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Market Perspectives: The Current State of International Investing

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MARKET PERSPECTIVES: THE CURRENT STATE OF INTERNATIONAL INVESTING

" The more things change, the more they stay the same."

~Jean-Baptiste Alphonse Karr (French journalist 1808-1890)

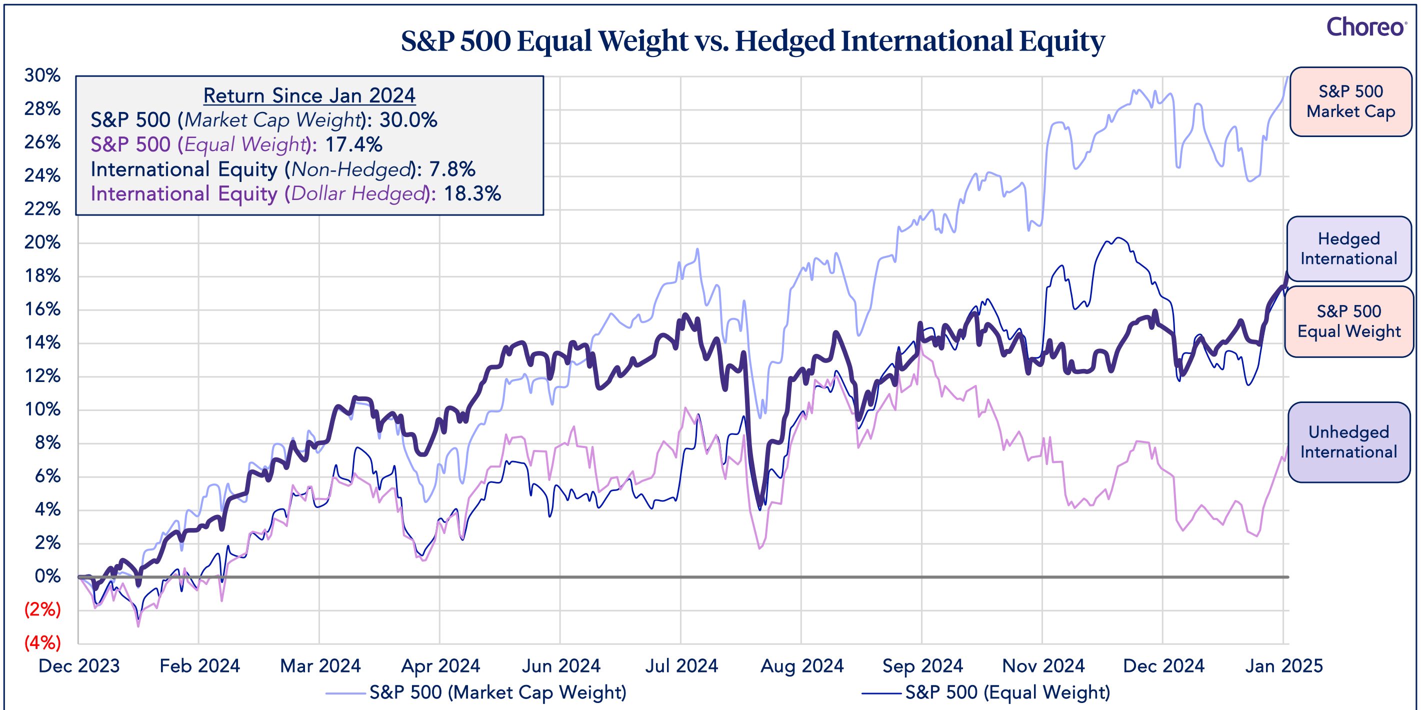
- Now a month or so into the new Administration, markets continue their upward march. Policy uncertainty is elevated, and volatility has slowly risen.
- Inflation data and economic resiliency continue to trend in the right direction, albeit at an unsteady pace with risks abound.
- Global markets have also advanced but remain volatile due to a variety of factors.
- Currency fluctuations continue to play an important role in markets and economic forces around the globe.

The groundhog emerged from his slumber on February 2 and saw his shadow, predicting six more weeks of winter. President Trump is back in the White House, markets march onwards, the debate on inflation rages, earnings season is off to a strong start, tariffs are being used once again as a bargaining tool, and many other similarities to prior times exist. At the same time, much has changed, with political forces seemingly veering towards some unchartered territory, artificial intelligence ramping up materially, and more uncertainty about where the many different economic forces are steering the economy. For nearly a decade, U.S. investors have seen market outperformance vs. foreign indices. International investing, however, does have a unique set of benefits and burdens. The rationale for international investing remains consistent, but it is worth re-examining the state of markets around the globe.

