

Lazard International Equity Portfolio

Commentary

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ASSET MANAGEMENT

Market Overview

- International equities rose again in the third quarter, adding to the strong performance for the year.
- Corporate profit growth accelerated outside the US.
- The US dollar stabilized after significant first half weakness.
- Increasing artificial intelligence (AI) investment plans fueled outperformance of semiconductors while banks continued to outperform.
- Consumer staples and healthcare sectors lagged on continued slow organic growth and tariff concerns.
- Emerging markets significantly outperformed developed, led by Asia with China, Taiwan, and Korea the standouts.
- Quality continued its multi-year underperformance, derating to ten-year relative lows, but began to turn in September
- International equities posted their second largest YTD performance through September in 30 years

International equities continued their strong run in 2025. The MSCI ACW ex-US and MSCI EAFE Indexes rose a strong 6.9% and 4.8% in the third quarter, adding to their robust start to the year. Year-to-date, the MSCI ACW ex-US and MSCI EAFE Indexes have risen 26.0% and 25.1% respectively.

International markets outperformed the US by over 10% year-to-date. Helping fuel this strong performance, companies outside the US have seen an acceleration in earnings growth expectations throughout 2025.

Ever-increasing AI capital investment plans drove semiconductor stocks to rise 12.3% within the MSCI EAFE Index and 15.3% within the MSCI ACW ex-US Index. Supportive loan growth, resilient margins, and de-minimis loan losses fueled EAFE and ACW ex-US banks to rally 12.6% and 8.2% during the quarter. Weak organic growth caused consumer staples to underperform as they fell a modest 1.0% in the MSCI EAFE Index and 0.6% in the MSCI ACW ex-US Index. Healthcare stocks, particularly pharmaceuticals, also lagged the market on tariff concerns.

Regionally, emerging markets outperformed developed during the quarter. Despite a still generally sluggish consumer economic backdrop, Chinese equities rallied 20.8% during the quarter driven by technology stocks and AI beneficiaries. In contrast, India fell 7.6% on tariff and valuation concerns.

Finally, quality as a style continued to lag. The derating that began earlier in the year persisted through most of the quarter but began to turn positive in September. Prior to this, the 12-month underperformance of quality versus the market was the largest in nearly 30 years.

Portfolio Review

During the third quarter, the Lazard International Equity Portfolio rose 5.8% (net of fees), ahead of the MSCI EAFE Index which rose 4.8%. Year-to-date, both the absolute and relative performance of the Portfolio was strong, rising 30.1% (net of fees) compared to the benchmark, rising 25.1%. During the quarter, stock selection was the primary driver of sector attribution, and the portfolio's out-of-index exposure to emerging markets positively contributed to regional attribution.

Positives

The Portfolio's slight overweight in banks helped performance as banks continued their historic run. For the quarter, banks rose 12.6% compared to the overall index which rose 4.8%. Over the past year, international developed banks rose 53.8% compared to the overall index which rose 15.0%. This outperformance stems from the resilience of their higher profitability, even amidst declining interest rates, thanks to i) interest rates which remain far from the COVID-19 era level lows; ii) bank's internal efforts to improve efficiency; iii) persistently benign loan losses, supported by a resilient job market. We continue to see loan growth, improved profitability, and shareholder returns as favorable for the banks we own:

- Bankinter (BKT) (1.6% weighting in the Portfolio) is a leading Spanish bank with operations in both Spain and Portugal. Shares rose after the company's consensus beating second quarter results. Net Interest Income (NII) came in 2.3% ahead of consensus expectations and AuM growth was up 18% year over year, supporting our investment thesis that BKT is diversifying its revenue stream. Additionally, costs were constrained below revenue growth, highlighting the company's strong fundamentals.
- Mizuho Financial Group (1.8% weighting) is a large Japanese bank. Shares rose after the company reported first quarter results and management revised up full year net profit guidance.

The buildout of data centers to support AI demand growth also benefitted the Portfolio. Data centers need power, and the demand for electrification has augmented the growth at some high-quality industrial companies the portfolio owns.

- Based in Switzerland, ABB (1.9% weighting) is one of the largest electrical and automation companies globally with #1 or #2 market share positions across almost all the company's key products and services. Shares rose after the company reported consensus beating second quarter results. Orders grew 14% organically, beating consensus by 11%, and electrification grew by 9% organically, beating consensus expectations by 5%. Electrification also continued to beat on margins, which expanded 56bps year over year. Management additionally commented that they were seeing broad-based growth across end markets and geographies.
- Based in France, Legrand (1.4% weighting) is a low and ultra-low voltage electrical equipment provider, with c.215,000 SKUs in product niches such as plugs, switches, circuit breakers, fuses and uninterruptible power supply. Shares rose after the company pre-released second quarter sales, which came in ahead of expectations, and raised full-year guidance.

