudent investment decisions and not merely chase what is working over the near-term. For some quarters now we have mentioned that select pockets of froth and excess have developed across world markets which have no real valuation support and are instead being driven by momentum and fund flows. A prime example of this phenomenon is the until recently popular cryptocurrencies which subsequently have declined in value by 70-90%. Another example is Japanese growth stocks, which aided by ultra-low interest rates, have more than tripled the returns of MSCI EAFE over the last five years. This is an important consideration as Japan is the largest international market presently with a weight in MSCI EAFE of 24.6%. In 2018, while we outperformed by more than 20% on days when MSCI EAFE was down, we underperformed for the full year as the market was led higher on up days by highly valued momentum and growth stocks. Another glaring case is that of peripheral European bonds, which despite having meaningfully lower credit quality and higher credit risk, offer lower yields than on US treasuries. Investors need to be aware of growing pricing anomalies of this nature and to ensure that they avoid inadvertently gaining exposure to them when using indexed products such as ETFs. We believe that over the long-term, fundamentals-driven active value investing could potentially deliver meaningful outperformance relative to passive, less attractively valued, technically-driven momentum ETFs.

Within Europe, pockets of clear value can be found, though these tend to be in the most cyclical areas of the market, including in financials and consumer discretionary and some judgement is required here to discern the sustainability of future earnings and dividends. Within Emerging Markets, the outlook is varied and in some cases positive given the wide diversity of countries and companies which fall under this umbrella term, with some countries and companies far better positioned than others. In Japan, there continues to remain only a limited number of companies which generate a combination of sustainably high and growing dividend payments. Across all international equity markets, we remain focused on using our disciplined approach to identify inefficiencies, whereby we are looking for attractively valued companies introducing new and innovative products in attractive and growing industries and led by management teams with an above-average ability to allocate capital efficiently.

With interest rates having been kept low by central banks globally for much of the last decade, the investment case for international equities often rested on prospects for earnings growth and their attractive valuation relative to fixed income, which translated into a generous equity risk premium in excess of 500 basis points. However, following the 2018 sell-off, a clear case can be made for international equities on the basis of absolute valuation alone. Our portfolio of high quality companies, for instance, is currently selling for 11.6 times forward earnings, which is the most attractive valuation level in over five years. We believe that our portfolio companies are currently trading at meaningful discount to their true intrinsic value, which would value them using normalized earnings along with a normalized price/earnings multiple.

With equity price multiples having recovered close to historical norms, going forward we believe that the bulk of returns will be generated via the components of dividend yield and earnings/dividend growth, which is in line with the long-term norm of equity markets globally. On both these measures we consider our portfolio to be well positioned with a higher, 5.4% dividend yield and a faster and more sustainable dividend growth profile relative to the benchmark MSCI EAFE. In 2018, 84% of our portfolio companies raised their dividend payments by an average of 13.6% YoY. In this regard, strong dividend increasers include Sinopec, Norilsk Nickel, United Overseas Bank, Lloyds Banking, British American Tobacco, Telefonica Brasil, Nippon Telegraph & Telephone, Daimler, BNP Paribas, Honda Motor, Smurfit Kappa, BOC Hong Kong, Manulife Financial and Imperial Brands. With strong balance sheets and continued earnings growth, we anticipate that this trend will continue in 2019 and beyond.

Best Regards,

Jim Cullen – Portfolio Manager
Rahul Sharma – Portfolio Manager
Pravir Singh, CFA – Director of International Research

Appendix: Portfolio Exposure and Characteristics as of 12/31/2018

Portfolio Exposure

Sectors	% Asset	Regions	% Asset
Communication Services	9.8	Developed Asia Pacific	12.2
Consumer Discretionary	5.8	Continental Europe	45.7
Consumer Staples	12.0	United Kingdom	23.2
Energy	8.8	North America	4.3
Financials	24.5	Asia Pacific Emerging	4.1
Health Care	15.8	Latin America	1.8
Industrials	9.2	EMEA	2.2
Information Technology	2.0		
Materials	4.6		
Real Estate	0.0	Developed Markets	85.4
Utilities	1.1	Emerging Markets	8.1
Cash	6.6	Cash	6.6
Total	100.0	Total	100.0

Top 10 Countries		Top 10 Holdings	
United Kingdom	23.2	Novartis	3.8
Switzerland	17.8	Roche Holdings	3.3
Germany	11.7	Nestle	3.3
France	8.4	Zurich Insurance Group	3.2
Netherlands	5.5	Allianz	3.0
Japan	4.7	United Overseas Bank	3.0
Canada	4.3	Total SA	2.8
Singapore	3.5	Munich Re	2.8
Australia	2.6	NN Group	2.8
Ireland	2.4	Unilever	2.7

Portfolio Characteristics

	Forward Price / Earnings	Forward Dividend Yield	Q4 18 LT Debt / Capital	Est. LT DPS Growth	Est. LT EPS Growth	Q4 18 Market Cap
SCCM Intl High Div ADR	11.6	5.4	30.6	7.9	9.6	81.7
MSCI EAFE Index	12.8	3.9	28.9	7.5	10.1	57.7

Source: SCCM Research, BCA Research, Bloomberg

Additional Disclosure: Sector weights, portfolio characteristics, ten largest holdings and other information constitutes supplemental information. Please see important disclosures listed on the following page.

*The study referenced is the Callan Periodic Table of Investment Returns which was simplified to include the following asset classes: International (MSCI EAFE), Emerging Markets (MSCI EM), US Value (S&P 500 Value), US Growth (S&P 500 Growth), Small Cap (Russell 2000), and Bonds (Bloomberg Barclays Agg.).

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Returns are expressed in US dollars. Gross of fee performance is calculated gross of management fees and custodian fees and net of transaction costs. Net of fee performance is calculated net of actual management fees and transaction costs but gross of custodian fees. Past performance does not guarantee future results. Individual account performance will not match the composite and will depend upon various factors including market condition at the time of investment. It should not be assumed that recommendations made in the future will be as profitable or surpass the historical performance of the securities in the composite.

The primary benchmark used is the total return indices for the MSCI EAFE Index. The **MSCI EAFE Index** is a free float-adjusted market capitalization index that measures the equity market performance of developed markets, excluding the US & Canada.
The **MSCI AC World Index ex-U.S.** measures stock performance throughout the world, with the exception of U.S.-based companies.

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