CAMBIAR INVESTORS
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3Q 2015

International Equity ADR Commentary

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Market Review

After fairly muted performance for the first half of 2015, global equities sold off in the third quarter. In contrast to prior pullbacks that were often met with buyers stepping in to buy the dips, investor sentiment towards stocks deteriorated considerably in the quarter. A popular Wall Street phrase is “stocks climb a wall of worry” – referring to the tendency for equity markets to overcome a host of negative factors and move higher. Yet is seems the wall got too high in the quarter. Global growth fears (led by China), increasing uncertainty of U.S. monetary policy, and continued pressure in Emerging Markets were just some of the concerns that had investors scrambling for the exits. While all of these factors warrant careful consideration, it is Cambiar’s view that the correction in the quarter was of the “shoot first/ask questions later” variety, vs. fundamentally driven. Given our value orientation, such reflexive selling can provide attractive entry points; to that extent, Cambiar used the market weakness to deploy capital into a number of new investments during the quarter.

Emerging Markets

The Cambiar International Equity ADR strategy has had very modest exposure to Emerging Markets (2% currently) in recent years. The portfolio’s active avoidance reflects our view on some of the challenges facing EM; these issues are not easy to solve, nor are they likely to suddenly improve in the near future. One of the most important headwinds is the declining growth rate in China. Over the past ten years, China’s tremendous growth and corresponding voracious appetite for imports helped support growth around the world. Sovereign beneficiaries included peer EM countries (e.g. Brazil) supplying the commodities that the Chinese were dependent upon. The subsequent slowdown in China has had a negative ripple effect on the many markets that were previously benefitting.

A second challenge relates to the strong flows of capital targeting the emerging world, as super-low interest rates and sub-par demand growth in developed markets drove the EM “carry trade”. This trade is now reversing, in part led by a stronger dollar and the inevitability of higher US interest rates. Additionally, the credit boom in many EMs has turned sour, clearly related to issues mentioned above as cash flow, currency and bond market dynamics in EMs turn more pernicious. An aspect of this secular turnabout is worth contemplating: growth in emerging markets is slowing, while the cost of capital is rising. The resulting combination is not helpful for EM equity prices.

A final event which is negatively impacting EM is the concept of “quantitative tightening”. This term refers to the reserve draw-down that is taking place in many countries around the world; from China’s declining reserves, to middle-eastern petro-states, as well as other EM economies facing higher demands for dollars. The easiest way to think about this concept is to remember that EMs had been accumulating reserves for years, due to factors such as persistent current account surpluses and huge inflows of hot money seeking higher returns. The process involved central banks buying dollars, typically “paying” with domestic currencies and often corresponding to significant balance sheet expansion (more cynically: money printing). The capital flows have now reversed, and these global reserve stockpiles appear to be shrinking. This has been called “quantitative tightening” by some, since it is moving in the opposite direction of reserve accumulation/balance sheet expansion. The operative word is tightening. Given all of the above considerations, Cambiar anticipates continued rough sailing in emerging markets; we are wary of attempts to catch the bottom.

International Equity ADR Portfolio

With all sectors of the market posting negative returns, a performance discussion for the quarter unfortunately becomes a relative exercise. On this basis, the Cambiar International Equity portfolio outperformed via solid downside protection vs. the MSCI EAFE Index. While we believe that investing in high quality companies is an important attribute in a variety of market environments, it is particularly beneficial during periods of stress, as higher quality companies often tend to hold up relatively better during market corrections.

International Equity ADR Performance

	3Q15	YTD	1 Year	3 Year	5 Year	Since Inception
ADR (g)	-6.7%	3.1%	0.1%	9.2%	8.4%	6.3%
ADR (n)	-6.8%	2.7%	-0.5%	8.5%	7.7%	5.3%
EAFE	-10.2%	-5.3%	-8.7%	5.6%	4.0%	2.1%

Inception Date: 2.28.2006 / See Disclosure – Performance

Portfolio performance within the international equity space is primarily a function of three factors: country allocation decisions, sector over/underweights, and individual company performance (i.e., stock selection). As it relates to the Cambiar International portfolio, stock selection is paramount in importance, and typically has the largest impact on overall performance vs. country and sector decisions. This was certainly the case in the third quarter (as well as on a year-to-date basis); positive stock selection has been a significant contributor to the portfolio's excess return.

Within the international equity markets, defensive/safe haven sectors such as Consumer Staples, Utilities and Healthcare were relative outperformers in the quarter. In contrast, sectors that are more positively correlated to global growth received the brunt of the market's selling pressure. Laggards included Basic Materials and Energy. Cambiar's selective avoidance of these latter sectors was a subsequent positive contributor to performance.

