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Market Ethos

The latest market insights from Richardson Wealth

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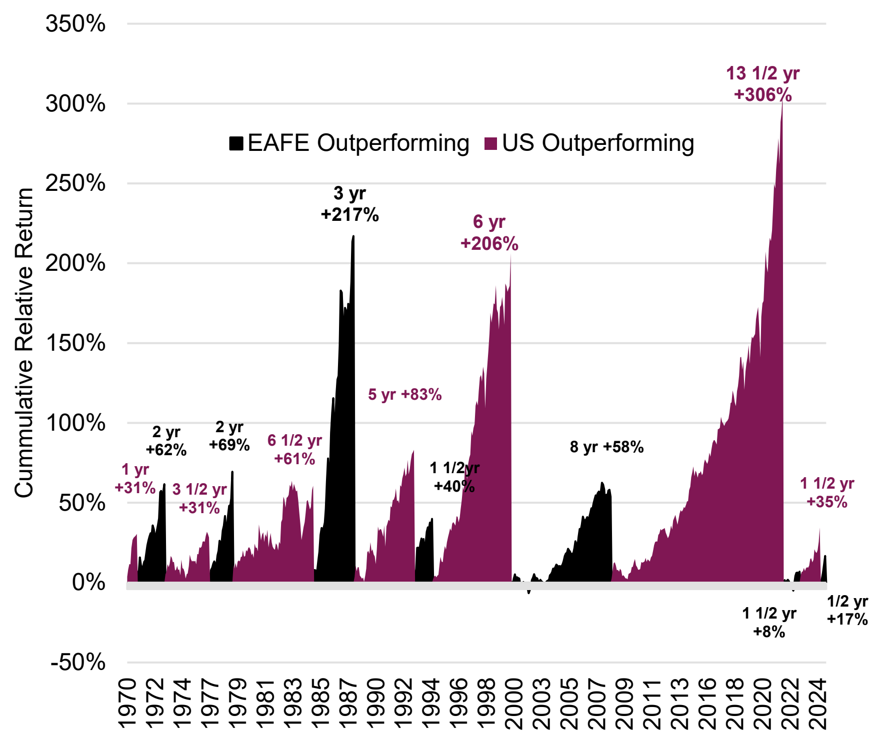
New tune or same old dance?

On a handful of occasions during the past 15 years, investors became excited about international equities emboldened by brief spats of outperformance against the mighty S&P 500. And in all those cases, it faded quickly as S&P 'exceptionalism' reclaimed its spot on the top of the performance tables. This wasn't always the case as there have also been extended periods when EAFE or international equities outperformed the U.S. Now with EAFE up about 13% so far in 2025 and the S&P 500 down around -2%, once again folks are talking international. Will this be yet another false signal or is this cyclical dance finally changing tunes?

So you are saying there's a chance?

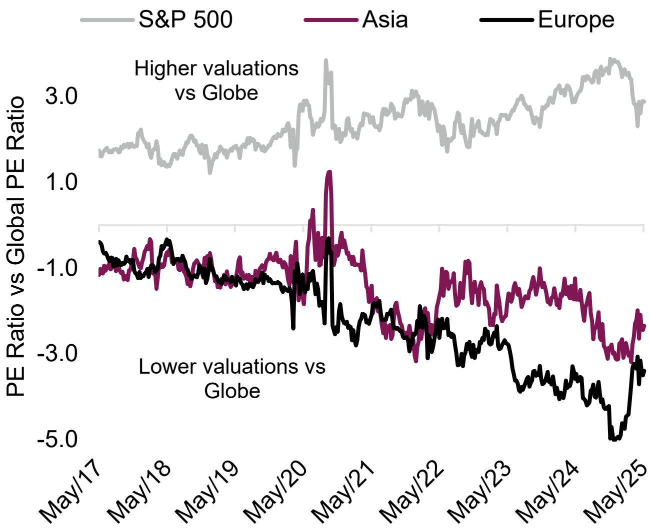


Source: Bloomberg, Purpose Investments, price returns 1970-94, 1994+ total return, USD

Comparing the U.S. equity market with EAFE is not as different as apples to oranges, but certainly different kinds of apples. The U.S. market is skewed to more technology and many globally operating companies. Japan too has a lot of technology, but certainly more consumer discretionary and less financials. Europe is more financials, less technology. This does help provide some diversification, from different mixes and exposures.

