William Blair

Summary & Outlook
International Leaders ADR SMA Strategy

Market Overview

Global equities declined in the first quarter (the MSCI ACWI IMI returned -1.61% for the quarter) as U.S. equities reversed course, posting their worst quarterly performance since 2022. Tariff uncertainty and implications of global growth fueled a swift reversal into value-oriented equities outperforming growth (the MSCI ACWI IMI Growth returned -6.74% for the quarter, while the MSCI ACWI IMI Value returned +4.02% for the quarter). From a global sector perspective, information technology sharply declined following the emergence of the Chinese artificial intelligence startup, DeepSeek (-11.69% for the quarter as measured by MSCI ACWI IMI) while energy and utilities led (+7.58% and +6.29%, respectively)

U.S. equities declined during the period (-4.89% for the quarter as measured by the MSCI USA IMI) with significant volatility stemming from uncertainty around the impact of tariffs on the U.S. economy and the path of inflationary trends. Concerns surrounding the profitability and competition within the AI market also weighed on returns, as the top performing mega-cap technology names underperformed, following strong performance in 2023 and 2024. As widely expected, the Federal Reserve left rates unchanged during the quarter however comments suggested that the Fed will also be watching for deterioration of growth in addition to the risks of inflation. Economic data within the U.S. was mixed, as February consumer confidence slipped to 98.3 for the month, however inflation eased more than expected, providing some relief to consumers. The primary focus of markets will be on April 2nd, when President Trump is expected to impose sweeping reciprocal tariffs on global trading partners, calling it America's Liberation Day.

European equities advanced during the first quarter (+9.99% for the quarter as measured by the MSCI Europe IMI) despite a looming trade war with the U.S., posing a threat to the eurozone economy. Sentiment however was boosted largely on a wave of optimism around fiscal and defense spending, particularly in Germany. The European Commission President announced a proposal of a €150 billion defense package, funded through a joint European budget. The European Central Bank announced another rate cut in March, bringing its key rate down to 2.5%. Inflationary trends continued to move in the right direction in the first quarter, with February and March data continuing to decline.

Emerging markets posted positive returns (+1.70% for the quarter as measured by the MSCI EM IMI), led by strong gains in Chinese equities (14.60% as measured by MSCI China IMI). Strength in China was boosted by U.S. tariffs thus far being better-than-feared, coupled with improving sentiment on information technology related names, following the emergence of DeepSeek, along with indications of a more supportive policy stance on the platform economy. Following strong performance in 2024, Indian equities were notably weak in the first quarter (-5.18% for the quarter, as measured by MSCI India IMI) amid a softer macro backdrop and earnings deceleration combined with extended valuations and foreign investor outflows weighing on performance. This was particularly evident within the higher momentum, smaller cap companies within India. Latin America returns advanced (+12.81% for the quarter as measured by the MSCI EM Latin America IMI) with broad strength from Colombia, China, and Brazil. EMEA was also positive (+6.81% for the quarter as measured by the MSCI EM EMEA IMI), with strength from Poland (+30.68% for the quarter, as measured by MSCI Poland 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 first quarter.

In first quarter of 2025, the International Leaders ADR SMA strategy underperformed the MSCI ACWI ex USA IMI index. From a sector perspective, allocation effect was negative driven by an overweight to information technology and an underweight to financials. Selection effect was negative primarily within consumer discretionary, financials, and information technology. This was partially offset by strong selection within industrials. On a regional view, allocation effect was positive due to an overweight in Europe and underweight in emerging Asia. Selection effect was negative primarily within Europe and Japan.

Consumer discretionary selection was negative primarily within China due to Trip.com and not owning Alibaba. Given the structural and cyclical challenges facing the Chinese economy, the strategy has been underweight China for some time. Recently, market sentiment has improved, and the cyclical economic trough appears close, if not already behind China. Alibaba significantly benefited from this shift in sentiment and was unowned in the strategy as we believe its competitive position in e-commerce is dwindling. Trip.com was an owned name that, after performing very well in 2024, gave back some of the strong performance after management announced a significant increase in investment for international expansion, eating into near-term margins.

Selection within financials was negative due in part to an underweight to banks, which continued to perform well given the higher-for-longer rate environment and high spread on loans-to-deposits creating a strong environment for net interest margins. Additionally, a position in Brookfield Asset Management was negative for performance within capital markets. Brookfield is an alternatives asset manager that we believe 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. After strong performance in 2024, Brookfield declined in the first quarter along with global alternatives managers given some of the uncertainty in global markets and global policy.