The U.S. economy (and markets) have had the good fortune to benefit from the groundbreaking and without hyperbole, humanity-changing companies based domestically. From FANMAG to the MAG 7, nicknames notwithstanding, our world runs differently than it did 20 years ago. Online shopping, work from home, social media and much more have altered the daily lives of billions of people. The handful of stocks that have led the charge in these areas have also led the markets in the U.S. broadly to outperform most others. Stripping away the outsized impact of those companies tells an entirely different story.

Similarly, the U.S. dollar has also performed strongly (more on this in a moment). When the impact of currency, and the impact of a handful of stocks is neutralized, the international markets have performed in line with the U.S. The graph below shows the returns since the beginning of 2024 through January 23, 2025. The S&P 500 was up 30.0%, dominated by the largest companies in the world (Nvidia, Microsoft, Apple, etc.). The S&P 500 index performance is based on market capitalization. In other words, the larger the company, the more impact their performance has on the index. When using an equal-weighted version of the S&P 500, where all companies are weighted the same, thereby eliminating the outsized impact of the mega-caps, performance drops to 17.4%: same universe, simply different weightings.

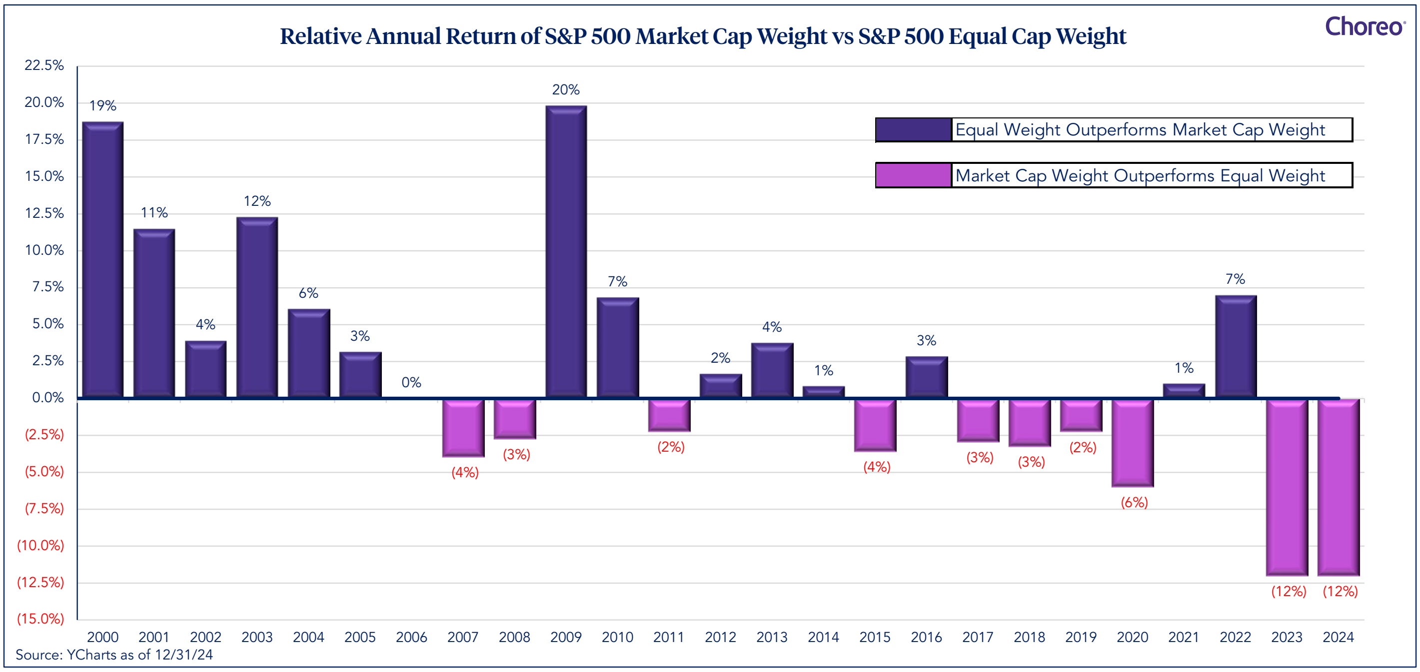
On the other hand, international markets as represented by the MSCI EAFE Index, were up just 7.8%, dramatically underperforming their U.S. counterparts. However, when neutralizing the impact of currency, that performance rises to 18.3%, as shown in the graph below.



