



# Uncut Gems: International Small Cap Equities

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Ryan Myers, Portfolio Manager

- The unique International Small Cap (ISC) universe
- Does value investing work in ISC?
- Causeway's "no trade offs" approach to ISC
- Portfolio case studies

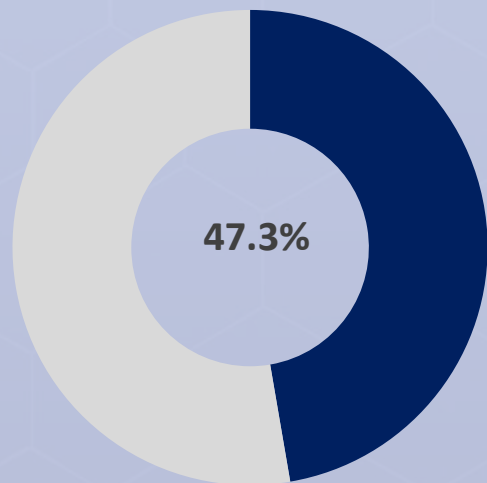
What % of total international stocks (by number) are small caps (i.e., in the ACWI ex US Small Cap index)?

- a. 22%
- b. 33%
- c. 44%
- d. 55%
- e. 66%

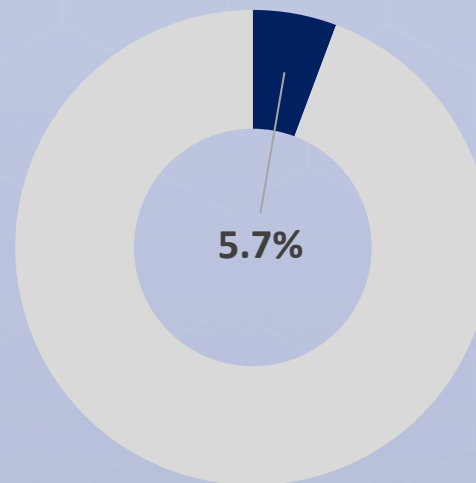
# International Small Caps are 2/3 of international stocks...

MSCI ACWI  
IMI Index

% ISC by Number

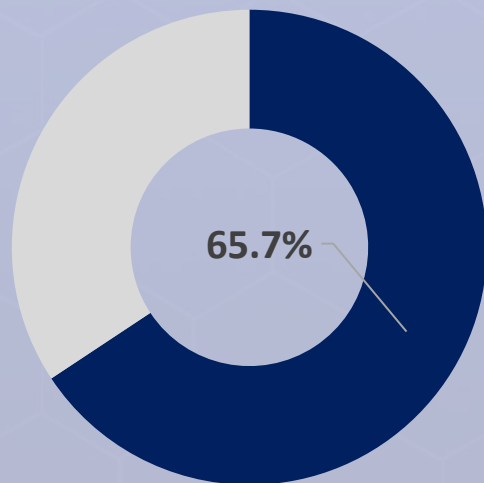


% ISC Index Weight

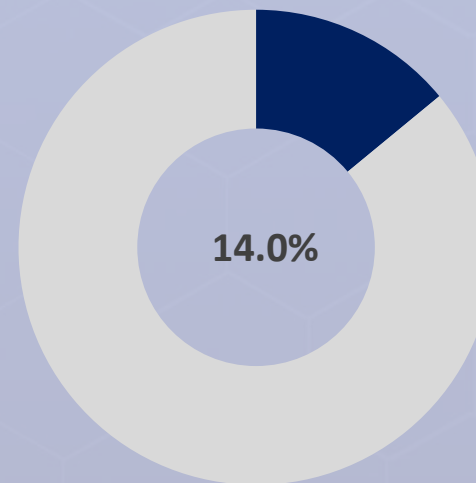


MSCI ACWI ex US  
IMI Index

% ISC by Number



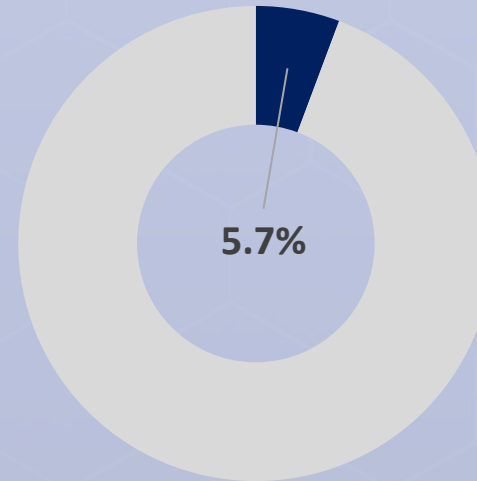
% ISC Index Weight



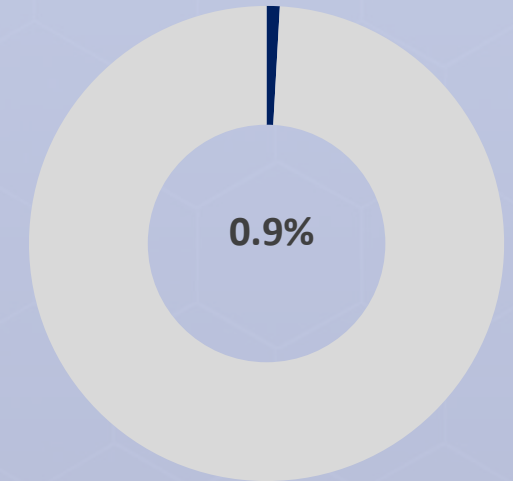
# ...but are significantly underowned by US investors

