

MEMORANDUM

DATE: February 2022
TO: State of Delaware Plans Management Board
FROM: CAPTRUST
RE: Fund Recommendation – Lazard International Equity R6

OVERVIEW

The review below highlights the differences in management, construction, and performance for the current Lazard International Equity R6 fund, along with two potential alternative recommendations. The review of these fund's emphasizes performance over the long-term, and aims to explain how these funds are expected to perform in various market conditions.

Lazard International Equity, the current fund, is a relative-value strategy, that focuses on companies that exhibit a combination of undervaluation and future expected profitability. While this fund is in the large blend space, it leans more towards value than growth.

T. Rowe Price Overseas Stock, pays considerable attention to valuations, invests across the style spectrum, and allows stock selection to result in moderate sector and geographic overweightings and underweightings. This fund is also in the large blend space, however, it has more of a true core approach; with a slight tilt towards growth.

American Fund Europacific Growth, uses a multimanager approach that targets firms with attractive growth prospects, with each manager selecting stocks within their preferred market sectors. This strategy is within the large growth space, however, our investment team feels that the risk/return profile of the growth category benefits participants, while offering similar diversification benefits.

Correlation of Funds

Name	Ticker	RLIEX	TROX	AEPGX
Lazard International Equity R6	RLIEX	1.00	0.97	0.95
T. Rowe Price Overseas Stock	TROX	0.97	1.00	0.97
American Funds Europacific Growth A	AEPGX	0.95	0.97	1.00

Source: Morningstar as of 10.31.2021 through 05.01.2015

CURRENT FUND: LAZARD INTERNATIONAL EQUITY

Management:

Michael Fry, this strategy's lead manager, has 40 years of industry experience and joined Lazard in 2005. He is supported by a seasoned portfolio management team averaging 9.5 years of tenure. The portfolio managers are supported by a large global platform of sector analysts who undertake accounting validation to ensure financial metrics are accurate.

More than 30 analysts support this fund and several other broad international funds; nearly all have been at Lazard at least five years, and about half have been at the firm at least a decade. This team's orientated approach has eased key-person risk to an extent, and a career-analyst track has also lent stability.

Process:

The investment process uses metrics like return on equity, return on assets, and operating margin in order to assess financial productivity. The next step is to compare those metrics with valuation measures such as price/book, price/earnings, price/cash flow and price/sales.

Since 2010, Michael Fry has led the five-person investment team. He is backed by a global research platform of analysts that is organized into six sector teams. The research team drives all initial investment ideas and presents their ideas to the portfolio management team.

It is the sole discretion of the portfolio manager on whether a stock is added to the portfolio. The strategy will hold 40 - 70 positions with market caps of \$5B or greater. The strategy seeks long-term investments while keeping turnover around 20% annually.

The strategy is well diversified across sectors and regions with specific risk controls for each. In addition, the team limits the maximum position size to 6% of the portfolio.

The strategy implements a fundamentally focused, research-intensive investment process that yields a portfolio of higher quality companies going through short-term concerns. This process along with a portfolio of 60 investment ideas can lead to shorter term volatility.

Performance:

Long-term performance has been consistent with the team demonstrating an ability to protect capital in downward markets. This can be seen with consistent down capture ratios between 80% and 90% over 3,

5 and 10-year spans. The strategy typically wins by shielding investors' capital in sell-offs, capturing only 87% of the index's drawdowns since inception.

2016 performance was a struggle for the strategy particularly in the 4th quarter. A focus on high quality ROE companies negatively impacted the portfolio as low quality, cyclical sectors drove the market. The portfolio will underperform when lower quality stocks lead the market.

This strategy also struggled in early 2020's pandemic-related sell-off. Its 34.2% decline from Jan. 22 through March 23 was slightly worse than the MSCI EAFE benchmark's 33.7% decline.

Over longer periods, however, performance has been more impressive. From manager John Reinsberg's January 1992 start through April 2021, the strategy's institutional shares' 6.0% annualized return outpaced its foreign large-blend Morningstar Category's 4.4% and the benchmark's 5.7%.

In 2021, the fund had periods of outperformance that created opportunities for potential reversal in the fund's longer term lagging performance. Unfortunately, the fund failed to capitalize on this momentum, and finished the year in the bottom quartile against peers due to a poor quarter four performance. While the fund's longer term history remains above the index, the trajectory of performance and inability for the fund to substantially protect on the downside has weakened our resolve in this strategy.

