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FISH WHERE THE FISH ARE

PART TWO OF TWO

THE ACTIVE MANAGEMENT CASE FOR INTERNATIONAL EQUITY MARKETS

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KEY TAKEAWAYS

THE ACTIVE MANAGEMENT CASE FOR INTERNATIONAL EQUITY MARKETS

- There are four aspects of international markets that put active equity managers into a position to add enduring value: (1) heterogeneity of international markets enlarges the opportunity set, (2) greater international market volatility increases investment opportunities, (3) lower international research coverage could lead to more pricing inefficiencies, and (4) more shareholder alignment in international markets could allow for improved investor outcomes.

- There are four requirements for active managers to exploit the potential in international markets: (1) perform thorough fundamental research, (2) focus on quality businesses, (3) invest across small to mega-capitalization range, and (4) have a long-term investment horizon.

- Active managers with the right investment process can exploit the unique opportunities in international markets to potentially deliver superior returns for investors over time.

INTRODUCTION

FISH WHERE THE FISH ARE

In honor of the late Charlie Munger, Warren Buffett’s right-hand man, a brilliant thinker, witty philosopher, and investment role model for fundamental based investors like ACR, we named this series of whitepapers after one of his famous quotes.

Charlie Munger's pithy advice, "fish where the fish are," resonates powerfully with us as international investors. The U.S. market often basks in the spotlight, but we believe that international equity markets present a stocked pond of attractive investment opportunities. In part one of our series, we discussed the valuation case for investing in international equity markets. We made the claims that the opportunity in international equity markets is the best we have seen in two decades and that the potential for outperformance could be sizeable in magnitude and duration. In part two, we will delve into why active management holds enduring advantages in capitalizing on the international investment opportunities.

“WE BELIEVE THAT INTERNATIONAL EQUITY MARKETS PRESENT A STOCKED POND OF ATTRACTIVE INVESTMENT OPPORTUNITIES”

We believe there are four distinct reasons why active international equity management has an enduring advantage over passive international market exposure. The caveat is that these advantages only accrue to the active manager with the right philosophy, discipline, and investment process.

1. **International Markets - A Larger Addressable Market for Quality Companies**

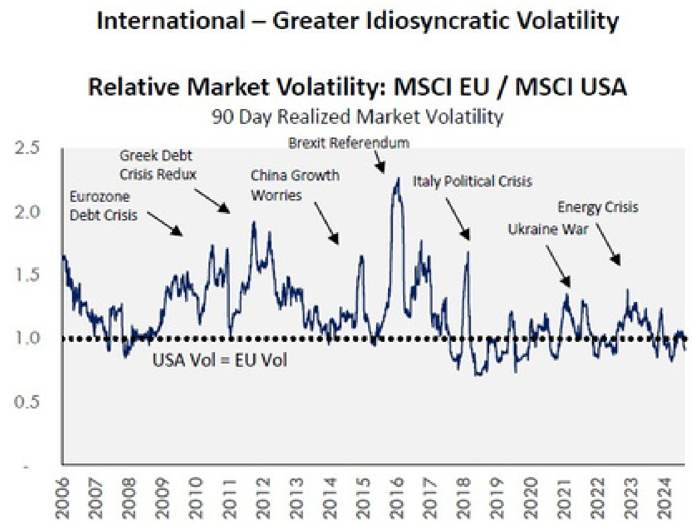
We see a broader opportunity set for high quality companies (i.e., companies with long-term viable products/services, strong market positions, attractive economics) in international markets. While the U.S. boasts a sizeable consumer base, its homogeneity often necessitates businesses to be large in order to compete effectively. This can limit the opportunities for smaller companies, which often face concentration risk in terms of customers, suppliers, or products, making them less adaptable to changing dynamics (i.e., lower quality).

In contrast, the heterogeneity of international markets (e.g., different languages, varying customer preferences, diverse regulations, smaller geographical regions) can allow smaller and mid-sized companies to thrive. These companies can achieve diversification across customers, suppliers, and product lines, leading to stronger competitive positions, improved corporate performance and longer-term viability (i.e., higher quality). Therefore, active managers with the flexibility to invest across all company sizes (small to mega-cap) and with a discipline of investing in quality businesses are best placed to exploit these international market opportunities.

Source: ACR analysis, Capital IQ

2. International Markets - Greater Idiosyncratic Volatility Provides Opportunities to Invest

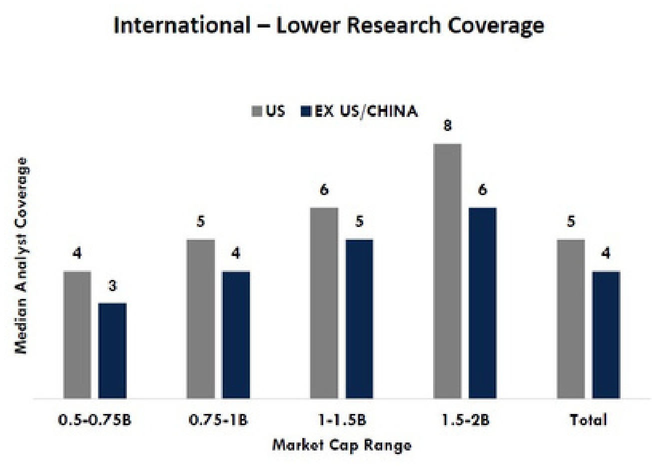
International markets experience more frequent idiosyncratic volatility due to diverse regulatory environments, fiscal policies, monetary policies, and business cycles. While short-term volatility can be unsettling, it presents distinct advantages for active managers. Active managers with the discipline to invest in quality companies stand to benefit as quality companies often increase market share during volatile economic periods. Further, volatility in security prices provides the patient and fundamental active manager the opportunity to invest in companies at discounted prices.



