CLEARPOINT

clearstead

DECEMBER 2020

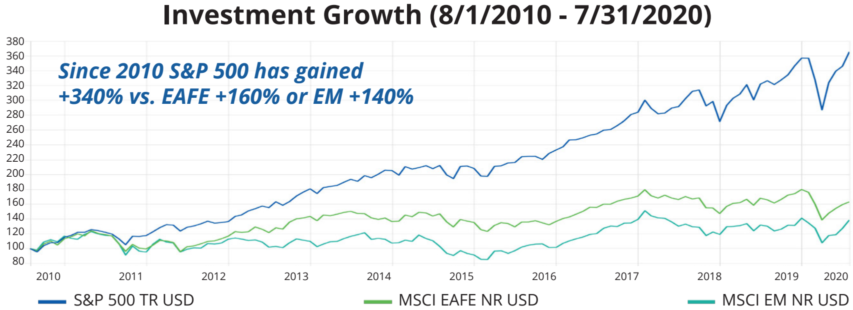
DANIEL MEGES, DIRECTOR, RESEARCH

A CASE FOR GLOBAL EQUITY: RECOGNIZING EXCELLENCE WHEREVER IT IS FOUND

BY DANIEL MEGES, DIRECTOR, RESEARCH

We are a decade into the outperformance of US equities (S&P 500) over foreign equity markets (MSCI EAFE & MSCI Emerging Markets). Given the exceptional run of US equity markets over the past ten years, it is not surprising that typical diversification—investing in anything other than large cap, US equities—has not paid off. Overall, non-US markets have generated half of the long-run returns of US equities, and the correlations of non-US equity markets over the past 20 years have risen dramatically. Despite the fact one should prudently allocate capital on long-run expected returns—as opposed to past returns—clients are rightly asking what would be the catalyst for either international equities or emerging markets to outperform the US in the coming years. Is there still a case to move beyond the S&P 500 for equity investors?

Investment Growth (8/1/2010 - 7/31/2020)



Source: Morningstar Direct. Past performance is no guarantee of future results.

CLEARSTEAD CONTINUES TO BOLSTER TEAM WITH NEW TALENT

We are pleased to announce that we have added talent to the Research & Investment Management and Private Client teams with Andres Arsuaga, Angela Kelly, and Kristen Low, respectively.

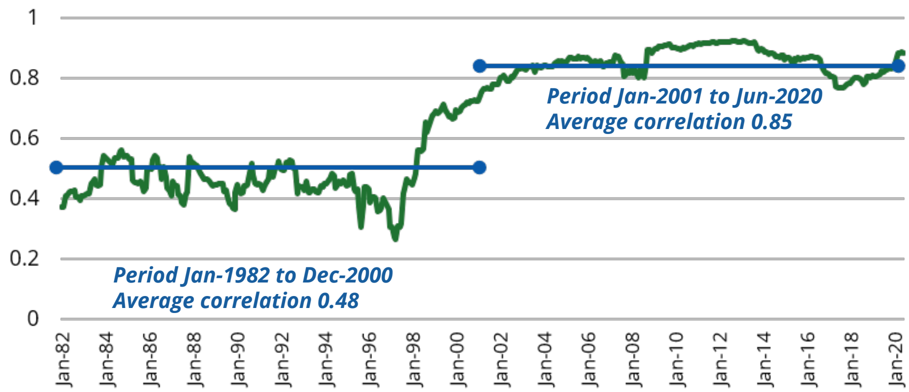
Andres Arsuaga has joined Clearstead as Director, Portfolio Management. Prior to joining Clearstead, Andres was Vice President, Financial Institutions Group at BlackRock in New York. Prior to BlackRock he worked at Sumitomo Mitsui Banking and KeyBank. Andres holds a Bachelor of Science degree in Business Administration and Finance from The Ohio State University and holds the Chartered Financial Analyst designation.

Angela Kelly has joined Clearstead as a Client Service Associate. Previously Angela has worked in a client service support role for a few different firms during her career in financial services, most recently Valley Creek Advisors. Angela holds a Master's degree in management from Gwynedd Mercy University.