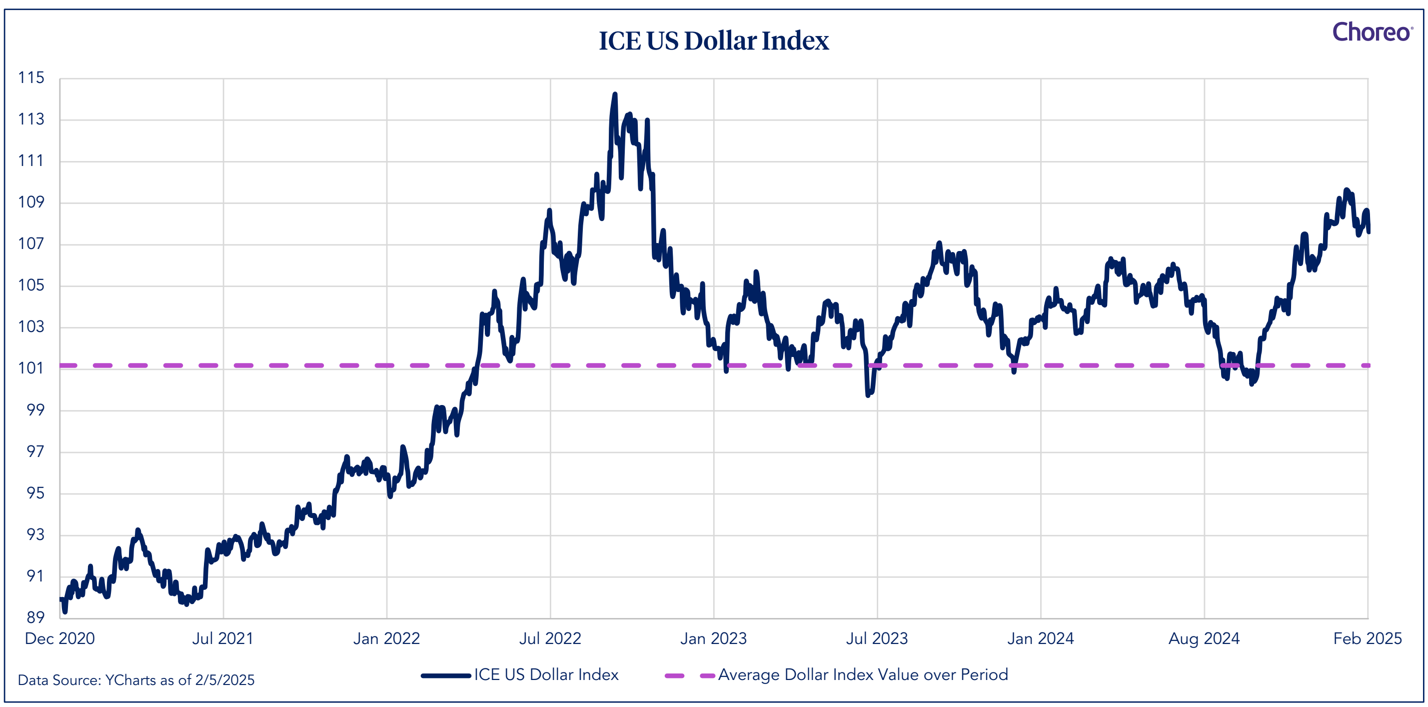
Data Source: YCharts as of 1/23/25, proxies used for asset classes are iShares Core S&P 500 ETF (IVV), Invesco S&P 500 Eql Wght ETF (RSP) & iShares MSCI EAFE ETF (EFA)

A possible conclusion is that U.S. market outperformance is essentially driven by a handful of stocks and dollar strength. While those are very real factors and should not be minimized, it does suggest that the high-level picture of markets may be obscured.