Source: ACR analysis, Capital IQ
Indices used defined in disclosures.

3. International Markets - Lower Research Coverage Increases Mispricing Opportunities

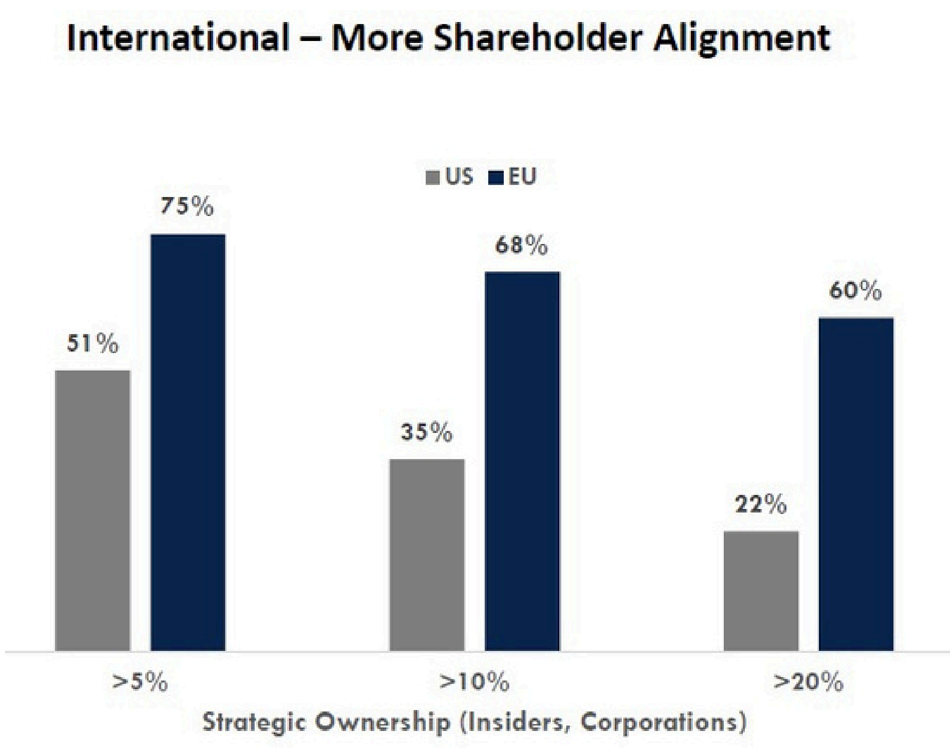
International equity markets have lower levels of research coverage than the U.S. market, and we believe this can lead to less efficiently priced securities. Active managers with an investment process underpinned by thorough fundamental research have a distinct advantage in addressing these structural international market opportunities.



Source: ACR analysis, Capital IQ

4. International Markets – Higher Levels of Management and Shareholder Alignment

International companies often show better alignment with shareholder interests due to higher ownership stakes by founders and families. While high insider ownership does not guarantee improved outcomes, it can act as a shield against the prevalent short-term focus in the U.S. This allows international management teams to prioritize long-term decisions that ultimately benefit shareholders. Active managers with a long-term investment horizon and a commitment to assessing management alignment are particularly well-positioned to capitalize on these inherent opportunities within international markets.



Source: ACR analysis, Capital IQ

CONCLUSION

We believe the case for active management in international equity markets is compelling. We have identified four enduring aspects of international markets that present active managers with the opportunity to generate satisfactory absolute and relative returns. However, to capture this potential, the active manager must have its principles and investment process aligned with the unique characteristics of the international markets. This requires a focus on deep fundamental research, a commitment to quality companies across all capitalization ranges (small to mega-cap), and a long-term investment horizon. By adhering to these principles, active managers can exploit the structural opportunities inherent in international markets and potentially deliver superior returns for investors over time.

"ACTIVE MANAGERS CAN EXPLOIT THE STRUCTURAL OPPORTUNITIES INHERENT IN INTERNATIONAL MARKETS AND POTENTIALLY DELIVER SUPERIOR RETURNS FOR INVESTORS OVER TIME."

DISCLOSURES

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Indices used:

- *MSCI EU - The MSCI European Union (EU) Index captures large and mid cap representation across the 13 Developed Markets (DM) countries and 4 Emerging Markets (EM) countries in Europe. With 301 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in the European equity universe.*

- *MSCI USA - The MSCI USA Index is designed to measure the performance of the large and mid cap segments of the US market. The index covers approximately 85% of the free float-adjusted market capitalization in the US.*