MSCI ACWI  
IMI Index

% ISC Index Weight

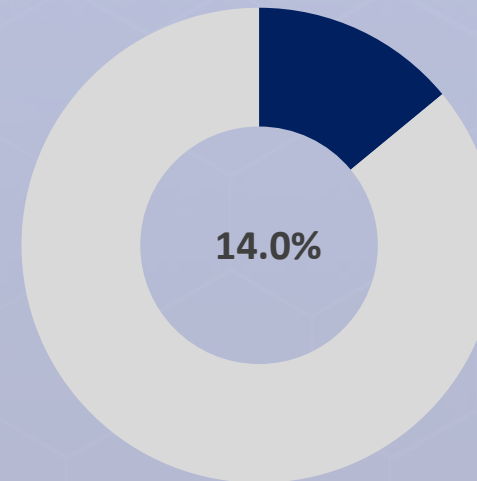


US Mutual Fund % ISC Exposure

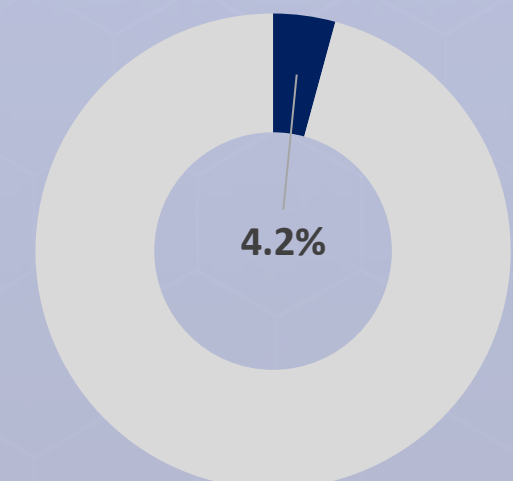


MSCI ACWI ex US  
IMI Index

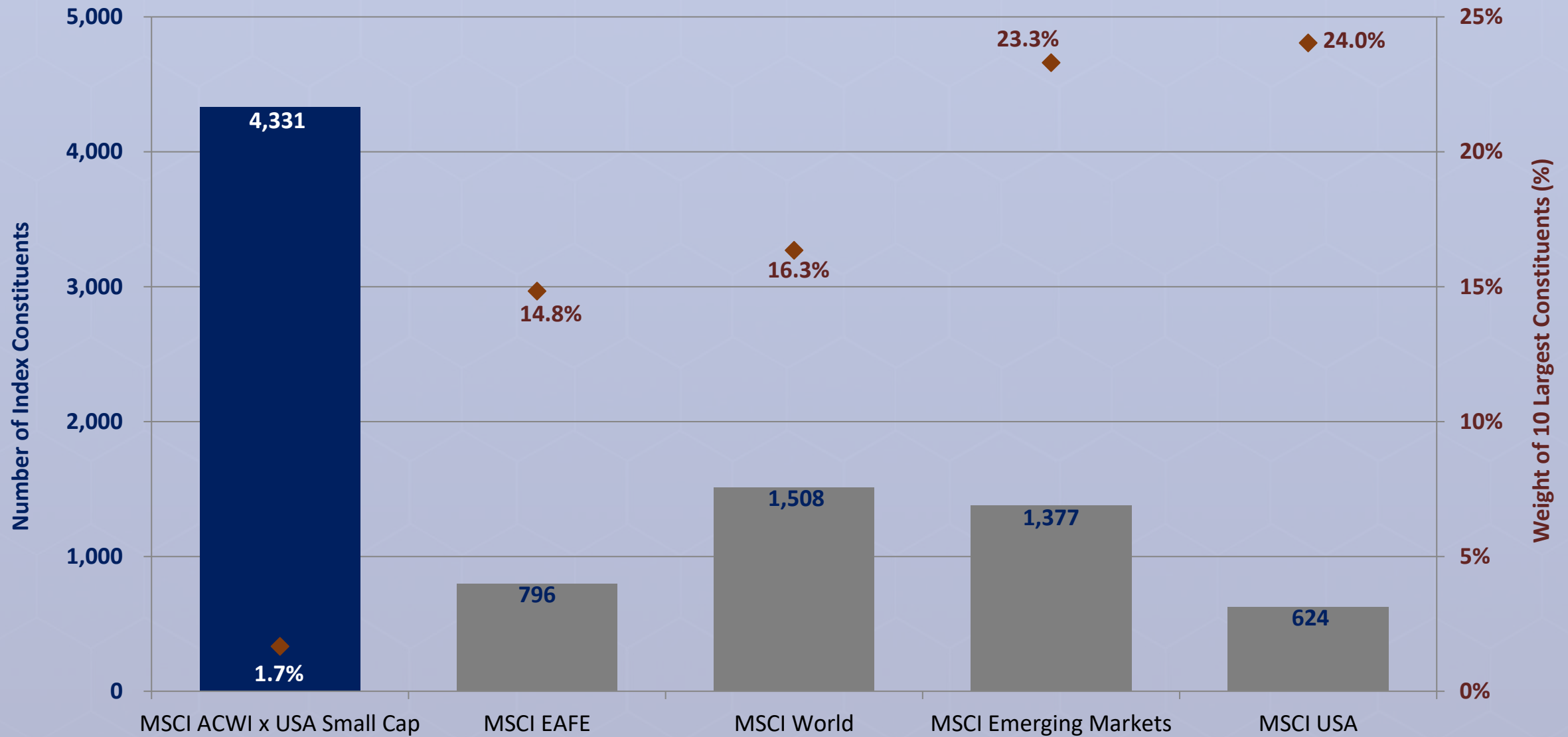
% ISC Index Weight



US Mutual Fund % ISC Exposure



# ISC universe is appealing for active management



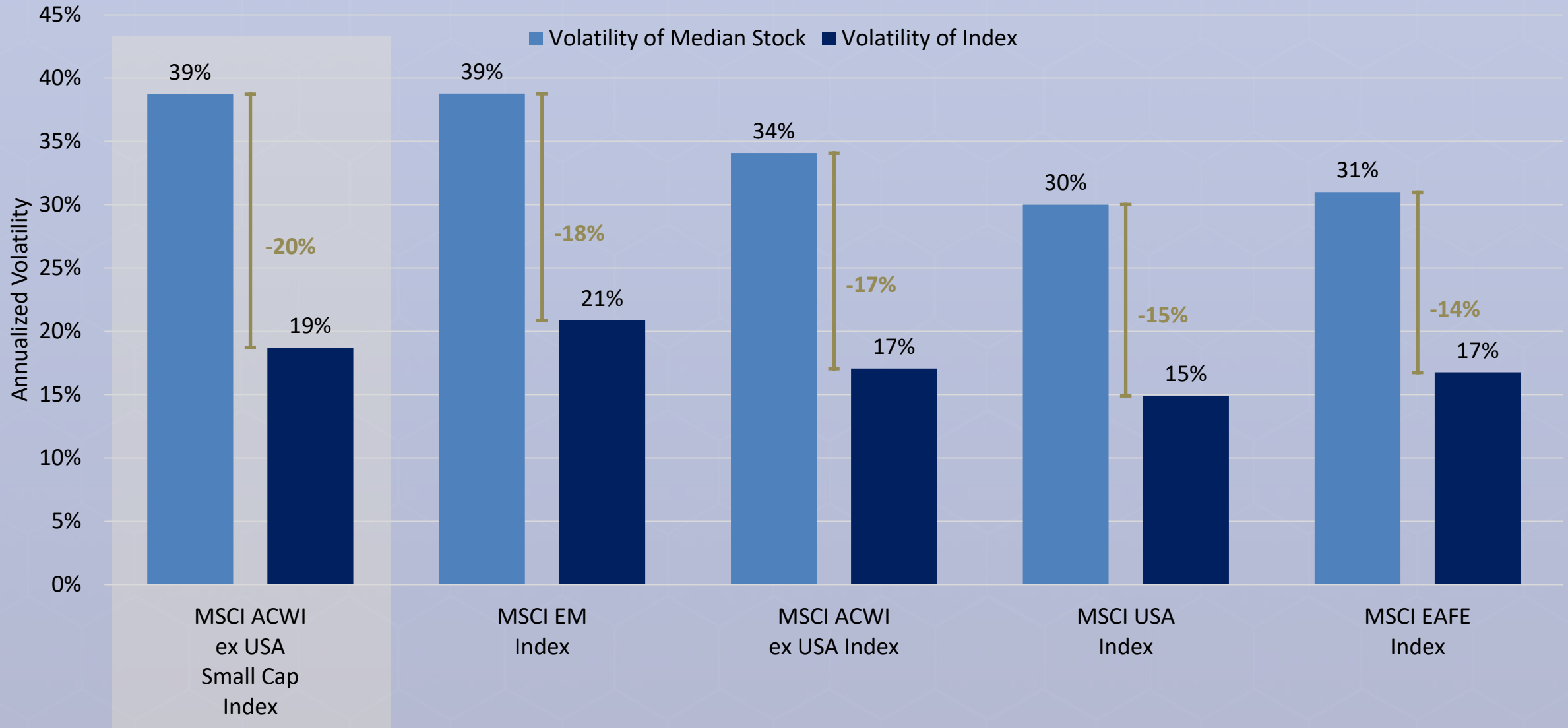
Note: Data as of December 31, 2022. The MSCI ACWI ex USA Small Cap Index's constituents range in size from US\$16mm to US\$6.86bn in float adjusted market cap, with a median size of US\$546mm. See Disclosures for more information about the indices. Source: MSCI, FactSet

The annualized volatility of the MSCI ACWI x US Index over the last 20 years was 17.1%.

What was the volatility of the MSCI ACWI ex US **Small Cap** Index?

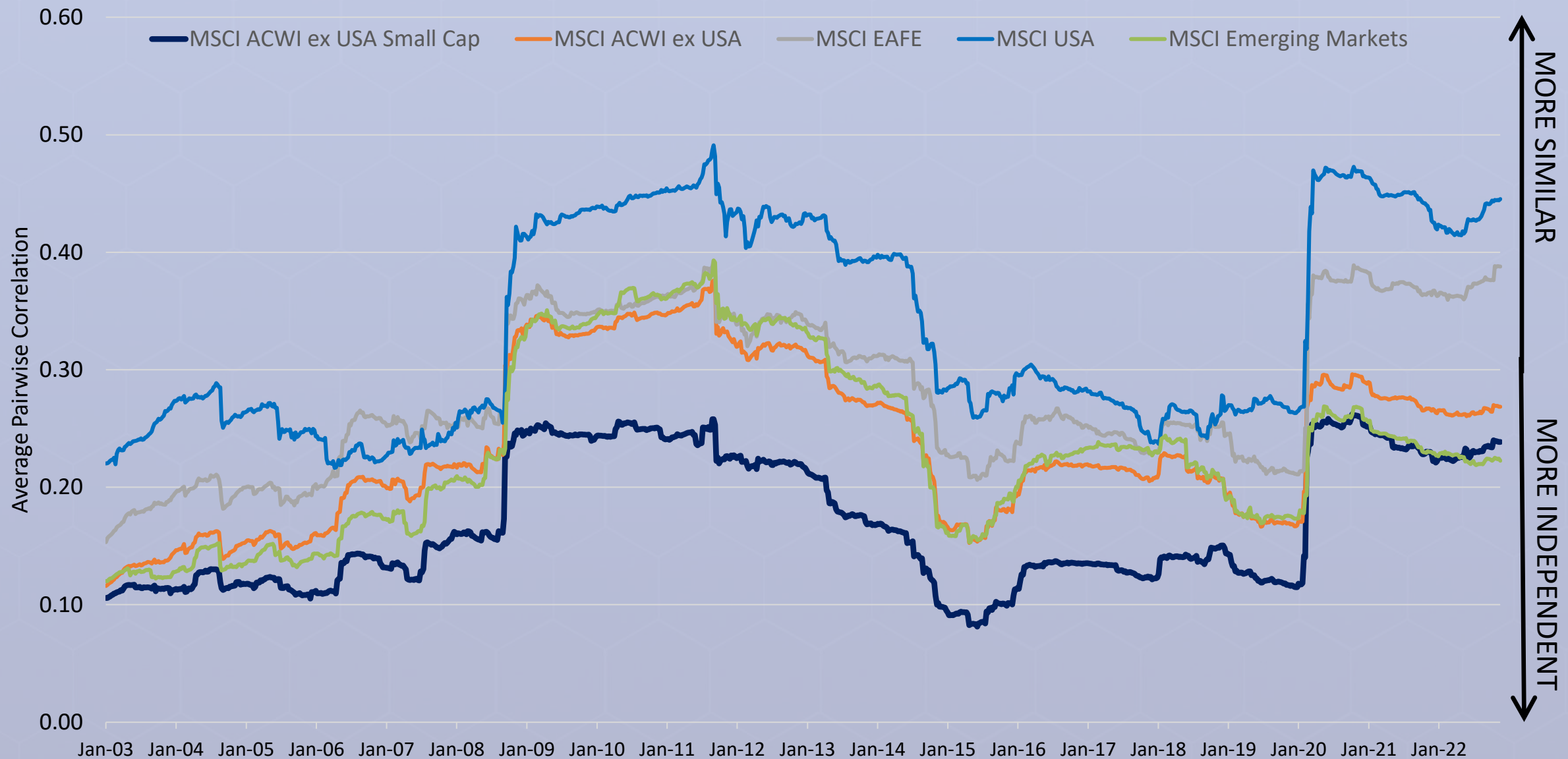
- a. 16.7%
- b. 18.7%
- c. 20.7%
- d. 22.7%
- e. 24.7%