POTENTIAL REPLACEMENT #1: T. ROWE PRICE OVERSEAS STOCK

Management:

Ray Mills has been the lead portfolio manager for the strategy for 21 years and is the sole decision maker for the fund.

Ray is supported by a team of 221 U.S. and non-U.S. research analysts that are sector specialists. Each analyst covers approximately 20-30 stocks each. There are approximately 20-30 analysts with names directly in the Overseas portfolio.

Portfolio managers across the T. Rowe franchise hold regular research meetings to discuss the current macroeconomic environment. Additionally, Ray has frequent meetings and ongoing communications with the analyst team to discuss company specific content. There is an annual review of each of the analysts that covers the success of their stock picks and their ability to get ideas into portfolios.

Process:

This strategy pursues companies with fundamental strengths and long-term prospects that are better than their stock prices indicate. Management looks for attributes such as accelerating earnings and cash flows, healthy financials, barriers to entry, and managements with sound strategic and operational vision. Valuation metrics include earnings, cash flow, sales, and asset-based metrics; emphasizing different metrics for different industries and stocks, and evaluating them from historical, relative, and absolute perspectives.

This is a core, mostly developed markets, non-US equity mandate. It allows for up to 15% emerging markets, but in practice is more in the 4-9% range with a focus on higher quality emerging market names. The strategy is all-cap in nature with 70-75% in large-cap (> \$25B market cap), 20% mid-cap and 5-10% small-cap.

The team benchmarks against the MSCI EAFE Index. While the bulk of the holdings will be core in nature, there will be some tails in smaller allocations with a deeper value or growth leaning in terms of valuation and growth rates.

The strategy uses a long-term approach to investing and turnover has averaged 20-30% historically. Identifying secular business drivers for a company is one of the most important aspects of the process. Strong management teams with a history of smart capital allocation decisions are also important.

Additionally, time is spent on valuation analysis for a company relative to the market, its own operating history and to its peers. The portfolio will hold 140-180 names which helps with the consistency of results and reduced tracking error.

There is a separate risk management team (the Steering Committee) that meets every two weeks to review all of the T. Rowe portfolios. Portfolio managers know that they are being watched, but are allowed to make their own decisions. Individual stock positions are limited to a maximum of 5% and regions/sectors are limited to +/- 10% relative to the MSCI EAFE Index.

A note on the portfolios emerging market exposure, in general, the portfolio manager keeps their Chinese holdings at relatively small position sizes given the higher regulatory risk environment. They have a good pulse on that market with several Chinese nationals in T. Rowe's Hong Kong office. Current policy issues are more significant than past regulatory episodes with China, and as such, the team builds in a higher equity risk premium for those holdings. The portfolio's direct China exposure is 1-2% presently, about ½ of what they have held in the past. While Ping An Insurance has been a tough name this year, it is very inexpensive relative to history, so they are maintaining the position size at this time.

Performance:

The fund performs strongly in all trailing time periods. As of 12.31.2021, the fund is in the 16th percentile for the 1-year, 25th percentile for the 3-year, 25th percentile for the 5-year, and 20th percentile for the 10-year.

Year-to-date as of January 31st, the portfolio has outperformed both indexes and is right at the top quintile of the peer group. Intermediate and longer-term performance is attractive relative to both benchmarks on an absolute and risk adjusted basis.

POTENTIAL REPLACEMENT #2: AMERICAN FUNDS EUROPACIFIC GROWTH

Management:

The strategy is run by an experienced team of 11 portfolio managers, who have an average tenure at the firm of 25 years. Each portfolio manager independently manages their portfolio based on their own investment approach. Some portfolio managers are more value-oriented, while others are more growth-oriented.

Carl Kawaja, who has been on the strategy since 2000, serves as the strategy's Principal Investment Officer and ensures that the overall portfolio remains balanced and consistent with its mandate.

The portfolio managers are supported by a large analyst team, who also manage a portion of the portfolio (roughly 15-20%).

While the strategy is classified as foreign large growth by Morningstar, it has more of a core growth approach due to the diverse views of the portfolio managers. This may cause the strategy's performance to differ from the peer group at times.

