SCHAFER | CULLEN
CAPITAL MANAGEMENT

**International High Dividend ADR**
Q2 2022 Commentary

## Market and Economic Review:

Global asset markets continued to struggle in the latest quarter as both equity and fixed income prices declined, which is a rare phenomenon. Within equities, value as a style was a relative safe-haven and outperformed growth by 450 basis points as high-valuation, momentum stocks posted steep declines. With persistently higher-than-expected inflation readings, which have been made worse by supply disruption in key commodities caused by the Russian invasion of Ukraine, both market participants and central bankers have been forced to adjust upward their medium-term outlook for interest rates and inflation. During the quarter, commodity prices moderated somewhat after their steep increases earlier this year. Oil and natural gas prices were virtually unchanged from the beginning of the quarter, despite some volatility in the quarter, while metal prices including iron ore, copper and nickel retraced their earlier gains, driven by uncertainty around Chinese demand and a broader global economic slowdown. In this environment, fixed income outperformed equities, long-term interest rates rose, and the US Dollar appreciated meaningfully on a trade weighted basis. Looking ahead, investors will be monitoring the evolution of the conflict in Ukraine, the response from Western allies and the extent to which inflationary pressures impact consumer and corporate spending patterns.

By sector, there were losses across the board, though Energy, Consumer Staples, Health Care, Communication Services, Utilities and Financials outperformed whereas Information Technology, Materials, Industrials, Real estate and Consumer Discretionary underperformed. By region, Western Europe marginally outperformed Developed Asia and Emerging Markets outperformed Developed Markets. Overall market breadth moderated somewhat in the quarter, with six out of a total of eleven market sectors outperforming, driven by steeper corrections in the more expensive parts of the market.

With momentum-based strategies having led markets higher on a multi-year basis, adhering to the price disciplines of low price-to-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.

## Portfolio Performance:

We outperformed our core benchmarks this quarter by between 210-470 basis points given both positive stock selection and allocation. 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.

| 6/30/2022 | Q2 | YTD | 1 Yr | 3 Yr | 5 Yr | 10 Yr | Since Incept* |
|---|---|---|---|---|---|---|---|
| **SCCM Intl High Div ADR (gross)** | **-9.7** | **-14.5** | **-12.2** | **3.1** | **2.2** | **4.9** | **5.0** |
| **SCCM Intl High Div ADR (net)** | **-9.8** | **-14.7** | **-12.6** | **2.7** | **1.7** | **4.5** | **4.5** |
| MSCI EAFE | -14.5 | -19.6 | -17.8 | 1.1 | 2.2 | 5.4 | 4.1 |
| MSCI EAFE Value | -12.4 | -12.1 | -12.0 | 0.2 | 0.5 | 4.3 | 3.0 |
| MSCI ACWI ex US Value | -11.9 | -11.8 | -12.8 | 0.6 | 1.2 | 3.8 | 3.7 |

