Quarterly Commentary

NYLI Epoch Global Choice ADR†

As of September 30, 2024

We expect moderate equity returns looking forward, reflecting a mixed macroeconomic and geopolitical backdrop.

Portfolio managed by:

EPOCH

Market Review

Most major equity indices around the world delivered mid to high single digit returns in the third quarter. The S&P 500 index rose 6% in choppy trading that featured two notable down legs: an 8% decline in the last two weeks of July and a 4% selloff in the first week of September. The best performing sector was utilities, which benefitted from investor enthusiasm around rising electricity demand from data centers. The worst performing sector was energy, reflecting the $12 per barrel decline in West Texas Intermediate (WTI) crude oil. Information technology, which has been a pillar of market strength for the last couple of years, was a laggard and has been exhibiting increasing levels of volatility. We continue to believe the sector offers numerous attractive quality growth opportunities at reasonable valuations for patient, long-term investors.

There was little variation in equity market returns (in U.S. dollars) across regions, with one exception: China. It rose 23% during the last week of the quarter, reflecting stimulus measures announced by Beijing. We are skeptical that these measures will fix the underlying causes of China's underperformance: real estate excesses, overinvestment in industrial capacity, insufficient domestic demand, and a heavy-handed state. However, the experience of Japan in the 1990s suggests such rallies can run for several months even if the economic policies ultimately prove to be insufficient at repairing the real economy.

Turning to the economic cycle, jobs growth in the U.S. has moderated from an unsustainable monthly pace of over 210k a year ago to a still robust 190k today. During this period, the unemployment rate has ticked up, from 3.8% to 4.1%. These metrics suggest the labor market is cooling but remains quite strong, with few signs of recession risks. Indicators such as small business sentiment, purchasing manager indices (PMIs), and delinquencies, particularly for credit cards and auto loans, reinforce the view of an economy that keeps chugging along.

Portfolio Performance

	Pure Gross Return	MSCI World Index	Net Return*
QTR	3.83	6.36	3.07
1 Year	27.99	32.43	24.26
3 Years	5.38	9.08	2.31
5 Years	8.72	13.04	5.55
10 Years	8.27	10.07	5.12
Since Inception[1] (05/31/2010)	10.42	11.07	7.20

ADR = American Depository Recepit

Past performance is no guarantee of future results, which will vary.

1. Inception date is May 31, 2010. Performance for the most recent quarter is preliminary and subject to change.

* Maximum program fee or highest advisory fee of 3% per annum (25 basis points per month).

† Effective 8/28/24, MainStay Epoch Global Choice ADR was renamed NYLI Epoch Global Choice ADR SMA.

Portfolio Review

The NYLI Epoch Global Choice ADR portfolio returned 3.83%, trailing the 6.36% return of the MSCI World Index. Sector allocation effect was negative, due to our lack of any holdings in the utilities and real estate sectors, which were the best performing sectors with an 18% and 17% return. Security selection was negative as well, driven by consumer discretionary, financials, and information technology.

At the individual security level, our top positive contributors in the quarter included Meta Platforms, Viper Energy, and Zoetis.

Meta continued its strong run of performance since bottoming in late 2022. The company reported good second quarter results with significant growth in revenue, net income, and free cash flow. Meta saw the number of monthly active users for its key platforms including Instagram, Facebook, Threads, Messenger, and WhatsApp continue to expand. We think the company is well-positioned to incorporate and monetize artificial intelligence capabilities within these platforms, which should increase average revenue per user over time.

Shares in Viper Energy rose after delivering a favorable earnings report, highlighted by solid production growth and stable profitability per barrel of oil. Viper also modestly increased full year 2024 production guidance. Majority owner Diamondback Energy confirmed that its acquisition of Endeavor Energy is on track to close by year end. The transaction will provide Viper significant opportunities to acquire additional production assets, increasing its long-term free cash flow growth potential.

Zoetis is a unique asset within the health care sector, providing products for companion animals and livestock. The company reported good second quarter results and announced a new $6 billion multi-year share repurchase program, representing 7.5% of market cap. We continue to like the company’s exposure to niche markets that do not face the same pricing, regulatory, or competitive threats as more traditional pharmaceutical companies do.

Our top detractors in the third quarter were Alphabet, Novo Nordisk, and Applied Materials.

Alphabet shares came under pressure after the U.S. Department of Justice ruled the company’s payments to Apple and Samsung for Google search to be the default search engine on their devices violated anti-trust laws. Proposed remedies are expected to be revealed during the fourth quarter, but this is likely to mark just the beginning of a multi-year legal process. The fundamentals of the company remain strong, with Alphabet reporting solid second quarter earnings that beat expectations. The company continues to benefit from cord-cutting and the shift of advertising dollars away from linear TV to platforms like Alphabet’s YouTube.