Process:

American's multimanager approach lets managers independently run their own sleeves of the portfolio. Each uses his or her own style, and their combination fulfills the strategy's growth mandate while adding diversification. The managers do not shy away from risk: emerging-markets stakes are usually relatively high, and occasionally individual managers will put a large allocation into one or a few stocks.

While each portfolio manager has a different investment approach, they all have a long investment horizon and annual turnover in the overall portfolio is roughly 25-30%. The compensation structure

reinforces this long-term mentality, as it is based on one, four, and eight-year periods with greater weighting on the longer periods.

Large analyst staffs support the managers with investment ideas and industry-specific analysis. A portion of the fund is devoted to an analyst-run research portfolio, too. This mix of independently managed portfolios across the international equity universe forms a broadly diversified portfolio.

The strategy has a sizable asset base of over \$100 billion. The long-term investment horizon and low overlap of individual portfolio manager holdings leads to more capacity. There are also benefits to scale, such as access to company management, a significant research budget, and lower expense ratios.

Due to the multi-manager approach, the strategy holds a large number of positions at roughly 300. However, the strategy is more concentrated in its top 20 holdings which comprise about 30% of the portfolio. Despite the large number of positions, the strategy will deviate from its benchmark in terms of sector and geographic weightings.

This large portfolio has distinctive sector positioning, though. Its tech stake has ranged from 11% to 21% over the past five years, versus the MSCI ACWI ex USA's 8%-13%. This posture contributes to the strategy's growth tilt relative to the core index.

There have been notable regional deviations, too. The managers have generally favored emerging markets, including Indian banks like HDFC and Kotak Mahindra, in the strategy's top-20 holdings. The strategy's India positioning has absorbed 7%-9% of assets over the past five years, versus 2%-3% for the index.

Performance:

Performance for the strategy is mixed, as there are differences in comparing against either a foreign large blend group (where our CAPTRUST's investment team classifies the fund) or a foreign large growth (where Morningstar places the fund). Versus its prospectus benchmark, however, the strategy has outperformed in the 3-, 5-, and 10- year time periods.

Performance in the last two downturns, however, was wanting. First, when international equities dropped from Jan. 29 to Dec. 24, 2018, the fund's 24.0% loss was 2.4 percentage points more than both the core and growth benchmarks. Most recently, the fund's 32.6% tumble in 2020's novel coronavirus-driven sell-off, though less than the core benchmark, was deeper than the growth index's 30.3% loss.

The strategy has made up lost ground in market rallies, though. The fund's robust rebound off March's lows contributed to its 24.8% 2020 calendar-year gain, which outpaced the growth and core benchmarks by 2.6 and 14.1 percentage points, respectively.

As of January 31st, the strategy has returned 2.19% versus the category return of 2.71% YTD. This is coming off of a weak 2021 for the strategy, which saw the fund's performance drop into the bottom quartile versus peers. A consideration for this, however, is that it is the fund's first bottom quartile annual performance in over 10 years. Due to this, we believe this could be a potentially strong opportunity to enter a strong historical strategy at a relatively lower price level.

Even with these highs and lows, however, the portfolios upside and downside capture ratios remain positive versus the index. Over the past 5 years, the fund's upside capture ratio has been 108 versus a category 103, while its downside has been 95 versus a category 81.

CONCLUSION

Lazard International Equity was originally selected for the lineup due to its value oriented approach to security selection, performance metrics, and protection of capital in down markets. While value has certainly been out of favor post 2015, the long-term performance of the strategy remains intact, still outperforming its benchmark over the 10-year time period.

Since the fund was selected, however, we continue to exist in a market environment that favors growth over value, with little signs of slowing down. For this reason, the two recommendations provided each offer a different approach to portfolio positioning within the international equity space.

T.Rowe Price Overseas Stock is our recommendation if the committee prefers to retain a true "core" approach. It has qualities of both a value oriented strategy, while still pursuing the growth names that have helped drive markets over the past few years.

American Funds Europacific Growth is our recommendation if the committee is less focused on retaining the current Morningstar fund style, and weighs more heavily the stronger risk/reward profile.

When comparing both replacement options, our investment team does expect the trend of growth outperforming value to continue over the long-term (being 5+ years as technology continues to advance, continuing to drive attraction into the space). Both options have their own tradeoffs, however, and either would be a suitable investment option for plan participants.