William Blair

Summary & Outlook

International Leaders ADR SMA Strategy

Market Overview

Global equities declined in the fourth quarter (the MSCI ACWI IMI returned -1.24% for the quarter and +16.37% year-to-date in USD terms) despite a significant rally in U.S. equities following the conclusion of the U.S. presidential election. However, enthusiasm faded following hawkish comments from the Fed, lowering expectations for the number of expected rate cuts in 2025.

Growth equities outperformed value-oriented equities (the MSCI ACWI IMI Growth returned +2.07% for the quarter and +22.42% for the year, while the MSCI ACWI IMI Value returned -4.62% for the quarter and +10.32% for the year). From a global sector perspective, communication services (+4.46% for the quarter and +30.29% for the year, as measured by MSCI ACWI IMI), consumer discretionary (+4.23% for the quarter and +18.33% for the year, as measured by the MSCI ACWI IMI), and information technology (+4.16% for the quarter and +30.11% for the year, as measured by MSCI ACWI IMI) led, while materials (-14.13% for the quarter and -7.00% for the year, as measured by MSCI ACWI IMI) and healthcare (-10.94% for the quarter and +1.24% for the year, as measured by MSCI ACWI IMI) lagged.

U.S. equities gained during the period (+2.52% for the quarter and +23.32% for the year, as measured by the MSCI USA IMI) as performance in the U.S. strengthened immediately following the results of the U.S. presidential election. Economic data was mixed throughout the quarter, with a focus on the labor market and inflationary data. Following choppy non-farm payroll data during the period, November's positive data reported ahead of expectations, easing concerns of a cooling labor market. However, inflationary data reversed course in the fourth quarter, pushing higher after the third quarter saw consistent disinflationary trends. At December's FOMC meeting, Fed Chair Jerome Powell cut interest rates by 25 basis points but signaled for fewer interest rate cuts going forward.

European equities declined during the fourth quarter (-9.83% for the quarter and +1.49% for the year, as measured by the MSCI Europe IMI) in part due to concerns over potential trade tariffs by the incoming U.S. administration. The European Central Bank announced its fourth rate cut in December, as inflationary trends have continued to move in the right direction coupled with weak economic data. However, while PMI data in recent months has indicated contraction, December's positive reading rose to 49.6, following November's figure of 48.3. The U.K. also declined during the quarter (-7.20% for the quarter and +7.17% for the year, as measured by MSCI United Kingdom IMI).

Emerging markets posted negative returns (-7.89% for the quarter and +7.09% for the year, as measured by the MSCI EM IMI), driven largely by concerns over President-elect Trump's proposed tariff's, particularly on China. As a result, China declined (-7.50% for the quarter and +18.76% for the year, as measured by the MSCI China IMI index). Latin America returns declined (-15.91% for the quarter and -26.78% for the year, as measured by the MSCI EM Latin America IMI) despite strong performance from Argentina, a standout in the region (+54.09% during the quarter and +116.52% for the year, as measured by MSCI Argentina IMI). EMEA was also negative (-3.80% for the quarter and +6.34% for the year, as measured by the MSCI EM EMEA IMI), with weakness from South Africa (-11.08% for the quarter and +9.67% for the year, as measured by MSCI South Africa IMI).

Performance

The William Blair International Leaders ADR SMA Strategy (net of fees) underperformed its benchmark, the MSCI ACWI ex US IMI index during the fourth quarter.

In 4Q 2024, the International Leaders ADR SMA strategy performed broadly in line with the MSCI ACWI ex USA IMI index. From a sector perspective, allocation effect was positive driven by an overweight to information technology and underweight to consumer staples. This was partially offset by negative impact from an overweight to healthcare and underweight to financials. Selection effect was negative primarily within industrials and healthcare. This was partially offset by strong selection in information technology. On a regional view, allocation effect was negative driven by an overweight to Europe and underweight to Canada. Selection effect was positive primarily within Emerging Asia.

