



# KayneCast

A Podcast Series by Kayne Anderson Rudnick



## Episode 82

### First Quarter 2019 Review of the International Small Cap Portfolio

Craig Thrasher, CFA

Portfolio Manager & Senior Research Analyst

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Intro: Hello, you're listening to KayneCast, a podcast that provides commentary on the economy and financial markets every quarter by the Kayne Anderson Rudnick investment management team.

Jordan: Hello, this is Jordan Greenhouse, Managing Director with Kayne Anderson Rudnick, and with me today I have Craig Thrasher, Senior Portfolio Manager of the Virtus International Small Cap stock portfolio. Today we're going to discuss the review of the first quarter of 2019.

Craig: Hi Jordan, glad to be here.

Jordan: Craig, first and foremost thanks for taking the time to discuss the portfolio with us. We have seen quite a reversal take place in the broader markets for the first quarter of 2019 compared to the end of the year in 2018. Can you walk us through performance of the International Small Cap Portfolio for the first quarter, along with index performance?

Craig: Yeah. As you mentioned markets around the world really had quite a sharp sell off in the fourth quarter of 2018, and in the first quarter we've seen broadly global equity markets having a strong rally in the first quarter of this year. Our benchmark, the MSCI ACWI ex-US Small Cap Index, was up just a little over 10% for the quarter and our International Small Cap Portfolio was able to outperform the benchmark slightly during this quarter. The institutional share class for the mutual fund was up 11.9%.

Jordan: As we begin to take a deeper dive into the actual portfolio, what would you say were some of the key contributors to the strategy's performance during the first quarter?

Craig: Well that's a good question because normally we wouldn't expect our portfolio to outperform in really strong up markets like we had in the first quarter of 2019. Typically our best relative performance comes in years like 2018 where markets are declining. However we did have an unusual amount of M&A activity during the first quarter this year. We had three of our significant holdings in the quarter involved in some form of mergers and acquisitions activity.

One of our largest holdings is a company called Vostok New Ventures. It's an investment holding company listed in Sweden and they sold their largest asset which was a stake in a company called Avito, to South African listed Naspers during the quarter.



Another holding they we have is a company called WABCO, which is a global leader in electronic braking equipment. They entered into a merger agreement where they agreed to be sold to another German auto parts supplier, ZF Friedrichshafen.

And then lastly we had a German listed online classifieds company Scout24 that received a takeover offer from a couple of private equity firms, Blackstone and Hellman & Friedman. In each of those cases the companies had pretty strong gains in the first quarter and so that allowed us to have strong relative performance even in a really strong first quarter during 2019.

Jordan: Now looking on the other side of the portfolio, what were some of examples of key detractors that you saw during the first quarter of 2019?

Craig: One of our largest detractors was a company called Moctezuma which is the third largest cement producer in Mexico. The shares underperformed recently as cement volumes have been subdued as construction activity has been a little bit lighter during the last few quarters and so that's led to some recent underperformance in Moctezuma. Another one of our detractors was a company called En-Japan, which is actually a recent addition to the portfolio. They are one of the leading job board operators in Japan and the stock has outperformed as the growth in that industry has decelerated a little bit in recent quarters leading to downgrades in the earning expectations.

And then lastly, a company called Douzone Bizon, which is a leading Enterprise Resource Planning company in Korea (ERP). That declined after they reported fourth quarter earnings where revenues and profits were somewhat below analysts' expectations.

In each of these three instances, we believe that the recent weaknesses is temporary in nature and doesn't reflect any long-term concerns about the competitive positions of the companies we're invested in.

Jordan: Craig, my last question for you is we've seen a slowdown in some areas of the globe which have coincided with some of the dovish commentary within the U.S. as well as globally taking place. How do you view the international markets and where are you uncovering continued opportunities?

Craig: We tend to find pockets of opportunities a lot of times when there's some types of cyclical concerns in the market. So for example we've been overweight in the U.K. for some time as Brexit-related fears have really dampened some investors' enthusiasm to invest in certain parts of the market there. In the fourth quarter we established a new position in a company called Mortgage Advice Bureau, which serves the mortgage broking industry in the UK. And as Brexit has dragged on, the housing market there has cooled, mortgage transactions



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have been declining and that's caused a correction in Mortgage Advice Bureau's stock, but we believe that the long-term attractiveness of the business is still intact and so we're happy to take advantage of that weakness to initiate a position there.

Similarly, we've seen in the semiconductor industry which is inherently very cyclical. In the second half of last year there's been quite a contraction in sales for some of the companies in that semiconductor supply chain and many of the stocks have sold off as a result of that. And during the first quarter we were able to buy a new position in a company called VAT Group, which is a Swiss company that sells really high-end vacuum valves mainly to the semiconductor industry. And they have great technology, extremely high market share in the markets that they play in, but the stock has sold off along with many of the others in the industry as the cyclical concerns have increased recently. And so as I mentioned, we're happy to take advantage of these cyclical concerns to buy into really great businesses that we think have great long-term prospects but are under somewhat near-term pressure, as far as then stock price due to those cyclical concerns.

Jordan: Once again, I'm speaking with Craig Thrasher, Senior Portfolio Manager of the Virtus International Small Cap Portfolio and his thoughts looking back at the first quarter of 2019 and overall outlook. Thank you again Craig for your time and valued insights you bring to our KayneCast listeners.

Craig: Great. Thanks for having me Jordan.