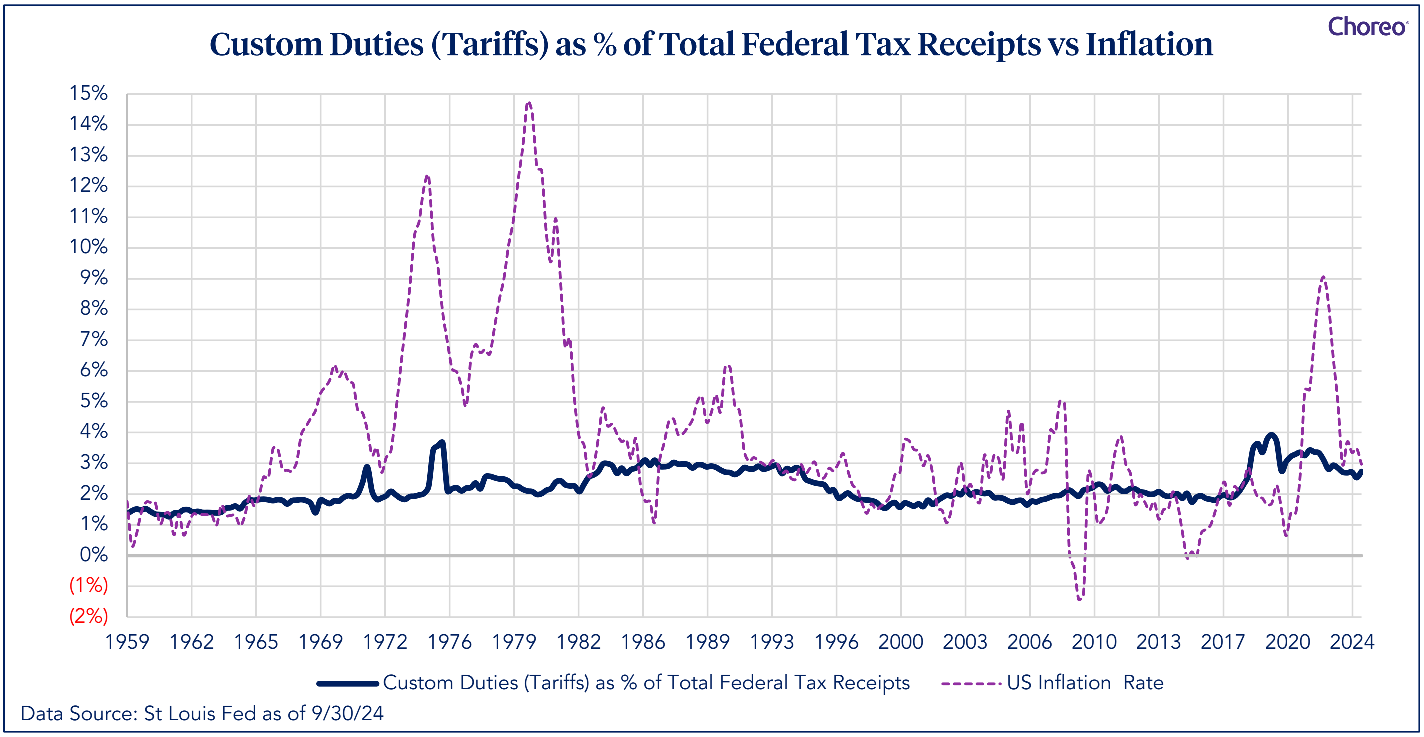
Furthering on the dominance of the mega-cap stocks, starting with the S&P 500, 2023 and 2024 saw the largest outperformance of the market cap weightings vs. equal weight in more than two decades. This occurred two years in a row, and the degree of outperformance is staggering as shown in the graph below. This further emphasizes the importance of the fact that the international markets simply did not have these companies.



Regarding the greenback, the U.S. Dollar Index, which is comprised of a basket of currencies, shows again that dollar strength has been a prominent force. There are many factors which impact the relative value of the dollar such as inflation and fiscal and monetary policy. Currency valuations can be complex; however, meaningful currency fluctuations challenge international trade dynamics and can cause market volatility. The graph below shows the movements of the U.S. Dollar Index since 2021 with the dollar appreciating 20% over the period.