A CASE FOR GLOBAL EQUITY: RECOGNIZING EXCELLENCE WHEREVER IT IS FOUND

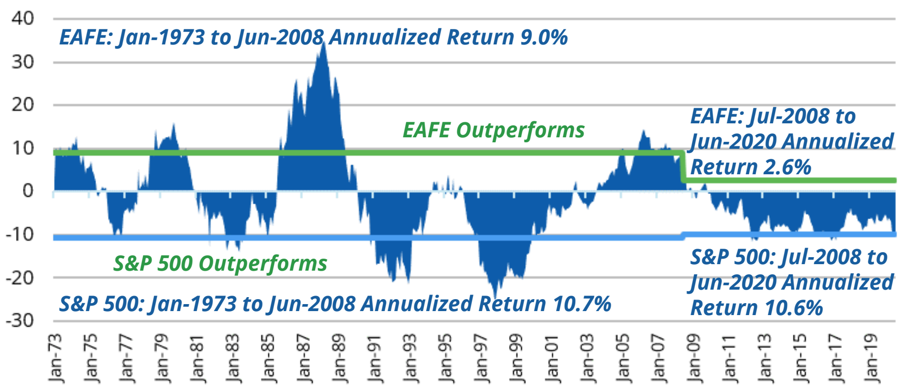
BY DANIEL MEGES, DIRECTOR, RESEARCH

Rolling 5-Year Correlations EAFE to S&P 500



Source: Clearstead, Morningstar.

Rolling 3-Year Returns: S&P 500 vs. MSCI EAFE



Source: Clearstead, Morningstar. Past performance is no guarantee of future results.

Despite the long period of S&P 500 outperformance over almost any non-US market index, there are highly profitable and high-returning firms found outside of the US. In fact, over the past decade, the top returning global firms are typically domiciled outside of the US, according to Clearstead analysis of the companies that comprise the MSCI All Country World Index (MSCI ACWI). Only once in the past ten years (2011) were a majority of the top 50 returning global large cap firms domiciled in the US. Even in spite of the strong positive gains of the S&P 500 through the first half of 2020, only nine US firms were among the top returning firms globally, while 32 firms (about 2/3rd of top 50 returning firms) were from China, according to Clearstead analysis. Unfortunately, these top-returning companies are often housed in indices that also include a lot of low-returning firms. Therefore, non-US equity portfolios that are not concentrated in their number of holdings are likely to exhibit greater exposure to the myriad of mediocre firms that underlie the various non-US equity universes. Owning anything but the best firms, within either the US or especially outside of the US, is a recipe for dragging down returns.

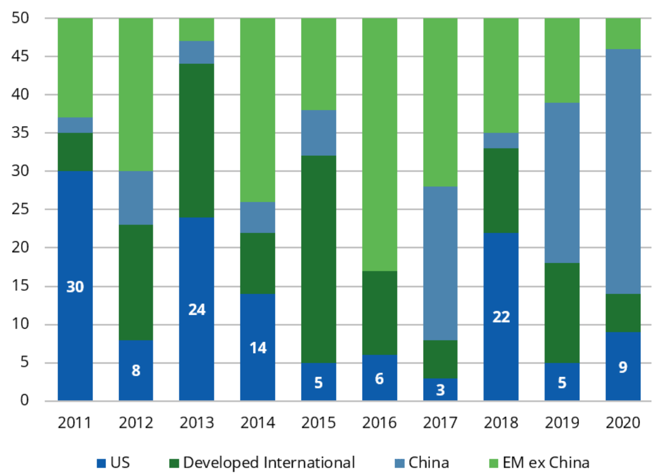
Kristen Low has joined Clearstead as an Administrative Assistant. Previously, Kristen was with TD Ameritrade. She holds a Master's degree in Sports Management from Cleveland State University.

These changes underscore the firm's commitment to building its investment consulting practice, promoting the next generation of leadership, and maintaining a rigorous investment process.

A CASE FOR GLOBAL EQUITY: RECOGNIZING EXCELLENCE WHEREVER IT IS FOUND

BY DANIEL MEGES, DIRECTOR, RESEARCH

Top 50 Returning Global Large Cap Companies by Domicile



Source: Clearstead, Morningstar as of 7/31/2020. Past performance is no guarantee of future results.

Trailing 10-Year EPS Growth

	S&P 500	EAFE	EM
Top Quintile EPS Grower	17.9%	15.9%	19.2%
Median Firm	10.9%	6.9%	9.0%
Bottom Quintile EPS Grower	3.6%	0.2%	0.7%

Annualized 10-Year Returns

	S&P 500	EAFE	EM
Top Quintile EPS Grower	17.9%	17.0%	18.4%
Index Return	14.0%	5.8%	3.3%
Bottom Quintile EPS Grower	8.5%	3.8%	3.0%

Source: Clearstead, Morningstar 7/1/2010 – 6/30/2020 10-Yr EPS CAGR, 10-Yr Annualized Returns. Past performance is no guarantee of future results.