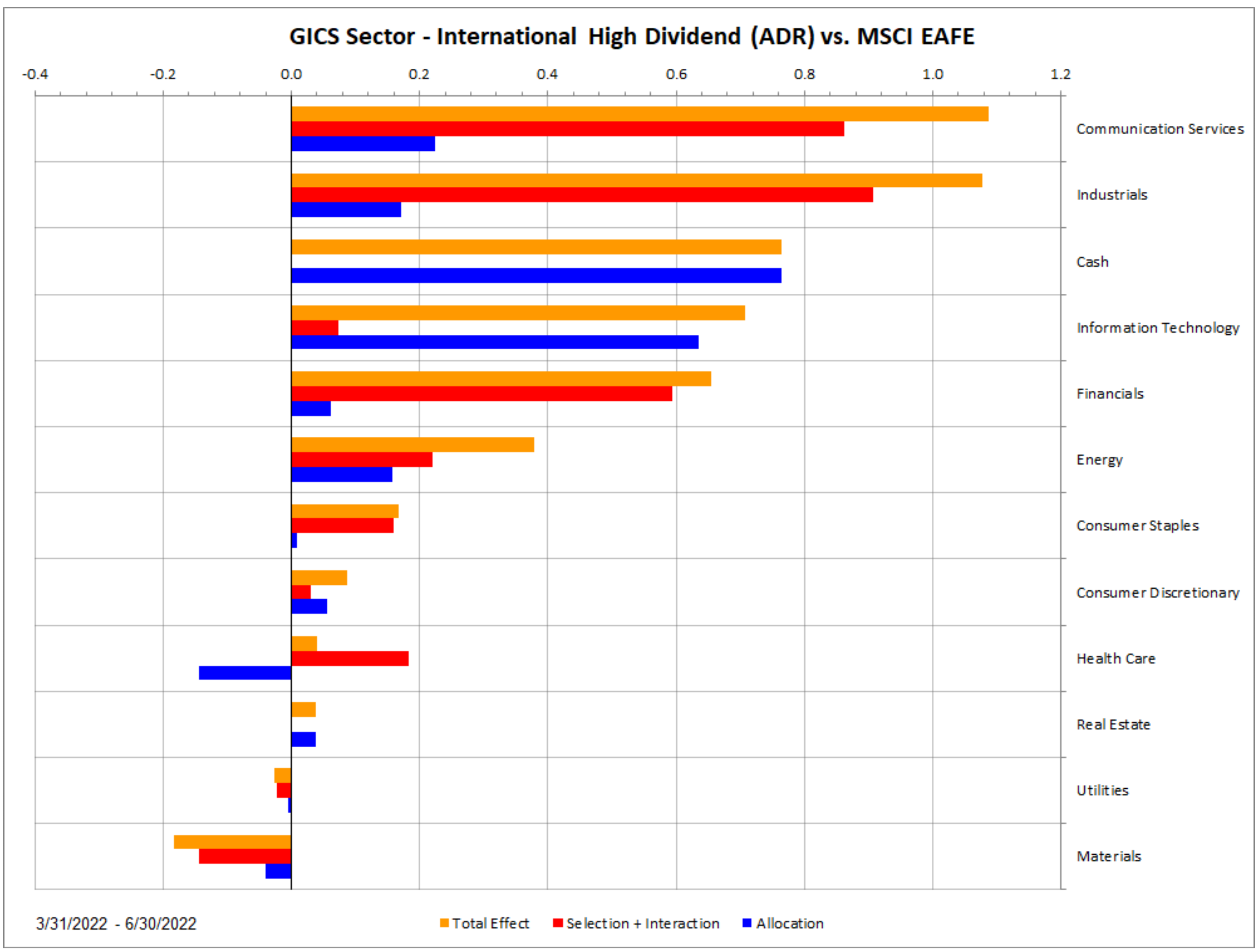
*6/30/2005. Performance for periods greater than 1 year is annualized. ***Past performance is no guarantee of future results.***

## Portfolio Attribution:

### *Sector Attribution*

The largest contributor to relative performance was our stock selection in eight out of eleven sectors, including ***Industrials***, ***Communication Services***, ***Financials***, ***Energy*** and ***Health Care***. Across these sectors, we benefited from our diversified exposure to global multinational companies exposed to the energy and defense complexes – TotalEnergies and BAE Systems – as well as companies with meaningful non-European exposure, including Xinyi Glass, Nippon Telegraph & Telephone, Softbank Corp. and Tokio Marine. Our performance also benefited from our underweight allocation to ***Information Technology*** and ***Industrials*** and our overweight allocation to ***Communication Services*** and ***Energy***. Among the strongest contributors was our position in Deutsche Telekom, which benefited from an anticipated private equity bid for its towers unit, which we believe will unlock shareholder value. Cash was a positive contributor to relative performance in the quarter.

The largest detractor from relative performance was our underweight allocation to ***Health Care*** and ***Utilities*** and our overweight allocation to ***Materials***. In some cases, our portfolio companies in these sectors were held back by negative short-term factors, but we see limited, if any, meaningful impact to the long-term earnings power of these companies. We remain comfortable with these allocation decisions based on valuations and the long-term outlook of our portfolio companies. Further detracting from relative performance was our stock selection in ***Materials*** and ***Utilities***.

