## International Equities: A perspective on valuations

A company's price to earnings ratio (PE ratio) is a valuation metric that measures the unit price of a company's earnings. It is a metric not only used for individual equities, but to gauge the valuation levels of indices and can provide insights into market perceptions regarding global equity markets.

For instance, as of September 30, 2023, the iShares Brazil exchange traded fund (EWZ) had a PE ratio of 5.1 and the iShares MSCI India exchange traded fund (INDA) had a PE ratio of 25.9 (and seeks to track the MSCI India Index).[1] Deciding whether to pay $5.10 for $1 of Brazilian earnings focused on steel and oil or $25.90 for a more balanced and future-focused $1 of Indian earnings can be difficult.

All things being equal, one could expect industries with a higher future growth potential to cost more. At approximately 80% off, Brazilian earnings might seem like a bargain barring any other considerations. However, it is our belief that after a more in-depth analysis regarding geography, government, demography, efficiency, and strategic partnership (among others), distinct nuances would become evident showing stark variations between these large emerging nations and explain some of the differences seen by market participants. Essentially, the market assigns a going rate for every dollar of earnings based on merit, mood, and perception. This is illustrated below as we analyze how some U.S. companies generally factor into the world's valuation equation regarding earnings.

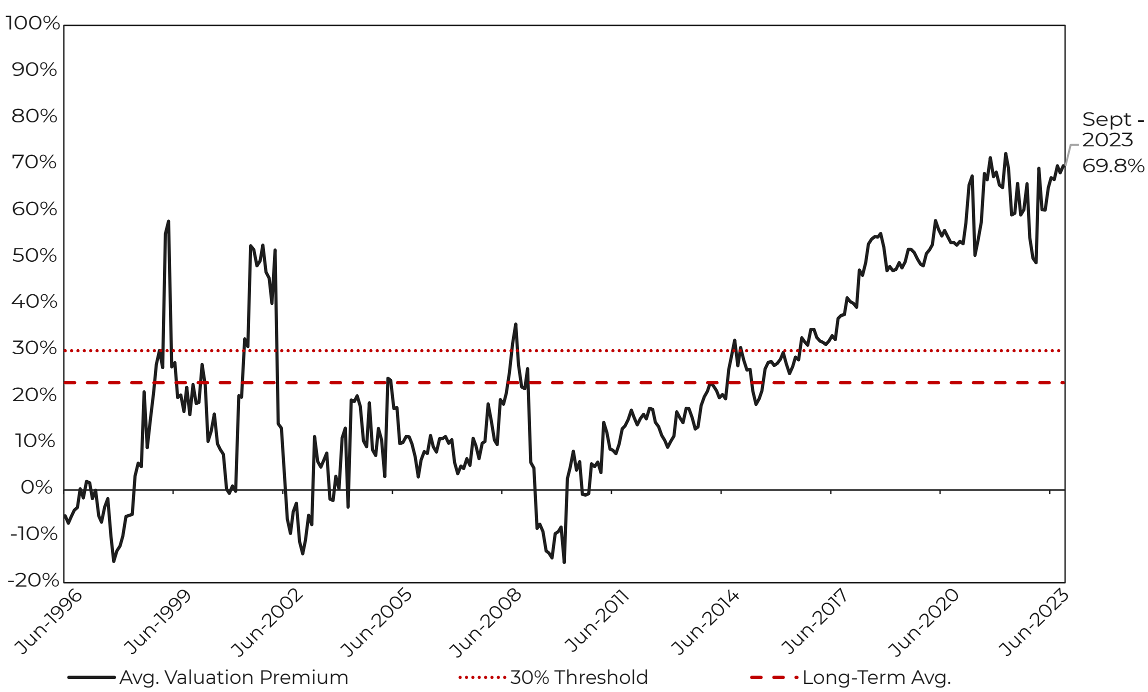
In using the most recent data available, Apple earned 57% of its revenue outside of the Americas. The same can also be true in reverse though. For instance, Toyota earned only 18.1% of its revenue in Japan, Samsung sold an even smaller share in South Korea, and ASML delivered all of its semiconductor manufacturing gear beyond the Netherlands. As shown above, with multiple foreign profit opportunities and consumer bases to explore, we think that the PE ratio is a good place to start to understand how beneficial cross-border investment can be.

