January 2025

Altrinsic Global Equity Commentary – Fourth Quarter 2024

Dear Investor,

Divergence in the performance between AI-led US markets and the rest of the world accelerated in the fourth quarter, fueled by optimism after the Trump election victory and a strong US dollar. The MSCI World index gained 1.9% in local currencies but declined by 0.2% in US dollars. The Altrinsic Global Equity portfolio declined by 5.2% gross of fees (-5.4% net), as measured in USD.[i] Underperformance was largely derived from our underweight exposure to the US and, more specifically, our lack of exposure to market-leading US "growth" companies. This differentiated positioning, coupled with underperformance in consumer discretionary, financials, and information technology, resulted in the quarter's disappointing performance.

Perspectives

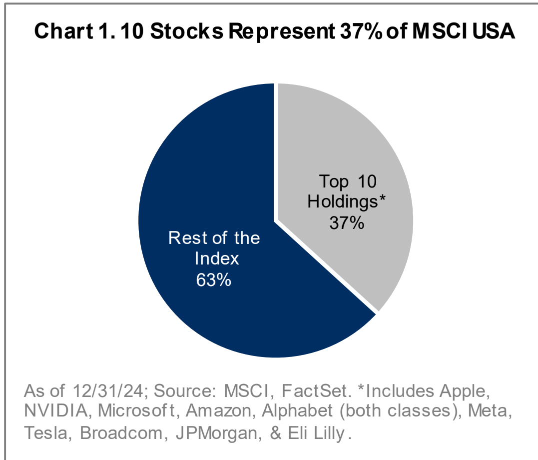
"US exceptionalism" continues to be the mantra in markets, and this has certainly been reflected in equity market performance, elevated valuations of the 'Magnificent 7' stocks, and the premium afforded to most US companies relative to their international peers. Innovation and growth have only been outpaced by the enthusiasm surrounding these companies. The US dollar has also benefitted, gaining 7.6% against the DXY basket of foreign currencies, with the recent rise reflecting interest rate differentials, anticipation of tariffs, and the associated changing terms of trade. In the case of both stocks and currencies, valuations have evolved from a stage of fundamental support to one driven by narratives and momentum, presenting risks for subpar returns among popular and crowded segments of the global equity landscape.

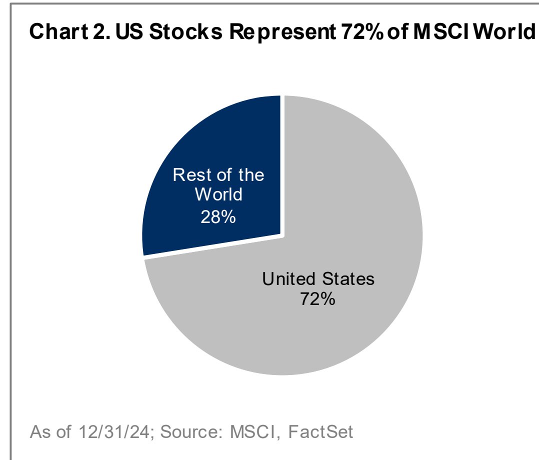
The situation in international markets is quite different: less loved, less crowded, lower expectations, compelling valuations, and undervalued currencies. This combination results in more favorable long-term return prospects. Successful long-term investing ultimately stems from the right blend of valuation (price paid), earnings and free cash flow (FCF) growth, and the appropriate appraisal of risks surrounding the investment. Reevaluating these pillars gives us confidence that the outlook is particularly compelling in non-US markets.

