Perspectives
Global Equities

Rosenberg Equities Client Portfolio Management Team

- **Economy and markets**: modest economic growth driven by US, equities up in Q2
- **Factors**: Quality rewarded while the May sell-off helped Low Volatility
- **Valuation**: level of mispricing is high and rising across markets
- **Earnings**: better-than-expected growth in sales and earnings reported

Economy and markets

The global economy continued to deliver modest growth in the second quarter on the back of a resilient US. Macroeconomic data disappointed elsewhere though, with the Eurozone, UK and China all showing signs of weakness.

Despite a broad-based sell-off in May over trade war concerns, global equity markets rose 4% in US dollar terms over the whole period (as measured by the MSCI World index), rounding off their best first-half gain in over two decades. Markets were supported by the increasingly accommodative tone from central banks and hopes for an easing of trade tensions between Washington and Beijing ahead of the G20 summit in Osaka.

Most major indices recorded positive growth, with developed markets generally outperforming their emerging market counterparts; US stocks reached all-time highs at the beginning of the period and finished strongly, Eurozone stocks also recovered after a mid-quarter drop, and Pacific ex-Japan stocks posted the best returns.

Investors favoured more cyclical sectors over the quarter. Financials led the market higher driven by strong gains for the insurance industry, while technology also performed well with software stocks fuelling much of the growth. Energy was the laggard on the back of weakened global demand. See Appendix for more details.

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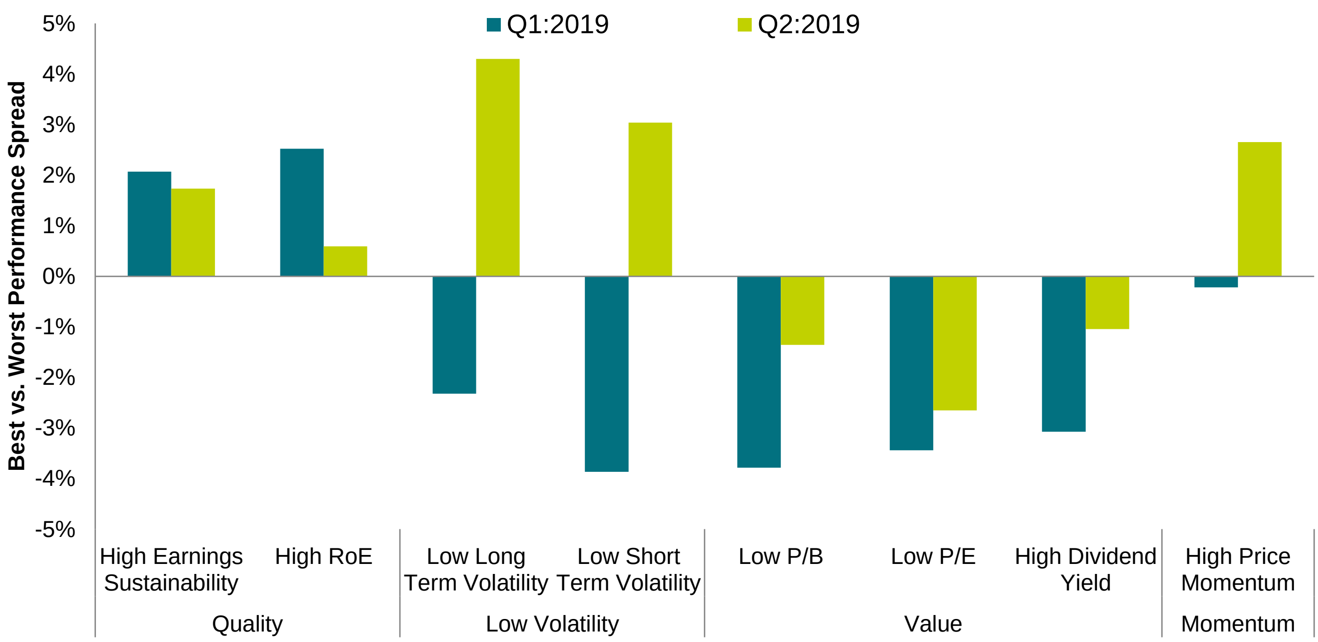
Factors

Our Factor Monitor, below, plots the performance of key style-based factors in Q1 and Q2 2019.