Instead of relying on a single, bottom-line metric, we think a different way to look at valuations paints the picture with broader strokes. To do this, we'll blend in two other valuation metrics: the price/sales ratio and the enterprise value/earnings before interest and taxes ratio. The former ratio covers the top line of the income statement (i.e., a company's revenue or sales before deducting operating costs), while the latter incorporates both a company's debt and a third "mid-table" income statement line.

Based on the average of the three (PE, price/sales, and enterprise value/earnings before interest and taxes ratios) the maximum length of available data tells us that sellers of U.S. equities demand a premium of 23% (please see Chart 1). For purposes of this commentary, we'll call this difference in metric between the Russell 3000 Index and MSCI All-Country World ex-U.S. Index, the Stateside Valuation Premium (SVP). One of the reasons that this makes sense is because the U.S. Dollar is the reserve currency of the world. On top of this, we believe the U.S. also has a well-known rule of law and global military capabilities.

What's interesting is that the premium has grown in the face of pandemic, war, and global inflationary pressures. Days after Russia invaded Ukraine, using the blend of U.S. company metrics above traded at a 72% premium, an all-time high. This analysis demonstrates this margin of safety allows for less desired international companies to under-promise and over-deliver when the safety and security of the U.S. becomes in demand. Going forward, it is important to keep in mind that past performance is not indicative to future results. Using all available data which dates back to 1996, the long-term average of the monthly SVP is a 23% premium, though

**Chart 1. Stateside Valuation Premium**



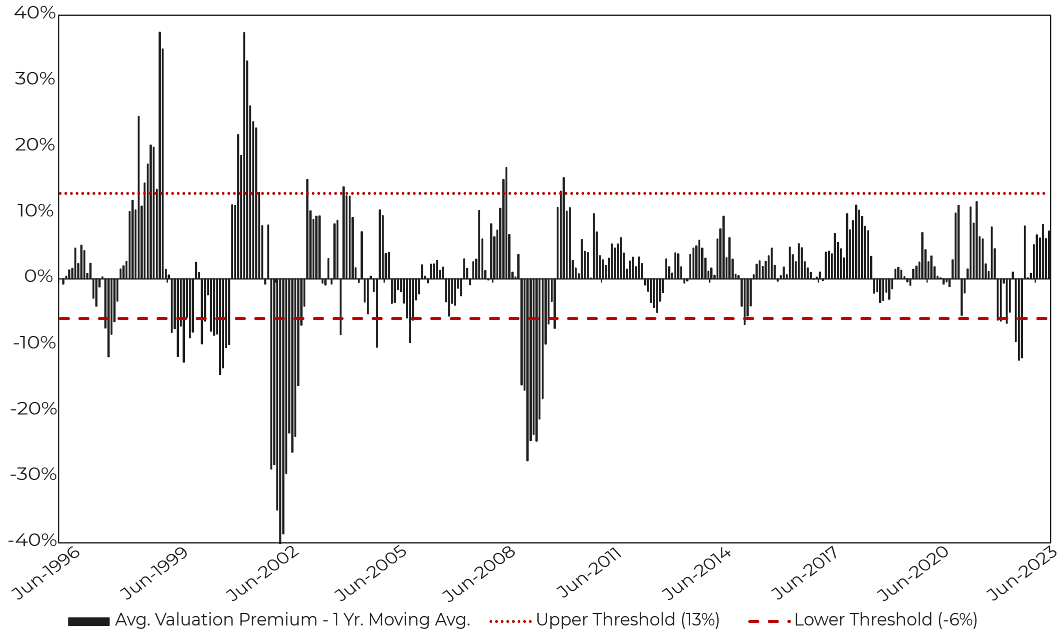

Source: Bloomberg Finance, L.P.. Analysis: Karpus Investment Management (6/30/1996 - 9/29/2023)