I. *Valuations*

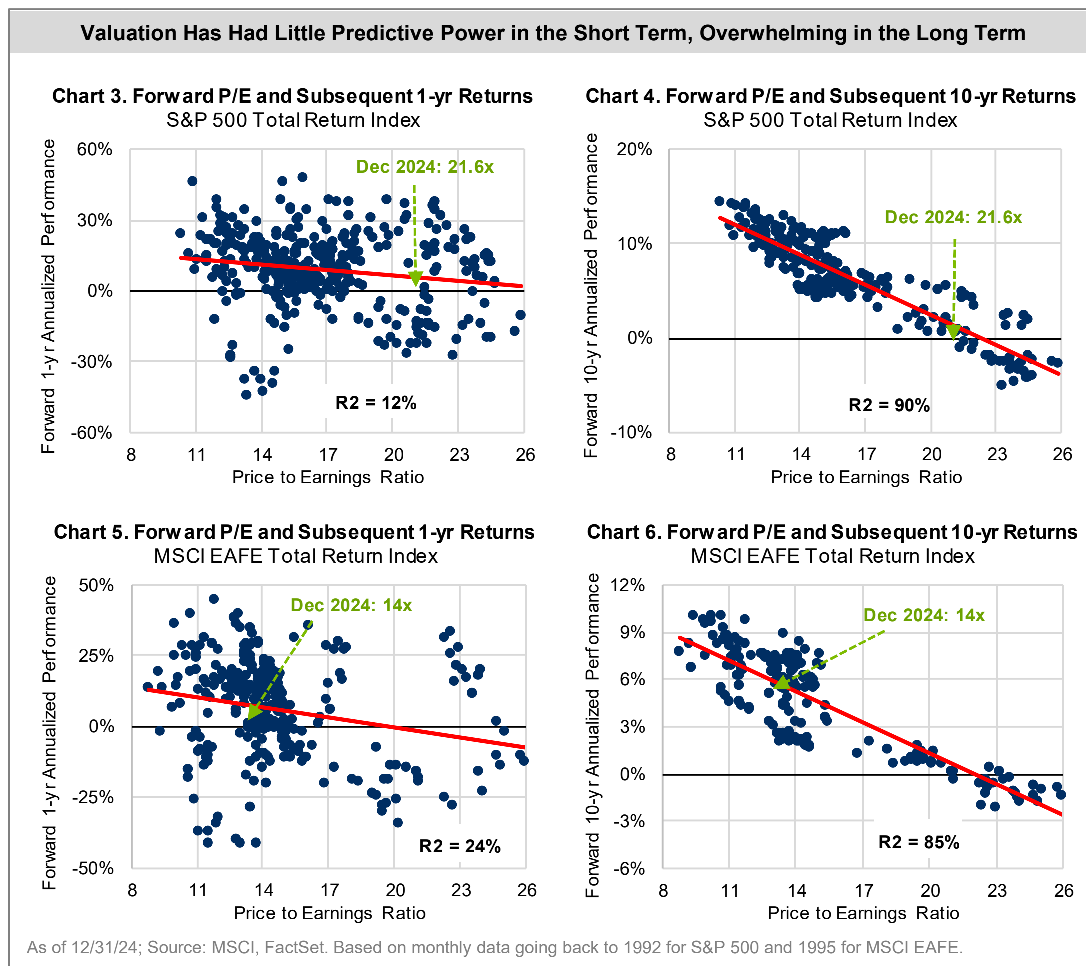
Valuation levels matter very little in the short term, but they matter overwhelmingly in the long term. Benjamin Graham famously said, "In the short run, the market is a voting machine, but in the long run it is a weighing machine." Sentiment, momentum, emotion, and liquidity often prevail in the short term, with

narratives surrounding stocks offering new and "transformative" ideas (AI, advanced robotics, GLP-1 drugs) contributing to lofty valuations. The proliferation of passive strategies and increased index concentration (**Charts 1 & 2**) have further exacerbated the procyclicality. But procyclicality works in both directions.





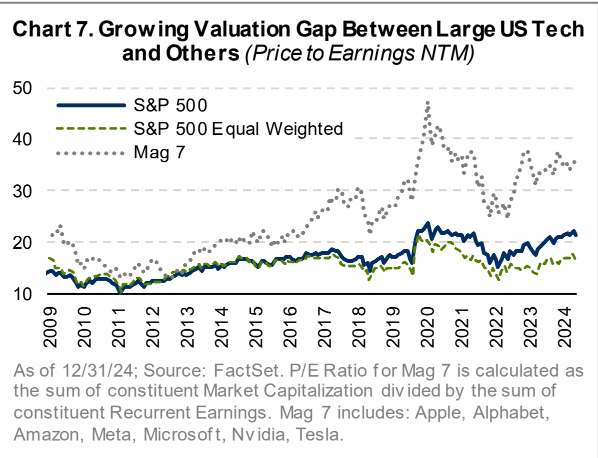
Over the long term, valuation has an outsized influence on returns. **Charts 3 & 4** (S&P 500) and **Charts 5 & 6** (MSCI EAFE Index) illustrate this relationship by looking back at the last 30+ years of data; the dots