Cambiar's holdings within the Consumer Discretionary were a value-add in the quarter; individual outperformers included Adidas (sports apparel) and Seven & I (convenience store operator). While negative on an absolute basis, the portfolio's media/cable and publishing holdings were able to hold their own in the quarter, and were additional contributors to performance. One Discretionary holding that was liquidated during the quarter was Daimler, as the position was nearing our price target and we began to grow increasingly uncomfortable with the company's exposure to China. Although Daimler was a modest detractor in the quarter, the portfolio sidestepped additional downside by completing our sale prior to the 'Emissiongate' scandal at Volkswagen.

As a sector, Information Technology constitutes a smaller percentage of the international benchmarks than it does in the US, and the company brands may be incrementally less recognizable than their US counterparts. That said, Cambiar has identified a number of international tech companies that meet our quality, valuation and hurdle rate criteria. Examples include semiconductors, security software, and an IT services company. For the quarter, Cambiar's tech holdings were positive contributors to overall portfolio performance, with two positions shrugging off the market's downward pull to post positive returns.

Financial Services continues to represent the largest sector in the Cambiar portfolio; performance within the underlying positions produced a small positive contribution vs. the benchmark. In addition to traditional bank and insurance companies, Cambiar also holds three real estate/property management companies with diverse geographic footprints, which delivered mixed performances in the quarter. On the downside, Global Logistic Properties (GLP) incurred a pullback on announced growth rates in its China development business that were lower than previously communicated. Despite the re-set in this segment of their portfolio, Cambiar remains constructive on the aggregate investment case for GLP, given its leadership market positions in China, Japan and more recently the USA, where it has become the second largest industrial landlord. While each of the portfolio's real estate holdings possess company-specific drivers, common themes for value creation include reduced vacancies/increasing rents, leading market positions, realization of strong valuations via non-core asset sales/development gains, and asset reflation/revaluation within their underlying portfolios. Capital return via an attractive dividend yield is an additional positive attribute for the sector – particularly in light of depressed global bond yields.

Looking Ahead

The third quarter was an important reminder that investing is not a linear process; equities are risk assets, and will move up and down over time. While it may be a painful ride in the short run, one result of the indiscriminate selling witnessed in 3Q is the subsequent increase in opportunities that arise from such dislocations. The Cambiar investment team continues to use the increased market volatility to our clients' advantage by identifying those companies where the market has wholly underestimated the potential for future success.

As we move into the final quarter of 2015, there is no shortage of debate on where equities go from here. Given the continued headwinds that include Fed uncertainty, China growth fears, and lack of inflation on a global basis, the path of least resistance seems to be lower. However, it would not take much for sentiment to improve towards stocks. A confirmation from management teams that business trends are not falling off a cliff (as is implied in many stock prices) would be a good start.

At a regional level, Cambiar continues to believe that Europe is in recovery mode, with many companies offering an attractive risk/reward profile. Given the run up in valuations earlier this year, the recent correction provides a potentially attractive entry point for investment candidates that have been under consideration for purchase.

The International portfolio continues to maintain a meaningful allocation to Japan. We are confident that Japan will see a household spending recovery, which is an important catalyst for the next leg higher in Japanese equities. The tone in Japan is one of optimism; meetings with company executives show a genuine shift in mindset towards corporate governance, vs. a compelled response to new rules. Prime Minister Abe has made no secret that an important performance indicators (in addition to higher economic growth and inflation) is a robust equity market. Cambiar continues to find good investment opportunities in Japan.

As always, we appreciate your continued confidence in Cambiar Investors.

Disclosure

Performance: The performance information represents the respective Cambiar strategy composite. Returns are presented net of actual management fees and transaction costs and include the reinvestment of all income. Gross returns do not reflect the deduction of management fees. Certain clients may receive differing net performance numbers based on their respective platforms and fee structures. Cambiar's past results do not necessarily indicate Cambiar's future performance and, as is the case with all investment advisors who concentrate on equity investments, Cambiar's future performance may result in a loss. Net of fees performance reflects a blended fee schedule of all accounts within the relevant composite and Cambiar clients and mutual fund investors may incur actual fee rates that are greater or less than the rate reflected in this performance summary. Index returns assume no management, custody, transaction or other expenses. Performance data presented is preliminary.

ADR Benchmark: The performance of the MSCI EAFE benchmark includes the reinvestment of all income. The MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the U.S. & Canada.

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