

Observations from Across the Pond

Marquette regularly sends a senior member of our research team abroad as part of ongoing manager sourcing and due diligence efforts. These trips include update meetings with investment managers with whom Marquette has existing relationships as well as on-site visits with potential new manager recommendations. The cadence of these trips was severely impacted by the COVID-19 pandemic, but with international travel now almost back to normal, Marquette sent Senior Research Analyst Evan Frazier on a whirlwind tour of Europe earlier this summer. Over the course of almost a week, Evan met with eight investment management firms across three cities. In this newsletter, Evan shares the perspectives, as well as more anecdotal information, he gained while on the ground in Europe, including insights on the region's economy, the corporate landscape, and the unique set of opportunities and challenges currently facing international markets.



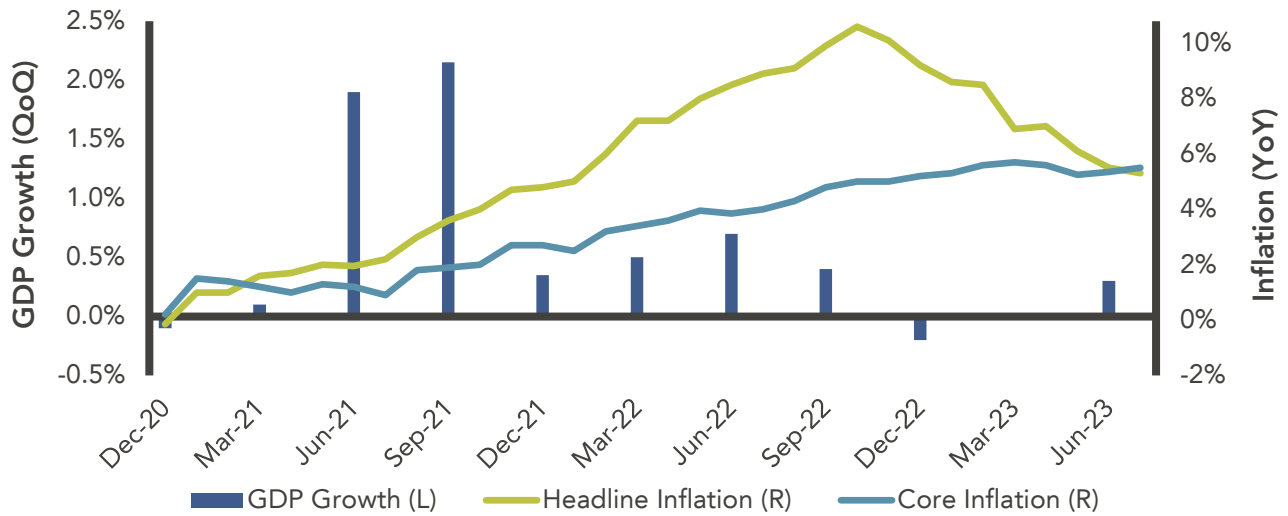
Evan Frazier, CFA, CAIA
Senior Research Analyst

THE EUROPEAN ECONOMY: UNEVEN FOOTING

Both investment professionals and laypeople alike characterized the state of the European economy as somewhat gloomy during my trip. Indeed, while the euro area did manage to notch positive GDP growth in the second quarter, advancing 0.3% from the previous three months, other headwinds, including sticky inflationary pressures, continue to hamper the region. To that point, euro area consumer prices rose 5.3% on a year-over-year basis in July, which actually represents a significant moderation from the increases of over 10% last year. Despite this improvement, several analysts and portfolio managers remain cautious about the trajectory of price levels over the coming months. Core inflation, which excludes food and energy prices that tend to be more volatile, has continued to climb higher after a brief correction earlier in the year. According to the European Central Bank (ECB), both headline and core inflation are not expected to retreat below 2% until the end of 2025, and many of the investment managers with whom I spoke noted that their portfolio companies continue to aggressively push through price increases as a

result. As seen in Exhibit 1 below, July marks the first time in over two years that the core figure surpassed the headline inflation rate in the euro area.