Within industrials, the primary drivers of negative selection were positions in Atlas Copco and Experian. Atlas Copco manufactures industrial equipment for industrial use such as air compressors, industrial vacuums, pumps, generators, and power tools. Recent results have been unfavorable given softness in construction and sluggish industrial activity. We believe our long-term thesis here is intact given exposure to the structural trends of decarbonization and AI, as the company is exposed to the semiconductor value chain.

Experian is a high-quality and diversified global credit information services company that provides critical data and analytics to a broad range of customers. We believe its dominant market position and unique data assets provide attractive long-term growth opportunities. Experian delivered a set of results that were broadly in line with market expectations on growth and profitability, and full year 2025 guidance for margins was improved to the high end of the previous guidance range. Despite this, the stock traded down in the fourth quarter, and the position was increased on the price weakness.

Selection within healthcare was negatively impacted by positions in Icon and Novo Nordisk. Icon provides contract clinical research services to the pharmaceutical industry. The recent pullback in the stock is due to slowing activity from pharmaceutical companies, which negatively impacts Icon's revenues. We believe there are further downside risks to earnings as biopharma companies slow down decision-making into 2025. Current market expectations are for R&D spend to increase next year back to normal levels, and we believe the risks are to the downside and this may weigh on Icon for several quarters; we therefore exited the position during the period.

Several data points lead us to believe competition is close to catching Novo Nordisk in the GLP-1 space. Specifically, its second-generation GLP-1, CagriSema, showed slightly less weight loss than the market was anticipating (23% vs. 25%). A Phase II trial for an oral version of the drug showed side effects that may hamper the drug's development. Novo is still an early winner and incumbent in the space, but its dominance may be fading, and this comes at a time where the stock was priced for better outcomes from these trials. The position was trimmed during the quarter.

Information technology security selection was positive due in part to Taiwan Semiconductor Manufacturing Company and Advantest. As the world's semiconductor foundry, TSMC is one of the most important companies in the world and is benefiting from the current cyclical and structural upcycle in semiconductors. Throughout the year, earnings consistently came in above expectations and AI demand continues to accelerate. After a midcycle correction in the third quarter, the semiconductor industry rebounded in the fourth quarter and the dominant players, including TSMC, outperformed.

Tokyo-based Advantest produces automated test equipment for semiconductors, a niche duopoly where Advantest has a 55% market share. We view Advantest as an AI enabler with an effective monopoly in GPU and high bandwidth memory semiconductor testing. Its products are highly specialized and deeply embedded in the semiconductor manufacturing process. In November, the company shared its fiscal second quarter 2025 results that included a significant beat and raise to forward guidance on earnings. This reflects high demand for GPUs and high bandwidth memory and the rising test intensity that comes with leading edge chips. Even with the recent stock performance, we still see upside given current expectations.

Positioning

During the quarter healthcare was reduced through the sale of Icon and trim of Novo Nordisk mentioned above.

Information technology was also reduced and includes a sale of Infineon. Infineon specializes in automotive semiconductors and the recent pullback is related to decelerating auto demand, albeit from unprecedentedly high levels. This led management to cut its forward sales guidance by 9% and has led to weakness in the stock. Earnings estimates for full year 2024 and 2025 continue to move lower, and we exited the position on growth concerns.

Financials was increased and includes a new purchase of Brookfield Asset Management (BAM). BAM is a diversified alternative manager with $514 billion in assets across credit, real estate, infrastructure, renewable power, and private equity. BAM spun out of parent Brookfield Corporation in 2022 to separate the asset-light business and unlock value. We believe BAM is well positioned to benefit from the attractive long-term structural growth across the alternatives industry given its strong brand, investment performance, global platform, solid distribution, and ability to conduct large transactions. Sector headwinds appear to be dissipating with early signs of accelerating capital markets activity driven by lower interest rates and the return of lending activity. Lower rates should also lead to improving sentiment on real estate, a key segment for BAM.