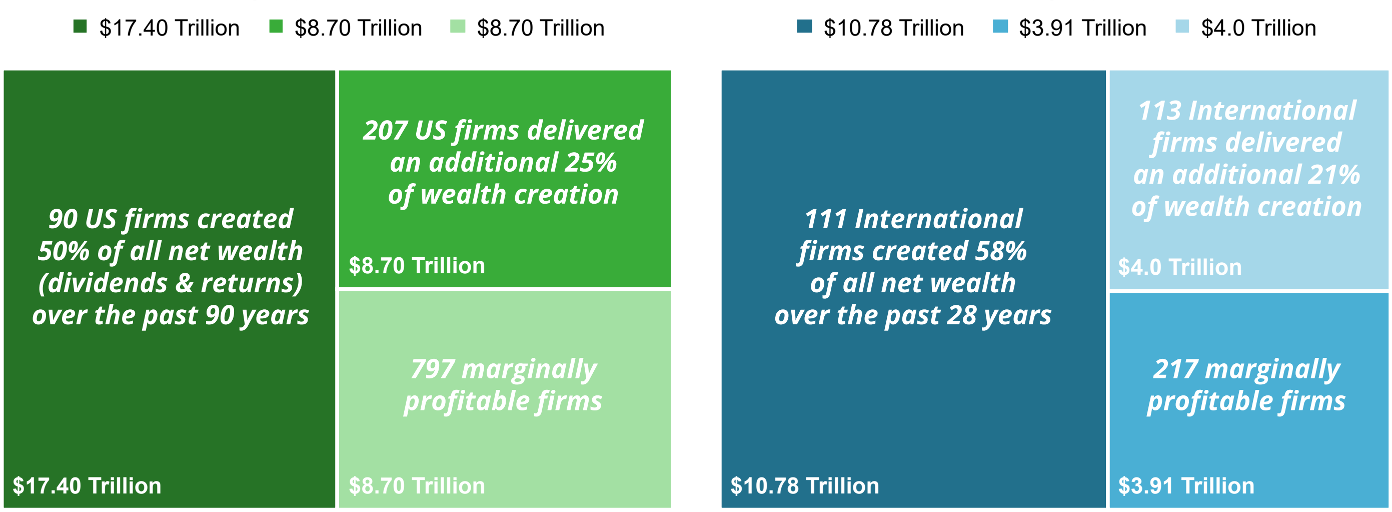
Top earning international and emerging market firms have grown profits and delivered returns on par with the top S&P 500 firms; while the median non-US firm has lagged its US peers.

Additionally, academic and financial research further reinforces the value to investors in seeking concentrated portfolios as these studies find that typically a small number of public firms drive the wealth creation for the vast majority of the market. Research by financial economist Hendrik Bessembinder shows that of the over 24,000 publicly traded firms that have existed in the US from 1926 to 2016, that only about 295—about 1.2% of firms that have ever existed—have produced approximately 75% of the total wealth creation of the US public equity market over the past 90 years. The vast majority (about 96%) of firms essentially produce annualized returns similar to that of investing repeatedly in 1-month Treasury bills. This analysis was repeated for non-US markets over the period from 1990-2018 and it found that "61% of non-US stocks, underperform one-month US Treasury bills over the full sample." Similarly, it found that outside the US, less than 1% of firms account for nearly all the $18.0 trillion in net wealth creation.[1] This analysis powerfully demonstrates the perils of relying on overly diverse—or de facto closet index-like portfolio—to generate excess returns.

Small Number of Firms Driving Wealth Creation

US Equity: 1926 to 2016

International Equity: 1990 to 2018



Source: Clearstead, Hendrik Bessembinder "Do Global Stocks Outperform US Treasury Bills?" SSRN July-2019; Hendrik Bessembinder "Do Stocks Outperform Treasury Bills, Aug-2016. Past performance is no guarantee of future returns.

A CASE FOR GLOBAL EQUITY: RECOGNIZING EXCELLENCE WHEREVER IT IS FOUND

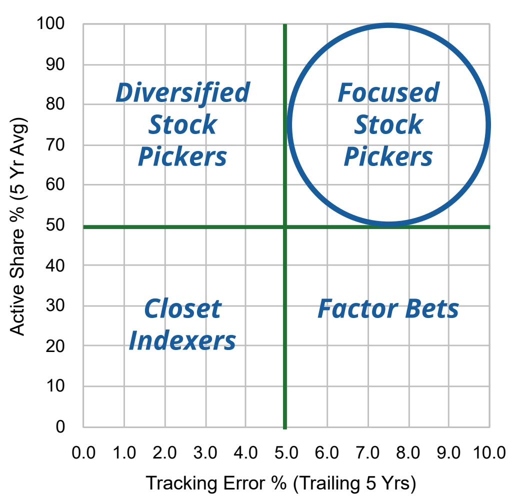
BY DANIEL MEGES, DIRECTOR, RESEARCH

Similarly, McKinsey research found that, in the past 20 years, the top 10% of companies with more than $1 billion in revenues has taken an ever-larger share of the total profits, while the losses of the bottom 10% have also grown.[2] According to this research, "among the world's largest companies, economic profit is distributed unequally along a power curve, with the top 10 percent of firms capturing 80 percent of positive economic profit."[3] These findings strongly favor concentrated stock pickers, which can focus on the best opportunities in each market and own less of the average or below-average companies, as measured by earnings growth. Furthermore, this trend of a concentrated number of firms generating out-sized returns is not only persistent but increasing.

