August 2020

Why International?

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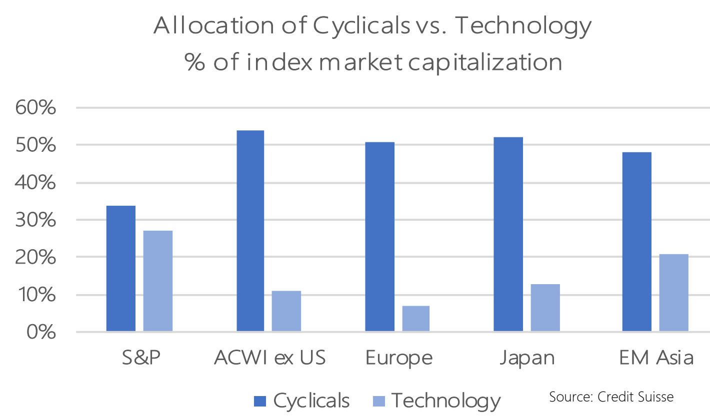
We began 2020 with the U.S. on the verge of celebrating the 11th year of a bull market and value nearly impossible to identify across most corners of the domestic market. In contrast, markets outside the U.S. had delivered solid, but sub-par relative results. This was largely due to the disparity in the benchmark weighting of the Technology sector versus the cyclically-oriented sectors (aka "old economy" businesses in the Materials, Financials and Energy sectors) in the developed international benchmarks. A strong U.S. Dollar, political turmoil and trade tariffs also played a role in the underperformance of international investments. Valuations outside the U.S. were trading at healthy discounts and growth appeared to be turning the corner as the IMF pointed to a trough in global growth with expectations for a rebound over the coming two years driven by ex-US growth.

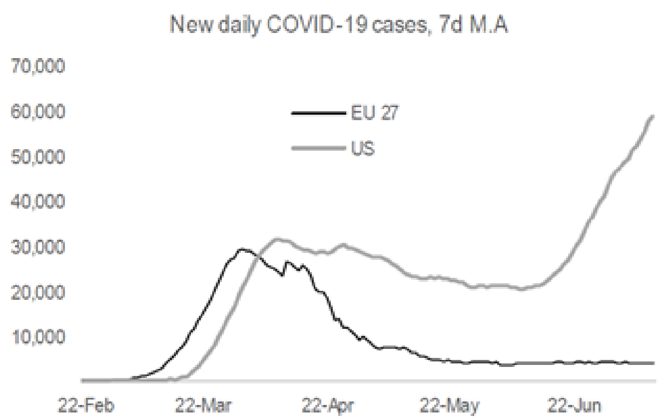


Just as soon as the enthusiasm began, the rug was pulled out from the world with the emergence of COVID-19 and the destruction of human life and economic prosperity it has caused. Global equity markets responded with sharp declines, economists slashed short-term growth prospects and unemployment reached historic highs. Developed market central bankers entered stage right with massive stimulus announcements, which in total, dwarfed the level of support provided during the 2008 Global Financial Crisis. The world is working on a path to recovery, which to date, has proved to be a slow, jagged line for the U.S., yet on a more promising speed in Europe and select countries in the emerging markets, i.e. China, Taiwan and Korea.

Opportunity Brewing in Crisis

It is easy to get caught up in the daily barrage of negative headlines; however, doing so is likely to lead to missed opportunity as positive developments quietly materialize. Europe is one such example, where several significant structural changes have occurred including the ECB expanding its balance sheet in similar aggressive fashion as the U.S. Fed and Germany easing fiscal policy by 8% of GDP in local currency terms. However, of greatest importance is the late-July announcement of the €750B Recovery Fund sealed by EU leaders. This is a historic moment for Europe as they now move closer to a fiscal union, which introduces the concept of common versus country specific debt. The passage of the deal may likely mark an inflection point for Europe as investors take advantage of an improving outlook.

Outside of the stimulus measures provided in Europe, other positive factors include economic damage that is less permanent due to a combination of furlough and loan guarantee schemes, which have resulted in lower unemployment and fewer projected corporate bankruptcies. Rating agency forecasts indicate default rates in Europe over the next year to be 6.2% compared to 11.2% for the U.S. Additionally, the EU should exit the crisis with government debt to GDP 43 percentage points below that of the U.S. The EU appears to be managing the virus more effectively than the U.S, which should lead to a faster improvement in GDP growth. As shown in the chart below, there is a widening gap between new daily cases in Europe relative to the U.S. Clearly, the U.S. does not have the same handle controlling the virus because the U.S. lockdown never reached the depths seen in Europe and the U.S. opened the economy significantly sooner.