Early in the quarter, Chinese company DeepSeek announced that it created a large language AI model that rivaled the best models currently in the market but with significantly less cost and computing power. This brings into question the amount of capital expenditures required to achieve impact from AI and led to a significant sell-off for semiconductors. Given the strategy's overweight to this industry, this was a headwind to performance with stocks such as Taiwan Semiconductor, ASM International, and Advantest all experiencing negative performance. Given the wider range of outcomes for AI capital expenditures, the portfolio's semiconductor exposure was reduced during the quarter.

Industrials stock selection was strong and primarily driven by BAE Systems and Thales, two European defense companies. The current U.S. administration has been clear that it will not support Europe, and NATO specifically, to the same extent that the U.S. has in the past. We believe this is a watershed moment for Europe and plans to increase defense spending at the aggregate EU level and individual country level have already been announced, with more possibly to come. BAE and Thales are well positioned to take advantage of this increase in defense spending as two of the major players in European defense. BAE Systems is the largest pure-play European defense contractor with exposure to some of the largest defense markets in the world. It boasts a large and diversified portfolio that includes some of the most successful and in-demand defense programs globally. Thales is among the world's leading providers of critical secure communications systems, with main applications in the defense, aerospace, telecommunication, and banking industries. Also benefitting from this theme was Safran. Safran manufactures aircraft, engines, and defense and communication equipment including navigation and GPS guidance systems and high-performance optics. The company also delivered a strong set of results, powered by the engine aftermarket (repair and replace), with full year 2025 guidance raised.

Positioning

During the quarter, exposure to financials was increased, primarily in banks. We expect that the conditions that have led to banks performing well are likely to persist in the short term, including higher-for-longer rates and high net interest margins. The increase was made through the purchase of several developed market banks that we think will benefit from this environment, including Royal Bank of Canada and UniCredit.

Materials exposure was reduced, which included sales of Linde and Sika. Linde primarily provides consumable gases across a wide array of industrial and commercial end markets that are integral to various production processes. While recent execution has been solid, forward-looking expectations for volume growth are challenged. Given the full valuation and recent strong share price, we are exiting for better opportunities. Sika is a construction materials company that has underperformed given weak end-markets, and we exited the position due to the resulting deterioration in earnings and growth outlook.

Within Europe, exposure to luxury was reduced through the sale of LVMH and trim of Industria de Diseno Textil, as luxury may be directly impacted by tariffs and potentially indirectly impacted through a weaker U.S. consumer. Exposure to construction was increased given the announced increase in infrastructure spending. This includes a purchase of Heidelberg Materials, a cement, aggregates, and ready-mix/asphalt supplier to the construction industry across infrastructure, commercial, and residential applications. We expect Heidelberg to benefit from increased infrastructure spending as Europe's largest cement producer and aggregates supplier.

Outlook

Policy uncertainty plagued global markets in the first quarter. Implications for global growth coupled with the emergence of DeepSeek, spurred a swift unwind of momentum and growth equities into value. This was evident with the outperformance of many pockets of the market that have been out of favor for some time, while the winners of last year tumbled, namely the U.S.

Shifting Balance of Power

The implications are potentially much greater, with the market now questioning both the status of U.S. Exceptionalism and the potential for a reshaping of globalization.

In summary, the construct of U.S. Exceptionalism is underpinned by long-term structural advantages including economic dynamism, superior technological innovation and sound, independent government institutions. Earlier this year, we argued that the proposed tariffs and trade policies could backfire resulting in an "own goal" undermining the U.S. growth advantage, reversing at least the more recent cyclical element of U.S. Exceptionalism. We didn't expect things to unfold so quickly or dramatically.

As discussed, the post-pandemic growth differential to the rest of the world has been the primary driver of the cyclical advantage enjoyed by the U.S. The proposed tariffs, if maintained at these higher levels, begin to challenge the growth differential, pressure U.S. inflation, lower visibility of growth, and reduce corporate confidence, leading to less economic activity.

Further, the confusing rational and chaotic implementation of proposals set forth by the Trump Administration have called into question the outlook for the long-term direction of globalization, and thus also the nearer term outlook for economic growth. These potential risks are causing the repricing of stocks, bonds, and currencies.

Based on these assumptions, we now expect GDP growth in the U.S. to be roughly 2% lower over a two-year horizon. However, we believe it is too early to fully price-in a recession as the administration will likely offset some of the tariff impact via tax cuts and financial deregulation. These potential rollbacks of capital and regulatory requirements for regional banks could spur credit growth, provide a boost to corporate earnings, and support consumer spending. These policies have yet to be articulated fully.