www.karpus.com
183 Sully's Trail, Pittsford, New York 14534
Phone: 585 586 4680
Fax: 585 586 4315

when it breaches a level of 30% from below, international equities had outperformed in five of seven occurrences, and by an average of 3.73% in the following 12 months. While that has been helpful in the past, the SVP hovers well-above the average premium consistently.

Using the same data, we can attempt to augment for the structural change (please see Chart 2). The difference between the SVP and its one-year trailing moving average (or the SVP Moving Average Differential) shows that when the SVP Moving Average Differential breaks above 13% from below (the "Upper Threshold"), international equities have outperformed an average of 5.53% the following 12 months and delivered alpha (returns exceeding the benchmark) 86% of the time. Additionally, all 7 instances come from different years as this accounts only for initial triggers. When using rolling dates, the results returned an average of 7.17% outperformance with positive outcomes for 21 out of 22 triggers, or 95% of the time. To be sure, the spirit of this holds true for any value over 13%, when using this analysis, but this is a more common point of occurrence.

**Chart 2. SVP Moving Average Differential**




Source: Bloomberg Finance, L.P.. Analysis: Karpus Investment Management (6/30/1996 - 9/29/2023)

The other side of the coin offers a curious perspective as well, though it has only shown promise in the last 20 years. When the ratio bypasses wider than a -6% reading (the "Lower Threshold"), international equities have outperformed U.S. stocks 50% of the time with an average outperformance of 2.8%. This was last triggered 11/30/2022, so forward 1-year returns are not yet available. These outcomes stand out when looking at the entirety of the dataset where international equities only come out on top for 39% of all periods.

In sum, when using this analysis, the MSCI All Country World ex. U.S. Index has outperformed the Russell 3000 Index when the SVP Moving Average Differential breaches the bounds stated above. This means, using these parameters, that the premium that investors pay for U.S. companies over international companies (compared to their average) has implications, regardless of the direction.

Market movement is anything but obvious and today is no different. What we see through the SVP is that U.S. companies have been on a trend of relative richness versus international companies on the heels of a decade of easy money policy. With an inverted yield curve and the U.S. Federal Reserve raising rates post bank failures, uncertainty is heightened. While we understand that entry points are never exact, perhaps now is a prudent time to consider diversifying into international closed-end funds which we believe offer exposure to foreign businesses, at times when we view they are below the value available in the open market.

1. Bloomberg Finance, L.P., Apple (AAPL) as of 9/24/2022, Toyota (TM) as of 3/31/2023, Samsung (005930) as of 12/31/2022, and ASML as of 12/31/2022.

*Sources: Bloomberg Finance, L.P., Congressional Research Service, iShares, Nuveen, Reuters.*

The Russell 3000 Index is a market-capitalization-weighted equity index that provides exposure to the entire U.S. stock market. The Index tracks the performance of the 3,000 largest U.S. traded stocks which represents approximately 96% of all U.S. incorporated equity securities. The MSCI All-Country World ex. U.S. Index 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. The Index return is net of withholding taxes and assumes daily reinvestment of net dividends thus accounting for any applicable dividend taxation. Each Index is unmanaged and cannot be purchased directly by investors. The above description of each index is as of 12/31/2022. Data provided by Bloomberg Finance, L.P..

KARPUS INVESTMENT MANAGEMENT

### Contacts

### Information/Queries

**Rochester, NY**
183 Sully's Trail
Pittsford, New York 14534
Phone: 585 586 4680
Fax: 585 586 4315

### Website

**www.karpus.com**

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