Negatives

Investors focus on AI also hurt a few high-quality data analytics companies in the Portfolio, such as RELX. Despite continued strong earnings of the companies the portfolio owns in the space, investors have become temporarily concerned that AI will disintermediate these data analytics companies and commoditize their content. For the companies the portfolio owns, we strongly disagree and have done significant proprietary work to reinforce our thesis on each name.

- RELX (2.0% weighting) is a UK-based professional publisher that owns quality information assets and develops sophisticated information-based analytics and decision tools, which are of high value to customers. The company has a highly profitable business model, fed by sticky, subscription-based revenue. Shares pulled back during the period, which we believe is related to investors' pricing in the markets view that AI might weaken competitive moats. To assess the risk and opportunity set in the space, our analysts established a framework for analyzing competitive advantages within the context of AI. Within RELX's legal segment, where data could be considered most 'at risk', RELX has a large, established, content dataset which helps control for hallucinations (inaccurate output). RELX's products/data are already integrated with customers giving them a distribution advantage vs a new player. RELX is one of the leading players in integrating technology to improve content (offering) as evidenced by accelerated organic growth within the legal division which increased to 7% up from 1-2% by upselling to analytics tools. Other divisions of RELX benefit from strong barriers to entry and AI risks are much smaller (e.g., data not easily accessible to public and/or not easy to replicate). We believe the share price reaction is overdone and not reflective of the fundamentals of the company.

Japan outperformed in the quarter, and the Portfolio underweight hurt performance as well as a few stocks within the country. Examples include:

- Nippon Sanso, (0.9% weighting) based in Japan, is a global producer of various kinds of industrial gases including oxygen, argon, and nitrogen. The industrial gas sector is consolidated among a few large players. The business is local in nature and represents a relatively inexpensive component in their clients' processes, high in volume, hence imported gases cannot compete with locally produced gases. This fact combined with the high capital intensity of the business, and mission critical nature of the products, provides the industry with high pricing power. Shares rose after the company reported first quarter results that came in below consensus expectations, driven by weakness in the US which impacted volumes.

Outlook

- While we expect geopolitical uncertainty to persist, earnings have remained resilient especially driven by AI spend
- International markets have historically delivered continued strong performance following solid return periods
- We believe International markets will continue to outperform US markets given the attractive earnings to valuation trade-off
- Tariff and trade unpredictability has hurt the shares of many high quality International companies with US revenues...
- ... But they may be poised to outperform as tariff implementation takes hold and margins / pricing power become important
- Potential opportunity for International equities and Relative Value investing

We believe geopolitical concerns will persist. From the ongoing Russia-Ukraine and Middle East conflicts to the stability of the US-China relationship, it is likely that these, and other geopolitical issues, will continue to result in volatile global equity markets. Add to this the fact that tariff implementation has begun, corporate profits may be impacted, either by decreasing margins or by passing along costs to the consumer. At times of uncertainty, stock-pickers who can find high-quality businesses likely to thrive in a changing world and are available at attractive prices could have numerous opportunities.

Despite the uncertainty, international markets delivered very strong absolute returns year-to-date, and we believe this trend can continue. While the dollar could rebound from oversold levels, factors such as U.S. fiscal policy and reshoring efforts may sustain its longer-term weakness. Add to this the increase in fiscal spending in Europe, both on defense and infrastructure, and European GDP growth could improve modestly. While it may be easy to believe much is in the price for international equities, given the year-to-date performance, we have found that historical periods of high returns have generated strong absolute returns going forward as well.

Despite strong recent performance, valuations for international equities remain deeply discounted compared to history.

Yet we believe the drivers of that steep discount are reversing. In the 5 years prior to the Covid-19 pandemic, exceptionally strong corporate profit growth, influenced significantly by the Magnificent 7, was an important component of US outperformance. The same was true of the strong US dollar. The combined effect of these two forces drove a strong positive re-rating of the valuation of US equities compared to international. This dynamic has changed. The US dollar may be structurally weaker (as we discussed above) and the spread in the EPS growth rates between the S&P500 and international equities has considerably narrowed.

As tariff implementation continues, we believe margins for many lower quality companies may be more vulnerable than higher quality for two reasons:

1. Higher quality companies tend to demonstrate stronger competitive advantages enabling pricing power in many of the goods and services they sell. This pricing power can help companies pass along their increasing costs without necessarily losing demand in the goods and services they sell. This could provide a higher quality company a better opportunity to sustain and/or improve margins than a lower quality company without pricing power.

2. Higher quality companies often have higher margins. Tariffs are being assessed to the cost of goods sold. As such, companies that plan to absorb the tariff impact without passing those higher prices along to customers, those that start with a higher gross margin (i.e. higher quality companies) should see much less net margin (profit) impact than lower quality companies.

Quality companies have lagged the market by a historic amount year-to-date. The valuation of quality companies is now near decade lows. We strongly believe this presents a compelling opportunity for quality companies, which have historically outperformed over the long term.

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