Source: Credit Suisse

On the valuation front, Europe trades at a 20% discount to the U.S. or 17.0x, which is below the historical average on a simple forward one-year P/E basis; however, Europe trades closer to average on a sector adjusted P/E basis with only a 5% discount*. Valuations for companies who can embrace change and thrive in a post-pandemic world will likely remain elevated relative to low margin, slow to adapt businesses whose earnings growth potential eventually falls short of their valuation. * Source: Credit Suisse

Currency: A double bonus on the horizon?

Since the end of March, U.S. investors have enjoyed a currency tailwind from foreign investments as the Dollar Index (which measures the currency against a basket of peers) has lost ~9.5% in value. A weaker Dollar is not necessarily indicative of a weak U.S. economy, but reflects a stronger global economy on a relative basis. Several catalysts have emerged to cause selling of Dollars including an increase in virus cases; passage of the EU Recovery Fund previously discussed; social and

Source: Refinitiv
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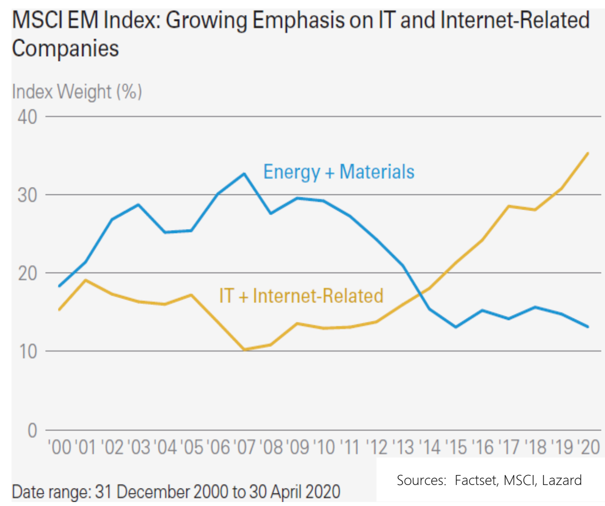
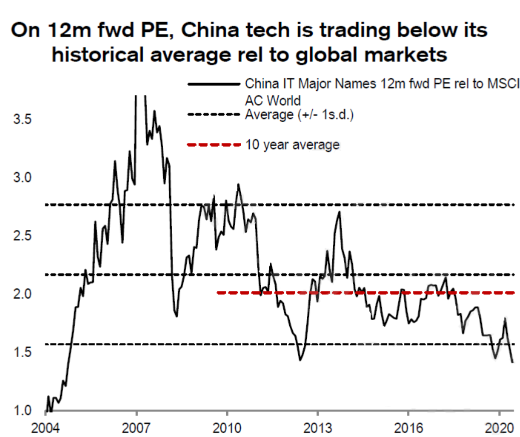
political unrest in the U.S.; and a narrowing breadth of economic data between the U.S. and the rest of the world.

In addition to the currency tailwind, U.S. investors may benefit if history repeats itself and Europe outperforms in concert with the Euro appreciating. In the past, this has occurred when European politics appeared to be at an inflection point. For example, the period in the late 1990s just before the Euro began as an accounting currency and more recently after Mario Draghi delivered his "Whatever it takes speech" in 2012. Time will tell if recent market trends since the establishment of the EU Recovery Fund fit this profile.

Emerging Markets Technology Fills The Gap:

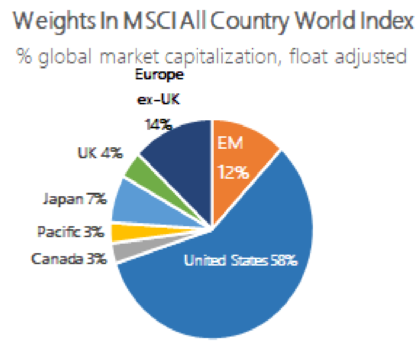


In the emerging markets, it is no surprise their economies and markets have been positively influenced by U.S. growth; however, today this region accounts for 60% of global growth due in large part to their younger population and ongoing urbanization. As shown to the right, there has been a growing emphasis on IT and Internet Related businesses, (which have tripled in the MSCI Emerging Market Index from their 2008 weighting) relative to energy and materials. Opportunities in emerging market technology, particularly in China, offer the opportunity to fill the gap the developed world ex-U.S. does not provide. As shown in the chart below, one-year forward valuations are attractive versus their ten-year average and relative to the developed world including the U.S. In the short-term, investors are likely to be cautious over heightened tensions between the U.S. and China related to the security of personal data on global technology platforms. From a macro perspective, a weaker U.S. Dollar, falling inflation and a global recovery that is being led by China offers an attractive combination. China, Taiwan and Korea account for nearly two-thirds of the Emerging Market market capitalization. These countries have controlled the virus with new cases on a seven-day rolling average per million people now at 18 versus 146 for the U.S. Additionally, mobility has also normalized relative to the rest of the world.



