

1Q 2014

# International SMA Commentaries



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## Market Review

Aggregate global equities posted modest gains in the first quarter – a moral victory of sorts, given the broad sell-off in stocks that occurred in January. Buyers stepped in toward the end of the quarter, and many indices needed the last week of March to get back into the black. Stocks remained resilient during the quarter, despite ongoing concerns about Emerging Markets, valuation concerns in the U.S., and the increasing political uncertainty via Russia and their activities in the Ukraine. While the MSCI EAFE Index gained 0.7% in the quarter, there was a fair amount of performance differentiation at the country/regional levels. Europe posted positive returns in most of their local markets, while Japan sold off in the quarter. Emerging Markets started the quarter deep in the red before battling back late to post a return of -0.4% for the quarter. Although EM valuations have certainly come down over the past year, one needs to have confidence in earnings (the ‘E’ in P/E); on this basis, Cambiar remains cautious, keeping us mainly on the sidelines for now.

## International Equity ADR Portfolio

The Cambiar International Equity ADR portfolio endured a challenging start to 2014, posting a 1Q return of -3.0% (-3.1% net of fees). While disappointed with performance in the quarter, we also recognize that predicting shorter-term price action in our holdings is not the goal; rather, the team’s focus remains on ensuring that the underlying investment thesis remains intact. If we are correct on this front, it should be eventually reflected in the stock price.

International ADR Performance						
	1Q14	YTD	1 Year	3 Year	5 Year	Since Inception
ADR (g)	-3.0%	-3.0%	20.5%	9.2%	19.0%	7.6%
ADR (n)	-3.1%	-3.1%	19.8%	8.5%	18.2%	6.6%
EAFE	0.7%	0.7%	17.6%	7.2%	16.0%	3.9%

Inception Date: 2.28.2006 / See Disclosure – ADR performance

In further dissecting performance in the quarter, there was no one holding or country allocation that led to the lagging return. Some of the weakness can be attributed to a pullback in positions that posted strong returns in 2013. For a small number of holdings, the underperformance was more company-specific in nature; in these cases, Cambiar sold the positions in favor of more attractive investment opportunities.

Financials comprised the single-largest detractor on a sector basis. While Cambiar’s focus on diversification within a sector (by region and industry) has often helped to provide balance from a performance perspective, it was not the case in 1Q. Notable laggards in the quarter included two Japanese financials, a Swiss-based private bank, and a UK-based global interdealer broker.

Cambiar also received below-benchmark performance from the portfolio’s holdings in the Industrial and Materials sectors. One position that was sold in the quarter was Bombardier, which had been in the portfolio for the past couple years. While Bombardier’s Transportation segment (locomotives, rails) has executed well over our holding period, the key part of the thesis was a new C-Series aircraft that is in production via the company’s Aerospace Division. Given the strength in the commercial aerospace industry, we believed that this new plane had very good orders potential. Yet the introduction of the aircraft continues to be delayed, leading to a team review and decision to liquidate.

There were some positives in the quarter, including strong stock performance within the Technology and Energy sectors. The improved returns from the portfolio’s Energy holdings are notable, as this sector was a source of underperformance in 2013. Cambiar also registered solid gains in the Consumer Staples sector, while performance in Consumer Discretionary was mixed.

At a country level, Japan remains the single-largest allocation within the International Equity portfolio. While Japanese equities lagged their European counterparts in the quarter, Cambiar’s Japanese positions outperformed the index. Investor concerns with respect to emerging markets was not only expressed in EM equities themselves, but was also reflected in the Japanese yen (strengthened) given the currency’s safe haven status. As a port in a storm, the yen was bid up during the quarter, resulting in

a headwind for Japanese equities. We do believe that as fear recedes with respect to Fed taper, and the Bank of Japan continues on the QE path, the yen will ultimately weaken. While cognizant of the risks related to our constructive view on inflation and economic growth in Japan, we believe that the combination of strong company fundamentals, reasonable valuations, the potential for structural reform and a strong macro tailwind in the form of QE presents an attractive investment opportunity within this sovereign.

As a reminder, Cambiar's high active share discipline may generate returns that differ from the index, particularly over short timeframes. While said performance variance has historically been of the upside variety for our clients, it can at times go the other way as well – as evidenced in the quarter. We remain confident on the positioning of the International Equity portfolio, and our ability to recoup the current performance deficit.

