ALTRINSIC

October 2021

Altrinsic Global Equity Commentary – Third Quarter 2021

Dear Investor,

The Altrinsic Global Equity portfolio declined 0.7% during the quarter, compared with the 0.0% return of the MSCI World Index and the 1.1% decline of the MSCI All Country World Index, as measured in US dollars[1]. Strong performance by our financials holdings was offset by weakness among health care and communications investments that lagged due to uncertainties stemming from COVID-19 and China. We believe the pandemic-related headwinds are passing, and pent-up demand for our health care holdings' non-COVID-19 vaccines and other medical treatments will materialize. China is more complicated as necessary policy transitions are underway, leading to increasingly compelling company-specific investment opportunities.

Investment Perspectives: Policy Transitions and Implications

The growth in corporate earnings and liquidity supporting equity markets for most of this year appears to have peaked just as uncertainties stemming from central bank policies, shifting regulatory regimes, and inflationary pressures have contributed to increased market volatility. Important transitions related to monetary and fiscal policies, addressing inequality, internet regulation, and energy policy are underway. Each of these changes is influencing the global economy and will continue to affect growth dynamics, inflationary pressures, asset prices, and equity market leadership in important ways.

Transitions in monetary and fiscal policies are among the most significant changes, as they directly impact interest rates, economic growth, and asset values.

Monetary policies in most developed economies have been highly accommodative since the global financial crisis, only to be supercharged during the onslaught of the pandemic. This contributed to inflation in asset prices ranging from stocks, bonds, and real estate to commodities and art. While the US Federal Reserve Bank is not ready to slow its bond purchases quite yet, the announcements after its September meeting marked an inflection point — from unrestrained support to slowing stimulus and eventual tightening. Some countries, including Brazil, have been forced to rapidly increase interest rates to temper spiking inflation.

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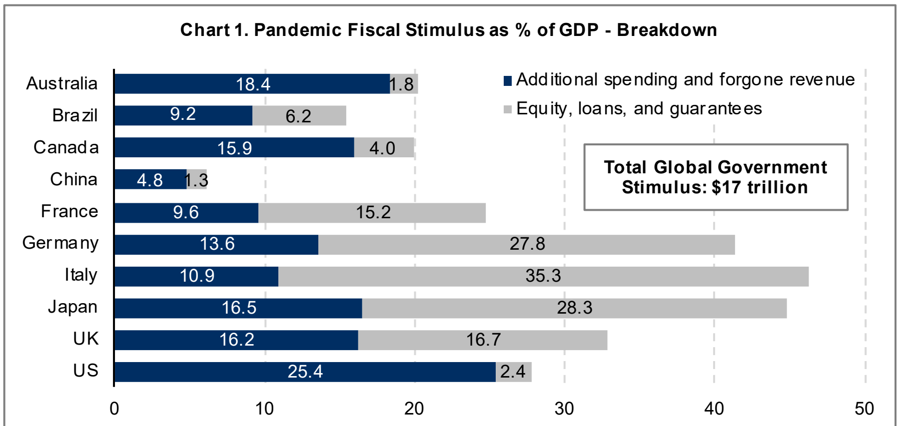
Receiving less attention, but of great significance, is the enormity of the fiscal stimulus that kept the global economy afloat during the depths of the pandemic. Total government stimulus related to the pandemic has reached approximately $17 trillion[2] globally, ranging from a massive 28% of GDP in the US to just 6% in China (**Chart 1**). Logic and history suggest that the positive fiscal impulse will naturally be followed by a drag – felt most in the nations providing the largest stimulus.



Source: IMF staff estimates; Note: Estimates are as of 06/05/21. Numbers in US dollar and percent of GDP are based on July 2021 World Economic Outlook Update unless otherwise stated.

While the shorter-term effects of expansionary fiscal stimulus efforts were welcome and arguably necessary, the impact of pulling forward such a significant amount of economic activity leaves future generations burdened with massive debt and the associated vulnerabilities. Many large nations, including the US, must now address their excessive debt levels. Similar to post-WWII, the likely path of least political interference will be inflation via financial repression (i.e. seeking to keep interest rates artificially depressed amidst rising inflation). The longer-term implications of financial repression are complicated and uncertain but likely include greater distortions and volatility in asset prices.

