William Blair



# Summary & Outlook

# International Leaders ADR SMA Strategy

## Market Overview

Global equities advanced in the second quarter (the MSCI ACWI IMI returned +11.62% for the quarter and +9.82% year-to-date) despite geopolitical and macroeconomic volatility at the beginning of the quarter after the U.S. introduced sweeping reciprocal tariffs in early April. However, partial rollbacks and resilient economic data helped stabilize markets. Value-oriented equities underperformed growth (the MSCI ACWI IMI Growth returned +17.06% for the quarter and 9.17% year-to-date, while the MSCI ACWI IMI Value returned +6.23% for the quarter and 10.51% year-to-date). This was reflected in global sector performance, with information technology (+23.09% for the quarter and 8.70% year-to-date as measured by MSCI ACWI IMI) and communication services leading (+17.66% for the quarter and 14.89% year-to-date as measured by MSCI ACWI IMI) while energy lagged (-2.86% for the quarter and +4.50% year-to-date).

U.S. equities finished higher in the quarter (+10.98% for the quarter and +5.55% year-to-date as measured by the MSCI USA IMI) after coming under pressure in the first quarter. Cooler inflationary data coupled with better-than-expected earnings helped fuel returns. The Mag 7 names also largely rebounded on renewed optimism surrounding the broader AI growth. The Federal Reserve left rates unchanged during the quarter, noting concerns about inflation following tariff announcements. Despite the most recent pause, market expectations still indicate a possibility of two rate reductions by the end of 2025.

European equities advanced during the second quarter (+12.20% for the quarter and +23.41% year-to-date as measured by the MSCI Europe IMI). Although European markets initially declined following U.S. tariff hikes, a partial rollback of tariffs in April led to a sharp rebound in equities. Sentiment was also boosted largely on the ongoing wave of optimism about fiscal and defense spending. The ECB cut interest rates for the eighth time in a year, acknowledging that inflation was under control, while also noting that it is approaching the end of the cutting cycle.

Emerging markets posted positive returns (+12.71% for the quarter and +14.62% year-to-date as measured by the MSCI EM IMI), aided by weakness of the U.S. dollar. Within EM Asia, Korea was a standout performer (+34.42% during the quarter and 40.60% year-to-date) following the conclusion of the presidential election and marking the end of the recent political instability. Chinese equities gained (+2.73% for the quarter and +17.73% year-to-date as measured by MSCI China IMI) despite escalation of a brief tariff war with the U.S. India also showed resilience (+10.42% during the quarter and 4.70% year-to-date). Latin America returns advanced (+15.86% for the quarter and 30.69% year-to-date as measured by the MSCI EM Latin America IMI) with strength from Mexico and Brazil. EMEA was also positive (+7.42% for the quarter and 14.74% year-to-date as measured by the MSCI EM EMEA IMI), with strength from Poland (+16.83% for the quarter and 52.68% year-to-date, as measured by MSCI Poland IMI).

## Performance

### 2Q 2025

The William Blair International Leaders ADR SMA Strategy (net of fees) outperformed its benchmark, the MSCI ACWI ex US IMI index during the second quarter and underperformed year to date.

In Q2 2025, the International Leaders ADR strategy outperformed the MSCI ACWI ex-US IMI index. From a sector perspective, allocation effect was positive, as the strategy benefitted from underweight exposures to consumer staples and energy and overweight exposures to information technology and industrials. Selection effect was positive due to strong selection within consumer discretionary and healthcare, offset by negative selection within industrials and financials. On a regional view, allocation effect was negative as an overweight to Europe weighed on returns, while selection effect was positive within Europe ex-U.K. and Latin America.