## Global Select Portfolio

The Cambiar Global Select portfolio struggled to keep pace with the MSCI All-Country World Index in the first quarter, trailing the benchmark by 300 basis points (net of fees). Security selection is the primary driver of excess return for the Global Select portfolio (vs.

country 'bets'); after success on this front via a strong 2013, stock selection was less effective in 1Q – leading to the strategy's underperformance.

Global Select Performance							
	1Q14	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception
Global (g)	-1.6%	-1.6%	22.7%	9.6%	23.3%	8.8%	9.1%
Global (n)	-1.9%	-1.9%	21.3%	8.5%	22.1%	7.8%	8.1%
ACWI	1.1%	1.1%	16.6%	8.6%	17.8%	7.0%	3.2%

Inception Date: 2.28.1998 / See Disclosure – Global Select performance

Buy/sell activity was elevated in the quarter, as the investment team sold a handful of positions that had reached their price targets and no longer offered an attractive risk/reward profile. Trades also included a small number of holdings where the original investment thesis was determined to be unattainable over our desired timeframe. In both cases, proceeds were redeployed into new investments.

As mentioned, Cambiar's non-U.S. holdings comprised the primary detractors in the quarter; in a reversal from 2013, the portfolio's investments in Japan and the UK were notable laggards in 1Q. There was no material change in fundamentals that caused the pullback in our UK names, and thus no portfolio management actions. Japan was one of the poorer-performing countries in the first quarter, as a strengthening yen, lack of newsflow on QE, and concerns surrounding the upcoming consumption tax all were a headwind for Japanese equities. While making some adjustments to our Japan holdings, Cambiar continues to maintain an overweight allocation, and we remain positive on the earnings outlook for our positions – despite the performance setback.

At the sector level, the portfolio's Energy positions were a notable positive in the quarter. Given the continued momentum in North America oil production, Cambiar's Energy positions are primarily U.S.-based, and include a refiner, exploration and production (E&P), and energy services companies.

Cambiar's Consumer Discretionary holdings were another value-add in the quarter, as the portfolio's aggregate holdings in the sector produced a positive return (vs. -2% for the index). Consumer Discretionary represents the largest relative overweight vs. the benchmark, and is comprised of a diverse mix of businesses with varying degrees of global exposure.

The portfolio's holdings within the more cyclically geared Industrials and Basic Materials sectors were a performance drag in the quarter, as both sectors were unable to keep pace with the index. Upon a company-by-company review, the team reduced the portfolio's exposure within these sectors. With many

economies around the globe experiencing varying levels of economic expansion, such a backdrop is supportive for our Industrial and Materials holdings; that said, we are also tracking each position to ensure that the company-specific drivers also remain in place.

## Looking Ahead

If the first quarter is any indication of stock performance for the balance of 2014, positive portfolio returns will require considerably more effort than the rising tide market of 2013. Differentiation by region, country and sector should place a higher premium on stock selection and active portfolio management – two hallmarks of the Cambiar discipline. Cambiar's emphases on quality and value creation continue to make us wary of Emerging Markets; we favor the more established franchises that are domiciled in the Developed Markets.

While the longer-term track records of the International Equity and Global Select strategies illustrate Cambiar's ability to outperform over full market cycles, it should be noted that success is not a linear process; periodic bouts of underperformance such as the first quarter may be occasionally incurred along the way. Although the International Equity and Global Select strategies have some work to do to get back to par for the year, we remain confident in the portfolios' ability to rebound from their respective first quarter deficits. Just as mean reversion is an underlying premise to the Cambiar process, we anticipate that there should be some performance reversion within the International and Global strategies over the balance of 2014.

As always, we appreciate your continued confidence in Cambiar Investors.

## Disclosure

**ADR Performance:** The performance information depicted above represents the Cambiar International ADR Composite. Returns are net of management fees and transaction costs and include the reinvestment of all income. Gross returns do not reflect the deduction of management fees. The performance of the MSCI EAFE benchmark includes the reinvestment of all income. The MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the U.S. & Canada.

**Global Select Performance:** The performance information depicted above represents the Cambiar Global Composite. Returns are net of management fees and transaction costs and include the reinvestment of all income. Gross returns do not reflect the deduction of management fees. The performance of the MSCI ACWI benchmark includes the reinvestment of all income. The MSCI ACWI (All Country World Index) Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets

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