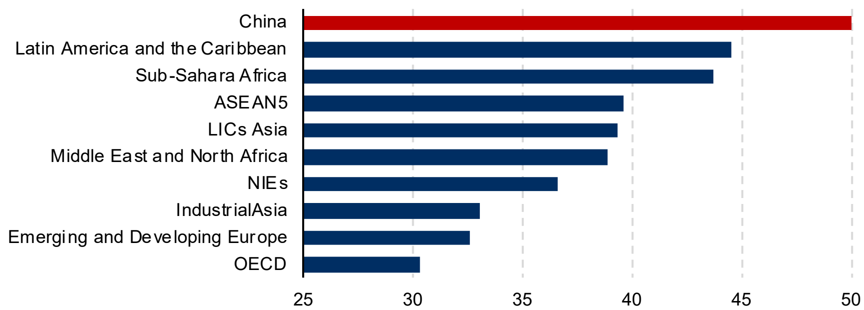
Important shorter-term implications of shifting fiscal and monetary policies include peaking liquidity conditions, slowing real economic and earnings growth rates, and a shift away from a supportive disinflationary backdrop to one risking stagflation. Developing countries with high debt levels and current account deficits are particularly vulnerable (Turkey, South Africa, Colombia, and India, to name a few).

Chinese President Xi's message of "common prosperity" marks an intensification of a global movement related to inequality in its many forms – wealth, income, and opportunity.

Ironically, the rise in asset prices resulting from the above-mentioned fiscal and monetary policies have further amplified these inequalities. Xi's directness in his messaging and crackdowns on for-profit tutoring, video gaming, monopolistic behaviors of tech giants, and reforming health care costs may surprise many; for others, these actions may be somewhat refreshing relative to the growing rhetoric of paying one's "fair share" and other band-aid approaches to addressing these shared concerns in major democracies.

As a point of reference, the top 1% of the US population owns about 35% of the wealth, compared to the Chinese top 1% that represents 31% today, up from 21% just 20 years ago.[3] Using the Gini coefficient (a measure of statistical dispersion used to represent income inequality) as another proof point, China ranks at the top of the chart relative to all other regions (**Chart 2**). China's blunt initiatives reflect an authoritarian approach to addressing this complicated and growing issue – compared to so-far-unsuccessful democratic efforts. In fairness, democratic processes often dilute the ability to get things done outside of crisis periods. China is not seeking to stomp out capitalism in the process, but rather what it deems capitalistic excesses. Considering China's demographics, it is essential to adjust economic imbalances and address inequality to avoid economic stagnation, broaden spending power, suppress social instability, and reduce reliance on Western capital and skills.

Chart 2. Regional Comparison of Income Inequality Levels
(Net Gini Index; in Gini points[1])



Source: SWIID Version 5.1; IMF, and IMF staff calculations; IMF Working Paper: *Inequality in China - Trends, Drivers and Policy Remedies, June 2018; [1]2015 (or latest available); average across the region;*
Note: ASEAN = Association of Southeast Asian Nations; LIC = Low-Income County; NIE = Newly Industrialized Economy; OECD = Organization for Economic Cooperation and Development.

Looking ahead, we expect an expanding role of government in most countries' economic models. This is already manifesting itself in tax proposals, regulatory and policy interference, and government expenditures. The important implication for investors is that rising taxes and regulation will increasingly weigh on growth and profitability, particularly in the US, which benefitted the most from years of regulatory ease, declining interest rates, and low taxes. A reset to lower growth could possibly be viewed favorably by the markets if it proves to be more sustainable. However, the risk of policy errors on this front skews to the negative.

The speed and boldness with which China has sought to address monopolistic activities, and the societal impact of internet companies, surprised markets.

Many other nations share China's aspirations to curb monopolistic behaviors and protect consumers from the ill effects of the internet, but inertia, vested interests, and democratic processes have slowed progress toward these objectives in Western nations.

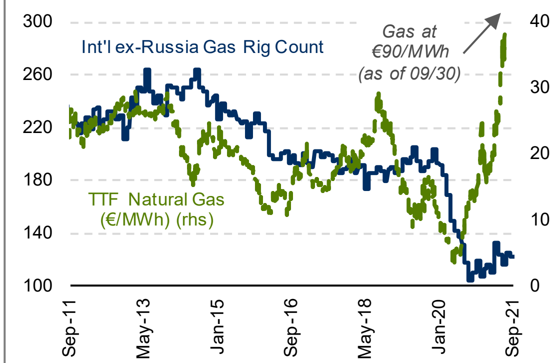
We have been visiting China for 28 years and have set very high hurdle rates when considering Chinese investments due to concerns about governance, interest alignment, disclosure, and valuation. Our base case assumption has always been that the number one priority is the interests of the Chinese Communist Party, but this has never meant that Chinese companies are 'uninvestable.' Instead, it has forced us to discount the opportunities accordingly and consider the appropriate risk at both the company and portfolio levels.

China's actions will slow its internet giants' growth rates and increase competition, but share prices discount an overly pessimistic long-term outcome in certain cases. We see compelling investment propositions in Alibaba, Trip.com, and Baidu. In total, our Chinese investments now represent just under 3% of the portfolio.