Within consumer discretionary, positive selection was due primarily to Mercadolibre. This was partially offset by negative performance from Trip.com. Mercadolibre, the leading e-commerce platform in Latin America, combines logistics, payments, and retail into a best-in-class ecosystem. The company posted 37% revenue growth year-over-year, as it executed successfully across both commerce and fintech segments. We believe the expansive Latin American market offers significant potential for long-term growth and investment. Trip.com is China's leading online travel agency with a dominant market share. It offers a comprehensive range of services, including transportation ticketing, hotel bookings, packaged tours, and destination resort tickets. While fundamental performance continues to benefit from the structural growth in Chinese consumers' travel spending, management reduced expected margins as it looks to expand the platform internationally.

Healthcare selection was bolstered by a position in Sandoz Group. Sandoz Group—spun out of Novartis in 2023—is a global leader in off-patent medicines, spanning generics and biosimilars. Although recent results modestly missed expectations, management reaffirmed full-year guidance, signaling confidence in its second-half performance. Multiple biosimilar launches are expected later this year, and the firm remains focused on expanding EBITDA margins through sales mix optimization, network streamlining, and continued transformation efforts.

Within industrials, Kingspan underperformed. Kingspan has developed differentiated insultation technology that offers energy efficiency, improved durability, reduced maintenance costs, and faster construction times. Overall, first-quarter results for Kingspan were solid despite what management noted as a sluggish start to the year. The company noted sentiment differences across regions as it relates to economic uncertainty but remains constructive on the second half of the year as Kingspan's order backlog continues to grow.

Financials selection was negative due to underperformance of Sumitomo Mitsui Financial Group (SMFG) and London Stock Exchange (LSE). Japanese banks, including SMFG, came under pressure after 10-year Japanese Government Bond yields fell sharply following April 2 U.S. tariff announcements, introducing growth and rate uncertainty. SMFG rebounded as yields recovered, yet still trails March highs, partly due to earnings guidance falling short of market expectations. LSE delivered in-line results and reiterated its full-year outlook, but the stock lagged amid concerns over IPO and M&A activity. We remain constructive on LSE's resilience given its diversified revenue base, particularly in data and risk services.

### YTD 2025

The International Leaders ADR strategy underperformed the MSCI ACWI ex-US IMI index in the first half of the year. From a sector perspective, allocation effect was negative due to overweight exposures to health care and consumer discretionary. Selection effect was negative primarily within financials and information technology, partially offset by strong selection within communication services. On a regional view, allocation effect was positive due to an overweight to Europe ex-U.K. and underweight in emerging Asia. Selection effect was negative primarily within Japan and Europe ex-U.K.

Financials selection was negative due in part to exposures to London Stock Exchange (LSE) and Sumitomo Mitsui Financial Group (SMFG). LSE is a best-in-class diversified global market infrastructure company with a very good M&A track record. The business mix stands out with roughly 60% of revenue from more durable non-transaction-driven businesses and significant exposure to structural growth opportunities (indices, OTC clearing). After strong performance of the stock over the past two years, LSE underperformed the market and financials in the first half of the year due in part to the strong U.K. sterling bringing down earnings estimates, as well as some uncertainty on the IPO and M&A market given macro risks and market volatility. We remain constructive on LSE's resilience given its diversified revenue base, particularly in data and risk services.

SMFG is a Japanese bank whose share price has been rewarded over the past few years as Japan normalizes its interest rate policy, providing a boost to earnings power for SMFG. Japanese banks came under pressure after 10-year JGB yields fell sharply following April 2 U.S. tariff announcements, introducing growth and rate uncertainty. SMFG's stock rebounded as yields recovered, yet still trails highs, partly due to earnings guidance falling short of market expectations.

Within information technology, negative selection primarily came from semiconductor holdings Advantest and ASM International. Underperformance for these companies was due to concerns on capital expenditures required for the AI infrastructure buildout that had been priced into the market after Chinese company DeepSeek announced early in the year that it created a large language AI model comparable to the best models in the market but with significantly less cost and computing power required.