Consumer discretionary was also increased, including a new purchase of Yum China. Yum China is the largest operator of restaurant chains in China, with approximately 15,500 locations across more than 2,100 cities. The company operates two flagship brands: KFC and Pizza Hut. We expect Yum to benefit from a potentially improving Chinese macro and consumer backdrop brought on by recent stimulus measures and restoration of consumer confidence. We view this as a high-quality business at an attractive valuation that gives exposure to a recovering China.

Outlook

Global equities ended positive in 2024 as performance of U.S. equities maintained dominance. However, numerous presidential elections across the globe and ongoing monetary policy decisions from central banks sparked significant market volatility throughout the year.

The reelection of President Trump sent U.S. equities even higher, for a strong finish to 2024. While the U.S. is ending the year from a position of strength, risks, particularly pertaining to policy and tariffs, have created more uncertainty for the global landscape as we enter 2025.

Within the U.S., the outlook for growth and inflation is now less clear as we believe uncertainty around policy changes to trade, tariffs, and immigration will create a wider distribution of outcomes.

As a result of the proposed policies by the new administration, the U.S. economy could see higher inflation, lower growth (though perhaps short-term upside), and therefore, lower corporate profits–but maybe not in 2025. More on the U.S. later.

The outlook for Europe also comes with considerable variability in outcomes. On the negative side, Europe runs the second-largest bilateral trade deficit (behind China) with the United States. Given that the incoming U.S. administration purports to abhor trade deficits, European exporters are firmly in the line of fire for tariff increases, likely to have a chilling effect on demand for their products.

At the same time, any tariffs will likely be preceded with inventory buildup, to the extent that importers are anticipating a disruption. In the opening quarters of 2025, U.S. demand for European goods may look stronger than purely economic fundamentals warrant.

On a more positive front, if the incoming U.S. administration succeeds in establishing a permanent ceasefire between Russia and Ukraine, European companies are likely to benefit from reconstruction efforts in Ukraine. Qatar is scheduled to bring online significant liquified natural gas (LNG) export volumes, which may help bring down energy prices closer to levels last seen prior to the 2022 Russia-Ukraine war.

Japan continues to progress with corporate governance reforms, with the recent report of a potential Honda/Nissan tie-up as further evidence that the quiet shake-up within Japan Inc. is underway. The market overall has a reasonable valuation, but we find that Japanese companies that already demonstrate global leadership are priced more in-line with their peers.

Within emerging markets, higher than previously expected U.S. interest rates and a stronger dollar may challenge EM currencies and investor sentiment in 2025.

India maintains one of the best economic backdrops of major markets in our view, with plenty of economic drivers as well as stock market support. Of particular interest to us are the domestic infrastructure build-out and related capital investment; continued strong consumption growth and shifts within that; and an under-valued financial sector. After years of stellar performance, Indian corporate valuations remain elevated, but we believe they are likely sustainable given continued EM investor flows out of China, and under-penetrated domestic equity participation.

China remains the biggest enigma, as stimulus and relatively low valuations could offer near-term opportunities, yet the long-term growth prospects remain tempered by structural economic challenges and policy uncertainties. President Xi Jinping appears committed to maintaining economic stability, and we anticipate the series of incremental positive measures will support China's 5% GDP target for 2024 and the growth trajectory for 2025. With valuations still relatively low and company fundamentals improving in certain areas, stimulus efforts could fuel short-term boosts to the equity market as Beijing focuses on stabilizing key economic sectors. But the sustainability of such rallies remains uncertain given the persistent structural challenges China faces. The country's long-term outlook is still clouded by high debt levels, demographic pressures, and slowing growth. We remain underweight to neutral across most of our Emerging Market and International/Global strategies.

US Exceptionalism: Entrenched or at a Peak?