# Larger reduction in ISC Index volatility from median stock volatility...





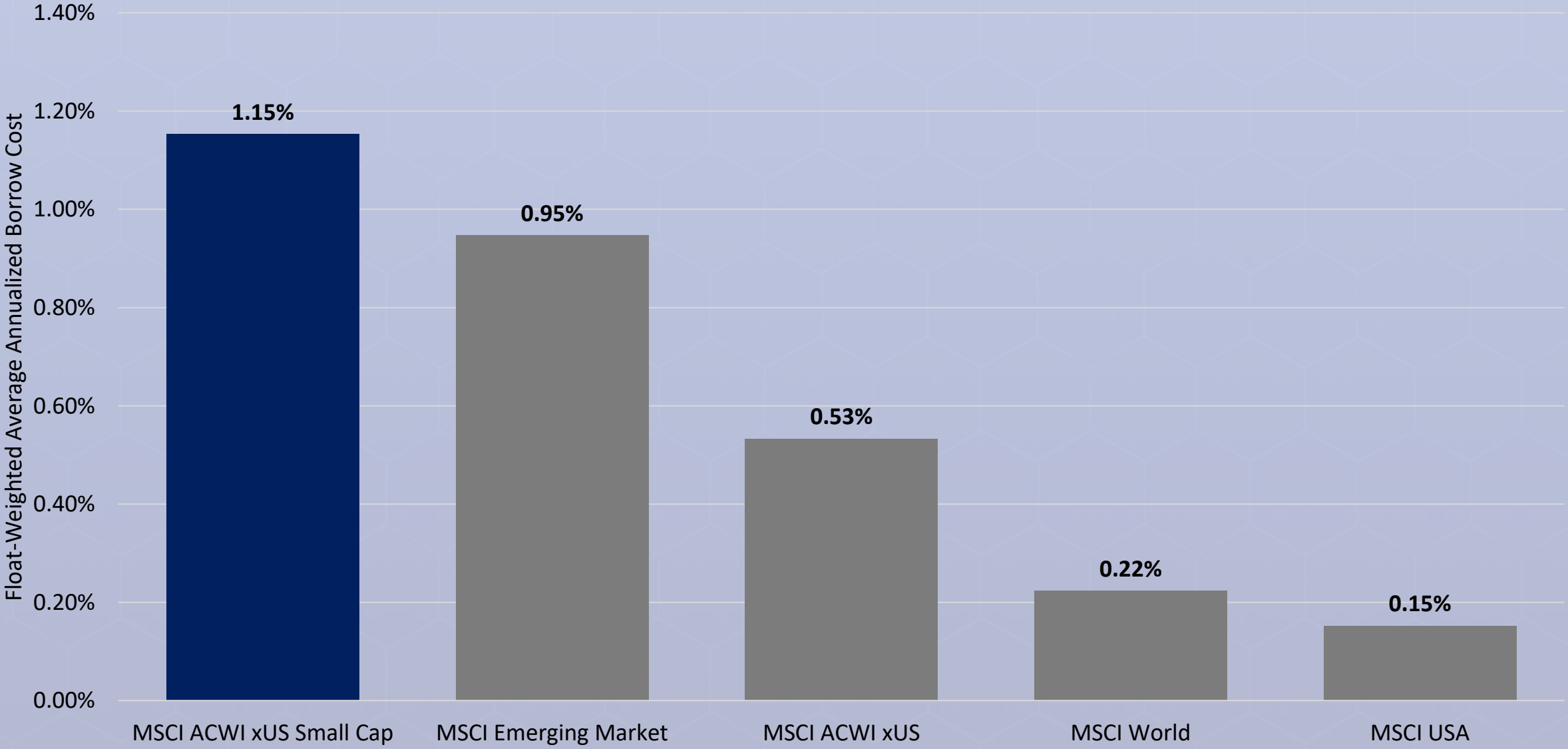
# ...because the ISC universe is highly diversified



Note: Mean pairwise correlation (average correlation among every pair of index constituents) using weekly USD returns on a trailing 156-week basis through December 31, 2022. See Disclosures for more information about the indices.