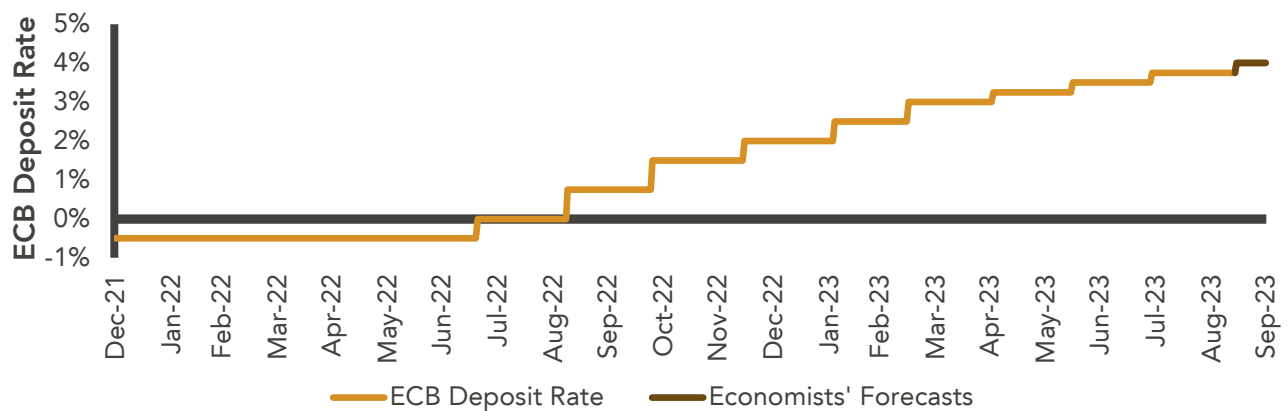
▾ **Exhibit 1:** Despite positive GDP growth, core inflation remains stubbornly high in the euro area



Source: Bloomberg, Eurostat as of July 31, 2023

In addition to challenges for both consumers and businesses in the region, elevated core inflation also creates some uncertainty regarding the trajectory of interest rates over the coming months. The deposit rate in the euro area stands at 3.75% at present, with the ECB likely nearing the end of its aggressive hiking cycle that began roughly one year ago. Still, ECB President Christine Lagarde has stated in recent days that another hike could take place in September depending on underlying inflationary trends, and other officials have indicated that even if there is a pause next month “it would be premature to consider it automatically the end of the cycle.” As shown in Exhibit 2 below, economists are currently anticipating a 25 basis point increase in the policy rate next month, and most of the investment professionals with whom I met concur with those forecasts.

▾ **Exhibit 2:** Economists expect another 25 basis point hike from the ECB in September

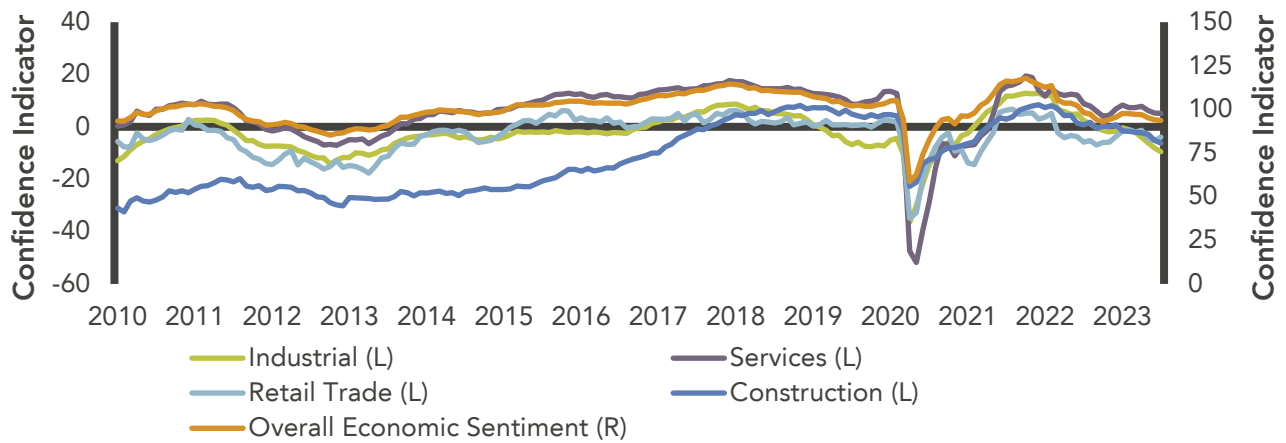


Source: Bloomberg as of July 31, 2023

Should the ECB raise its deposit rate to 4.0% or higher in the coming months, it may come at the expense of economic growth and confidence, which has already been waning. After reaching a post-pandemic peak in late 2021, confidence in the euro area industrial, services, retail, and construction spaces, as measured by the

