

Quarterly Commentary: Factor-Enhanced Quantitative Portfolios (QPs) International ADR V+M+Q

Fourth Quarter (Q4) 2020

Market Environment

The US economy suffered through the shortest but most severe recession on record as a result of the pandemic, but is in the midst of staging a strong recovery. Additional fiscal support and the increasing number of Americans being vaccinated increase the prospects that the economic recovery will be able to pick up steam by mid-2021. The Bureau of Economic Analysis released the third estimate of the third-quarter 2020 real GDP, a record-setting seasonally adjusted annualized increase of 33.4%, a substantial rebound from the second quarter's decline. The employment situation continued to show improvement over the past three months, with the November report showing an average of approximately 522,000 jobs added each month of the quarter, and that the unemployment rate fell to 6.7%. The Federal Open Market Committee (FOMC) maintained its supportive monetary policy response to the pandemic, leaving the federal funds rate target range of 0% to 0.25% unchanged. The central bank also reiterated that it expects interest rates to remain near zero until sometime in 2023.

Portfolio Commentary

In the fourth quarter, the Factor-Enhanced Int'l ADR V+M+Q generated a gross return of 14.09%, whereas the S&P/BNY Mellon DM ex US Classic ADR Index returned 16.42%. For the full year, the strategy produced a gross return of 8.10% compared with the 8.01% return for the ADR Index.

Similar to domestic equities, international developed markets equities declined early in the quarter, but rebounded in November and December as news of the COVID-19 vaccine rollout reenergized investors. Factor performance was mixed in international equity markets. The size and value factors recorded positive gains for international developed markets, whereas the momentum and quality factors declined. The strategy primarily tilts toward the value, momentum, and quality asset pricing factors, which contributed (deducted), 82, -143, and -23 basis points, respectively. Although the size factor is not explicitly captured in the Factor-Enhanced strategies, the portfolios tend to have slightly lower weighted-average market capitalizations than the benchmark. The implicit size exposure positively contributed 63 basis points to performance.

As with each series of the QPs, the strategy is constructed to maintain sector weights in line with those of the benchmark, serving to mitigate one dimension of active risk. Differences in the portfolio's sector weights compared with those of the benchmark subtracted from performance during the quarter, but security selection within sectors remained the primary determinate of relative performance. Security selection detracted 211 basis points.

Positively contributing to the Factor-Enhanced Int'l ADR V+M+Q strategy's performance during the quarter was an overweight to Futu Holdings Ltd ADR (FUTU), which boosted performance as a result of the stock's 60% surge. Investors became optimistic, as the financial services company experienced strong user growth.

The portfolio's overweight to Sony Corp. ADR (SNE) was a positive for performance, as the stock gained 32%. The company's higher-margin gaming and music segments contributed to earnings growth in its latest report.

An overweight to Criteo SA ADR (CRTO) also boosted performance, as the company's stock rallied 68% in the quarter. The company projected 2021 growth supported by the continued shift toward e-commerce.

The portfolio suffered during the quarter as a result of its overweight to Japan Exchange Group Inc. ADR (JPXGY). The financial data and exchange company declined 8%, consolidating strong gains from prior quarters.

An overweight to SAP SE ADR (SAP), which declined 16%, was a detractor from performance. The company's third-quarter financial results and forward-looking guidance disappointed.

The portfolio's overweight to Dai Nippon Printing Co Ltd ADR (DNPLY) detracted from performance as a result of the stock's 11% decline. The stock pulled back in part due to investors' fears that a resurgence of COVID-19 cases could weigh on the industrials company in the first half of the year.

Looking ahead to the first quarter of 2021, we will be watching closely whether recent gains in the size and value factors are sustained, and whether factor performance on balance becomes a positive contributor to performance.

Model Portfolio Attribution

	Performance Driver	Active Return Contribution	Portfolio Exposure	Average Weight in Model	Comments
Contributors	Futu Holdings Ltd. ADR	+35 bps	Overweight	1.24%	The stock surged 60%, as investors became optimistic about the company's strong user growth.
	Sony Corp. ADR	+28 bps	Overweight	2.26%	The stock gained 32%, as the company's higher-margin gaming and music segments contributed to earnings growth in its latest report.
	Criteo SA ADR	+15 bps	Overweight	0.37%	The stock rallied 68% in the quarter, as the company projected 2021 growth.
	Shin-Etsu Chemical Co. Ltd ADR	+12 bps	Overweight	1.50%	The stock returned 34% in the quarter.
	Genmab A/S ADR	+11 bps	Overweight	1.50%	The stock returned 11% in the quarter.
Detractors	Japan Exchange Group Inc. ADR	-45 bps	Overweight	1.26%	The financial data and exchange company declined 8%, consolidating strong gains from prior quarters.
	SAP SE ADR	-40 bps	Overweight	1.54%	The company's third-quarter financial results and forward-looking guidance disappointed.
	Dai Nippon Printing Co Ltd ADR	-19 bps	Overweight	0.64%	The stock pulled back 11%, as investors feared that a resurgence of COVID-19 cases could weigh on the industrials company in the first half of the year.
	Koninklijke Ahold Delhaize NV ADR	-18 bps	Overweight	1.51%	The stock declined 5% in the quarter.
	Arkema SA ADR	-15 bps	Overweight	1.34%	The stock returned more than 8% in the quarter, but trailed the overall Materials sector's performance.

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Quantitative Research Group

Disclosure

The **Russell 1000 Index** is a market capitalization weighted benchmark index made up of the 1000 largest U.S. companies in the Russell 3000 Index. The **Russell 1000 Value Index** refers to a composite of large and mid-cap companies located in the United States that also exhibit a value probability. The **CRSP US Large Cap Index** includes U.S. companies that comprise the top 85% of investable market capitalization.

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