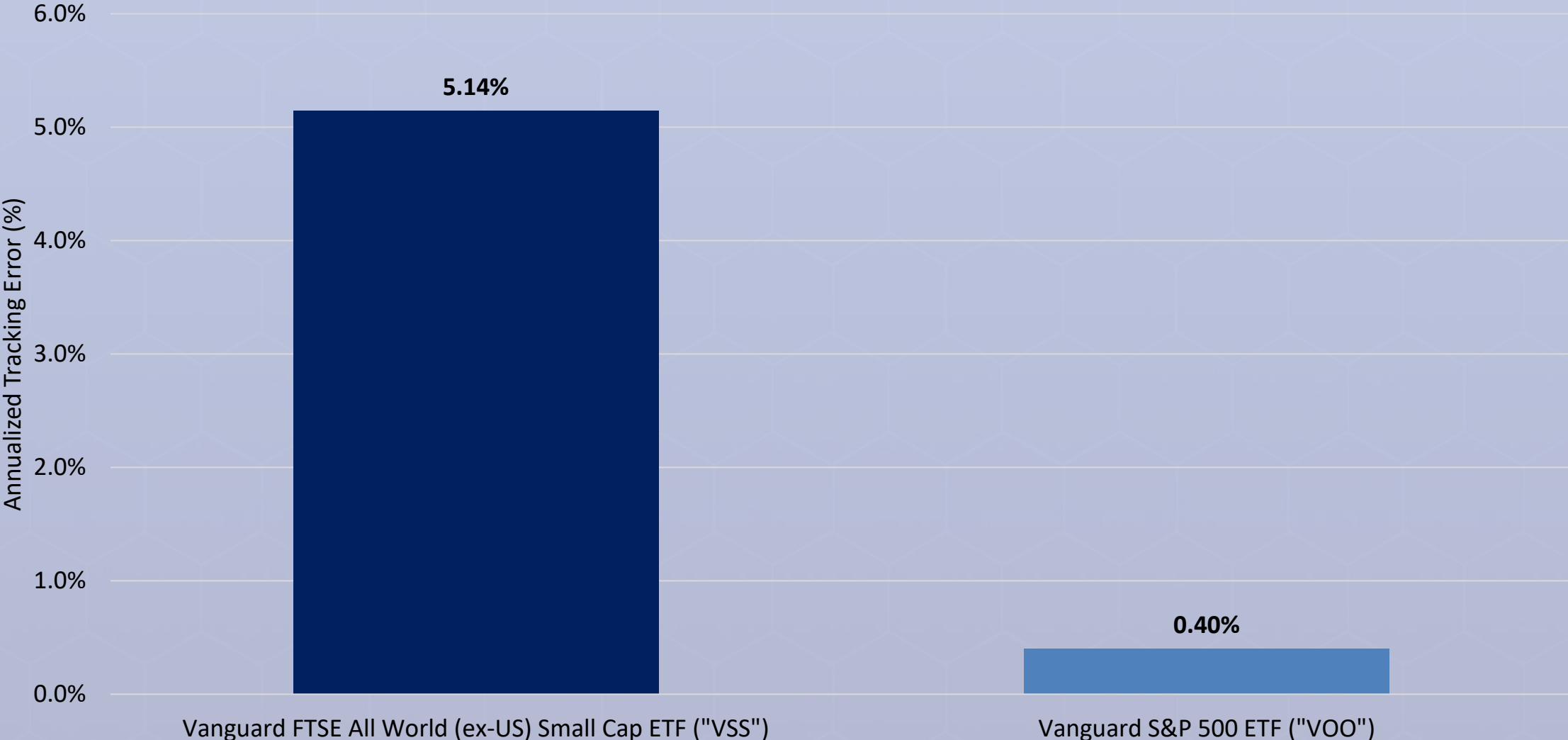
Source: MSCI, Causeway Analytics

# Higher borrow costs lowers market efficiency



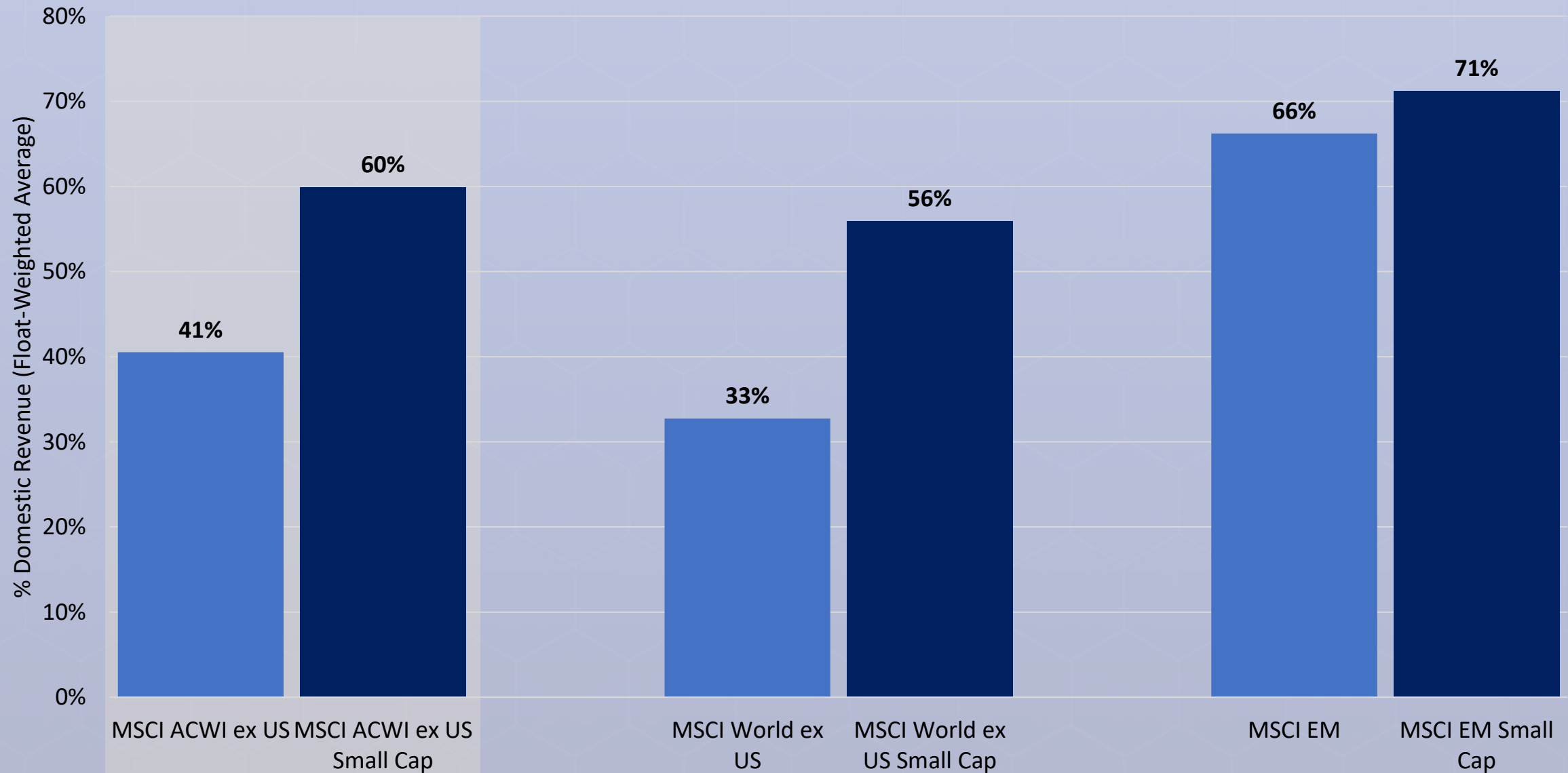
Note: Float-weighted average annualized borrow cost across the constituents of each respective index as of January 20, 2023. Source: Citi, MSCI, Causeway Analytics

# Breadth of universe makes passive replication challenging



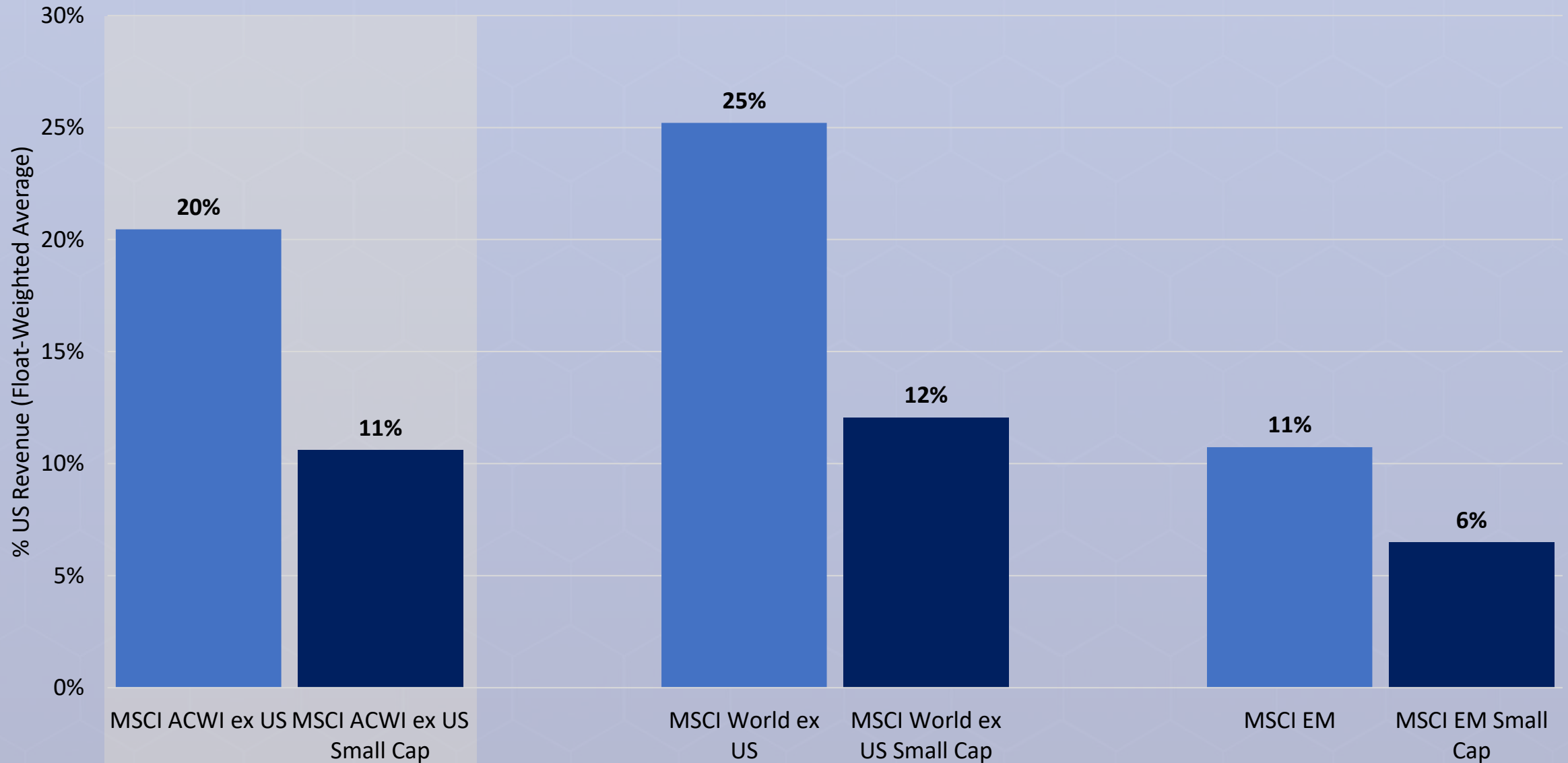
Note: Tracking error to each respective index calculated using trailing 5 years of weekly returns as of January 27, 2023. Source: MSCI, FactSet