Exhibit 1: Rosenberg Equities Factor Monitor

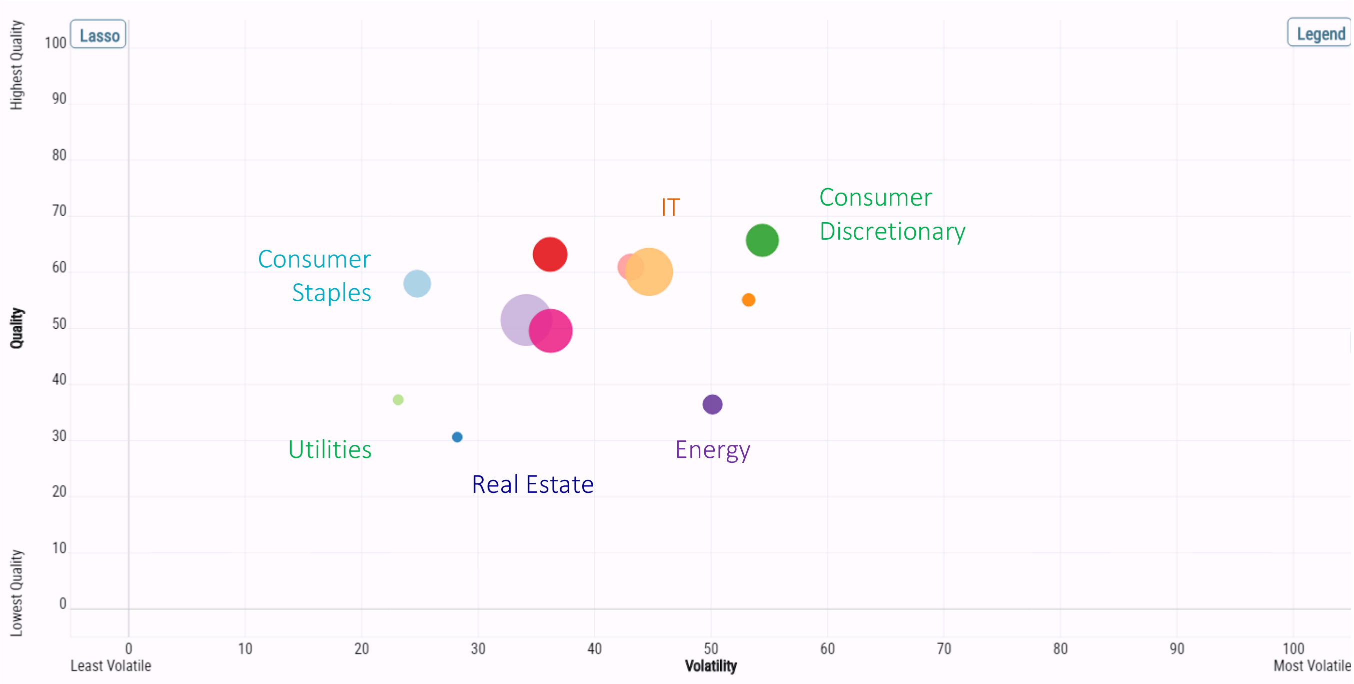


Source: Rosenberg Equities, MSCI. Data as of 30 June 2019. Investment universe is MSCI World Index; performance spread calculated using gross of fees returns, in USD. See Important Information section for more details*. Performance spread buckets are not actual Rosenberg Equities portfolios.

