ClariVest
Asset Management LLC

The stars are aligning for international equities

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A typical investor in U.S. large-cap stocks has had a great run over the last decade or so and would not have regretted avoiding international exposure altogether during that period. But we believe the case for international equities has become compelling now. The usual draws of accessing more opportunities and lowering overall portfolio risk are coupled with attractive valuations and some huge catalysts (more on these shortly).

Lessons from history

Empirically, both U.S. and International stocks[1] have had long runs where one outran the other. We have just witnessed a stretch of U.S. exceptionalism (see chart, this page).

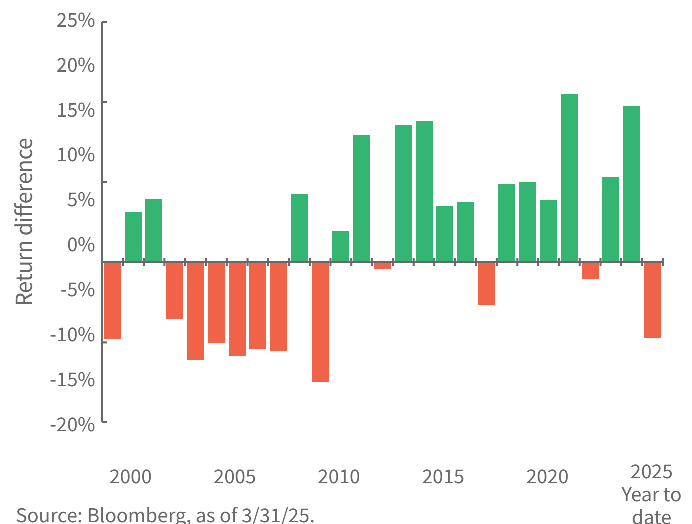
But investors may have forgotten that international stocks have gone on long runs as well, as recently as the 2000s. Those who forget history are condemned to repeat it – and quite possibly could miss out on some strong returns abroad.

Tastes great, less filling

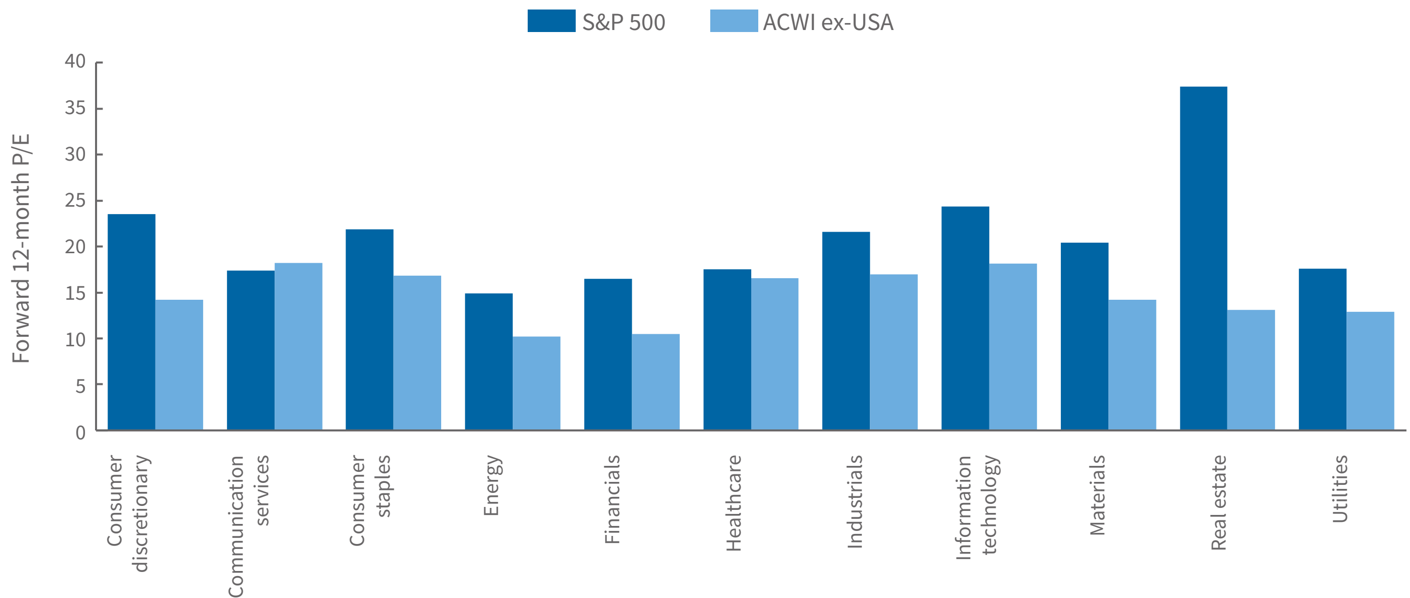
From a global market coverage perspective, adding international equities to a U.S. portfolio means the investor gains exposure to 46 more countries and thousands more companies. This represents a massive jump in the opportunity set for active managers to add value.

