Cambiar Europe Select ADR 3Q 2018 Commentary

Market Review

European equities managed to scratch out a positive return for the third quarter, with the MSCI Europe Index gaining 0.8%. In general, European equities have yet to gain traction in 2018, as attractive valuations/fundamentals at the company level have been offset by unsettling headlines and related political concerns. Given the fairly wide divergence between growth and value in 2018, investment style has been an additional headwind for EU equities. Europe is more widely regarded as a 'value market' – in light of the larger composition of traditional value sectors such as financials, healthcare and consumer staples companies. Investors seeking growth have subsequently rotated dollars to markets such as the U.S., where there is a larger concentration of technology and related candidates.

For the quarter, positive performance within markets such as Switzerland and France were offset by pullbacks in Italy and the United Kingdom. The weakness in these latter markets was more a function of macroeconomic concerns – as uncertainty regarding Brexit and the populist agenda in Italy had investors moving to the sidelines until there is more clarity on both of these fronts.

Europe Select ADR

CONTRIBUTORS

Top Five	Avg. Weights	Contribution
AXA	3.1	0.28
SAP	4.3	0.28
Roche Holding	2.8	0.25
Deutsche Post	3.1	0.22
DNB	3.1	0.22

DETRACTORS

Bottom Five	Avg. Weights	Contribution
Adecco Group	2.5	-0.25
Intesa Sanpaolo	2.2	-0.26
Julius Baer	2.6	-0.40
Bayer	1.1	-0.44
Paddy Power Betfair	2.4	-0.60

A complete description of Cambiar's performance calculation methodology, including a complete list of each security that contributed to the performance of the Cambiar portfolio mentioned above is available upon request. Please contact Cambiar at 1.888.673.9950 for additional information. Past performance is no guarantee of future results.

	3Q 2018	YTD	1 Year	3 Year	Since Inception
Europe Select ADR (gross)	-0.7%	-3.8%	0.6%	8.5%	6.3%
Europe Select ADR (net)	-0.7%	-3.8%	0.6%	8.5%	6.2%
MSCI Europe	0.8%	-2.5%	-0.3%	7.7%	3.2%

Cambiar Europe Select ADR Composite Inception Date: 10.31.2014. See Disclosure – Performance

The Cambiar Europe Select ADR strategy posted a small loss in the third quarter, subsequently trailing the MSCI Europe Index. Consistent with Cambiar's bottom-up discipline, stock selection is the driving force behind strategy performance, vs. Cambiar attempting to outperform via large sector or country bets. Although the portfolio demonstrated positive stock performance in sectors such as Technology and Materials for the quarter, these bright spots were offset by more challenged performance within Healthcare and Consumer Discretionary.

In light of Cambiar's benchmark-agnostic portfolio, some degree of performance variability should be expected – particularly on a quarter-to-quarter basis. Over time, we want this variance to work to our client's benefit (which has been the case over the life of the strategy). Yet pockets of underperformance are inevitable. In aggregate, the Cambiar team remains constructive on the positioning of the Europe Select portfolio. Trading at an aggregate P/E of 12.5x, the portfolio clearly reflects a fair amount of pessimism. Should the headline noise within the EU abate (or turn more constructive) and investor sentiment improve, we believe the Europe Select ADR portfolio is well positioned to make up some ground.

At an individual stock level, Paddy Power Betfair (Consumer Discretionary) represented the largest drag on return for the quarter. The Ireland-domiciled gaming company reported below-market earnings due to increased investments as part of a larger plan to position Paddy Power as a beneficiary for the anticipated approval of sports betting across the U.S. The company has a net cash position and consistent free cashflow generation, a portion of which is used to increase shareholder return via dividends and share buybacks. The opportunity in the U.S. is in the early innings, but could be a powerful earnings catalyst for Paddy Power in the coming years.