Abroad, threats from the U.S. government have catalyzed some positive action within Europe, with signs the economic malaise may be lifting. This is evidenced by Germany relaxing its fiscal conservatism, which includes amendments to long-standing debt policies to enable higher defense spending, as well as facilitating the creation of a €500bn infrastructure fund.

Undeniably, if kept at current proposed levels, U.S. tariffs will pose a challenge for Europe, especially for exporters.

The upside is that this threat presents an opportunity for Europe to pivot toward domestic-driven growth. Proposed fiscal stimulus and credit cycle expansion, coupled with the revitalization of Europe's military-industrial complex, could serve as a key driver of technological innovation. Together, these are critical steps toward establishing deeper liquidity and maturity in euro-denominated financial markets, which could result in a structural tailwind for sustained European growth. Overall, we expect the growth differential between Europe and the United States to narrow considerably over the next 12-18 months, with European economic momentum accelerating just as U.S. growth stabilizes or potentially slows.

China is likely to bear the brunt of any material change to trade policy. While the tariffs will be non-negligible, China is also increasingly proving its ability to produce more domestically, moving up the value chain in response to isolationism. Additionally, its reliance on U.S. trade has significantly decreased, as their exports to the U.S. have more than halved in the last six years.

The "DeepSeek Moment" for China was akin to Open AI's "Chat GPT moment" of 2022 – immediately bringing attention to a step change in compute capabilities. At the very least it served as further evidence that China was closing the technological innovation gap to the U.S. As we've discussed previously, China's threat to U.S. tech dominance is not to be dismissed, as they have been gaining ground for well over a decade. Taken further, this challenges the U.S.'s technological strength that is a foundation of their "Exceptionalism."

Both cyclical and structural changes to U.S. Exceptionalism are now on the table, being priced at a greater than zero probability of weakening. The third pillar, strong institutions, while not yet directly under fire, could be, as the administration has questioned the legitimacy of numerous agencies and the authorities that have governed them. It is undetermined if these views are well-founded or misguided, but the challenge alone has caused some market stress.

We can only speculate about the ultimate motivations of the U.S. Administration and the future policy changes that may be proposed or even implemented. We do believe that risk to the systems we were all accustomed to for decades may be under more disruption than any time in recent memory. Global trade, corporate leadership, economic outcomes, and market reactions are all likely to be more different than we expected, even immediately following the November election. The related constructs of U.S. Exceptionalism and Globalization are being challenged.

Overall, the "Liberation Day" tariff policy introduces stagflation risk in the U.S., accelerates global trade rebalancing, and reduces leverage of the U.S. Dollar. We believe the second quarter will be shaped by unfolding negotiations, enforcement capacity, and fiscal/monetary responses. It is unlikely to expect the market to stabilize, or risk assets (e.g., growth equities) to outperform until we see progress on any or all of these matters.

Given these changes, and a higher level of uncertainty, where do we expect to find growth and market leadership? Two (related) themes that resonate are the development of infrastructure and the shift to increased domestic manufacturing. Infrastructure development is a global phenomenon, with key areas being Europe and Japan (not to mention the U.S.) who have under-invested for decades, in both digital and physical infrastructure. Examples include compute/digital, energy, defense, and transportation. This is a geo-strategic imperative as much as it is a growth imperative. As we've already started to see in China, manufacturing will likely begin pivoting closer to each respective demand center. We expect this will be true for Europe in particular. Importantly for allocators and global investors, we believe there is a strong case to be made for international or non-U.S. equities over U.S. shares. We expect economic growth and corporate profit gaps to narrow, with a backdrop of supportive valuations.

International Leaders ADR SMA Strategy

First Quarter 2025

				Annualized			
Composite Performance (%)	Qtr	YTD	1 Yr	3 Yr	5 Yr	10 Yr	Since Inception (Jan 1 03)
International Leaders ADR SMA (Gross of fees)	**1.58**	**1.58**	**-4.10**	**1.47**	**9.02**	**5.17**	**7.40**
International Leaders ADR SMA (Net of fees)	**0.82**	**0.82**	**-6.95**	**-1.53**	**5.81**	**2.07**	**4.25**
MSCI AC World ex-US IMI Index	4.59	4.59	5.50	3.99	11.02	5.02	7.45
MSCI EAFE Index	6.86	6.86	4.88	6.05	11.77	5.40	7.06

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Index

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