represent the level of annualized returns earned on the respective indices based on the price/earnings multiple paid at the time. On a short-term basis, the correlation is very low, but over a 10-year period, it is over 85%. Based on this relationship, the 10-year forward annualized returns are much more favorable for non-US markets.

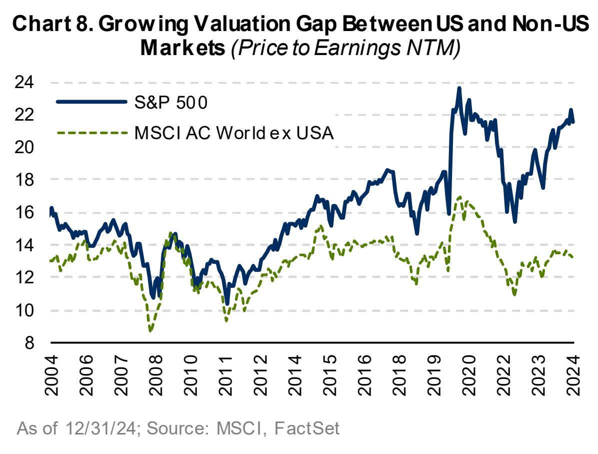
As we assess the narrow market leadership that is extended by most measures and by historical comparisons, we believe that, while possible, it is unlikely that many companies, particularly those in the US, can deliver on the long-term expectations embedded in their valuations. The likely best-case scenario is for them to tread water or experience a form of purgatory until fundamentals catch up with valuations. **Chart 7** reflects the gap in valuations between the small sub-set of leading US tech stocks, the large-tech-dominated S&P 500 Index, and the broader equal-weighted S&P 500 Index. **Chart 8** illustrates the growing spread between US and non-US markets. Looking beyond the small subset of market darlings, there is a lot of value in today's markets, with the most compelling dislocations outside of the US.

Chart 7. Growing Valuation Gap Between Large US Tech and Others *(Price to Earnings NTM)*



As of 12/31/24; Source: FactSet. P/E Ratio for Mag 7 is calculated as the sum of constituent Market Capitalization divided by the sum of constituent Recurrent Earnings. Mag 7 includes: Apple, Alphabet, Amazon, Meta, Microsoft, Nvidia, Tesla.

Chart 8. Growing Valuation Gap Between US and Non-US Markets *(Price to Earnings NTM)*



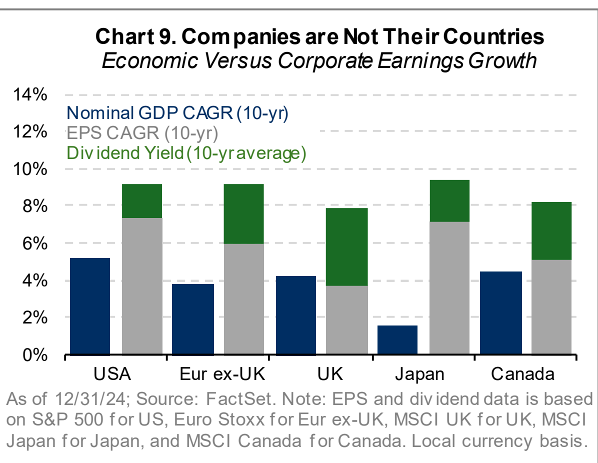
As of 12/31/24; Source: MSCI, FactSet

I. *Earnings and Free Cash Flow*

Valuation is unequivocally important, but focusing on it without regard to quality is fraught with its own dangers, typically leading to lower quality, highly cyclical, and/or overleveraged companies. It is a common misperception that non-US companies are domiciled in countries that are 'economic basket cases' and therefore do not grow. However, investments are made in companies and not countries, so ultimately, underlying EPS (as opposed to GDP) is most reflective of the investment landscape.

