

Where Indexing Makes Less Sense

The Case for Active Management in Non-U.S. Markets

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For much of 2016, the investment markets saw the continuation of an indexing trend as equity fund flows went predominantly to passive strategies.

Why Has Indexing Increased in Popularity?

Debates over the relative merits of active versus passive strategies have raged for years. However, the impetus for many to switch from active to passive in recent years has been simple: Indexing has benefited equity investors in the U.S. markets.

For a number of reasons, active domestic funds have had a hard time keeping up with U.S. indexes and – at least in the near term – investors in U.S. equity funds have been rewarded for the decision to go passive.

Conversely, although international equity funds have also seen a growing trend toward passive strategies, investors have not generally been rewarded for indexing their international holdings.

Percentage of Funds Beating Their Benchmarks

	U.S. Large Blend Category vs. S&P 500	Foreign Large Blend Category vs. ACWI ex-U.S.
1-Year	11	21
3-Year	6	60
5-Year	12	78
10-Year	23	N/A
Since Inception*	42 (11/13/00)	60 (3/26/08)

*Data as of 9/30/2016. Source Morningstar Direct: The above data represents the percentage ranking of the Vanguard 500 Index Fund (VFIAX) for the S&P 500 versus the Morningstar US OE Large Blend category and the iShares MSCI ACWI ex US ETF (ACWX) for the ACWI ex-US versus the US OE Foreign Large Blend category.

Why Has Active Management Continued to Add Value in Non-U.S. Markets?

We believe there are several factors at play here. First, worldwide investing offers an expanded opportunity set – particularly with regard to emerging and developing countries – over investing in domestic markets alone.

Consider that 95% of the global population and 75% of the world’s economic activity (as represented by nominal global GDP) can be found in emerging and developing countries outside the United States. Given elevated growth rates in these non-U.S. countries, active managers simply have more opportunity to find strong, high-quality growth investments.

Furthermore, a sound strategy around variables such as currency, country and sector allocation can give the active manager greater opportunity to outperform a static index.

The Importance of Stock Picking

With U.S. and international markets increasingly correlated, we at Chautauqua Capital believe successful stock picking is the only route to outperformance.

To capture the full benefit of stock selection skill, we believe portfolios should be invested for the long term, on a conviction-weighted basis, in a concentrated set of best idea investments.

To mitigate the risks within a concentrated portfolio, our team enforces rigorous quality criteria and employs a thoughtful approach to sector and geographic diversification while applying a forward-looking valuation discipline. For example, the team keeps weightings of the four major macro sectors – defensive (healthcare, consumer staples, utilities, telecom), economically sensitive (consumer discretionary, information

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technology, materials, industrials), energy and financials – in line with the benchmark weight. This helps us to reduce volatility in the portfolio without sacrificing the benefit of our best ideas.

Chautauqua's rigorous, risk-conscious approach has enabled our International Growth Equity strategy to meet or outperform its benchmark over rolling time periods for more than a decade:

Percentage of Time the Chautauqua International Growth Equity Strategy Met or Outperformed the MSCI ACWI ex U.S. – ND Index	
Rolling Time Periods Since 1/1/2006	% of Time Met or Outperformed Benchmark
1-Year	73%
3-Year	87%
5-Year	100%
7-Year	100%
10-Year	100%

Source: eVestment analytics. Performance numbers used are though each month-end period from the Chautauqua International Growth Equity since inception. Net returns shown are based on performance from January 1, 2006, to June 30, 2016. Past performance does not guarantee future results.

Why Excess Return Matters More Today Than Ever Before

In an environment where the risk-free rate of return (as measured by the 10-year bond) yields 1.7%, investors are looking for higher returns in their portfolios – often incurring greater risk and less liquidity than traditional stocks and bonds.

Since inception, the [Chautauqua International Growth](#) strategy has provided, net of fees, 342 basis points of annualized outperformance versus the MSCI ACWI ex-U.S. benchmark and 370 basis points vs. the MSCI EAFE index.

	Cumulative Return (%)			Average Annual Return (%)			
	QTD	YTD	1-Year	3-Year	5-Year	10-Year	Since Inception (1/1/2006)
CCIG Gross	6.45	6.55	20.20	4.03	9.15	5.96	7.24
CCIG Net	6.38	6.32	19.82	3.67	8.72	5.74	7.03
MSCI ACWI ex-U.S. GD	7.00	6.29	9.80	0.64	6.52	2.63	3.73
Excess Return (Net)	-0.62	0.03	10.02	3.03	2.20	3.11	3.30

Data as of 9/30/2016

Our goal is to provide 300 basis points of outperformance over a normalized investment cycle of three to five years. And in today's investment world, an extra 200-400 basis points of return can significantly improve the chances of meeting portfolio expectations.

To learn more about Chautauqua Capital Management's views on the international markets, our disciplined investment approach and our offerings for both institutional and individual investors, visit chautauquacapital.com.

Investors should carefully consider investment objectives, risks, charges and expenses. This and other important information is contained in the fund prospectuses and summary prospectuses, which can be obtained from a financial professional and should be read carefully before investing.

Performance data represents past performance and does not guarantee future results. The investment return and principal value of the investment will fluctuate so that shares, when redeemed may be worth more or less than their original cost. Current performance data may be lower or higher than the data quoted. For performance data to the most recent month end, visit chautauquacapital.com.

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