# ISC stocks have more exposure to their local economies...



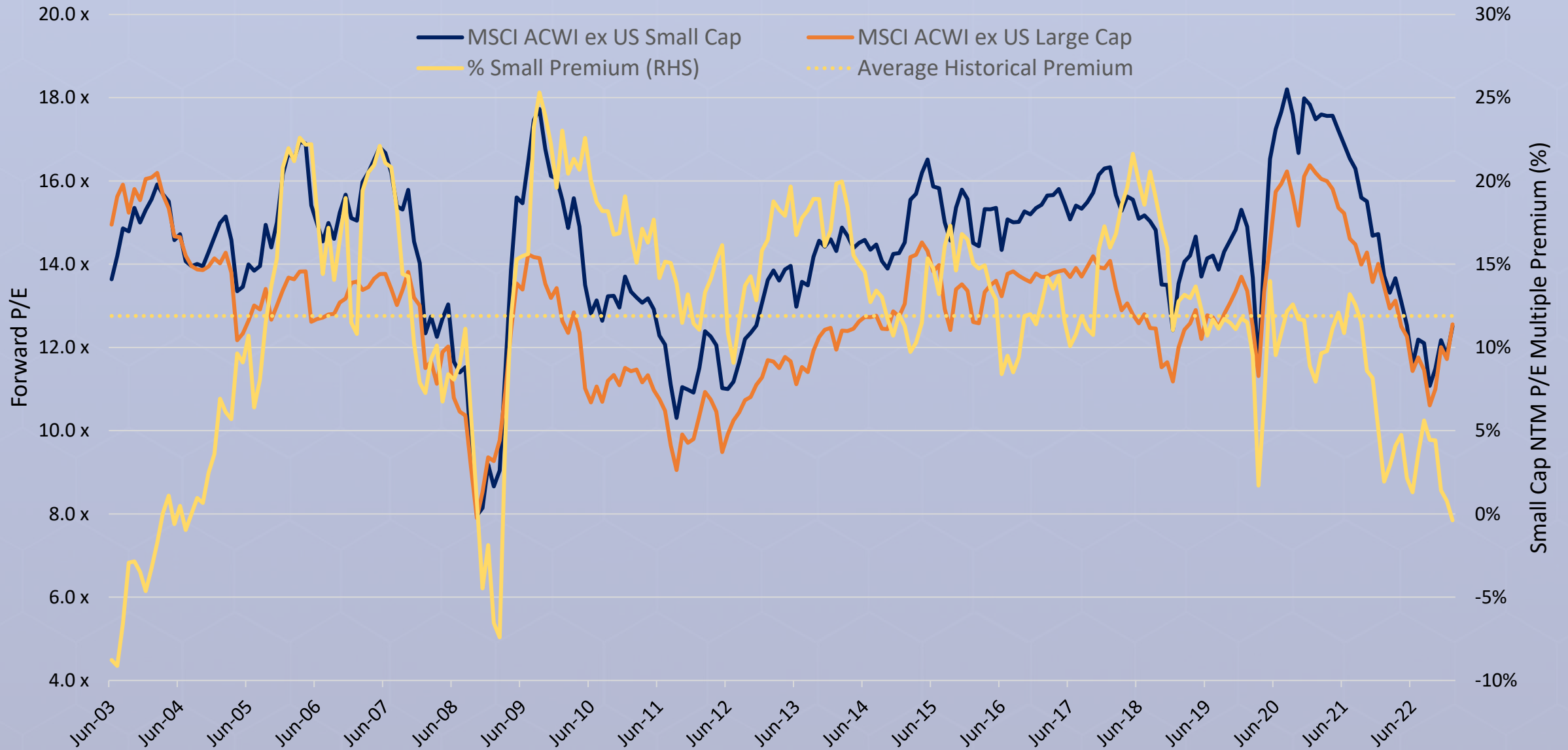
Note: Represents the float-weighted average revenue exposure to each constituent's respective domestic market based on most recently available data as of January 31, 2023. Source: FactSet, MSCI, Causeway Analytics

# ...and less exposure to the US (and the USD)



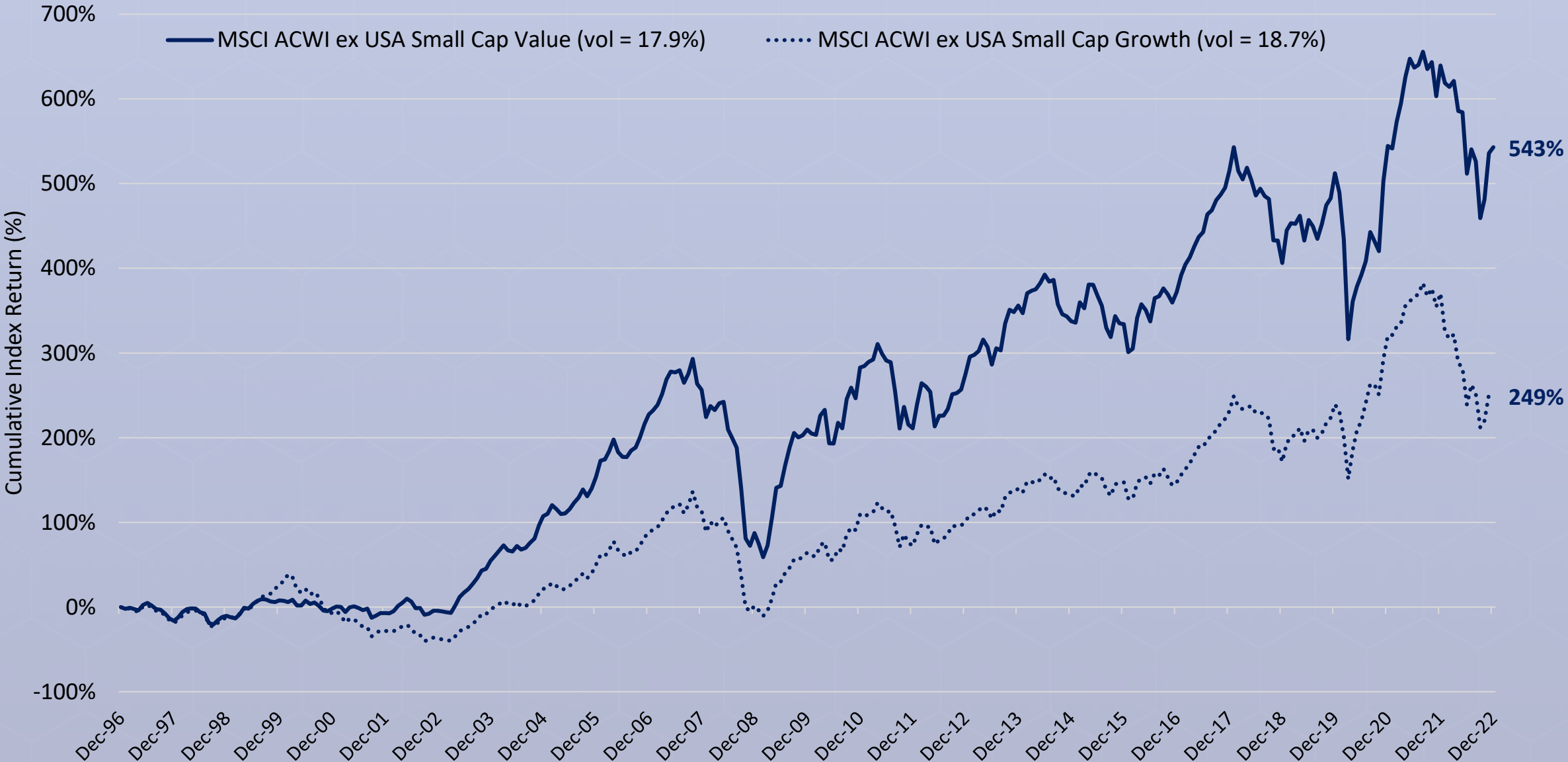
Note: Represents the float-weighted average revenue exposure to the United States based on most recently available data as of January 31, 2023. Source: FactSet, MSCI, Causeway Analytics

