

## Taking a look at International Equities

Looking back three years as of the end of October 2023, domestic stocks (as measured by the S&P 500 Index) have returned a total of 34.3%, or 10.3% per year. For the same three-year time period, international stocks (as measured by the MSCI All-Country World ex. U.S. Index) have lagged, returning a total of 11.1%, or 3.6% per year. Complicating matters further, few investors are comfortable with the economic outlook going into 2024 as distinct challenges face each of the world's economies.

Although the phrase "past performance does not predict future results" is popular in the finance industry, it is so for good reason. The U.S. may have fared better for the period noted above, but it is important to remember this has not always been the case. Using the same indices as above, if one were to look back at the 10 years ending October 2023, they would find that U.S. stocks outperformed their international counterparts. However, for the 10 years prior to that, internationals outperformed the U.S. Indeed, an illustration of the unpredictability of domestic versus international equity performance can be seen in Chart 1, looking at rolling 5-year forward annualized outperformance of the S&P 500 Index versus the MSCI All-Country World ex. U.S. Index.

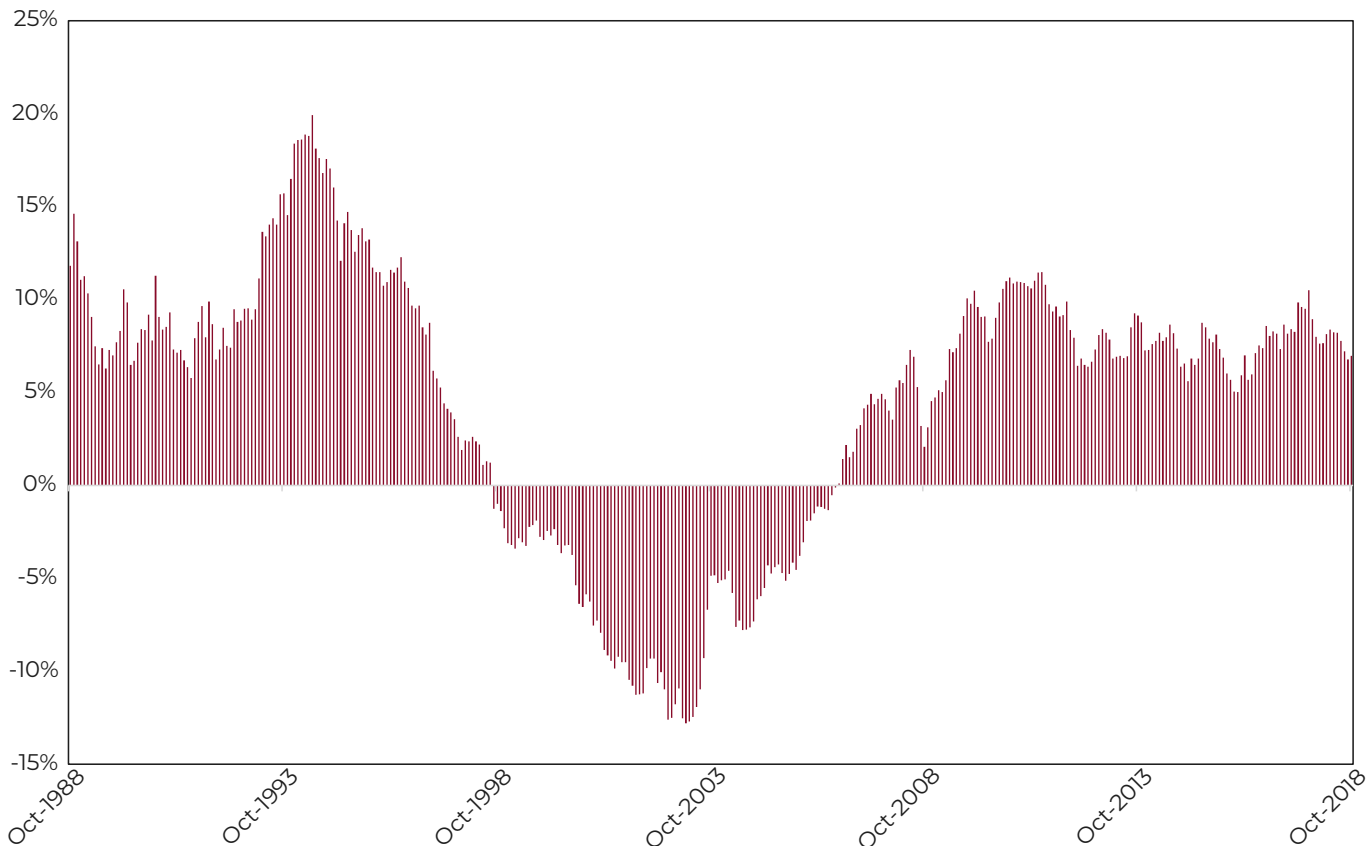
Bringing the question to more recent times, recession risk, military aggression, increased global financing costs, inverted yield curves, and the depletion of quantitative easing all threaten a soft recovery.