European Commission, has dropped dramatically in recent months, as has the overall economic sentiment indicator for the region as a whole (*Exhibit 3*). Additionally, the Eurozone Composite Purchasing Managers' Index dropped to 48.6 in July, the lowest reading for the metric since last year and, according to Bloomberg, worse than what forecasters had been anticipating. Any PMI figure below 50 represents a contraction. When I discussed the factors behind this slowdown with portfolio managers, many were quick to note that Germany has been particularly challenged of late. Indeed, despite emerging from a technical recession in the second quarter (Germany's GDP was flat after contracting in the two prior periods), the country continues to experience a slump in its key manufacturing sector and is, according to the International Monetary Fund, on pace to be the only Group of Seven nation to see a decline in output in 2023. Based on both formal and informal conversations I had throughout the week, low demand for credit among companies, production cuts, and a slowing services sector seem to be other key drivers behind the souring sentiment across the broader region.

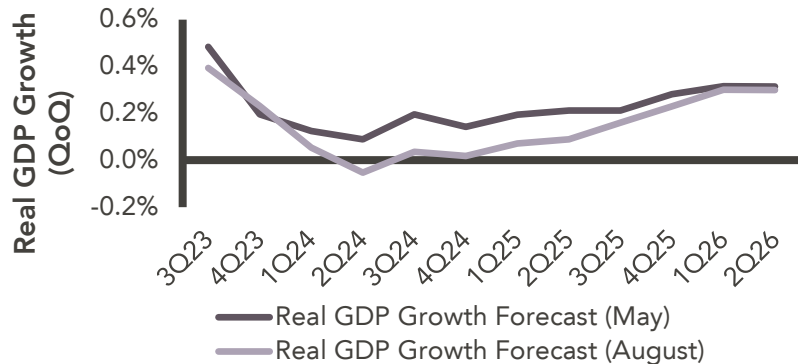
▾ **Exhibit 3:** Economic confidence in the euro area has waned in recent months



Source: Bloomberg, European Commission as of July 31, 2023

In the United Kingdom, the economic picture is similarly bleak. The Bank of England (BOE) raised its key rate to a 15-year high of 5.25% earlier this month and markets currently expect up to 75 basis points of additional increases through the first quarter of 2024. This tightening has largely been in response to the UK's own inflation problem, with headline inflation near 8% — the highest among the Group of Seven nations. Despite recent rate hikes, the BOE expects price pressures, particularly those impacting the services sector, to remain at "elevated" levels for some time. Additionally, the BOE's own forecasts project that Britain's economy will stagnate over the next two years,

▾ **Exhibit 4:** The UK is poised for a period of economic stagnation, according to BOE forecasts



Source: Bloomberg, Bank of England as of July 31, 2023

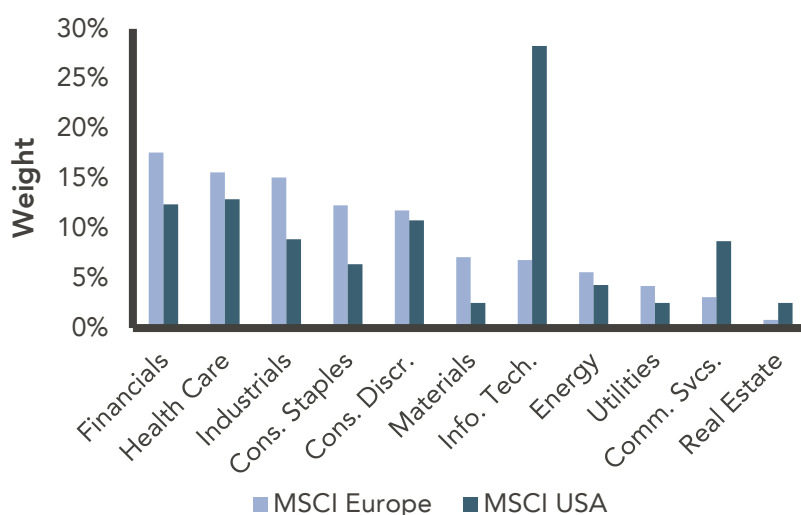
challenges for the region’s economic prospects. Finally, hearing both investment professionals and laypeople note that the current climate may present difficulties for Prime Minister Rishi Sunak’s bid to win an election, which must be held by early 2025, was also noteworthy. Whether in the corporate boardroom or on the streets, fears appear to be mounting that Sunak’s plans to stabilize the UK economy are seriously lacking.