The standalone risk (as measured by annualized standard deviation[2]) of the U.S. market, as reflected by the MSCI USA Index, is 17.3%, but when investors combine U.S. stocks with the MSCI ACWI (All Country World Index) ex USA Index in the proportions of their respective market caps, the overall portfolio risk drops to 15.8% as of March 31, 2025. More opportunities, less risk!

S&P 500 Index return minus MSCI ACWI ex USA Index return



Source: Bloomberg, as of 3/31/25.



Source: Bloomberg, as of 3/31/25.

Discounts almost everywhere you look

The prospect of accessing a richer opportunity set while lowering portfolio risk is even better right now because of the gulf in valuations between the U.S. and international markets. The ACWI ex USA Index is about 20% cheaper than the S&P 500 on both a trailing and forward earnings basis. This is not just a reflection of the higher weight in the United States of growthy sectors like information technology. When compared sector by sector, the non-U.S. market is mostly more favorably priced than the U.S. market as of March 31, 2025, despite the recent international outperformance. See table above.[3]

Why now?

The icing on the cake is that there are several potentially powerful catalysts abroad. Germany and China, by far the biggest economies in Europe and in the emerging markets, respectively, are making policy moves that could turbocharge non-U.S. markets. Interestingly, these policy moves are partly a reaction to the tariff gyrations emanating from the United States. Meanwhile, while Japan has gotten off to a slow start in 2025, in our view it continues to be a market of meaningful potential as it continues down the path of reforming corporate governance and exiting deflation.

The German government recently approved a 500 billion Euro package focusing on revitalizing infrastructure, energy systems, transportation, and education while expanding digitalization. It also plans to exempt defense spending from the country's overall debt limit. Germany has historically been quite austere about fiscal deficits and government debt. It is this sudden turnaround, in addition to the sizable amounts involved, that has led to a powerful market response. Friedrich Merz, the probable next German chancellor, labeled the plans for defense spending as "whatever it takes" – the phrase that Mario Draghi, the former president of the European Central Bank, memorably used to calm market nerves during the euro crisis in 2012.

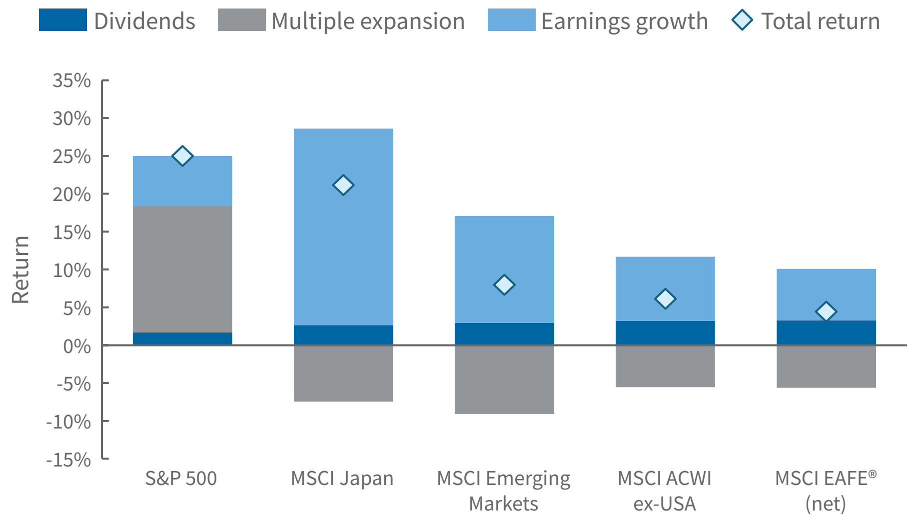
China, in an about-face from 2020, is opening the door to animal spirits with President Xi Jinping acknowledging the importance of the private sector, as demonstrated by his meeting with top business leaders in February. Innovation efforts in China's tech sector had already received a boost from the unveiling of DeepSeek and other highly rated artificial intelligence (AI) models built relatively inexpensively. In some ways, such breakthroughs should not be a surprise: According to a study from the Paulson Institute, 47% of the world's top quintile of AI researchers received their undergraduate degrees in China.[4] In another significant shift, the Chinese government has been expounding a lot lately on the merits of domestic demand. Officials also have announced several stimulus measures on this front and are considering ramping these up as necessary. This would help spur the Chinese economy as its usual engines of exports and infrastructure have been under pressure.