Positive selection within communication services was due to outperformance of Spotify Technology and Sea Ltd. Spotify is a leading global provider of streaming music services with roughly 260 million paying subscribers and 620 million total monthly active users including the company's freemium/ad-supported product. Market share is estimated at 35%. We see a long runway for user growth while monetization and profitability are key priorities. The company has been able to smoothly implement price increases in recent years without issue. During the first quarter, the company had the largest addition of new subscriber adds since 2020.

Sea Limited is an Indonesian digital platform that provides e-commerce, gaming, and financial services. The e-commerce business, Shopee, is the largest pan-regional e-commerce platform in Southeast Asia and Taiwan and has a significant presence in Latin America. The stock appreciated on strong fundamental growth across all three key business segments and management's upgraded forward guidance.

## Positioning

During the quarter exposure to healthcare was reduced and includes sells of AstraZeneca and Novo Nordisk. In our view, pharmaceutical companies face a tougher growth environment following strong periods of growth during the covid years. We continue to see growth slowing for the winners of the past few years and therefore feel it is prudent to exit positions in these companies to fund positions in the higher growth areas. While Novo Nordisk remains a key player in the GLP-1 space, several data points lead us to believe the stronghold on the market is weakening given the success of new entrants and the lack of significant advancement of an oral version of its GLP-1.

Exposure to the materials sector increased and includes additions to the position in Heidelberg Materials and a purchase of Air Liquide. As one of the leading suppliers of industrial gases—essential to sectors like food & beverage, steel, and semiconductors—Air Liquide is a high-quality compounder with attractive self-help potential and a favorable industry backdrop. Air Liquide offers a compelling alternative to Linde, which was sold in the first quarter, with similar dynamics but more upside to improving macro conditions and limited direct tariff risk.

Utilities exposure also increased due to a purchase of Enel. A leading electricity distributor across Italy, Spain, Chile, and Peru, Enel is well positioned to benefit from the long-term electrification theme, especially in Europe. The company offers compelling growth in renewables and earnings accretion through minority buyouts, supported by an experienced management team.

## Outlook

The first half of 2025 generated plenty of news flow to worry about - tariffs, wars, the "Deep Seek" moment. Yet, equity markets performed well: Developed Markets outside the U.S. returned more than 17%, while the broader U.S. indices fell short of a 6% return. We see collapsing growth differentials –economic growth in the U.S. is now expected to be weaker relative to its 4-year recent trend, while the economies of Japan and the Euro Area may actually accelerate – as a primary explanation for what is happening in the global financial markets.

For us as quality growth investors, seeking answers to "where is growth" and "where is it changing" remains central to how we invest. Quality companies are able to exploit opportunities afforded by economic growth, and some – these are more rare and more valuable – actually create new demand. As equity investors, we define growth as improvement in earnings and cash flow generation.

## Wedges are Back

So, the world outside of the U.S. has performed significantly better than the U.S. for the first time in nearly a decade. How can this be when discussion of U.S. exceptionalism is all the rage? In a nutshell, GDP growth outside the U.S. is improving; we see it in the Euro Area, Japan, and China. It remains true that U.S. companies innovate and commercialize scientific breakthroughs particularly well, but others are now moving to create conditions to unlock domestic growth opportunities. Why now?

## Action and Reaction

A flurry of policy changes by the Trump administration is forcing countries around the world to grapple with now inescapable challenges. Specifically, how to respond to a reduced, or a more costly, U.S. security blanket? How to adjust to a new tariff regime from the world's principal demand center? How to stay relevant in the age of AI? More fundamentally, how to overcome stagnant or falling incomes which are fueling political populism without upending the global order that led to unprecedented peace and prosperity? Policy responses to each of these questions are sources of economic growth.

Tariffs are back even though they are widely seen to have been inimical to growth when last tried in earnest a century ago. When the goods you sell to the world's largest economy become more expensive at the stroke of a pen, you are forced to innovate, and to seek out new markets. Said another way, a new problem requires a new solution, a path to which lies through stronger domestic growth. For Europe, it means removing internal barriers to trade and unleashing investment. In China, it's about building out a social safety net to generate stronger domestic demand.