Global factor trends Q2 2019

- **Quality:** Quality was rewarded over the quarter as sectors with high Quality exposure led the market. Exhibit 2 below plots a recent view of each sectors' Quality (and Volatility) exposure using our own measures of factor exposure. The IT and consumer discretionary sectors were among the highest in terms of Quality exposure, and outperformed in the second quarter (see appendix). Meanwhile, exhibit 2 also shows that real estate and energy have lower Quality exposure, and these sectors lagged the broad market in Q2.
- **Low Volatility**: Low Volatility outperformed the broad market over the quarter, driven by strong performance in May. As the trade war between the US and China escalated, volatility in equity markets increased and investors turned toward more defensive areas. As shown in exhibit 2, we view the utilities and consumer staples sectors as having the highest exposure to Low Volatility, and these sectors were among the top performers in May when the market was more turbulent.
- **Momentum:** Momentum has become increasingly correlated with Low Volatility and, as such, Momentum outperformed in Q2, driven by gains in May.
- **Value:** Value continued to exhibit the weakest performance on our Factor Monitor in Q2. The increasingly accommodative tone from central banks weighted on performance and Value-exposed sectors such as Energy and Materials delivered weak performance.

Exhibit 2: Sector exposure to Low Volatility and Quality



Source: Rosenberg Equities, MSCI. Data as of 30 November 2019. Investment universe is MSCI World Index. Sector definitions based on GICS. Chart shows sector exposure to Low Volatility and Quality using Rosenberg Equities' proprietary measures of factor exposure. See Important Information section for more details*.

Valuation

In recent quarters, we have examined what Rosenberg Equities' proprietary valuation model can tell us about the degree of mispricing in the current market environment. By concentrating on the S&P 500 Index, we have been able to place our analysis in a long-term context, making use of the fair value estimates we've calculated for the stocks in this index since the early 1970s.

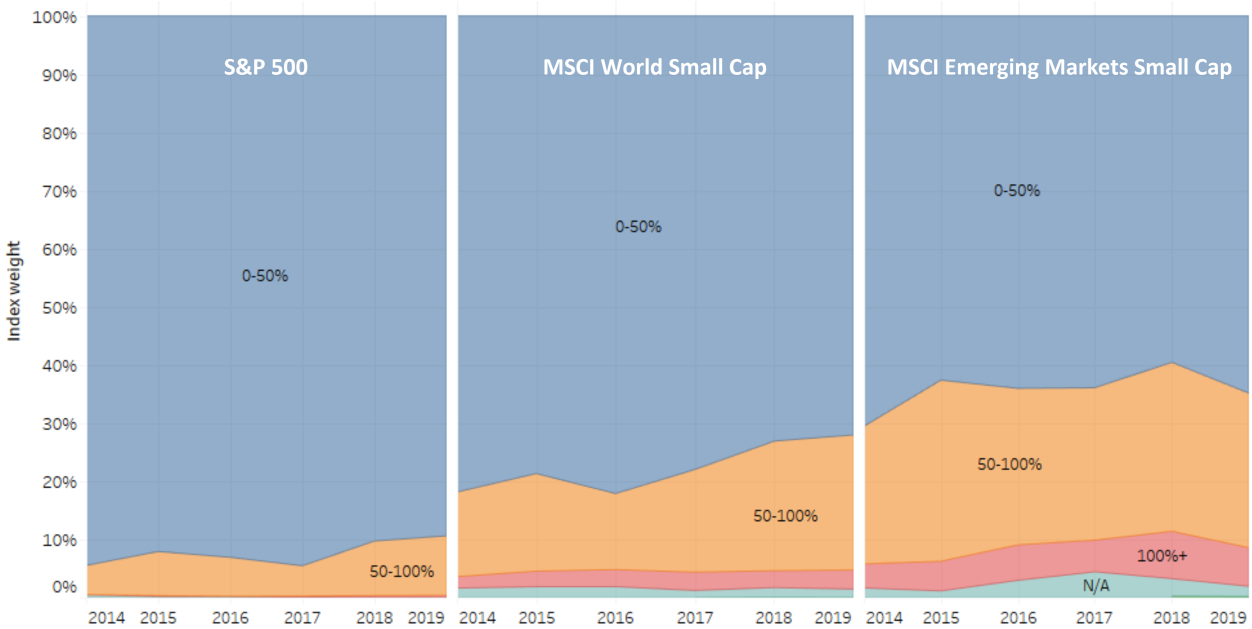
We've found that today's level of mispricing in US large cap equities is greater than at any time since the late nineties tech bubble, with fully 10% of the S&P 500 trading at least 50% above or below our assessment of intrinsic value.