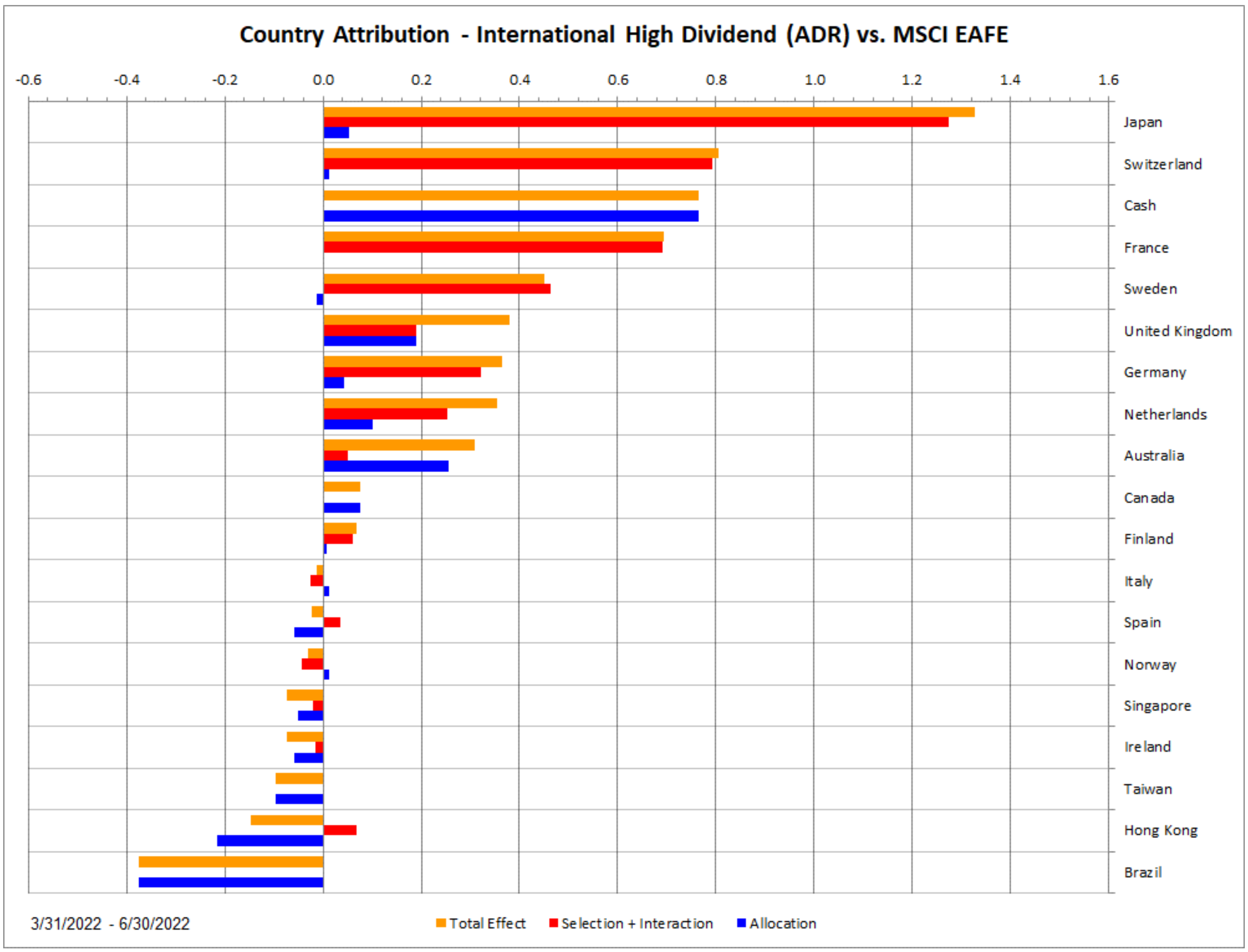



Source: Bloomberg, 06/30/2022

### *Country Attribution*

The largest contribution to relative performance came from our stock selection in ***Japan***, ***Switzerland***, ***France***, ***Sweden*** and ***Germany***. Across these countries, we benefited from our exposure to non-Euro denominated companies, including Tokio Marine, Nippon Telegraph & Telephone, Novartis, Zurich Insurance and Svenska Handelsbanken. Our relative performance also benefited from our underweight allocation to ***Australia*** and ***Netherlands*** and our overweight allocation to the ***United Kingdom*** and ***Canada***. We made these allocation decisions based on our assessment of the leading market positioning and valuation of these companies, including BAE Systems, British American Tobacco and NN Group. Cash was a positive contributor to relative performance in the quarter.

The largest detractor from relative performance was our underweight allocation to ***Hong Kong*** and ***Denmark*** and our overweight allocation to ***Taiwan*** and ***Ireland***. We made these allocation decisions based on our assessment of the long-term earnings and dividend growth prospects of these companies, while looking to avoid exposure to high levels of financial and/or operating leverage. Further detracting from relative performance was our stock selection in ***Norway***, ***Italy***, ***Singapore*** and ***Ireland***. Across these countries, performance was primarily impacted by temporary headwinds for a subset of our portfolio holdings.