# International Small Caps atypically trading at parity with large caps



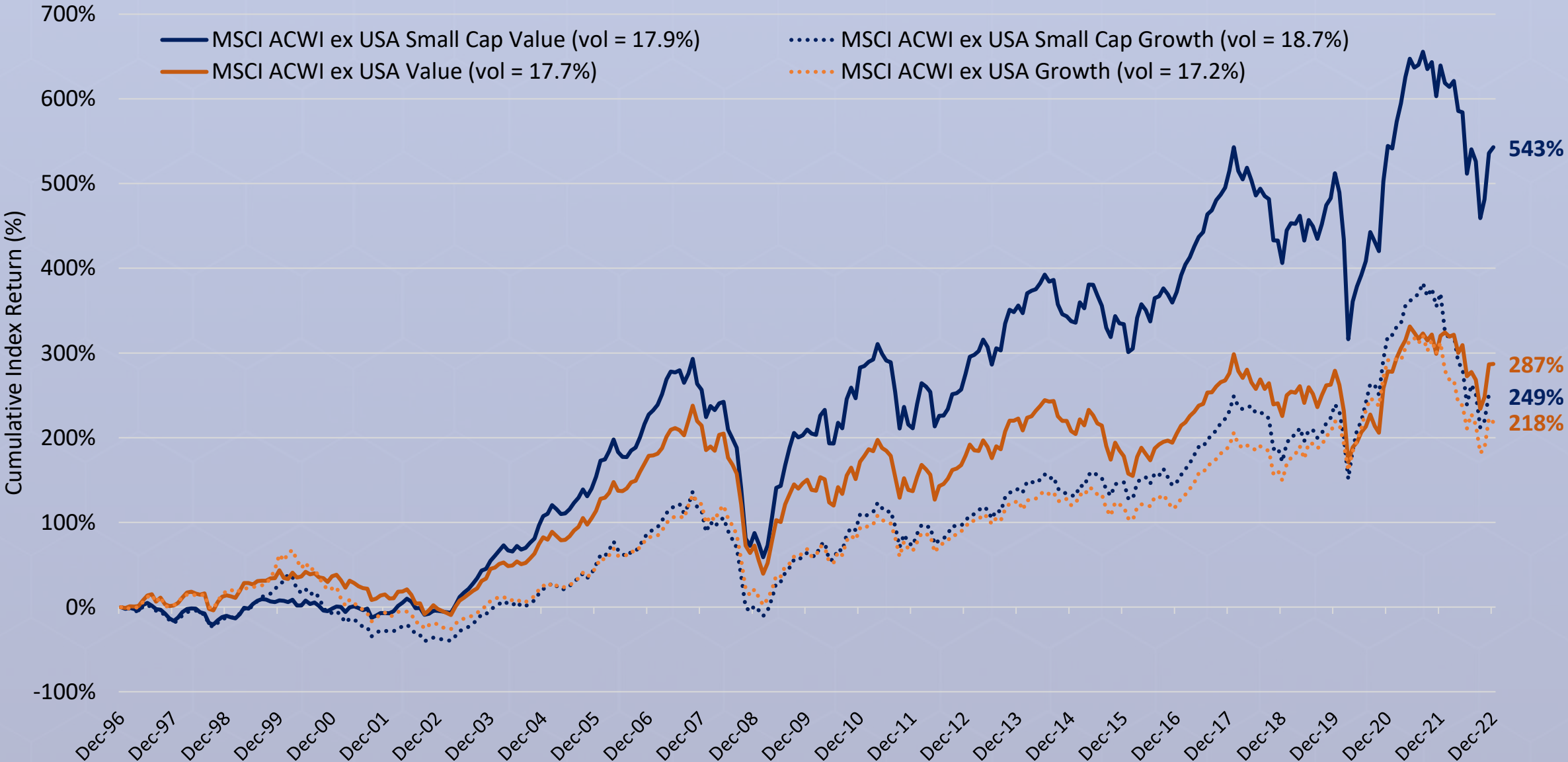
Note: The "Forward P/E" of a stock is its price divided by the consensus EPS estimate for the next twelve months. "% Small Premium" is the forward P/E ratio of the MSCI ACWI ex US Small Cap Index divided by the forward P/E ratio of the MSCI ACWI ex US Large Cap Index, less 100%. June 30, 2003 – January 31, 2023. Source: MSCI, FactSet, Causeway Analytics

# ISC Value Index has Outperformed Larger Cap and Growth Indices



Note: Cumulative USD index returns beginning December 31, 1996 (beginning of MSCI ACWI ex USA Value/Growth indices). Source: MSCI, FactSet, Causeway Analytics

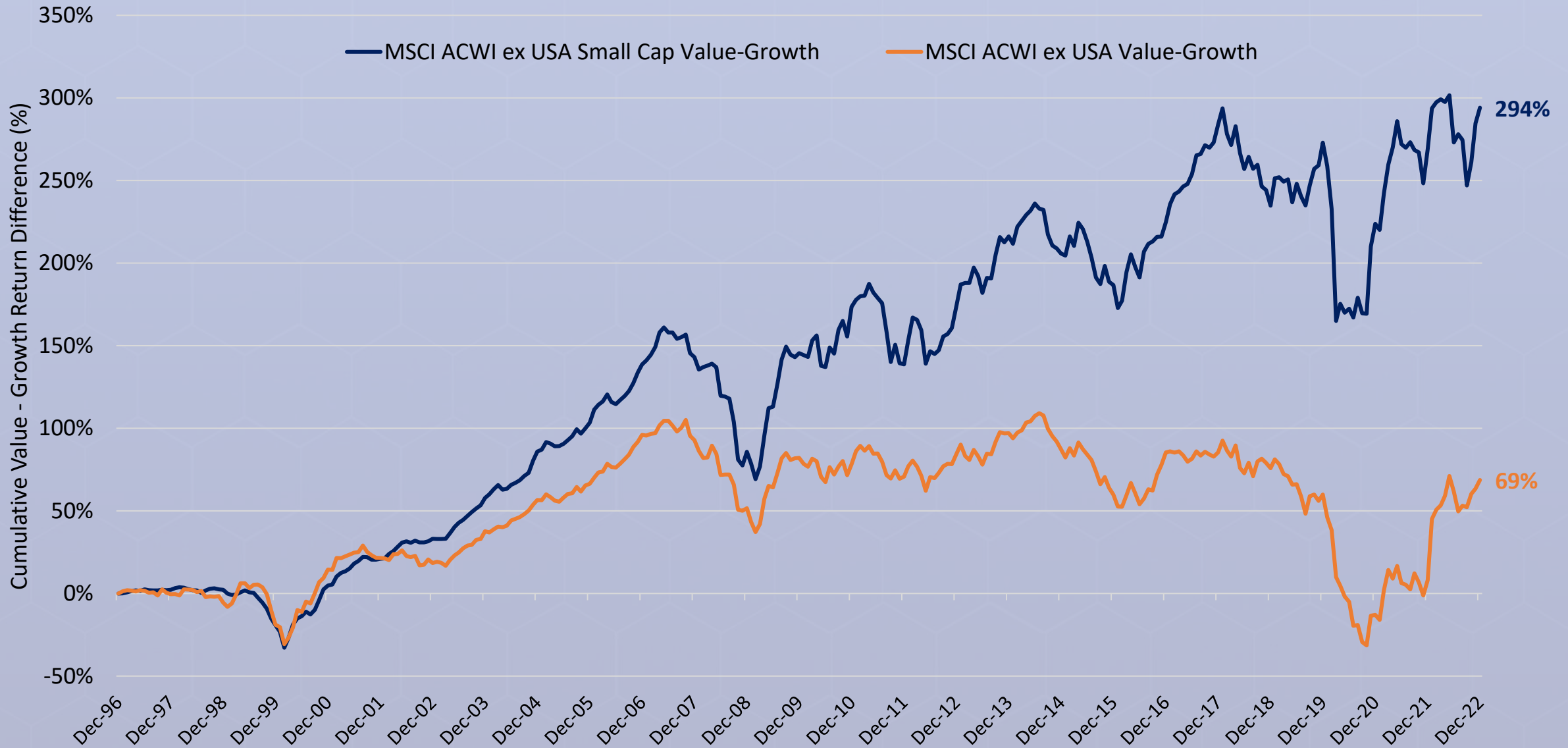
# ISC Value Index has Outperformed Larger Cap and Growth Indices



Note: Cumulative USD index returns beginning December 31, 1996 (beginning of MSCI ACWI ex USA Value/Growth indices). Source: MSCI, FactSet, Causeway Analytics



# Value's relative performance even better within Small Caps



Note: Cumulative USD return difference between 1) the MSCI ACWI ex US Small Cap Value Index and the MSCI ACWI ex US Small Cap Growth Index and 2) the MSCI ACWI ex US Value Index and the MSCI ACWI ex US Growth Index since December 31, 1996 (beginning of ACWI ex USA Value/Growth indices). Source: MSCI, FactSet, Causeway Analytics

Quantitative  
Research  
&  
Portfolio  
Management

Fundamental  
Feedback

## Quantitative Research and Portfolio Management

- Diverse alpha factor groups drive stock selection

|                        |                                    |
|------------------------|------------------------------------|
| Company-Specific (90%) | Valuation                          |
|                        | Earnings Growth                    |
|                        | Technical Indicators               |
| Top-Down (10%)         | Competitive Strength               |
|                        | Macroeconomic<br>Country Aggregate |

- Proprietary risk model and constraints promote diversification
- Optimization maximizes risk-adjusted expected returns

## Fundamental Feedback

- Fundamental analysts review certain positions for “red flags,” but usually confirm the quantitative model’s stock selection
- Quantitative PMs may reduce or exit positions
- Fundamental insights also inspire new alpha and risk factor research

Which of these stocks was a constituent in the ACWI ex US Small Cap Index 20 years ago (3/31/2003)?