EUROPEAN EQUITY MARKETS: DIFFERENTIATED CHARACTERISTICS AND PERFORMANCE

Speaking to portfolio managers and investment analysts provided a stark reminder of the extent to which the composition of the equity market in Europe differs from that of the United States. As shown in Exhibit 5, nearly half of the MSCI Europe index, which is comprised of large- and mid-cap businesses in 15 developed market countries across the continent, falls within the Financials, Industrials, and Consumer Staples sectors,

relative to just over 25% of the MSCI USA index. Conversely, the Information Technology and Communication Services sectors, which represent over one-third of the MSCI USA index, constitute less than 10% of the European market. Naturally, the different composition of these indices will lead to very different valuation and growth outlooks. For instance, the MSCI Europe index currently trades at roughly 12.7x forward earnings and 1.9x book value, compared to 20.3x and 4.5x, respectively, for the MSCI USA index, since the European benchmark is more heavily exposed to sectors that are typically cheaper and grow more slowly. For the same reason, the European index boasts a higher dividend yield — 3.2% vs. 1.5% for the MSCI USA index. Perhaps unsurprisingly, the U.S. index has notched returns well in excess of the European benchmark in the last several years, and with lower volatility, given the recent success of more growth-oriented assets (*Exhibit 6*). That said, the differences between the two equity markets allow investors to experience diversification benefits, as the correlation between these two indices has decreased in recent time. It is worth pointing out that each of the global equity managers with whom I met during the trip maintain significant exposures to both the United States and Europe, as they feel there are companies in both regions that present attractive investment opportunities on a go-forward basis.

Exhibit 5: Financials, Industrials, and Consumer Staples make up a significant percentage of the European equity market, while the U.S. is dominated by technology-oriented companies



Source: MSCI as of July 31, 2023

Exhibit 6: The MSCI USA index has delivered higher returns and lower volatility over the last decade

		3 YR	5 YR	10 YR
RETURN	MSCI Europe Index	11.1%	5.8%	5.9%
	MSCI USA Index	13.2%	12.1%	12.6%
STD DEV	MSCI Europe Index	19.9%	19.3%	16.2%
	MSCI USA Index	18.3%	19.1%	15.1%

Source: MSCI as of July 31, 2023

FLYING IN 2023: DELAYS FOR DAYS!

Some readers may have first-hand knowledge of what was by far the low point of my travels: excruciatingly long flight delays on both sides of the Atlantic. Beyond allowing me to become well acquainted with the layouts of various airports across the world, these experiences brought to life the current state of air travel, marked by staffing shortages and increased travel demand. According to Bloomberg, growth in demand for flights to Europe from the U.S. has outpaced pre-pandemic levels by roughly 20% since the start of the summer and airports across Europe have struggled to keep up. For instance, London's Heathrow Airport (the site of one of my long delays) saw nearly 40% of its flights depart behind schedule during the month of June. These figures, as well as my experiences while on the trip, will hopefully serve as reminders to readers who may be flying to Europe (or anywhere else, for that matter) in the near future to plan accordingly!