Source: Bloomberg, 06/30/2022

## Portfolio Changes:

### *Purchases*

**Shell PLC (United Kingdom, Energy)** – Shell is a leading integrated oil and gas company operating in over 70 countries around the world. The company is a top five producer of oil and gas globally and operates an integrated business model, with operations across several verticals, including Upstream (exploration and extraction of crude oil, natural gas and natural gas liquids), Integrated Gas (management of liquefied natural gas (LNG) activities), Downstream (trading and refining of crude oil and other chemical feedstocks) and Renewable and Energy Solutions (development and sale of low-carbon sources of power, including wind, solar, hydrogen, etc.). Owing to early and bold management actions, the company is a leading facilitator of the global energy transition: Shell is one of the largest producers, traders and shipping operators of LNG as well as a prominent player in the transition to renewable power generation globally. Over the short term, heightened geopolitical risks and uncertainty stemming from Russia's invasion of Ukraine should translate into growing demand for Shell's oil & gas products and services, particularly for its LNG production, transportation and storage operations. As we look to the years ahead, we expect Shell to reduce its reliance on carbon-based fuels in favor of low- and zero-carbon energy products and services, a transition that will be funded by cash generated from its oil, gas and LNG operations. We believe that Shell's transition is occurring at a rate that outpaces its major peers, ensuring the company's relevance in a low-carbon future, reducing business cyclicality and mitigating regulatory risks. Moreover, we believe that Shell's progressive dividend policy and balance sheet strength will translate into a growing stream of shareholder distributions in the years ahead. Shares of the company are valued at 6.1 times forward earnings and offer a 3.9% dividend yield.

### *Sales*

None

## Outlook:

With the MSCI World index falling by over 20% this year, we have officially entered a bear market, which should offer great opportunities for long-term investors given that valuations for companies have fallen and become more attractive. While a bear market and its related near-term declines may provoke some degree of fear and uncertainty, history shows that once a bear market has officially been confirmed, following a decline of at least 20%, equity market returns from that point out are robust. Below, we have examined data from the seven bear markets that have occurred over the last 50 years. What we see is that bear markets, on average, take 10 months to be confirmed and that once confirmed, future market returns are strong: on a 5- and 10-year basis, markets return an average of +90% and +187%, respectively, with positive returns in 100% of instances. On a 1- and 3-year basis, average returns are also positive, at +20% and +29%, respectively, though the track record here is more mixed with positive returns only in around 70% of instances. Thus, though it may not be apparent at the time, equity market returns following a 20% decline are among the strongest in the equity market cycle. However, some patience and the necessary passage of time is required to achieve the best results in this regard.

**MSCI World Index Returns Once a Bear Market Is Confirmed**

| Bear Market Start Date | Bear Market Confirmation Date | Bear Market Months To Confirm | Total Return 1 Year | Total Return 3 Year | Total Return 5 Year | Total Return 10 Year |
|---|---|---|---|---|---|---|
| 03/31/1973 | 05/31/1974 | 14 | +6.0 | +13.7 | +43.8 | +137.5 |
| 11/30/1980 | 07/30/1982 | 20 | +46.7 | +92.2 | +318.0 | +393.9 |
| 08/31/1987 | 11/30/1987 | 3 | +27.5 | +21.9 | +38.4 | +181.4 |
| 12/29/1989 | 09/28/1990 | 9 | +24.5 | +48.2 | +82.4 | +260.8 |
| 03/27/2000 | 03/09/2001 | 12 | -8.9 | -1.2 | +24.1 | +41.8 |
| 10/12/2007 | 09/04/2008 | 11 | -14.0 | -2.1 | +30.4 | +107.7 |
| 02/19/2020 | 03/12/2020 | 1 | +60.5 | ??? | ??? | ??? |
| **Average: All Bear Markets** | | **10** | **+20.3** | **+28.8** | **+89.5** | **+187.2** |
| **12/31/2021** | **06/13/2022** | **6** | **???** | **???** | **???** | **???** |

Source: SCCM Research, Bloomberg, 06/30/2022.
Please note that prior to 1999, total return data is available on a monthly basis and not daily.