- a. BYD Co Ltd (US\$101 bn market cap)
- b. London Stock Exchange (US\$50 bn)
- c. Merck KGaA (US\$82 bn)
- d. Safran SA (US\$62 bn)
- e. Sika AG (US\$43 bn)

**Centrica (CNA-LN)** is a diversified electricity and gas utility in the United Kingdom

CCM ISC Portfolio Weight: 2.33%

MSCI ACWI ex USA Small Cap Index Weight: 0.19%

**Active Weight: 2.14%**

|                        | Alpha Category       | Weight (%) | Alpha Score (-3 to +3) | Notes  |
|------------------------|----------------------|------------|------------------------|--|
| Company-Specific (90%) | Valuation            | 27         | 1.7                    | Trades at 5x 2023E EPS, estimated 100% cumulative FCF yield over next 4 years      |
|                        | Earnings Growth      | 27         | 1.7                    | Centrica favorably exposed to commodity process given upstream assets              |
|                        | Technical Indicators | 18         | 0.6                    | Stock rose following better-than-expected resolution of windfall tax on generation |
|                        | Competitive Strength | 18         | -0.4                   | Operates in highly regulated sector  |
| Top-Down (10%)         | Macro                | 5          | -0.5                   | UK: Declining leading economic indicators and PMI                                  |
|                        | Country Aggregate    | 5          | -0.8                   | UK: Country aggregate downgrades and negative momentum                             |
| <b>Final Alpha</b>     |                      | 100        | 2.0                    | Final alpha score in the 97 <sup>th</sup> percentile                               |

# Case Study: FinVolution

**FinVolution (FINV-US)** is a leading online lender in China, providing loans to individuals and small businesses

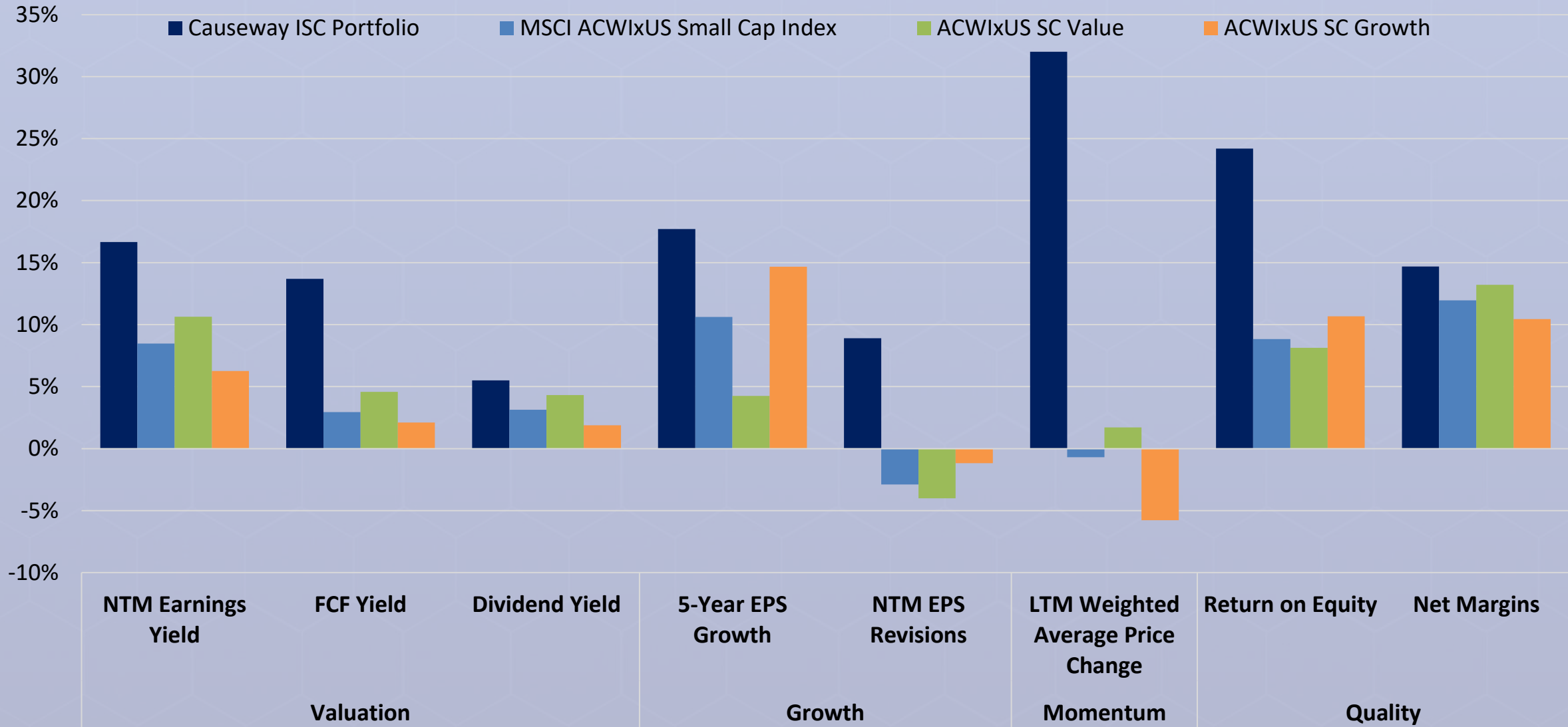
CCM ISC Portfolio Weight: 1.62%

MSCI ACWI ex USA Small Cap Index Weight: 0.02%

**Active Weight: 1.60%**

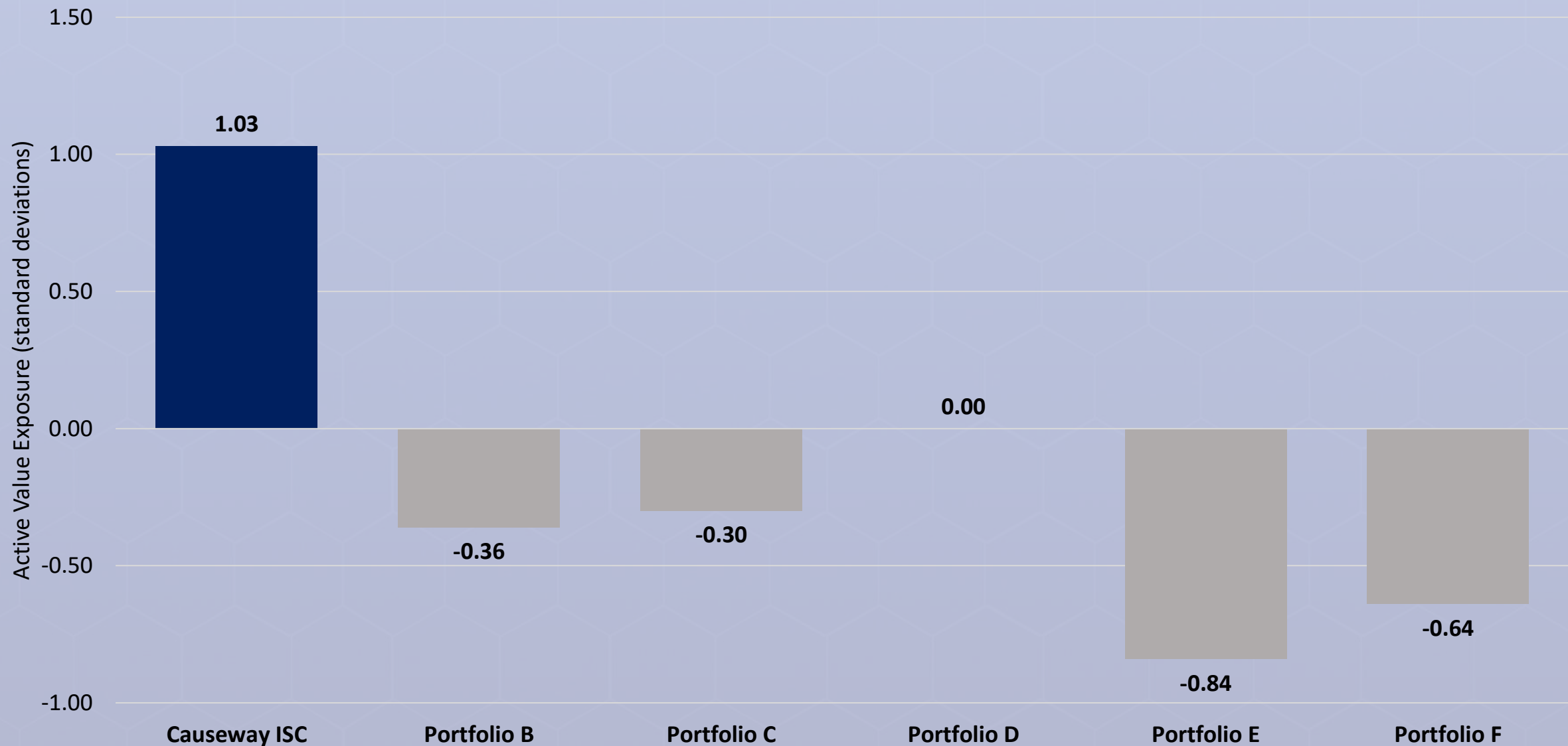
|                        | Alpha Category       | Weight (%) | Alpha Score (-3 to +3) | Notes   |
|------------------------|----------------------|------------|------------------------|---|
| Company-Specific (90%) | Valuation            | 43         | 2.1                    | Inexpensive stock with high dividend yield and more share buybacks expected                           |
|                        | Earnings Growth      | 20         | 1.9                    | China reopening and recent robust loan origination growth driving estimate upgrades                   |
|                        | Technical Indicators | 9          | 1.8                    | Stock has partially participated in the China reopening rally   |
|                        | Competitive Strength | 18         | 1.1                    | Strong brand recognition and expansion internationally benefitting margins                            |
| Top-Down (10%)         | Macro                | 5          | 1.3                    | China: Positive leading economic indicators, country PMIs   |
|                        | Country Aggregate    | 5          | 1.8                    | China: Attractive interest rate-adjusted valuation, country aggregate momentum, and earnings upgrades |
| <b>Final Alpha</b>     |                      | 100        | 3.0                    | Final alpha score in the 99 <sup>th</sup> percentile  |