The U.S. has long spent more on defense than the next ten NATO members combined. The Russia-Ukraine war, coupled with the U.S. wavering to uphold its NATO commitments jolted the European Union to ratchet up its defense spending. Most members recently committed to elevate military and related spending to 5% of GDP, something that seemed unthinkable only a few years ago. But why spend more to buy gear from an increasingly fickle partner? Europe is mobilizing funds and streamlining procurement to enable the rapid rise of its domestic defense industry. Even Germany finally shed its fiscal straitjacket and committed to spending at least 500 billion euros over the next decade to upgrade its infrastructure and military capabilities. Little wonder that many new defense companies have sprung up in Europe in the last 5 years in a sector that remained taboo for decades.

Underpinning these recent policy changes is the challenge of generating income growth in most modern, mature democracies. Following the GFC, most countries, with the notable exception of the U.S., embarked on the path of fiscal consolidation, which resulted in chronic underinvestment, anemic economic activity, and the rise of populism. In response, the political class in most established democracies is now prioritizing economic growth as an antidote to economic stagnation and rising populism. Indeed, U.S. tariffs can be seen as a political response to the hollowing out of the middle class, and market share loss to producers from other countries. The exact policies are specific to local conditions: Japan continues to focus on improving capital allocation and corporate governance, with South Korea now looking to follow suit. China is stabilizing its real estate market and rolling out social services provision where people live, not where they're registered. In Europe, the now famous Draghi report is taken as a blueprint for policies to streamline intra-EU regulations so European domestic markets can grow, and European companies can regain competitiveness.

Technological advancements underpin economic and political realignments. The rapid proliferation of Artificial Intelligence, or AI, capabilities is already redefining modern warfare and soon will be evident in healthcare and manufacturing. It's not only about where we work, but whether we drive to get there, how we spend our leisure and what we consume. To enable these advancements, datacenters need to become as ubiquitous as factories were fifty years ago. Underpinning datacenters requires building out all the attendant additional electricity generation and related infrastructure necessary to connect and operate these facilities. In other words, more economic growth in most parts of the world underpinned by investment into power generation and distribution.

## Same as it ever was

Proliferation of economic growth as an outcome of solving current challenges is perhaps less surprising than meets the eye. Our strategy team have framed their answer to the question of why growth happens via a framework they call the Perpetual Growth Machine. Its core thesis is that human beings want to improve their lot, always have, always will, and so they deploy their ingenuity and resources toward developing new tools, new solutions and growth is the result. Acute problems generate solutions, and this process results in economic growth. And solutions to existing problems generate new challenges which in turn must be overcome. This machine is always on: identify where people are trying to solve current problems, and this will point to where growth is improving. Then, witness the effect of this improvement on asset price performance.

# International Leaders ADR SMA Strategy

Second Quarter 2025

| Composite Performance (%) | Qtr | YTD | 1 Yr | Annualized 3 Yr | 5 Yr | 10 Yr | Since Inception (Jan 1 03) |
|---|---|---|---|---|---|---|---|
| **International Leaders ADR SMA (Gross of fees)** | **13.70** | **15.49** | **11.48** | **13.64** | **7.59** | **6.63** | **7.93** |
| **International Leaders ADR SMA (Net of fees)** | **12.88** | **13.81** | **8.21** | **10.30** | **4.42** | **3.49** | **4.77** |
| MSCI AC World ex-US IMI Index | 12.71 | 17.88 | 17.83 | 13.92 | 10.20 | 6.18 | 7.94 |
| MSCI EAFE Index | 11.78 | 19.45 | 17.73 | 15.97 | 11.16 | 6.51 | 7.51 |

https://williamblair.com/~/media/Downloads/IM/Composite_Disclosures.pdf

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