Lastly, we believe Japan remains an interesting market for equity investors. It is supported by ongoing reforms in corporate governance that have been driven by the Tokyo Stock Exchange's insistence that listed companies improve their return on equity (ROE). Also helping is an undemanding yen, which benefits exporters and boosts tourism-related spending, and the end of

the long-lasting deflationary era in Japan, which suppressed economic growth, as consumers and businesses tended to delay spending and investment while prices were falling.

While these developments are centered in specific countries, many of the potential beneficiaries are in other countries. For example, Germany's spending announcement has already supported a rally across Europe. China's growth in the 2000s led to a massive boost for commodity producers based half the world away in Latin America. Closer to home, we expect that a Chinese resurgence would likely be a tide to lift the boats of China's regional trading partners such as South Korea and Taiwan. More generally, these bright spots will likely help foster enthusiasm for non-U.S. equities.

U.S. versus non-U.S. components of return in 2024



Source: Bloomberg, as of 12/31/24.

Conversely, the United States for quite a while has benefitted from a virtuous cycle – the stock market performed well, and so attracted more investments, which helped it do well. That cycle in part is how it ended up so expensive and arguably priced for perfection. As seen in the chart on this page, its outperformance last year versus non-U.S. markets had less to do with delivering earnings and more to do with expanding multiples[5] – not a confidence-inspiring result!

Now that there's been some negative news inside the United States in stark contrast to the positive news outside, we believe this cycle could easily turn into a vicious cycle inside the U.S. and a virtuous cycle outside the U.S.

Conclusion

There are no guarantees in investing. There are, however, steps investors can take to mitigate their potential downside and to raise their odds of capturing sources of future returns. We believe adding international to a domestic portfolio at this point helps meet both objectives.

[1] We use the MSCI ACWI ex USA Index as our proxy for international investing. It encompasses both developed and emerging markets and captures about 85% of the global equity opportunity set outside of the United States.

[2] Calculated using the trailing five years of monthly net returns data. We use the MSCI USA Index for the United States for the sake of consistency. Data as of 3/31/25. Source: MSCI.

[3] Calculated using 12-month forward price-to-earnings (P/E) ratios. Data as of 3/31/2025. Source: Bloomberg

[4] The Global AI Talent Tracker 2.0, Marco Polo/The Paulson Institute, March 6, 2024.

[5] Source: Bloomberg

About the authors

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Investing involves risk, including risk of loss.

Diversification does not ensure a profit or guarantee against loss.

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International investing presents specific risks, such as currency fluctuations, differences in financial accounting standards, and potential political and economic instability. These risks are further accentuated in emerging market countries where risks can also include possible economic dependency on revenues from particular commodities or on international aid or development assistance, currency transfer restrictions, and liquidity risks related to lower trading volumes.

Investing in Large Caps is based on the expectation of positive price performance due to continued earnings growth or anticipated changes in the market or within the company itself. However, if a company fails to meet that expectation or anticipated changes do not occur, its stock price may decline. Moreover, as with all equity investing, there is the risk that an unexpected change in the market or within the company itself may have an adverse effect on its stock.

Sector investments are companies engaged in business related to a specific sector. They are subject to fierce competition and their products and services may be subject to rapid obsolescence. There are additional risks associated with investing in an individual sector, including limited diversification.

Definitions

Animal spirits is a phrase used to describe how human emotion, irrational thinking, and a herd mentality among market participants can drive financial decision-making and investing in uncertain environments and volatile times. British economist John Maynard Keynes coined the phrase in his 1936 book, "The General Theory of Employment, Interest, and Money."