CONCLUSION

Despite the aforementioned travel hiccups, a week on the ground in Europe meeting with portfolio managers and analysts provided an invaluable reminder of the vital role the region plays in the global financial system, where Marquette clients have direct investment exposure. It showcased the differences in the opportunity sets when it comes to U.S. and European equity market investing, and underscored the fact that attractive international equity valuations have to be weighed against uncertain economic outlooks and high inflation. Lastly, the trip was a helpful reminder of why we get away from our desks and spend time with managers in person in their offices, wherever they may be. We look forward to keeping you all apprised of our future manager due diligence trips. ■

PREPARED BY MARQUETTE ASSOCIATES

180 North LaSalle St, Ste 3500, Chicago, Illinois 60601 PHONE 312-527-5500
CHICAGO BALTIMORE MILWAUKEE PHILADELPHIA ST. LOUIS WEB marquetteassociates.com

CONFIDENTIALITY NOTICE: *This communication, including attachments, is for the exclusive use of the addressee and contains proprietary, confidential and/or privileged information; any use, copying, disclosure, dissemination or distribution is strictly prohibited. Marquette Associates, Inc. retains all proprietary rights they may have in the information.*

Marquette Associates, Inc. ("Marquette") has prepared this document for the exclusive use by the client or third party for which it was prepared. The information herein was obtained from various sources, including but not limited to third party investment managers, the client's custodian(s) accounting statements, commercially available databases, and other economic and financial market data sources.

The sources of information used in this document are believed to be reliable. Marquette has not independently verified all of the information in this document and its accuracy cannot be guaranteed. Marquette accepts no liability for any direct or consequential losses arising from its use. The information provided herein is as of the date appearing in this material only and is subject to change without prior notice. Thus, all such information is subject to independent verification and we urge clients to compare the information set forth in this statement with the statements you receive directly from the custodian in order to ensure accuracy of all account information. Past performance does not guarantee future results and investing involves risk of loss. No graph, chart, or formula can, in and of itself, be used to determine which securities or investments to buy or sell.

Forward-looking statements, including without limitation any statement or prediction about a future event contained in this presentation, are based on a variety of estimates and assumptions by Marquette, including, but not limited to, estimates of future operating results, the value of assets, and market conditions. These estimates and assumptions, including the risk assessments and projections referenced, are inherently uncertain and are subject to numerous business, industry, market, regulatory, geopolitical, competitive, and financial risks that are outside of Marquette's control. There can be no assurance that the assumptions made in connection with any forward looking statement will prove accurate, and actual results may differ materially.

The inclusion of any forward-looking statement herein should not be regarded as an indication that Marquette considers forward-looking statements to be a reliable prediction of future events. The views contained herein are those of Marquette and should not be taken as financial advice or a recommendation to buy or sell any security. Any forecasts, figures, opinions or investment techniques and strategies described are intended for informational purposes only. They are based on certain assumptions and current market conditions, and although accurate at the time of writing, are subject to change without prior notice. Opinions, estimates, projections, and comments on financial market trends constitute our judgment and are subject to change without notice. Marquette expressly disclaims all liability in respect to actions taken based on any or all of the information included or referenced in this document. The information is being provided based on the understanding that each recipient has sufficient knowledge and experience to evaluate the merits and risks of investing.

This presentation does not constitute an offer to sell, or a solicitation of an offer to buy, any interest in any investment vehicle, and should not be relied on as such. Targets, ranges, and expectations set forth in this presentation are approximations; actual results may differ. The information and opinions expressed herein are as of the date appearing in this material only, are subject to change without prior notice, and do not contain material information regarding the Marquette Model Portfolio, including specific information relating to portfolio investments and related important risk disclosures. The descriptions herein of Marquette's investment objectives or criteria, the characteristics of its investments, investment process, or investment strategies and styles may not be fully indicative of any present or future investments, are not intended to reflect performance and may be changed in the discretion of Marquette. While the data contained herein has been prepared from information that Marquette believes to be reliable, Marquette does not warrant the accuracy or completeness of such information. Client account holdings may differ significantly from the securities in the indices and the volatility of the index may be materially different from client account performance. You cannot invest directly in an index.

About Marquette Associates

Marquette was founded in 1986 with the sole objective of providing investment consulting at the highest caliber of service. Our expertise is grounded in our commitment to client service — our team aims to be a trusted partner and as fiduciaries, our clients' interests and objectives are at the center of everything we do. Our approach brings together the real-world experience of our people and our dedication to creativity and critical thinking in order to empower our clients to meet their goals. Marquette is an independent investment adviser registered under the Investment Advisers Act of 1940, as amended. Registration does not imply a certain level of skill or training. More information about Marquette including our investment strategies, fees and objectives can be found in our ADV Part 2, which is available upon request and on our website. For more information, please visit www.MarquetteAssociates.com.