The +2,400 basis points outperformance of international Value versus Growth since Pfizer's positive COVID-19 vaccine announcement on November 9, 2020 is encouraging and may indicate that we are in the early stages of a turn towards Value. This rotation is taking place in an environment of higher interest rates and firmer commodity prices, which should be positive for value stocks. In this context, it is also important to note how historically oversold Value remains from a long-term perspective. Currently, on a trailing ten-year basis, the performance of MSCI EAFE Value is 171 basis points a year below that of MSCI EAFE Growth, whereas over the last 47.5 years MSCI EAFE Value has outperformed MSCI EAFE Growth by 198 basis points a year. The current extreme 369 basis points annualized performance deficit versus the historical average, which translates into a greater than two standard deviation event, shows that Value is more out of favor today versus at the height of the Tech Bubble of 2000, following which MSCI EAFE Value returned 95% over the next 7 years (April 2000 – March 2007) while MSCI EAFE Growth returned only 8%.

For some time now, global equity markets have tolerated elevated valuations, especially in pockets of the Information Technology and Consumer Discretionary sectors globally, which are correcting after being in a full-fledged mania. Many of these high valuation companies have disproportionately benefitted from a one-time pandemic-induced disruption, though we believe that this is more than adequately reflected in their current valuations. In this regard, the speed with which the Chinese Information Technology companies, which until recently were stock market darlings, have corrected by over 50% from their recent highs, highlights the importance of staying alert to complacency regarding high valuations. Over 60% of growth companies in the Russell 3000 index currently are losing money, which is near an all-time high. Past episodes of a similar nature have marked a major top in speculation and subsequently led to major declines, such as in 2000 and 2008. In contrast to these clear cases of excesses across asset markets, we would highlight the attractive valuations of our strategy, which is currently trading at 10.7 times forward earnings with a 5.4% dividend yield. These valuations are attractive on an absolute and relative basis: current valuations for our strategy are more attractive than in 89% of quarterly periods since the inception our strategy in 2005 and relative to most equity indexes/ETFs, our strategy is valued at a 20-40% discount. We believe that the outlook for long-term investors in the strategy remains more favorable than usual from this point on, as our portfolio of high-quality value equities should continue to generate sustainable long-term earnings growth while our portfolio valuations are already deeply discounted.

Currently, the consensus on Bloomberg forecasts that consumer price inflation will average 4.4% in both the United States and European Union between 2022 and 2024. This is well above the average rates of 1.9% and 1.2% over the last eight years as well as the key central bank inflation target rates of around 2.0%. In this environment, our strategy offers an attractive +5% yield, which is meaningfully higher than what is available on other income alternatives. Further, our portfolio companies, since the inception of our strategy in 2005, have been able to grow their dividend payments above the rate of inflation. Hence, our strategy offers the twin benefits of attractive current income and good built-in inflation protection via our ownership of a portfolio of attractively valued, well positioned companies with growing demand for their products and the ability to raise prices. This should help ensure that we should be able to provide satisfactory long-term returns across most macroeconomic environments.

The, until recently, positive intermediate-term outlook for the global economic recovery coming out of the COVID-19 induced recession has been dampened by the Russian invasion of Ukraine, along with the impact this event has had on commodity input costs and the need for central banks to raise policy rates to dampen uncomfortably high inflation readings. The current environment of slower economic growth, combined with increased input cost pressures has the potential to hurt profit margins of companies unless companies can also correspondingly raise their selling prices. If economic weakness continues while inflation continue to rise faster than disposable income, this is likely to dent consumer confidence and spending. Higher inflation also limits the tools available to central bankers to stimulate economic growth, as lower interest rates and/or higher asset prices are likely to exacerbate already high consumer price inflation, which in turn would lead to lower consumer spending and weaker overall economic growth. Against this backdrop, current consensus expectations for year-over-year earnings growth of 11% and 8% for global companies this year and next may turn out to be too sanguine.

As we look ahead, we have chosen to adopt a barbell approach with our portfolio holdings whereby we have allocated to defensive sectors which are likely to be broadly unaffected by an economic slowdown, while also investing in some more cyclical companies which we believe are better placed to either benefit from higher inflation and/or are better placed to pass on higher cost inflation to their customers. We believe that this balanced approach is prudent given the wide range of economic environments which we may experience going forward including recession, stagflation and a rebound in economic growth. Our shopping list of ideas has grown of late, as markets have corrected, and we plan to go through these names methodically to make further portfolio changes as opportunities arise. We are looking to identify companies with durable competitive advantages and growing earnings while avoiding ones with leveraged balance sheets and weak business models.