The skyrocketing prices of energy are drawing attention to the unintended consequences of well-intended energy policies aimed at addressing climate change and other environmental issues.

Surging demand for natural gas coupled with reduced capex investment and a series of weather-related issues (ice storm in Texas, hurricane in Louisiana, and a lack of wind in Europe) have contributed to major supply/demand imbalances and soaring prices throughout 2021. **Chart 3** illustrates the greater than 50% decline in natural gas rig counts since 2014 and the surge in global gas prices. The rise in prices is particularly concerning for Europeans heading into winter, as almost 50% of homes rely on natural gas for heating. Beyond the 'tax' that higher energy prices place on consumers, especially for the most vulnerable populations, there are additional broad geopolitical and economic implications; the most immediate of these relates to inflation.

Chart 3. Gas Drilling Depressed Amid Lower Fossil Fuel Investment and Despite Global Gas Price Spike



As of 09/30/21; Source: Bloomberg, Baker Hughes

Surging consumer demand, aggressive government stimulus efforts, higher energy prices, and COVID-19 related supply chain disruptions have contributed to the current inflationary environment. Markets are trying to determine whether these dynamics are transitory or lasting; either way, the disinflationary conditions supporting asset prices during recent decades appear to be ending. Slowing growth and rising inflationary pressure are contributing to growing risks of stagflation and policy errors.

What are the investment implications of these policy transitions?

- The robust COVID-19 related earnings growth that has been the primary market driver during the last year has likely peaked. Earnings might continue to be strong, but vulnerability stems from historically peak margin levels, persistent supply chain disruptions, rising input costs, high debt levels (for companies and countries), growing regulatory headwinds, higher tax burdens, and potentially higher borrowing costs.
- Liquidity, broad indicators of financial conditions, and central bank asset purchases are peaking or are already in the process of subsiding. This major source of speculative froth is dissipating.
- China is investable, via the right companies at the right prices, and with the appropriate consideration of risk.
- The role of governments will continue to expand in the global economy, individual companies, and our everyday lives. Economic and corporate earnings growth will likely be lower because of these changes but could prove to be more sustainable if sensibly addressed.

- The long-overdue broadening out of market leadership that began with vaccine approvals in September 2020 should persist. The virtually uninterrupted leadership by highly valued growth stocks initially gave way to lower quality and leveraged deep cyclical stocks. Market leadership has subsequently ebbed and flowed between these two segments of equity markets. We see vulnerability at both extremes, with growth stocks often priced for unfettered growth and permanently low-interest rates, while many cyclical stocks are priced for a new normal in profitability.

Considering this segmentation and the related vulnerability, we believe the best opportunities are elsewhere, among companies for which the investment rationale is less likely to be captured by popular "factors":

- Companies less dependent on the broad economy and interest rates with unique drivers of value creation within their control are increasingly attractive in a world with a volatile macro backdrop and high embedded expectations.
- Companies undergoing transitions to improve business quality are often missed by simple factor screens and frequently take time to play out, providing an advantage for those with a long-term perspective.
- Regionally, companies domiciled in non-US equity markets generally have lower valuations and lower earnings expectations embedded. It is difficult to generalize about emerging markets, but fault lines are appearing in markets with weak financial and external imbalances. Opportunities are growing in others, including China and South Korea.
- On a sector basis, financial and health care companies offer compelling opportunities. Among financials, opportunity exists among less balance-sheet-intensive businesses like exchanges, insurance brokers, and non-life insurers that are improving their businesses and less exposed to disruption. In health care, we are likely to see the greatest innovation over the next decade, R&D efficiency is poised to improve, and management teams are increasingly focused on shareholder value. Current valuations are depressed due to near-term political uncertainty, not reflecting the positive changes.

Investment Activity and Performance Review

Varying market dynamics during the quarter led to disparate performance attribution. The period was a supportive environment for financials, with long-term interest rates moving modestly higher while inflation expectations remained robust. Our insurance-related holdings rose due to strong margin improvement and continued competitive discipline. Chubb and Tokio Marine announced large buybacks, bolstering managements' strong capital allocation credentials. Aon shares rose after the canceled merger with Willis Towers Watson (WTW), removing the potential for distraction. Aon and WTW have successfully improved the quality of their businesses with a greater focus on health/benefits, monetizing their massive data troves, improving cost structures, and enhancing free cash flow conversion. Less market-friendly regulators ultimately blocked the merger, but the subsequent decline in WTW stock prices presented an attractive opportunity to re-establish a position, especially in light of enormous cost-cutting potential if WTW management follows the blueprint set out by Aon's already successful strategy.