Chart 9 provides a broad perspective of economic and corporate earnings results over the last 10 years. US economic and earnings growth has outpaced most other nations, with productivity, a confident consumer, low interest rates, lower tax rates, buybacks, and massive fiscal stimulus playing supportive roles. Internationally, economic growth has been more muted, yet EPS growth has been solid and perhaps underappreciated. When also incorporating dividend yields, the value accrued to shareholders in the US versus outside the US has been comparable. Further, many of the best non-US companies have diversified their businesses with large and sometimes overwhelming amounts of revenue

Chart 9. Companies are Not Their Countries
Economic Versus Corporate Earnings Growth

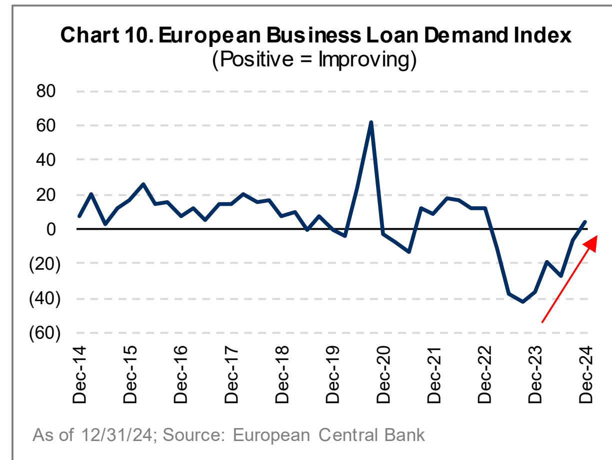


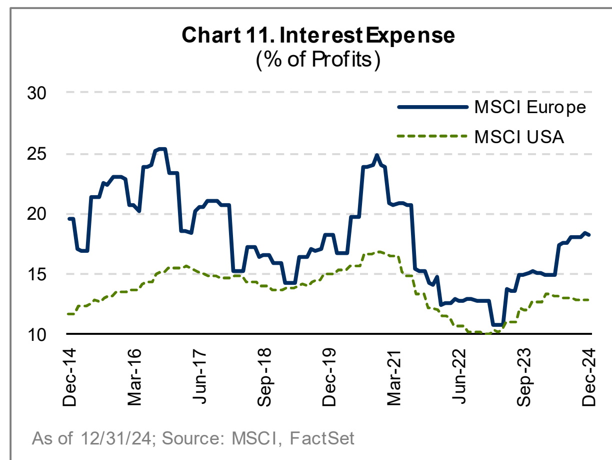
As of 12/31/24; Source: FactSet. Note: EPS and dividend data is based on S&P 500 for US, Euro Stoxx for Eur ex-UK, MSCI UK for UK, MSCI Japan for Japan, and MSCI Canada for Canada. Local currency basis.

generated outside their home market. After a period of massive outperformance in the US, expectations for many US companies are elevated, particularly among the large market constituents.

From a long-term investment perspective, we currently find the most compelling opportunities among companies with modest yet durable growth prospects, embracing change/AI/digitization to improve growth and profitability, and/or incorporating more productive capital allocation than markets are recognizing. These investments did well during the second half of the year (in local currency terms), but they have been unable to keep up with leading US growth stocks.

From a regional perspective, companies in Europe, Japan, South Korea, and other emerging markets have expectations that are low and likely to be surpassed. Europe's macro environment has been particularly weak, as politics, energy, Chinese demand, and uncertainly surrounding US trade policy have weighed on sentiment. However, financial conditions in Europe have been improving. Loan demand is finally turning positive (**Chart 10**), and European banks have stopped tightening lending standards for the first time in years. Just as important is the structure of debt in Europe. As highlighted in **Chart 11**, interest costs are a higher proportion of profits relative to the US, and variable rate debt is far more prevalent in Europe than in the US. Thus, while the US benefitted over the last few years from longer-duration debt structures, Europe now stands to benefit in the current rate environment.