Central Banks have been forced to abandon their ultra-accommodative policies of the last decade to try and reign in higher-than-expected inflation. While equities and fixed income have begun a process of pricing in a more normalized level of interest rates, this process of valuation adjustment downward may continue unless there are credible signs that inflation is falling in a meaningful way. In this environment, government bonds have a real yield, defined as the stated yield minus the rate of inflation, which is negative and most asset prices appear somewhat richly valued in absolute terms and thus offer lower prospective returns. International dividend-paying value equities, we believe, are one of a few bright spots in this regard given their attractive valuations in both absolute and relative terms. Following a robust recovery in dividend growth in 2021, we anticipate another strong year of dividend growth in 2022. In the first half of this year, 90% of our portfolio companies which have declared dividends have raised their dividend payments and across our entire portfolio, dividend income has grown by 13.6% YoY on a weighted average basis. We believe that our companies have strong balance sheets and robust business models and we anticipate that this trend for dividend growth will continue over the long-term.

Best Regards,

Jim Cullen – Portfolio Manager
Rahul Sharma – Portfolio Manager
Pravir Singh, CFA – Portfolio Manager
Anuca Laudat, CFA – Portfolio Manager

## Appendix: Portfolio Exposure and Characteristics as of 6/30/2022

### *Portfolio Exposure*

| Sectors | % Asset | Regions | % Asset |
|---|---|---|---|
| Communication Services | 11.7 | Developed Asia Pacific | 23.1 |
| Consumer Discretionary | 6.6 | Continental Europe | 44.6 |
| Consumer Staples | 11.1 | United Kingdom | 17.1 |
| Energy | 6.5 | North America | 4.9 |
| Financials | 25.4 | Asia Pacific Emerging | 1.4 |
| Health Care | 10.6 | Latin America | 3.0 |
| Industrials | 9.3 | EMEA | 0.0 |
| Information Technology | 1.4 | | |
| Materials | 8.3 | | |
| Real Estate | 0.0 | Developed Markets | 89.6 |
| Utilities | 3.0 | Emerging Markets | 4.4 |
| Cash | 6.0 | Cash | 6.0 |
| Total | 100.0 | Total | 100.0 |

| Top 10 Countries | | Top 10 Holdings | |
|---|---|---|---|
| United Kingdom | 17.1 | Nippon Telegraph & Telephone | 4.3 |
| Japan | 14.1 | Novartis | 3.9 |
| Switzerland | 13.7 | BAE Systems | 3.6 |
| France | 10.7 | United Overseas Bank | 3.5 |
| Germany | 6.4 | Tokio Marine | 3.4 |
| Canada | 4.9 | Nestle | 3.4 |
| Australia | 4.1 | Zurich Insurance | 3.4 |
| Singapore | 3.5 | Shell | 3.4 |
| Sweden | 3.4 | Softbank | 3.3 |
| Brazil | 2.5 | TotalEnergies | 3.2 |

### *Portfolio Characteristics*

| | Forward Price / Earnings | Forward Dividend Yield | Q2 22 LT Debt / Capital | Est. LT DPS Growth | Est. LT EPS Growth | Q1 22 Market Cap ($B) |
|---|---|---|---|---|---|---|
| SCCM Intl High Div ADR | 10.7 | 5.4 | 32.0 | 8.4 | 10.0 | $86.8 |
| MSCI EAFE Index | 13.3 | 3.7 | 29.9 | 7.5 | 10.1 | $73.8 |

Source: SCCM Research, BCA Research, Bloomberg

**Beta** is a measure of the volatility, or systematic risk, of a security or a portfolio in comparison to the market as a whole. **Downside Capture** Ratio represents the degree to which a strategy outperformed or underperformed the benchmark in periods when the benchmark return was negative. The lower the downside capture ratio, the better

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The primary benchmarks used for comparison purposes are the net return indices for the MSCI EAFE Index, MSCI EAFE Value Index and the MSCI ACWI ex U.S. Value 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 EAFE Value Index captures large and mid-cap securities exhibiting overall value style characteristics across Developed Markets countries around the world, excluding the US and Canada. The MSCI ACWI ex U.S. Value Index captures large and mid-cap securities exhibiting overall value style characteristics across Developed and Emerging Markets countries around the world, excluding the US.

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