This quarter, we focus on a much shorter time period, but cast a considerably broader net. In addition to the S&P 500 Index, exhibit 3 tracks how mispricing in the MSCI World Small Cap and MSCI Emerging Markets Small Cap indices has evolved over the past five years.

In all three markets, we see evidence of high, and rising, mispricing. That this is particularly true of the two small cap indices is in line with both our intuition and longer-term experience that less efficient markets – with more constituents but fewer analysts covering each stock – can be particularly attractive for active investors.

Of course, for investors to benefit from a mispricing it must, at some point, correct. Waiting for this process to occur can be challenging, but history suggests that the best investment opportunities have often appeared at times when the gulf between price and fair value is greatest.

Exhibit 3: Degree of mispricing, December 2014 to June 2019.



Source: Rosenberg Equities, Standard & Poor's, MSCI. Data as of 30 June 2019. Mispricing is based on Rosenberg Equities' valuation model. No representation is made that the degree of mispricing estimated by Rosenberg Equities will be recognised by the market.

Earnings

The possible slowdown in global earnings growth was a risk we highlighted in our Q1 commentary, as weak guidance raised concerns of an earnings recession. But in Q2, market volatility and trade war uncertainty were shrugged off as equities rallied supported by better-than-expected earnings. Exhibit 4 below shows that, over the course of the earnings season, actual growth numbers came out positive as the MSCI World companies outperformed their year-over-year sales and earnings growth estimates; sales growth was up over 4% and earnings growth up 1% - modest but still positive. Our strategies remain focused on predicting forward earnings more accurately and buying earnings cheaply.

Exhibit 4: Sales and earnings growth reported in Q2, MSCI World constituents

		Sales Growth			Earnings Growth		
Sector (GICS)	# Reported	# Positive	# Negative	Growth %	# Positive	# Negative	Growth %
All Securities	**1379**	**905**	**449**	**4.40%**	**707**	**481**	**1.05%**
- Energy	75	44	31	-1.55%	27	33	-12.69%
- Materials	107	54	45	-0.73%	36	52	-25.22%
- Industrials	238	172	63	8.01%	137	62	5.12%
- Consumer Discretionary	183	123	57	2.38%	73	77	-4.52%
- Consumer Staples	97	58	36	1.36%	40	31	2.91%
- Health Care	116	90	26	11.67%	70	34	9.21%
- Financials	206	131	69	6.55%	117	81	3.20%
- Information Technology	147	94	52	4.40%	88	49	-2.29%
- Communication Services	83	56	27	6.08%	43	25	8.37%
- Utilities	63	40	23	1.47%	36	18	11.21%
- Real Estate	64	43	20	3.50%	40	19	7.35%