Annualized estimates represent short-term calculations or rates that have been converted into annual rates.

DeepSeek is a Chinese artificial intelligence startup that in January 2025 became a leading free downloadable app in the United States. This followed DeepSeek's announcement that its AI model performed as well as market-leading models and that it was developed at a significantly lower cost. This led to a selloff of well-known U.S. technology stocks on Jan. 27, 2025.

Factor investing is an approach to investing that selects securities based on characteristics associated with higher returns. These characteristics, or factors, can be macroeconomic factors or style factors. Macroeconomic factors are focused on broad risks across asset classes and include the rate of inflation: growth in gross domestic product; and the unemployment rate. Style factors include differences in growth versus value stocks; market capitalization, and industry sector. Factor performance refers to a focus on performance of securities within a particular factor or between groups of different kinds of factors.

Forward price-to-earnings (forward P/E) is a version of the ratio of price to earnings that uses forecasted earnings for the P/E calculation. The earnings used in this ratio are an estimate and therefore are not as reliable as current or historical earnings data.

Market capitalization, or market cap, refers to the total dollar market value of a company's outstanding shares of stock.

A multiple, sometimes referred to as the price multiple or earnings multiple, is a measure of a company's value based on the ratio of its current share price to its earnings per share. This ratio is known as the price-to-earnings ratio, or P/E.

Price-to-earnings (P/E) ratios measure a company's current share price relative to its earnings per share. The ratio is used to help assess a company's value and is sometimes referred to as the price multiple or earnings multiple.

A quintile is a statistical value representing 20% of a given set of data. The first, or lowest, quintile represents the lowest fifth of the data (1% to 20%), and the highest quintile represents the top fifth (81% to 100%).

Return on equity (ROE) is a measure of financial performance calculated by dividing net income by shareholders' equity.

Standalone risk is the risk associated with a specific asset, group of assets, or area within capital markets.

Standard deviation is a measure of the dispersal or uncertainty in a random variable. For example, if a financial variable is highly volatile, it has a high standard deviation. Standard deviation is frequently used as a measure of the volatility of a random financial variable.

Total return, when measuring performance, is the actual rate of return of an investment or a pool of investments over a given period of time. Total return includes interest, capital gains, dividends, and distributions realized over the specified period. Total return accounts for two categories of return: income including interest paid by fixed-income investments, distributions, or dividends and capital appreciation, representing the change in the market price of an asset.

Trailing indicators are data or measurements that reflect events, trends, results, or developments that took place in the past. Trailing indicators typically refer to a specific time period for which the data in question is aggregated, summed, or averaged. Trailing indicators help reflect trends that occur over specified periods of time.

U.S. exceptionalism, often referred to as American exceptionalism, is an idea centered on the notion that the United States is a unique and even superior nation as a result of historical, ideological, religious, and/or, in the context of finance, economic reasons. Proponents of American exceptionalism often expect or advocate for the United States to occupy or play a leading role in global affairs.

Indices

The MSCI ACWI (All Country World Index) ex USA Index captures large- and mid-cap representation across 22 of 23 developed markets countries (excluding the United States) and 24 emerging markets countries. With 2,056 constituents, the index covers approximately 85% of the global equity opportunity set outside the United States. Developed markets countries include Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the U.K. Emerging markets countries include Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Kuwait, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Saudi Arabia, South Africa, Taiwan, Thailand, Turkey and United Arab Emirates.

The MSCI EAFE® (Net) Index measures the performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada. The MSCI EAFE® (Net) Index subtracts any foreign taxes applicable to US citizens but not applicable to citizens in the overseas country.

The MSCI Emerging Markets® Index measures the performance of large and mid-cap stocks across 24 emerging markets (EM) countries. EM countries include Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Pakistan, Peru, Philippines, Poland, Qatar, Saudi Arabia, South Africa, Taiwan, Thailand, Turkey and United Arab Emirates.

The MSCI Japan Index is designed to measure the performance of the large- and mid-cap segments of the Japanese market. With 183 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in Japan.

The MSCI USA Index is designed to measure the performance of the large and mid-cap segments of the US market. With 589 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in the U.S.

The S&P 500 Index measures changes in stock market conditions based on the average performance of 500 widely held common stocks. It is a market-weighted index calculated on a total return basis with dividend reinvested. The S&P 500 represents approximately 80% of the investable U.S. equity market.

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