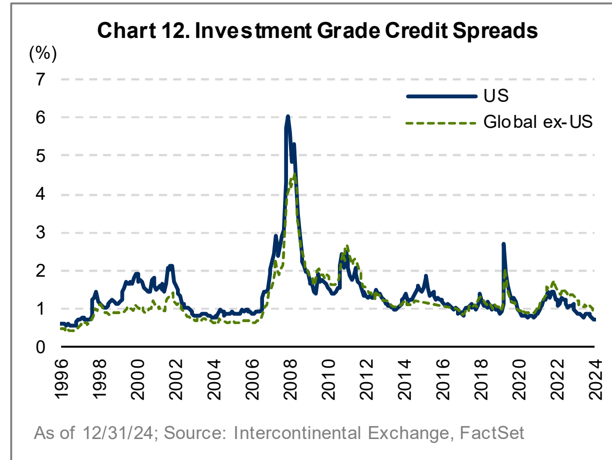


In Asia, earnings expectations are undemanding in Japan and South Korea. Shareholder-friendly reforms should boost earnings growth beyond levels that one might expect in otherwise mature economies. Historically, many Japanese and South Korean corporates have prioritized social initiatives and/or focused on top-line growth with little regard for financial productivity (i.e., ROE). Now, meaningful change is emerging, which is improving the investment opportunity set in both countries.

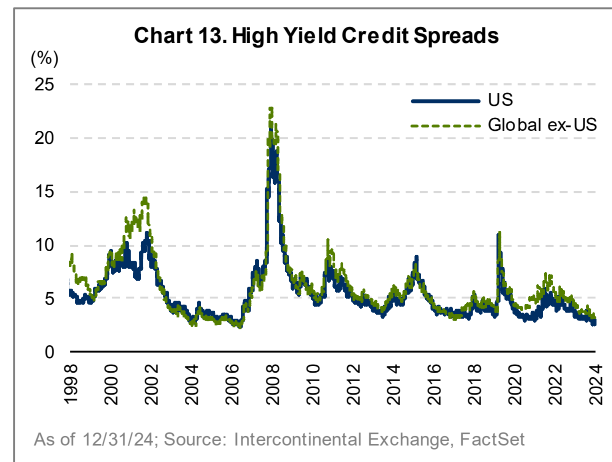
II. *Risks*

A multitude of interrelated risks span the world today, including geopolitical, policy-related, macroeconomic, credit, and excess leverage, to name a few. In theory, these considerations should be reflected in interest rates, risk premiums, and currency movements. At times, however, they can be overemphasized or underappreciated, presenting opportunities.

Geopolitics took center stage in 2024, as more than 70 elections were held in countries representing more than half of the world's population. While many were highly charged, we believe *The Economist* said it best, claiming 2024 "…affirmed the resilience of capitalist democracies, including America's."[1] We believe that US and Chinese policies relating to trade, security, and economic growth (particularly in China) will be the most consequential in the year(s) ahead. Currently, market consensus is overwhelmingly against China's ability to endure a second Trump presidency and/or stimulate domestic consumption. An end to the prolonged war in Ukraine could be a major boost to the EU. President Trump's policies, notably deregulation and tax cuts, have been greeted favorably by markets. Others, including deportation and tariffs, could stoke inflation and slow economic activity.



Deglobalization, necessary infrastructure spending, energy transition, aging labor forces, slowing immigration, excessive stimulus, high debt levels, and persistent fiscal deficits in major economies are supportive of sticky inflation and long-term interest rates remaining higher for longer despite slowing growth. In the US, for example, the ten-year Treasury bond yield ended last year nearly one percentage point higher than when the Federal Reserve began easing in September. Sovereign bond markets finally appear to be tuned in to the potential ramifications of excessive deficit spending and high government debt levels. Higher long-term rates and slowing economic activity are among the greatest risks in major economies, including the US. Corporate credit markets, however, do paint a more optimistic picture, with credit spreads declining to some of their lowest levels in decades (**Charts 12 & 13**).



Performance Review

The Altrinsic Global Equity portfolio underperformed the MSCI World Index in the fourth quarter as market leadership, dominated by US "growth" companies in general and the 'Magnificent 7 in particular, was a major headwind. As noted above, we are underweight these stocks due to their excessive valuations. From a sector perspective, negative attribution was mainly driven by consumer discretionary (Lojas Renner, Alibaba Group, not owning Amazon & Tesla), financials (Itau), and information technology (Samsung, not owning Nvidia, Apple, & Broadcom). Positive attribution was primarily due to our underweight exposure to both health care and utilities, where initial Trump administration appointees and higher interest rate expectations, respectively, pressured the sectors.