Novo Nordisk shares were pressured by competitive concerns related to its obesity franchise when Roche reported positive phase 1 results for its oral weight loss drug. Despite promising early results, potential commercialization of this drug remains several years away. Meanwhile, Novo has a huge lead in terms of product innovation and the ability to supply the obesity market, where demand remains insatiable.

Applied Materials declined due to geopolitical concerns. The Biden administration considered further restrictions on sales to China while Donald Trump suggested a lack of support for Taiwan should the China-Taiwan situation escalate. Despite the potential for these issues to weigh on sentiment and perhaps China sales in the near term, Applied's longer-term fundamental outlook remains robust given its mission critical role in providing tools for chip makers to meet growing global demand for artificial intelligence applications.

During the quarter, we initiated positions in two new holdings, AXA SA in financials and Curtiss-Wright Corporation in industrials. AXA is a long-term holding within our Shareholder Yield franchise. Curtiss-Wright is held in our U.S. Fundamental strategies. We believe these investments upgrade the portfolio in terms of business quality, risk diversification, and multi-year compounding potential.

AXA SA is diversified global insurer. Key businesses include property and casualty insurance, and life and health insurance. The company also operates an asset management unit it plans to sell to focus on its core insurance businesses. AXA is a quality business with a strong regulatory capital position, high market share across businesses and geographies, and technical expertise selecting, underwriting, and pricing risk. These attributes allow it to generate sustainable earnings growth, strong cash generation, attractive Return on Equity (ROE), and growing book value over time. Its diversified business and geographic mix, high solvency, and prudent asset allocation provide resilience through market cycles. CEO Thomas Buberl has led a successful multi-year restructuring since taking the helm in 2016, which simplified the business, repositioned towards technical risks from market risk, strengthened the balance sheet, and increased cash generation. The company intends to return €17 billion or 75% of underlying earnings to owners through dividends (60%) and share repurchases (15%) from 2024-2026, which represents nearly one quarter of its current market cap. Retained earnings are slated to fund organic growth and deliver book value compounding. AXA shares appear undervalued due to near-term concerns related to the current business cycle, French political developments, and European economic conditions. We believe fundamentals should prove more resilient than expected, powering mid- to high-single digit earnings growth, mid-teens ROE, robust capital returns, and attractive share price appreciation over the medium term.

Curtiss-Wright is a diversified industrials company providing highly engineered and mission critical technologies to customers in defense, commercial aerospace, power, and industrial markets in the U.S., Europe, and Asia. The company's key end markets should benefit from multi-year tailwinds as defense spending increases in an escalating threat environment, commercial aerospace build rates accelerate to meet rising global travel demand, and nuclear power generation grows as it is recognized as a cost-effective, reliable, and clean energy source. Curtiss-Wright is well positioned to capture these growth opportunities at attractive returns given its long-standing customer relationships, multi-decade "know how" accumulation and transfer, and record of delivering innovative, safe, reliable, and efficient solutions to customers in these markets. Led by CEO Lynn Bamford since 2021, management has created significant value for owners by successfully executing its Pivot to Growth strategy focused on maximizing revenue, operating income, and free cash flow growth. The company prioritizes reinvestment in the highest return internal projects and strategic merger and acquisition (M&A) to accelerate profitable growth. We believe valuation reflects guidance for double-digit free cash flow (FCF) per share growth powered by mid-single digit organic growth in its core businesses, incremental growth from strategic acquisitions, and margin expansion via volume absorption and operational excellence. However, the current share price may not fully reflect significant upside optionality in CW's commercial nuclear business.

We exited Jacobs Solutions as the stock price appreciated towards our assessment of intrinsic value. We had been consistently trimming our position as the investment case played out and the market price increasingly reflected the company's business model transformation into a provider of less volatile and higher value services and solutions. We used the sale proceeds to fund our purchase of Curtiss-Wright, which we believe upgrades the portfolio in terms of business quality and offers more compelling risk-return characteristics.

Outlook

Consensus expects S&P 500 index, earning per share (EPS) growth of 11% in 2024 and 15% in 2025. However, the 2024 estimate masks an extreme dichotomy, with Tech+ earnings rising by 30% and the remainder of the market at 6%, which is just barely above nominal gross domestic product (GDP) growth. The corresponding EPS growth estimates are somewhat lower for Japan (9% and 9%) and Europe (4% and 10%), but more optimistic in the near term for China (16% and 10%).