A global equity approach implies that Clearstead expects several of the key trends of the past decade (US equity outperformance, winner-take-all corporate markets, limited real GDP growth, low inflation, and increasingly synchronized global markets) to be more likely to continue in the coming years than mean revert to what investors experienced in the period from 1980-2008. As the environment for the "average" firm becomes more challenged, the implications of choosing a sub-optimal strategy becomes ever more apparent, particularly in non-US public equity markets. It is therefore both prudent as a fiduciary as well as investment savvy to ensure our approach to all public equity investing reflects these trends. This research note makes the case for global equity as an optimal approach to address these trends and challenges and increases the likelihood of delivering on our client's investment expectations.

Identifying the small number of global firms with robust, long-run earnings potential requires identifying a highly skilled, active global equity manager. Selection of global equity managers should reflect the benefits of a concentrated portfolio as well as Clearstead's broader analysis of the literature surrounding effective active management. Namely, that asset managers should be lower in fees, long-term oriented, co-invested in their strategies, have teams of size, talent, and diversity commensurate with the global opportunity set, and their portfolios should be concentrated and exhibit high active share. Because these managers are being charged with identifying the small number of firms that are driving long-run wealth creation, it would unsurprising if these managers are oriented along at least some portfolio metrics generally associated with traditional "growth" investing.

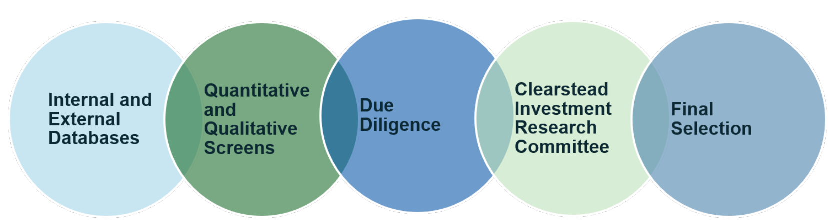
Clearstead Advantage: 6P Manager Due Diligence Process



Active Management - Skin in the Game

<u>Avoiding red flags</u> and <u>alignment of interests</u> bolsters sustained excess returns:

- PM's with skin in the game are more aligned with their clients/co-investors.
  - "Mutual funds with managers who are personally invested outperform their peers by an average of 1.44 percentage points per year." *Portfolio Manager Ownership and Fund Performance*
- Avoid red flags: Dark Triad (narcissism, Machiavellianism, and psychopathy)
  - Team-based approach is associated w/ sustained excess returns; avoid key-man risk.



Source: Clearstead.

The changing nature of global growth requires a new approach to equity investing, away from restrictive regional silos towards the widest possible opportunity set. As business cycles around the world converge, diversifying investments into global regional indices is increasingly less relevant than simply finding the best investment ideas anywhere in the world. A global approach to public equity investing a prudent response to 21st century challenges and ever-evolving world economy, and Clearstead has the talent and experience to guide our clients' portfolios to take advantage of this new investment environment.

A CASE FOR GLOBAL EQUITY: RECOGNIZING EXCELLENCE WHEREVER IT IS FOUND

BY DANIEL MEGES, DIRECTOR, RESEARCH

Sources:

(1) Hendrik Bessembinder "Do Global Stocks Outperform US Treasury Bills?" SSRN July-2019.

(2) "What every CEO Needs to Know about 'SuperStar' Companies" McKinsey Global Institute, April 2019.

(3) Ibid.

MARKET BENCHMARK RETURNS

December 30, 2020		1M	3M	12M	YTD
US Large Cap	S&P 500	10.9%	3.9%	17.5%	14.0%
US Small Cap	Russell 2000	18.4%	16.9%	13.6%	10.4%
Developed Intl	MSCI EAFE	15.5%	8.0%	6.4%	3.0%
Emerging Intl	MSCI Em Mkt	9.2%	9.7%	18.4%	10.2%
Real Estate	NAREIT	9.7%	3.5%	-7.7%	-8.4%
Core Fixed	BarCap Agg	1.0%	0.5%	7.3%	7.4%
Short Fixed	BarCap 1-3Yr	0.1%	0.1%	3.5%	3.2%
Long Fixed	BarCap LT G/C	3.5%	1.7%	15.0%	16.3%
Corp Debt	BarCap Corp	2.5%	2.0%	9.2%	8.9%

Source: Bloomberg

Past performance is not indicative of future results.