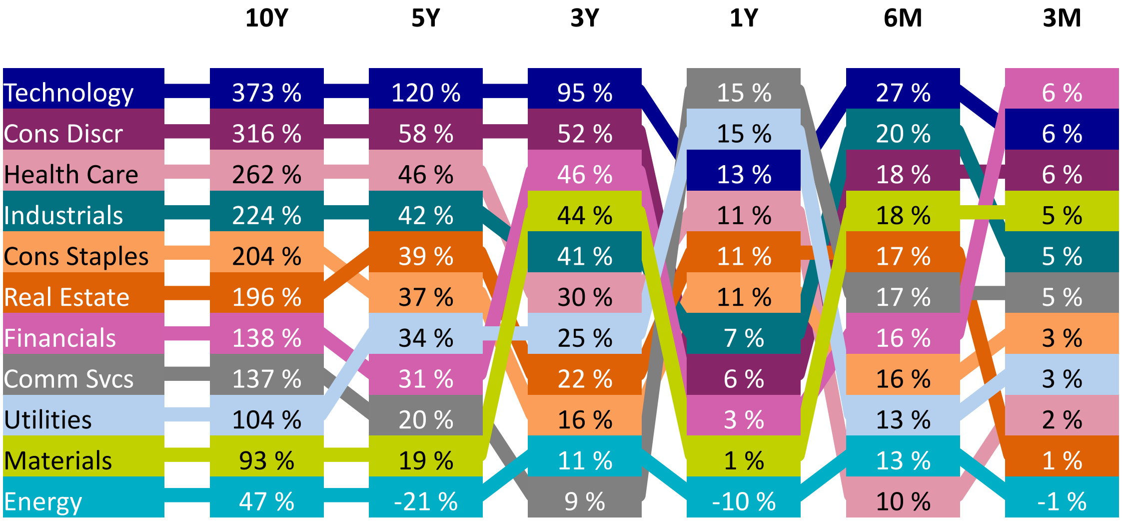
Source: Bloomberg, Rosenberg Equities. Data as of 30 June 2019. Table shows number of companies per sector reporting positive or negative year-over-year growth in each category vs. estimates.

Summary and outlook

- The global economy continued to deliver modest growth in Q2 on the back of a resilient US. Macroeconomic data disappointed elsewhere though, with the Eurozone, UK and China all showing signs of weakness. Looking ahead, the key threat to growth for both the US and the rest of the world would be an escalation of trade tensions.
- Trade-related macro uncertainty has led to a wave of dovish commentary from major central banks. We now expect the US Federal Reserve to deliver two rate cuts this year and the European Central Bank to cut its deposit rate in September on the back of persistent weakness in the Eurozone. In the absence of a major negative trade shock, our view is that policy stimulus should support economic growth into 2020.
- Low Volatility and Momentum outperformed in Q2, driven by performance in May when a sell-off sparked by trade tensions hit global equity markets. Meanwhile, sectors with high Quality exposure led the market, and with a demanding backdrop for earnings, Quality should continue to perform well if investors seek out those companies with a proven track record of sustaining profitability and delivering stable earnings growth.
- Value continued to underperform, although we believe it is currently oversold and cheap by historical standards. Valuation dispersion is elevated, meaning there is increased opportunity to identify undervalued stocks. We've also found that today's level of mispricing in US large caps is greater than at any time since the late nineties tech bubble, while we also see evidence of high, and rising, mispricing in both global and emerging markets small caps – areas of the market with less analyst coverage and therefore fertile ground for active stock pickers.
- Better-than-expected earnings were reported in Q2, with modestly positive year-over-year earnings growth of 1%. Looking ahead, we expect equities to continue to deliver low single-digit earnings growth on the back of soft top line growth. However recent margin pressures, driven by rising labour costs, may ease if macro conditions continue to weaken and rate cuts follow.