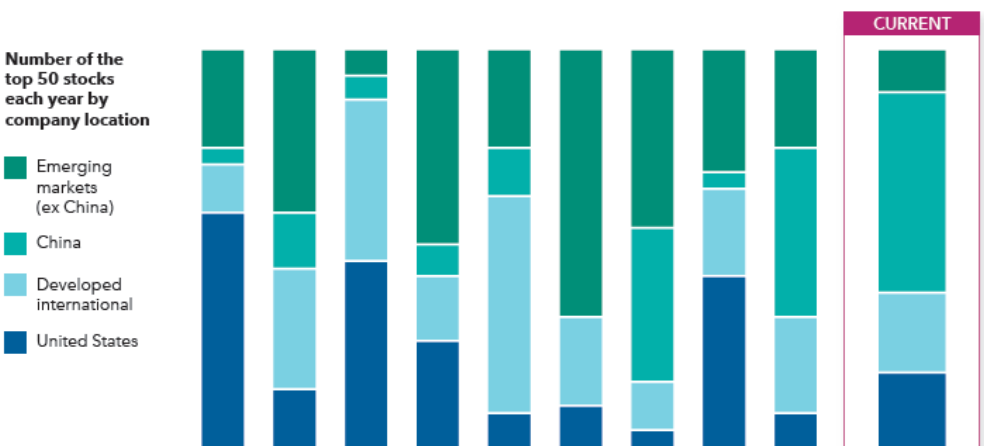
Back to the basics: Investors should focus on stocks not borders

So, why bother with international diversification? The opportunity set outside the U.S. is robust with roughly three times as many investable foreign stocks as domestic names. From a market cap perspective, the U.S. currently represents 58% of the MSCI All Country World Index, which is expected to decrease with slower domestic growth eventually leading to a higher allocation to international markets. Investors who have abandoned diversification to international equities have significant opportunity cost. Of greatest importance, however, is stock picking with the evaluation of company fundamentals and sources of revenue, not where a company has its mail delivered. A recent study by Empirical Research Partners highlights the importance of bottom-up research. In 1992, most of emerging market company performance could be explained by its domicile or sector. Today, nearly two-thirds of EM returns can be attributed to company fundamentals. As of May 31, 2020, avoiding or underweighting ex-US investments over the previous ten years has been detrimental to returns. 75% of the top performing stocks over this period are domiciled outside of the U.S., despite what the headline index performance shows.



Sources: MSCI, JPAM

75% of the top stocks since 2011 have been based outside the U.S.