Regarding valuations, the next twelve-month P/E ratio for the S&P 500 index is currently 21x, well above the historical mean of 17x. Further, the tech sector is trading at 26x, significantly above its historical average. We'd argue that the winner takes all (or at least most) dynamics of the digital age should result in structurally higher returns on invested capital at steady state for the tech winners, justifying higher valuation multiples relative to history. S&P 500 index ex-tech is trading on a relatively moderate 17x, just slightly above its historical average, which is supportive of a broadening of the market should a recession be avoided. Further, markets outside the U.S. optically look attractive, with Europe at 14x and Japan at 15x. Both are trading at remarkably large discounts to the U.S. but we'd still emphasize being selective as these markets have no shortage of structurally challenged, lower growth, lower return companies.

What does all this mean for the equity market outlook? Historically, in the 12-months following the Fed's first cut, the S&P 500 index has risen by 12% on average, provided a recession is avoided. This is a powerful reason to maintain a constructive stance on equities. We forecast most major equity markets to appreciate over the next 12 months, with the U.S. leading the pack due to superior earnings growth. We are less optimistic regarding China on a 12–18 month view but acknowledge the current stimulus-driven surge could continue a little longer.

Concerning risks, consensus appears overly optimistic regarding the outlook for some pockets of tech earnings. It is possible that too much earnings growth has been priced in and the capex plans of the hyperscalers could be unsustainable. This is especially true if the artificial intelligence (AI) killer apps remain years away. That said, capex cycles often last four or five years and the current boom just started in 2022 with the release of ChatGPT. While a bust might not be imminent, this backdrop does imply that equity markets will remain choppy and volatile. A second risk centers on geopolitics with recent developments in the Middle East especially worrisome.

From a portfolio perspective, we continue to focus on owning a diversified collection of quality companies that consistently earn excess returns on capital. We expect our holdings to generate, sustain, and grow free cash flow over time at rates that exceed the overall market and/or their sector peers. We also seek management teams with a demonstrated ability to thoughtfully allocate capital between value-creating reinvestment and shareholder distributions, and whose economic interests are aligned with those of minority owners. Finally, we strive to buy these companies at reasonable or cheap valuations. We complement this bottom-up focus with a portfolio construction process that emphasizes creating a well-diversified portfolio where stock-specific risk is the dominant source of risk.

Although our relative performance year-to-date has trailed the benchmark, over the last twelve months we have transitioned the portfolio to a state we believe sets us up for future success. While we would like to win every quarter, we know that is simply not possible while staying true to our investment philosophy and process. In the short-term, the market is fickle with different styles, themes, and narratives coming in and out of investor favor. But over the long-term, company fundamentals assert themselves and we believe our investment approach to own companies that compound free cash flow per share at superior rates to the market should deliver attractive risk-adjusted results when purchased at reasonable prices.

Definitions:

The **S&P 500** Index is widely regarded as the standard index for measuring large-cap U.S. stock market performance.

The **Nasdaq-100** Index includes 100 of the largest domestic and international non-financial companies listed on The Nasdaq Stock Market based on market capitalization.

About risk- The principal risk of investing in value stocks is that the price of the security may not approach its anticipated value. Investing in smaller companies involves special risks, including higher volatility and lower liquidity. Investing in mid-cap stocks may carry more risk than investing in stocks of larger, more well-established companies. Foreign securities are subject to interest rate, currency exchange rate, economic, and political risks. These risks may be greater for emerging markets.

Past performance is not indicative of future results. Portfolio data and holdings are as of 09/30/24, are based on total net assets, and may change daily. The opinions and statements expressed herein are for informational purposes and subject to change without notice. The securities discussed are not intended to be, and are not, an indication to buy, sell, or hold. Rather, the securities are mentioned to give insight into the largest contributors to performance and the largest detractors from performance so that clients and prospective clients can more readily obtain an understanding of the risk characteristics of the portfolio and the portfolio management process followed by Epoch.

The Morgan Stanley Capital International World Index—the MSCI World Index—is a free float-adjusted market capitalization weighted index that is designed to measure the equity performance of 23 developed markets. An index is unmanaged and investors can not invest directly in an index.

The Nikkei 225 Index is a priceweighted equity index, which consists of 225 stocks in the prime market of the Tokyo Stock Exchange.

Free cash flow (FCF) represents the cash available for the company to repay creditors or pay dividends and interest to investors.

Please keep in mind that there is no assurance that investment objectives will be met, as the underlying investment options are subject to market risk and fluctuate in value.

These are Epoch's opinions, which are subject to change, and there is no guarantee that these results will occur.

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New York Life Investments
Managed Accounts
30 Hudson Street
Jersey City, NJ 07302

888-474-7725
www.newyorklifeinvestments.com