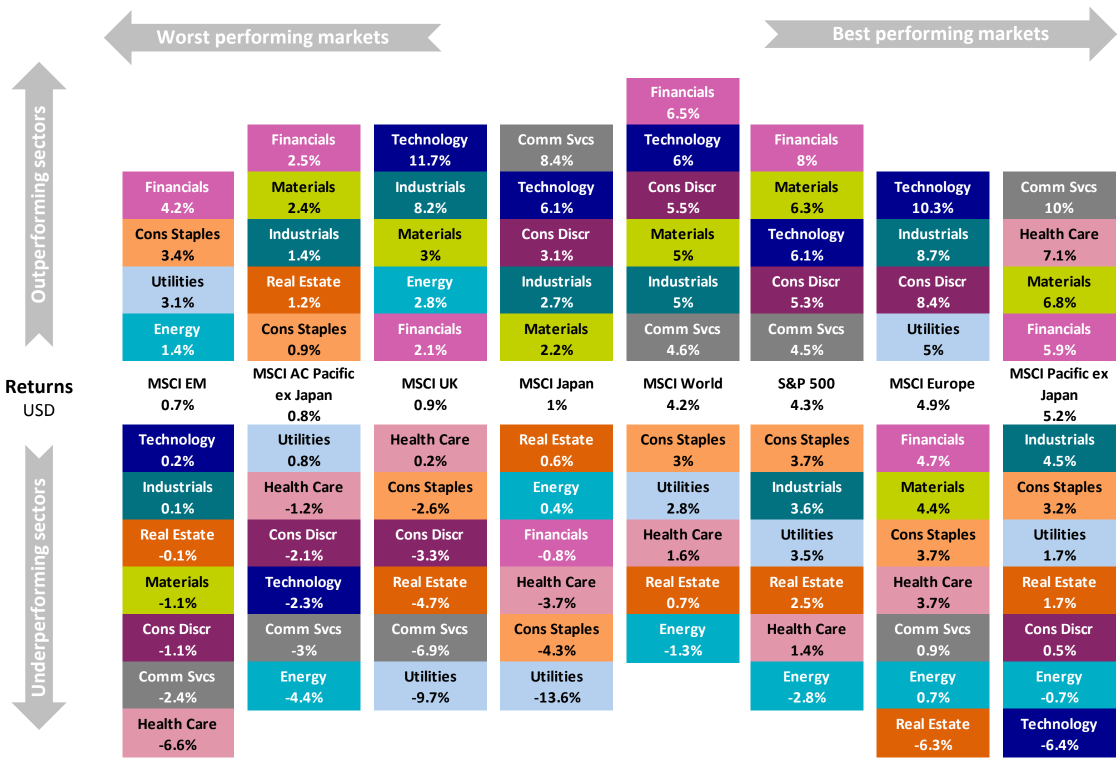
Appendix

Global sector returns (MSCI World Index), all periods as at 30 June 2019



Source: Rosenberg Equities, MSCI. Exhibit shows cumulative return of each global sector in USD over period shown to 30 June 2019. Sector returns are based on GICS classifications, calculated with gross dividends re-invested in USD terms.

Regional sector returns, Q2 2019



Source: Rosenberg Equities, Thomson Reuters DataStream, I/B/E/S, S&P, MSCI as of 30 June 2019. Past performance is not a guide to future performance. It is not possible to invest in an index. Index returns are calculated gross dividend re-invested in local currency terms. Sector returns are based on GICS classifications.

Important Information

*The Factor Monitor calculates the performance of companies that rank highly (top 30%) relative to those that rank poorly (bottom 30%) on each measure. This best-versus-worst performance spread allows us to characterise a given period according to factor dominance and provides insight into the drivers of return in the market. For each factor we measure the performance of the best (top 30%) of the market by square root of market cap on a regionally neutral basis, rebalanced every month during the timeframe shown. Returns of the factor "portfolios" are calculated on a dividends reinvested basis and shown gross of management fees and in USD terms. Past performance is no guarantee of future performance. Please note that the factor "portfolios" are (i) hypothetical in nature and used to illustrate market dynamics in the past, (ii) not actual Rosenberg Equities portfolios, (iii) not available for investment, and (iv) should not be understood as being representative of Rosenberg Equities Sustainable Equities strategies.

Below we provide details of the company-level measures used in the Factor Monitor: (i) Low volatility: We measure both market volatility (beta) and stock specific risk over both the long term (5-year horizon) and short term (1-year horizon); (ii) Quality: We measure both simple Return on Equity (RoE) and Earnings Sustainability. Earnings Sustainability is Rosenberg Equities' proprietary measure of earnings quality that predicts the likelihood that a company will deliver positive recurring earnings and sales growth next year. Companies with stable historical earnings growth that has not been distorted by accounting anomalies (e.g. by inappropriate accruals or extraordinary items) will likely have high earnings sustainability; (iii) Value: We use three key measures within the value spectrum: price-to-book, price-to-recurring earnings and dividend yield. In this way, we hope to capture the varying flavors of value investing, acknowledging that they do not always perform in unison; (iv) Momentum: We measure trailing price momentum of a security relative to its local market over the last year, ignoring the most recent month to reduce the effect of short-term price reversal.

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