

International Small Cap Value – 1Q2025

Hi, my name is Matthew Ring and I'm a Portfolio Manager for the International Small Cap Focused Value Strategy at Pzena Investment Management. With tariffs dominating the headline, it's easy to forget the international small cap market started off strong in the first quarter. Europe was the biggest positive, discounting a less chance of recession, and yet small caps continue to underperform large cap, creating an even bigger valuation opportunity than we've seen before in our portfolios.

Uh, we had strong absolute returns but we trailed the benchmark slightly. Our biggest detractors were in Consumer Discretionary and Real Estate. Companies like toy maker and IP-for-children creator Spin Master was weak on lower-than-expected earnings, and French real estate company Nexity—while they're doing a lot of great things to shore up the balance sheet, the outlook for 2025 still remains uncertain. But these are positions that we can add to because of the balance sheet strength and because we know that the future does look better, and that housing in France will come off the bottom.

On the positive side, we had strength in Financials and Information Technology. Companies like Unicaja, the Spanish bank, led the market on improved outlook for Europe, and our agricultural distributor Origin was strong as the planting season looked like it was going to be stronger in 2025 than 2024.

We were fairly active by our standards in the portfolio this quarter in terms of new additions and exits. We exited an Italian asset manager, Anima, as well as direct UK motor insurer Direct Line—both were bought out in M&A transactions in the quarter—as well as a number of Japanese industrials on better valuations. We added three new names in the quarter. First of all, in the sort of category of fallen “green angels,” or companies that benefited from high levels of demand either in the pandemic or from green subsidies, was Ariston. Ariston makes air and water heaters for residential use, and when demand came down, the stock started pricing in a below-replacement-demand future for them, and we were able to add that without much expectation in terms of the demand outlook for the stock to be really cheap. We also added Italian sailboat manufacturer Beneteau and German DIY company Hornbach, which is a market share gainer in Europe but currently punished because of the macro environment.

While tariffs and volatility continue to be top of mind for investors, it's important to keep a couple of things in mind. First of all, in the small cap space, it tends to be more local-for-local than large cap peers. Our fundamental research process also does a lot of scenario analysis and scrubs balance sheets to make sure companies can withstand any sort of macro scenario, with a lot of work on individual company footprints and how tariffs can affect each business versus its competition. And third, small cap valuations are now near their all-time lows, which is a great potential starting point for an investment in this space. We're optimistic about the opportunity in international small caps right now, and our team remains disciplined in trying to find that value across the globe.