# Cheaper than Value Index / Growthier than Growth Index



Note: All data as of December 31, 2022. Portfolio characteristics are derived from a representative account in the Causeway ISC strategy. See Disclosures for definitions. Source: FactSet, MSCI, Causeway Analytics

# Value exposure rare among largest ISC strategies



Note: See Disclosures for more information. "Causeway ISC" refers to a representative account of the Causeway International Small Cap strategy. Portfolios B – F represent the largest five actively managed funds in the Lipper "Int Sm/Mid-Cap" category based on assets as of December 31, 2022. Risk Lens results collected on January 27, 2023 based on latest publicly available portfolio data. Source: Causeway Risk Lens

# Causeway ISC is not style dependent

Batting Average (% of months with positive active return)

|                         | Causeway ISC |             | Portfolio B |             | Portfolio C |             | Portfolio D |             |
|-------------------------|--------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
|                         | Up Months    | Down Months | Up Months   | Down Months | Up Months   | Down Months | Up Months   | Down Months |
| ACWI xUS SC Value       | 67.4%        | 50.9%       | 34.9%       | 72.7%       | 39.5%       | 58.2%       | 58.1%       | 49.1%       |
| ACWI xUS SC Growth      | 50.9%        | 67.4%       | 72.7%       | 34.9%       | 58.2%       | 39.5%       | 49.1%       | 58.1%       |
| ACWI xUS                | 63.4%        | 54.4%       | 61.0%       | 52.6%       | 65.9%       | 38.6%       | 61.0%       | 47.4%       |
| High Momentum           | 59.3%        | 56.4%       | 71.2%       | 33.3%       | 57.6%       | 38.5%       | 52.5%       | 53.8%       |
| Low Momentum            | 56.4%        | 59.3%       | 33.3%       | 71.2%       | 38.5%       | 57.6%       | 53.8%       | 52.5%       |
| Yield Curve (US 10Y-2Y) | 56.1%        | 59.6%       | 58.5%       | 54.4%       | 41.5%       | 56.1%       | 56.1%       | 50.9%       |
| US Dollar (DXY)         | 60.7%        | 54.8%       | 55.4%       | 57.1%       | 62.5%       | 33.3%       | 55.4%       | 50.0%       |

Note: Portfolios B, C, and D reflect the three largest actively managed funds in the relevant Lipper category as of the end of the last quarter that are not ETFs, index products, or fund-of-funds, which invest at least 10% in emerging markets and have operated since or earlier than the inception date of the Causeway ISC strategy. November 2014 – December 2022. Past performance is not a guarantee of future results. See Disclosures. Source: FactSet, Bloomberg, MSCI, Causeway Analytics



- Universe's breadth and inefficiency well suited to active management
- Valuation matters, especially with higher costs of capital and macro concerns
- Causeway's ISC strategy, harnessing multiple sources of alpha, aims to outperform the index in a variety of market environments

An aerial photograph of a coastal town, likely in Hawaii, featuring a sandy beach, rocky coastline, and a hillside covered in houses and palm trees. The image is overlaid with a dark blue geometric pattern consisting of overlapping hexagons and a central blue octagon with a gold border.

**Q & A**

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**Thank You**

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*Investing involves risk, including possible loss of principal. In addition to the normal risks associated with equity investing, international investing may involve risk of capital loss from unfavorable fluctuations in currency values, from differences in generally accepted accounting principles, or from economic or political instability in other nations. Emerging markets involve heightened risks related to the same factors, as well as increased volatility and lower trading volume. Investments in smaller companies involve additional risks and typically exhibit higher volatility.*

*The MSCI ACWI ex USA Index captures large and mid cap representation across 22 of 23 Developed Markets countries (excluding the US) and 24 Emerging Markets countries. With 1,856 constituents, the index covers approximately 85% of the global equity opportunity set outside the US. The MSCI ACWI ex USA Small Cap Index captures small cap representation across 22 of 23 developed markets (excluding the US) and 24 emerging markets. With 4,334 constituents, the index covers approximately 14% of the global equity opportunity set outside the US. The MSCI ACWI ex USA Small Cap Value Index captures small cap securities exhibiting overall value style characteristics. The value investment style characteristics for index construction are defined using three variables: book value to price, 12-month forward earnings to price and dividend yield. The MSCI ACWI ex USA Small Cap Growth Index captures small cap securities exhibiting overall growth style characteristics. The growth investment style characteristics for index construction are defined using five variables: long-term forward EPS growth rate, short-term forward EPS growth rate, current internal growth rate and long-term historical EPS growth trend and long-term historical sales per share growth trend. The MSCI ACWI IMI Index captures large, mid and small cap representation across 23 Developed Markets and 24 Emerging Markets countries. The MSCI ACWI ex US IMI Index captures large, mid and small cap representation across 22 of 23 Developed Markets countries (excluding the United States) and 24 Emerging Markets countries. With 6,645 constituents, the index covers approximately 99% of the global equity opportunity set outside the US. The MSCI EAFE Index is a free float-adjusted market capitalization weighted index, designed to measure developed market equity performance excluding the U.S. and Canada, consisting of 21 stock markets in Europe, Australasia, and the Far East. The MSCI World Index captures large and mid cap representation across 23 Developed Markets countries. The MSCI World ex USA Index captures large and mid cap representation across 22 of 23 Developed Markets countries excluding the US. With 913 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. The MSCI World ex USA Small Cap Index captures small cap representation across 22 of 23 Developed Markets countries (excluding the US). With 2,499 constituents, the index covers approximately 14% of the free float-adjusted market capitalization in each country. The MSCI Emerging Markets Index is a free float-adjusted market capitalization index, designed to measure equity market performance of emerging markets, consisting of 24 emerging country indices. The MSCI USA Index is a free float-adjusted market capitalization weighted index, designed to measure large- and mid-cap US equity market performance. The MSCI USA Index is member of the MSCI Global Equity Indices and represents the US equity portion of the global benchmark MSCI ACWI Index. The Indices are gross of withholding taxes, assume reinvestment of dividends and capital gains, and assume no management, custody, transaction or other expenses. It is not possible to invest directly in these indices. You may not redistribute the MSCI data or use it as a basis for other indices or investment products. Accounts in the strategy may invest in countries not included in the benchmark index. Accounts will not be invested in all the constituent securities of their benchmark indices at all times, and may hold securities not included in their benchmark indices.*

*The MSCI ACWI ex USA Small Cap Index was launched on June 1, 2007. The MSCI ACWI ex USA Index and MSCI Emerging Markets Index were launched on January 1, 2001. Data prior to the respective launch dates were backfilled by MSCI.*

*The Causeway international small cap strategy uses quantitative factors that can be grouped into six categories: valuation, earnings growth, technical indicators, competitive strength, macroeconomic, and country. The relative return attributed to a factor is the difference between the equally-weighted average return of the highest ranked quintile of companies in the strategy's universe based on that factor and that of the lowest ranked quintile of companies. "Alpha" is a measurement of performance return in excess of a benchmark index.*

*NTM earnings yield is analysts' estimated earnings per share for the next twelve months divided by the current market price per share. FCF yield is free cash flow per share divided by the current share price. Dividend yield is dividends paid divided by share price. LTM weighted average momentum is the portfolio-weighted average share price change over last twelve months. NTM EPS revisions is analysts' estimated next twelve months earnings per share revisions. 5-year EPS growth is the slope of a linear regression using the last 5 years of reported EPS. Return on equity is net income divided by shareholders' equity, and is calculated as a weighted average, winsorized using maximum Return on Equity figures at 3 standard deviations from the mean (winsorization is a statistical technique intended to remove the impact of outliers). Net margins are net profits divided by total revenue X 100. NTM price/earnings spread is analysts' estimated price per share divided by earnings per share for the next twelve months. Price/book spread is current price per share divided by book value per share. Characteristics are weighted averages of companies in the ISC representative account and indices.*

*For further information on the risks regarding investing in Causeway's strategies, please go to <https://www.causewaycap.com/wp-content/uploads/Risk-Disclosures-1.pdf>*

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*Risk Model. Causeway's risk model analyzes multiple factors for each fund holding (excluding certain portfolio ETFs, fixed income, and commodities and other derivatives) to calculate the fund's style exposures, forecast the fund's volatility, and forecast the fund's beta.*

*Active Style Exposures. The universe is all equity securities globally with average daily trading volume over the prior 90 days above \$500,000. Every security in the universe is scored on each of 8 style dimensions. These standardized scores range from +3 to -3, with a score of 0 being equal to the weighted average score across the universe, +3 being most representative of the style, and -3 being least representative of the style. Fund style exposures are the weighted average of the style scores of all fund holdings. Value, Long-term growth, leverage, liquidity, and size style scores are calculated relative to country. Momentum, volatility, and cyclical style scores are calculated on a global basis. Active style exposures measure the difference between the fund style exposures and the benchmark style exposures.*

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