Negative attribution came primarily from Heineken, Biogen, and recently purchased Chinese companies. Heineken is a large holding that is well-positioned at the premium end of the beer market, with leading positions in growing markets throughout Asia and Africa. COVID-19 flare-ups in several of these markets (Vietnam in particular) will pressure near-term results, but the long-term growth trajectory remains intact. After launching a controversial new drug for Alzheimer's in June, Biogen announced that the uptake was slower than expected due to the controversial approval, lack of infusion infrastructure at many institutions, and, most importantly, lack of a consistent reimbursement guidelines from Medicare. We believe reimbursement will be resolved in early 2022, in addition to having Phase III results from another Alzheimer's drug. In China, increased regulatory scrutiny among internet and casino companies weighed heavily on stock prices. While some have permanent implications, mostly in the education and internet gaming spaces, companies with gambling, retail, and internet search exposure have company objectives aligned with the Chinese Communist Party, so we expect more modest long-term effects.

The most significant investment activity during the quarter involved establishing new positions in WTW (as previously mentioned), Adidas, and New Relic, and increasing position sizes in Acuity Brands, Cisco, Aena, Henkel, and Liberty Global. Capital was redeployed from the sales of Ambev, American Financial Group, Lloyds Banking Group, and Sandvik, and we meaningfully trimmed positions in Exelon, Aon, Oracle, Kroger, and Berkshire Hathaway.

Adidas, the world's second largest sporting goods company (behind Nike), has a rare combination of brand strength, category momentum, and depressed margins. Management focus on maintaining sales growth while improving margins to category peers should lead to a multi-year run of double-digit earnings and cash flow growth that is not fully discounted at the current stock price.

New Relic is a leading vendor of Application Performance Monitoring (APM) software, which is a large and growing market. New competition, a delayed product update, and go-to-market changes have impacted the company's results recently. The company has a solid management team, high quality engineering talent, and a leading APM product with a good reputation among developers. We believe recent product enhancements, new partnerships, and go-to-market changes offer a credible path to accelerating growth and creating significant value for shareholders.

Table 1 (on the next page) depicts our greatest sources of differentiation versus broad markets. [4] Overall portfolio risk remains below market levels.

Table 1: Altrinsic Global Equity Portfolio – Sources of Differentiation

	Altrinsic Global	Over / (Under) Weight vs. World
Non-Bank Financials	23.0	15.3
Health Care	13.8	1.2
Food & Beverage Staples	9.4	5.8
Banks	2.7	(3.4)
Info Tech	8.3	(14.0)
Consumer Disretionary	8.4	(4.4)
Energy & Materials	6.2	(1.2)
Industrials	10.3	(0.2)
Utilities	1.5	(1.2)
Real Estate	2.2	(0.4)
Communication Services	8.2	(1.0)
Cash	3.2	3.2
Other	2.6	0.3

Overweight:

- **Insurance** – Strong outlook for demand and competition; enhanced business mix and cost cutting opportunities
- **Exchanges** – Solid moats with improving prospects for data and clearing penetration
- **Health Care** – Reduced patent cliff risk, investing heavily in innovative sciences, attractive valuations
- **Food & Beverage Staples** – Strong category mix with premiumization, reopening, and cost cutting opportunities

Underweight:

- **Banks** – Valuations do not account for risks around disruption, commoditization and regulation
- **Information Technology** – Risks around end demand, competition, and regulation are not reflected in valuations
- **Consumer Discretionary** – Many companies are expensive on normalized profitability with various disruption risks
- **Energy & Materials** – Less favorable risk/return given commodity price vs marginal cash cost

Conclusion

Important policy shifts that are underway will likely have long-term societal, economic, geopolitical, and market implications. In the near term, they are contributing to tightening financial conditions and economic growth that should slow to more normal levels. Both popular growth stocks and deep cyclical businesses remain highly valued, with the greatest opportunity among businesses less driven by the broad economy and among well-capitalized businesses executing on underappreciated initiatives to further strengthen their quality. We are confident that our investments' compelling valuations and favorable fundamental underpinnings will generate attractive risk-adjusted returns. Further optionality is derived from potential takeover activity by strategic and cash-rich private equity buyers.

Thanks for your interest in Altrinsic.

Sincerely,

John Hock
John DeVita
Rich McCormick

[1] *Performance is presented gross 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. 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.*

[2] *Estimate as of 09/27/21. Source: IMF staff estimates and national authorities. Note: Figure represents COVID-19 related fiscal measures since January 2020, expressed in USD.*

[3] *Source: Credit Suisse Research Institute's "Global Wealth Report 2021" published in June 2021.*

[4] *As of date 9/30/2021. Source: FactSet and Altrinsic. Altrinsic sector weights are based upon a representative fully discretionary account with the Global mandate. Altrinsic independently analyzes each security recommended for purchase and categorizes it into the MSCI GICS sector that it deems most appropriate. Altrinsic's sector classification may differ from MSCI.*