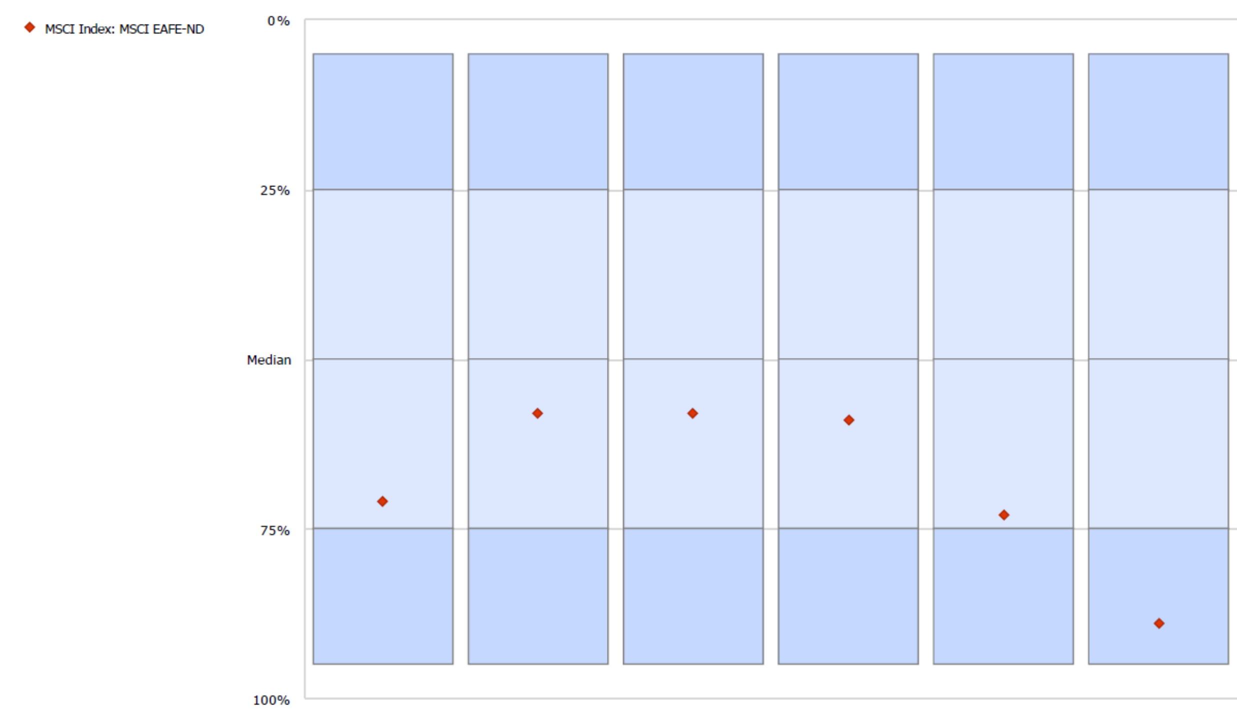


Index return	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020 YTD
U.S.	2.1%	16.0	32.4	13.7	1.4	12.0	21.8	-4.4	31.5	-5.0
Non-U.S.	-13.7%	16.8	15.3	-3.9	-5.7	4.5	27.2	-14.2	21.5	-14.8

Sources: Capital Group, MSCI, RIMES. 2019 as of 11/30/19. Returns are in USD. Top 50 stocks are the companies with the highest total return in the MSCI ACWI each year. Returns table uses S&P 500 and MSCI ACWI ex USA indexes for U.S. and non-U.S., respectively. The MSCI ACWI ex USA is a free float-adjusted market capitalization-weighted index that is designed to measure equity market results in the global developed and emerging markets, excluding the United States.

Why Active Management?

By definition, passive management funds match market returns by investing in a broad basket of stocks. There is no need to focus on individual stocks, their fundamentals or even where they are located. While managers in the U.S. have had an increasingly difficult time adding value versus S&P 500 over the last ten years, this has not been the case for international managers as the vast majority of managers outperformed the index over this period. Why? As previously mentioned, the large opportunity set of out-performing stocks leads to a robust pool of opportunities for talented, active managers to build high active share portfolios, meaning they do not look like the index. As shown in the chart below, an investment in EAFE (a blend of growth and value, larger cap companies in Europe, Australia and the Far East) over the last ten years has resulted in less than mediocre performance, hence the value add of active management. To be fair, many international managers have a maximum allocation to emerging markets in their portfolios, which if invested in technology, has been a boost to performance.



Universe: eVestment EAFE Large Cap Core Equity

	VT	RM	MRQ	Rk	1 Year	Rk	3 Years	Rk	5 Years	Rk	7 Years	Rk	10 Years	Rk
5th percentile			21.73		6.37		6.80		5.90		7.65		9.07	
25th percentile			18.53		1.29		3.62		4.24		5.63		7.73	
Median			16.46		-3.49		1.31		2.47		4.70		6.84	
75th percentile			14.59		-6.82		-0.66		1.50		3.91		6.22	
95th percentile			12.15		-10.52		-3.11		0.14		2.45		4.95	
# of Observations			134		133		125		114		102		92	
MSCI Index: MSCI EAFE-ND	IX	IX	14.88	71	-5.13	58	0.81	58	2.05	59	3.93	73	5.73	89

Results displayed in USD using Spot Rate (SR).

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From the March 2009 market trough, to the February 2020 market peak, the S&P 500 has generated in excess of 250% on a cumulative basis relative to the MSCI All Country World Index-ex U.S. Market trends do not last forever, so prudency would indicate an analysis of portfolio concentrations to determine how diversified your investment eggs are to their respective baskets. The current valuation/growth tradeoff in international investments offers a compelling argument for rebalancing some assets into higher growth, attractively valued opportunities with higher dividend yields to capture what may be the winner(s) of the current decade.

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