Heathcare stocks comprised the top-performing sector within the index during the third quarter. Cambiar garnered solid contributions from positions such as EssilorLuxottica and Roche, but these gains were overshadowed by the drawdown in Bayer AG. Cambiar's thesis for Bayer was predicated first-and-foremost on the synergistic combination of Monsanto's seeds business with Bayer's Crop Chemicals franchise. Stable/improved performance within the company's pharmaceutical and consumer health divisions were additional catalysts that we believed would support a re-rating in the stock. This investment case was materially altered by the August lawsuit against the company's RoundUp Ready product. Cambiar was aware of the glyphosate case; that said, the ruling was unexpected – via the size of the judgment and the precedent that subsequently opened the door for potentially thousands of additional lawsuits. In light of the increased litigation risk and diversion of management focus, we deemed the situation too hard to handicap and subsequently liquidated our position in Bayer during the quarter. Unexpected developments (negative and positive) are part of the business, but a disappointing outcome nonetheless.

Cambiar's stock selection within Financials had been a consistent bright spot for the Cambiar portfolio over the past eighteen months, before posting a relatively weak performance in the third quarter. Ongoing uncertainty surrounding Brexit came back into focus during the quarter, resulting in a buyer's strike of sorts for UK equities. UK bank position Lloyds lost ground in 3Q – despite the company's profitability, solid cash returns to shareholders (5.1% yield), and attractive valuation. Additional examples of macro concerns trumping company specifics were the weakness in Banco Santander and Julius Baer, which were penalized in the quarter for their exposure to Emerging Markets. We believe Santander's operations in Brazil are improving, while Julius Baer's growth prospects for private banking services in end markets such as Asia remain intact. Perhaps the most notable example of the macro environment setting the cadence for stocks was Intesa Sanpaolo, which pulled back in response to the current political climate in Italy – more specifically, the deficit-spending plans of the populist coalition. Cambiar's view is that these types of events come and go in Italy, and current tensions will undoubtedly pass. We view Intesa to be the best bank in Italy, with one of the strongest capital levels in the European Union. Given the company's track record of profitability and attractive level of cash dividends, we remain investors in the company. In each of these cases (and investing in general), longer-term success often requires looking past the news of the day and remaining focused on the more enduring earnings drivers in a company.

Cambiar garnered positive contributions in the quarter from software company SAP (Technology), as well as Royal DSM and ArcelorMittal from the Basic Materials sector. As discussed in our 2Q commentary, we believed that ArcelorMittal could emerge as a likely beneficiary from tariff activity, vs. the discount priced into the stock by the market. While one quarter is still too early to declare victory, we are encouraged by the stock's rebound in 3Q.

Trade activity was slightly elevated vs. past quarters, with four purchases and three sales. Cash had been slightly elevated in the 7-8% range, but was lowered to ~4% by quarter-end. Unlike 2017, cash levels have not been a drag on performance for the portfolio in 2018. There were no significant changes at a country level – France and Germany remain the two largest allocations, while Europe Select continues to maintain an underweight positioning to UK stocks (13% for Cambiar, vs. 25% for the index). After posting solid gains in 2Q, UK stocks faltered in 3Q – as concerns surrounding the terms/timing of this sovereign's exit from the UK had investors moving to the sidelines.

Looking Ahead

As we look ahead to the final three months of 2018, there is no shortage of pending newsflow for investors to digest – continued trade posturing with China, mid-term elections in the U.S., Britain's ongoing negotiations to leave the EU, Italy's fiscal budget, and turmoil in various emerging markets. And these are just the headlines we know about. Needless to say, markets are likely to remain volatile until the market gets a clearer picture of expected outcomes. Cambiar certainly considers the relevant macro inputs as part of our research process; however, the goal is to not let these events dictate buy/sell decisions, as that is a good way to whipsaw the portfolio. Market volatility is not a bad thing – as it can produce price dislocations at the individual company level.

At a regional level, Cambiar continues to believe that Europe offers an attractive combination of low valuations and low expectations – even a modest uptick in either measure could provide a meaningful re-rating in the portfolio's European/UK holdings. Above all, the focus at Cambiar remains on identifying quality companies that we believe trade at reasonable valuations, possess competitive advantages vs. their peers, and can produce through-cycle profits.

We appreciate your continued confidence in Cambiar Investors.