[1] Source: The Economist, *What to make of 2024*, 12/19/24, https://www.economist.com/leaders/2024/12/19/what-to-make-of-2024.

In consumer discretionary, fears of sustained consumer weakness in Brazil and China weighed on Lojas Renner and Alibaba Group. We believe, however, that both companies operate resilient businesses and management-led efforts to further advance their competitive positionings through portfolio restructuring and adept product management will bear fruit.

Similarly, in financials, Itau fell on fears the country's growth outlook would worsen amidst rising rates, but its strong management team, lower-risk balance sheet, and attractive digital presence put the company in a position of strength to weather near-term volatility.

In information technology, Samsung is actively addressing recent missteps in AI-focused products, which should re-accelerate sales growth and allow the company to resume its market-leading position within memory semiconductors.

Health care companies experienced significant declines following Trump's controversial nomination of Robert F. Kennedy Jr. to lead the Department of Health and Human Services, which adds uncertainty to an already tightening regulatory environment. Utilities were impacted by expectations of higher-for-longer interest rates that made equity yields relatively less attractive. We remain selective in these highly-regulated markets and favor companies with business improvement opportunities and/or reasonably priced assets that can add value to end consumers, thus reducing regulatory risk.

Investment Activity

We took advantage of market volatility to initiate five positions (Textron, Okta, Constellation Brands, Capgemini, and WillScot Holdings) and exit two positions (Ionis Pharmaceuticals, Sunrise Communications) during the quarter.

Textron, a manufacturer of advanced aviation, defense, and industrial products, is poised to benefit from a major military contract, the replacement of aging aircraft fleets, and streamlining its portfolio. Okta, a leading identity access management software vendor, operates in a large and growing addressable market and is transforming from providing point solutions to integrated identity, access, and governance software. Constellation trades at a deeply discounted valuation despite refining its portfolio to focus on first-class alcoholic beverage brands, which we expect to be among the fastest growing and most profitable in the world. Capgemini, a leading European IT services provider, will be a key beneficiary of rising digital transformation spending in Europe. WillScot Holdings has built the dominant franchise in temporary office space and storage facilities; we expect significant opportunities to come from easing cyclical pressures, continued pricing power, and expanding value-added services.

We sold Ionis following questionable capital allocation decisions, which eroded our confidence in management's ability to effectively monetize their technology. We exited our position in Sunrise, a Swiss telecommunication company, following its spin-off from Liberty Global as the shares traded in line with our estimate of its intrinsic value.

Closing

Recent performance has been below our expectations and ambition, but being different is most opportune when it is most difficult. Most objective measures (valuations, credit spreads, and bullish investor sentiment, among others) suggest a high degree of complacency in markets. A deeper look highlights how much of this complacency is

concentrated in a small number of widely held stocks with exciting "stories" and valuation levels reflecting this enthusiasm. We see the best opportunities outside of the headlines and, most notably, in international markets. Our investments and overall positioning are quite different from popular indices, and we believe it has seldom been more important to be so.

Thank you for your interest in Altrinsic. Please contact us if you would like to discuss these or other matters in detail.

Sincerely,

John Hock
John DeVita
Rich McCormick

[i] Performance is presented gross and net of management fees for the composite and includes the reinvestment of all income. Gross returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. Net of fee performance was calculated using the highest applicable annual management fee of 0.85% applied monthly. Policies for valuing investments, calculating performance, and preparing GIPS reports are available upon request. Past performance is not indicative of future results. The outlook and opportunities noted throughout this letter are the opinions of Altrinsic as of the date of this letter. There is no guarantee that we will be successful in implementing investment strategies that take advantage of such perceived opportunities or that any investment in the securities discussed will be profitable. Please see Important Considerations and Assumptions at the end of this letter for additional disclosures. Data sourced from FactSet, MSCI, and Altrinsic research.