A globally applied fundamental process that integrates proprietary systematic and traditional research

Strategic Global Advisors

Quarterly Update

Divergent Paths

A seemingly unremarkable -0.71% return for the MSCI EAFE Net Index in the fourth quarter of 2016 masked a deeply divergent set of returns across sectors and countries. Energy stocks, which were the top performing group for the quarter and for the year, closely tracked the continued climb of oil prices. During the same period, Healthcare stocks were down dramatically, with uncertainty looming around the future of health insurance providers.

Currency effects had a major impact on a divergence in performance between non-US and US stocks in the quarter. While the Russell 1000 returned +3.67%, the MSCI EAFE Net Index returned +7.07% in local currency terms but -0.71% in US dollar terms. Outside developed markets, the MSCI Emerging Markets Index return was down 4.16% presumably reflecting negative sentiment for outsourcing and potential for deteriorating trading relationships.

While investors in the U.S. responded well to the prospect of fiscal stimulus, reduced corporate regulation, and lower taxes following the U.S. presidential election, foreign markets were tempered by concerns over protectionist talk and the overhang of uncertainty surrounding Brexit.

SGA Research: Dividends

Recent research conducted by SGA observed that investor demand for return of capital (both dividend yield and share buybacks) has been increasing over the past 20 years. There is also evidence of structural investor demand for income, as investors tend to pay a higher valuation premium for dividend yield when corporate bond yields are low.

Although high dividend stocks have a reputation for defensiveness, we found they are no less volatile, and experience similar downside capture, even in market corrections or bear markets. Moreover, a mechanical strategy of buying the highest yielding stocks in an index would be fraught with heavy sector and country biases that limit diversification. In fact, the majority of excess return from the high dividend yield strategy in the past 20 years can be explained by risk factors in SGA's risk model.

In keeping with our investment philosophy, SGA's portfolios are typically close to neutral relative to their corresponding benchmark with respect to dividend yields, but have positive active exposure to share buybacks. This is by design, and reflective of our current and previous research which indicate that high dividend yield strategies are not a source of persistent risk-adjusted excess returns. On the other hand, share buy-backs are an important component of SGA's external financing alpha factor, as our research shows buybacks convey an important signal that management believes their stock is undervalued.

Strategy Update

The three SGA international equity strategies highlighted below under-performed in 2016 but all three strategies had positive excess returns for the three and five-year periods ending December 31, 2016.

International Equity	YTD	3-Yrs*	5-Yrs*
SGA (Gross)	0.44%	1.71%	9.79%
SGA (Net)	-0.55%	0.70%	8.71%
MSCI EAFE (Net)	1.00%	-1.60%	6.53%
SGA Excess (Gross)	-0.56%	3.31%	3.26%

International All Cap Equity	YTD	3-Yrs*	5-Yrs*
SGA (Gross)	1.31%	2.25%	10.38%
SGA (Net)	0.30%	1.24%	9.28%
MSCI World ex-US IMI (Net)	2.95%	-1.20%	6.44%
SGA Excess (Gross)	-1.63%	3.46%	3.93%

International Small Cap Equity	YTD	3-Yrs*	5-Yrs*
SGA (Gross)	2.40%	3.45%	12.78%
SGA (Net)	0.87%	1.91%	11.12%
MSCI World Ex-US Small Cap (Net)	4.32%	1.36%	8.96%
SGA Excess (Gross)	-1.92%	2.09%	3.82%

***annualized**

Click here for a full update and additional disclosures on SGA's Strategies

Please feel free to contact us with any questions.
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Important Risk Considerations: There is potential for shortfall in any investment process due to a variety of factors including but not limited to, data and system imperfections, analyst judgment, and the complex nature of designing and implementing portfolio construction systems and other quantitative processes in particular pose broader risk because they may be more pervasive in nature. Furthermore, the Advisor's systems may not necessarily perform in a manner in which they have historically performed or were intended to perform. The Advisor recognizes that such shortfalls are inherent to both fundamental and quantitative processes, and believes that combining both approaches improves the opportunity to reduce these shortfalls. However, these efforts may not necessarily result in the identification of profitable investments or the management of risk. Past performance is not indicative of future results.