Given the strong relative performance of the U.S. equity markets over the last several years (now nearly two-thirds of the MSCI ACWI index, from 50% a decade ago, and 56% as recently as 2020), combined with (or is it supported by?) the positive U.S. economic growth differential, a great deal of digital ink has been spent recently on the notion of U.S. exceptionalism. While long a construct (Tocqueville circa 1835) broadly applied to the unique nature of our government and societal structures, more recently it has been invoked as an explanation for the United States' superior innovation, economic growth, and investment returns. This has seemingly only been accentuated since the pandemic.

The questions for allocators and investors alike are, why did this develop and how likely is this to persist? What could slow or even reverse this trend? To what degree is it structural and persistent or merely cyclical in nature? Are we likely at or near peak US exceptionalism? We will attempt to answer these questions during the course of the year but wanted to provide an outline to our current thinking.

In a high-level summary, the concept of exceptionalism as it is currently popularly interpreted centers on the unique combination of 1) economic dynamism, 2) technological innovation, and 3) strong institutions giving the United States a distinct advantage over other major economies and markets.

Many of these characteristics have been in place for several decades, so what is behind the pronounced reaction in the markets now? We believe that since the pandemic, the economic stimulus response and large domestic consumption market have given the U.S. an economic edge. At the same time, developments in advanced computing and the further rise of tech platform companies have shown off the US's innovation advantage, manifesting in superior corporate performance. All of this at a time where the market is trying to assess the new "normal" global growth rate in a post-pandemic world, and many markets particularly Europe and China are going through their own unique growth challenges. In a phrase, the US has been the clearest safe port in a storm.

It is unclear that the economic differential will persist and there are several reasons the U.S., in particular, could suffer from an "own goal," with some current or proposed economic, political, or trade policies at risk of backfiring. The current gaps between the U.S. and the rest of the world in terms of economic growth and corporate profit margins (and related, stock valuations) are all at or near the last several years' highs. It therefore may be fair to assume that the growth differential is at or near a cyclical peak.

Of greater interest are the potential challenges to the more structural underpinnings. Perhaps the driver attracting the most attention is the U.S. technological advantage and the belief it is entrenched and even widening. This could indeed be the case, but the progress is not always clear to determine and certainly not linear. This is also expressed in a relatively narrow group of U.S. tech corporations that are deemed to be the current and future winners. China's threat to tech superiority is very real and not to be dismissed lightly. Assuming the U.S. indeed enjoys a durable advantage, at some point too there needs to be an assessment of the valuation premium the market is willing to put on that advantage. While this is primarily related to technology and tech-enabled companies, to a degree it has created a bit of a halo effect for the broader U.S. market.

Multiples are a function of interest rates, growth expectations, and animal spirits. Those have all been more or less favorable for the last few years but could shift to headwinds in 2025. To summarize, the key near-term risk comes from a combination of policy uncertainty and market concentration, making the shares of the highly valued companies vulnerable. For now, we believe there are too many positive structural attributes in place to deny the U.S. advantage and suggest that the balance of power shifts back to long-term averages. But many of these could be subject to change after decades of development, and we will address some of them later in the year. At the same time the cyclical winds could easily shift and even modestly slower growth than expected could extract a toll on valuations. We will be monitoring these issues and will report back in more detail throughout the year, as these are critical considerations for asset allocators and global investors alike.

International Leaders ADR SMA Strategy

				Annualized			
							Since Inception
Composite Performance (%)	Qtr	YTD	1 Yr	3 Yr	5 Yr	10 Yr	(Jan 1 03)
International Leaders ADR SMA (Gross of fees)	**-7.43**	**0.42**	**0.42**	**-3.70**	**4.08**	**5.66**	**7.41**
International Leaders ADR SMA (Net of fees)	**-8.14**	**-2.55**	**-2.55**	**-6.56**	**1.00**	**2.54**	**4.26**
MSCI AC World ex-US IMI Index	-7.61	5.23	5.23	0.50	4.12	4.91	7.32
MSCI EAFE Index	-8.11	3.82	3.82	1.65	4.73	5.20	6.82

https://williamblair.com/~/media/Downloads/IM/Composite_Disclosures.pdf

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Index

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