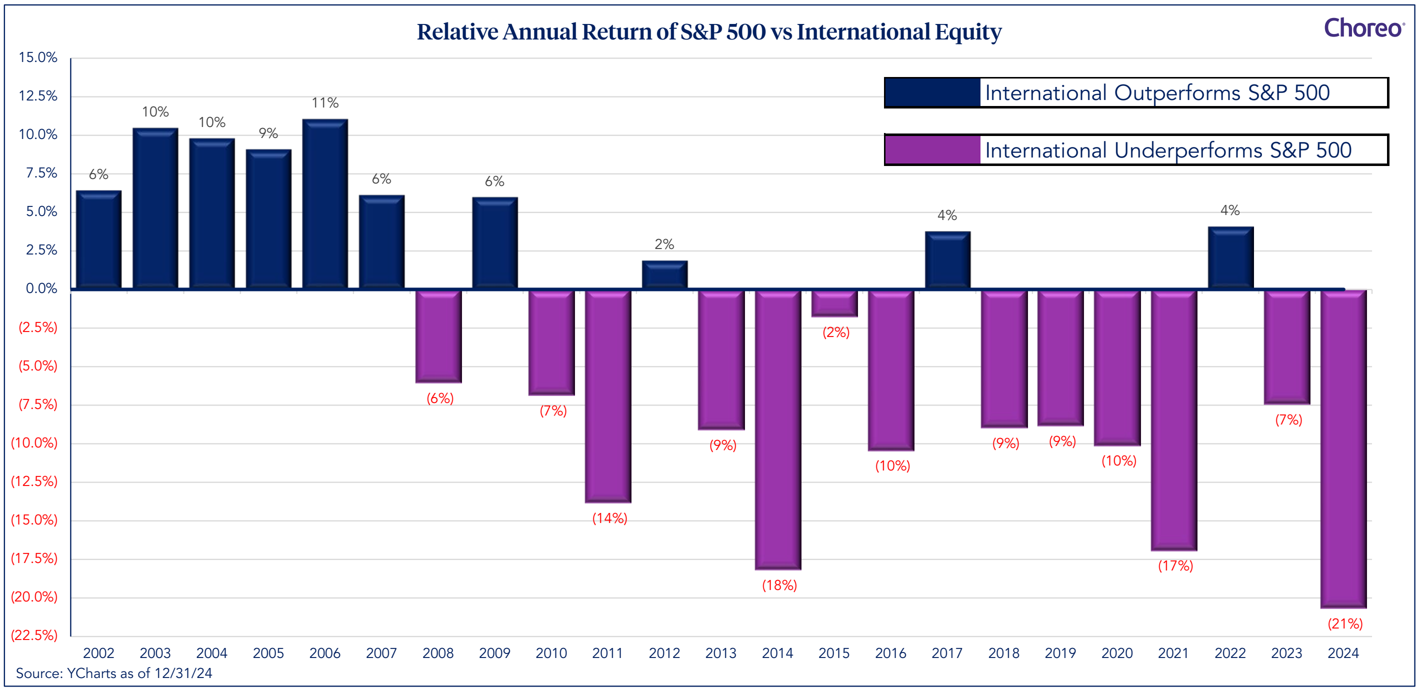


Tariffs are another potential barrier to international trade and accordingly could impact stock prices. Generally speaking, tariffs are an added cost on incoming goods and services. The graph below highlights the history of these charges as a percentage of total federal tax receipts against inflation. Intuitively, a higher tax on anything could put upward pressure on prices (i.e., inflation) although practically speaking the impact on inflation has been shown to be far more complex. There are often offsets, trade patterns switch, substitution may occur, and many other factors develop to obscure the true impact. Importantly, the overarching driver of inflation will likely see tariffs as a factor, but perhaps less so than the broad economic environment. The size and duration of policy are likely to also be impactful.



A globally diversified portfolio has the potential to mitigate the risks of any changes occurring in ANY country, not just the U.S.[1] The argument for diversification internationally ultimately comes down to portfolio risk mitigation. There have been lengthy periods of time in which the U.S. has underperformed international markets. The graph below shows that while those timeframes have primarily not been in recent years, there does tend to be a cyclicality to it. As show above, if not for a handful of U.S. mega-cap stocks and a strong U.S. dollar this might already be the case now.

[1] Diversification does not assure a profit, nor does it protect against a loss of principal. Diversification among investment options and asset classes may help to reduce overall volatility.



Conclusion

Global investing adds an element of diversification which has been tested for many decades. In advance, it is unknowable how assets will perform. The inclusive global approach allows access to unique companies with differing benefits, characteristics and risks. As always, please reach out with any questions and we thank you for the opportunity to serve.

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