Given all of this, how do we think an investor should approach the question of global equity diversification within their portfolio?

In today's deglobalization-tilted environment, geography can be a useful starting point. From a geographical standpoint, the U.S. is further insulated from military aggression and dependence on their exports than is Europe. This, along with trepidation around winter energy access places Europe in a vulnerable position. Further, a singular interest rate set for a multitude of economies could prove troublesome especially when the ECB's main refinancing rate is at levels not seen since 2001.

As another example of an impact based on geographic locale can be seen in developed nations in Asia (e.g., Japan) that are within striking distance from hostile forces just as China shows amplified hostility in the Taiwan Strait. Further, the more success Taiwan earns, the more it undermines the

**Chart 1. Rolling 5-Year Forward Annualized Return Alpha Comparison**  
S&P 500 Index vs. MSCI ACWI ex. U.S. (October 1988 - October 2018)



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values of the Chinese Communist Party, and Xi Jinping. With the incumbent party looking to secure a third term, we think that continued discontent is likely. From these points of view, it seems as though the U.S. is the only major nation with little to worry about from its geographic neighbors.

Moving on to valuations, the U.S. trades at a premium to many other countries. As of November 29, 2023, at 20.6 times its earnings, the S&P 500 Index is 54% more expensive per dollar of earnings than the MSCI All-Country World ex. U.S. Index at 13.4. When smoothing earnings using the cyclically adjusted price-to-earnings (CAPE) ratio and looking back to the turn of the millennium, the U.S. is near an all-time comparative richness (see Chart 2). Although the price/earnings ratio is only one metric, the story remains the same with many others (e.g., price-to-book, price-to-cash flow).

**Chart 2. S&P 500 Index vs. MSCI All-Country World ex. U.S.**  
Cyclically Adjusted Price-to-Earnings Premium (CAPE)



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While the U.S. may have its share of flaws, its robust system of government, rule of law, currency, and economy are considered safe havens by many. When the dust settles and the world seems a bit more at ease, it is important to note that the tide can turn and shift toward higher perceived growth opportunities. As this shift occurs, potential opportunities can become more sought after than stability, and international equities can be poised to outperform.

What can be difficult and nearly impossible to predict is when these types of shifts can happen – let alone with any consistency. In the late 1990s, at the peak of the dot-com craze, it would have been heresy to suggest international stocks would have the edge. Yet they did, and by a margin.

While we would not suggest that investors bet against American business, it is important to remember that the United States was once an emerging market in the eye of the global powerhouse of Great Britain. Anything can happen, and the only thing to be expected is change. In sum, it is worth remembering that over certain periods, international exposure can outperform, and as is the goal of diversification, dampens vicissitudes through vast streams of earnings from unrelated companies and countries. We feel that looking toward heavily discounted international equity closed-end funds can offer value in the meantime.

Sources: Alpine Macro, Bloomberg Finance, L.P., The International Energy Agency, The Wall Street Journal

The S&P 500 Index is widely regarded as the best single gauge of large-cap U.S. equities and serves as the foundation for a wide range of investment products. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalizations as of 12/31/2022. The MSCI All-Country World ex. U.S. Index (MSCI ACWI ex. U.S.) is a market-capitalization-weighted equity index that captures large and mid-cap representation across 22 of 23 developed market countries (excluding the United States) and 24 emerging market countries as of 12/31/2022. The Index return is net of withholding taxes and assumes daily reinvestment of net dividends thus accounting for any applicable dividend taxation. The Index is unmanaged and cannot be purchased directly by investors. Data provided by Bloomberg Finance, L.P.



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