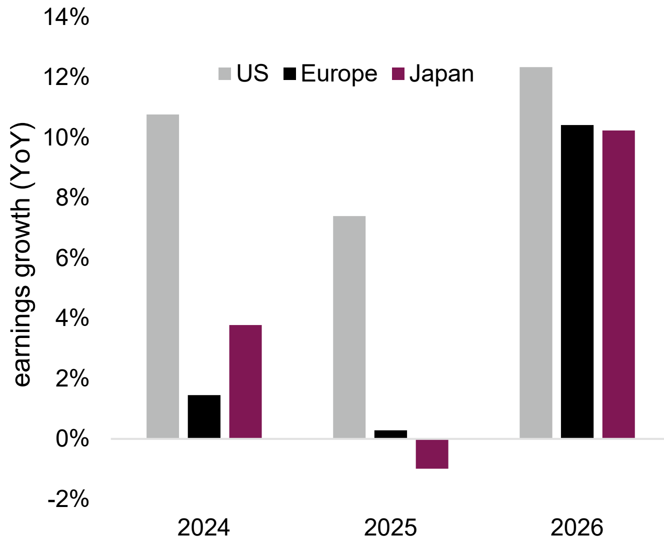
So, could we be entering a long period of international outperformance vs the U.S.? The setup is in place, but it has been in place for many years. Valuations naturally favour international, but that is usually the case given the sector differences and the valuations of those relative sectors. That being said, the valuation spread was very extreme at the end of 2024, a bit less so today. And it is not earnings growth as estimates for 2025 have come down more outside the U.S. We have a hard time believing investors are banking on 2026 estimates at this point with so much uncertainty.

Valuations still favour international



Source: Bloomberg, Purpose Investments

It sure isn't earnings growth, unless we are waiting for 2026



Source: Bloomberg, Purpose Investments, local currency

Probably more important than the above fundamentals are the starting points and relative changes. The U.S. dominated the 2010s thanks largely to technology megacaps. This received a boost following COVID as U.S. policy was much more stimulative, both monetary and fiscally. This helped the U.S. economy grow faster than most others that were more restrained in their stimulus and spending.

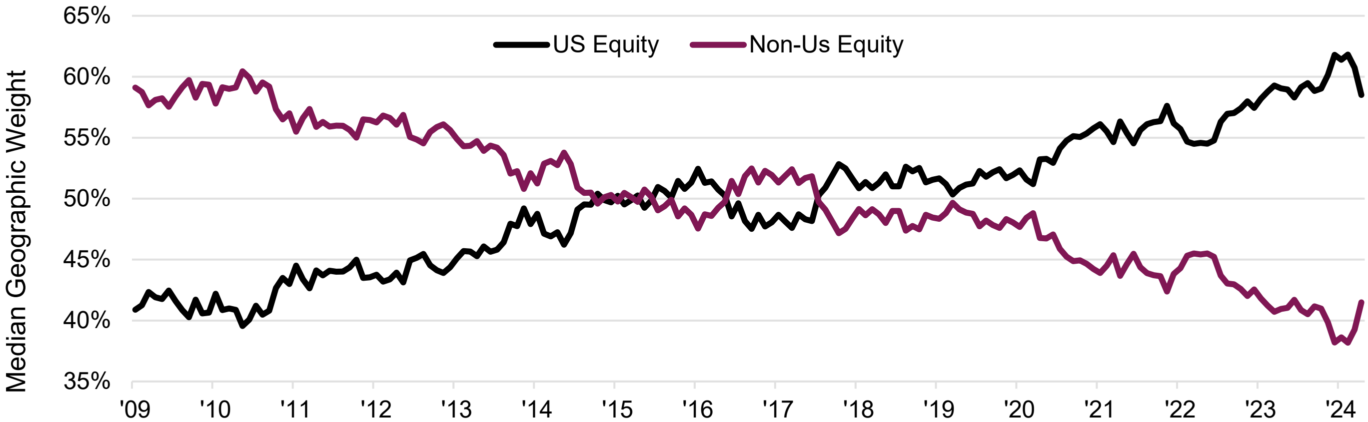
This may be changing. The U.S. is beginning efforts to grapple with their deficit — think DOGE. Meanwhile, more and more international countries are starting to increase spending or spending plans. Adding to this is the fact that the market has such high expectations for the U.S. economy and market, with much lower expectations for many international economies and markets. The bar is set pretty low in many places.

Most would agree the European consumer is in very good shape. Japan is finally making progress on reforms to encourage more investor-friendly company behaviours, with some negative sentiment around U.S. policy added in.

If the cycle has changed to favour international, the challenge for many portfolios will be a preponderance of U.S. equity overweights and subsequent international underweights. This isn't just at the client portfolio level. A common theme in multi-asset portfolios today is to rely on global equity managers for international exposure; but these days "global" is often just shorthand for "mostly U.S." You actually have to go back a decade to find a time when non-U.S. equity made up the larger share of global equity products. Since then, the shift toward U.S. exposure has been steady and significant. Today, the median global equity manager in North America has roughly 60% of their portfolio in U.S. equities.

One could argue that due to the U.S. massively outperforming international markets over the past 15 years, the U.S. weight would naturally increase, even if trimmed a bit along the way. The chart below just left the original region weight and applied market growth, looks pretty similar to the changing global manager weights above. In fact, all these charts look similar to the global market cap charts over time.

Roles Reversed
North American Global Equity Managers

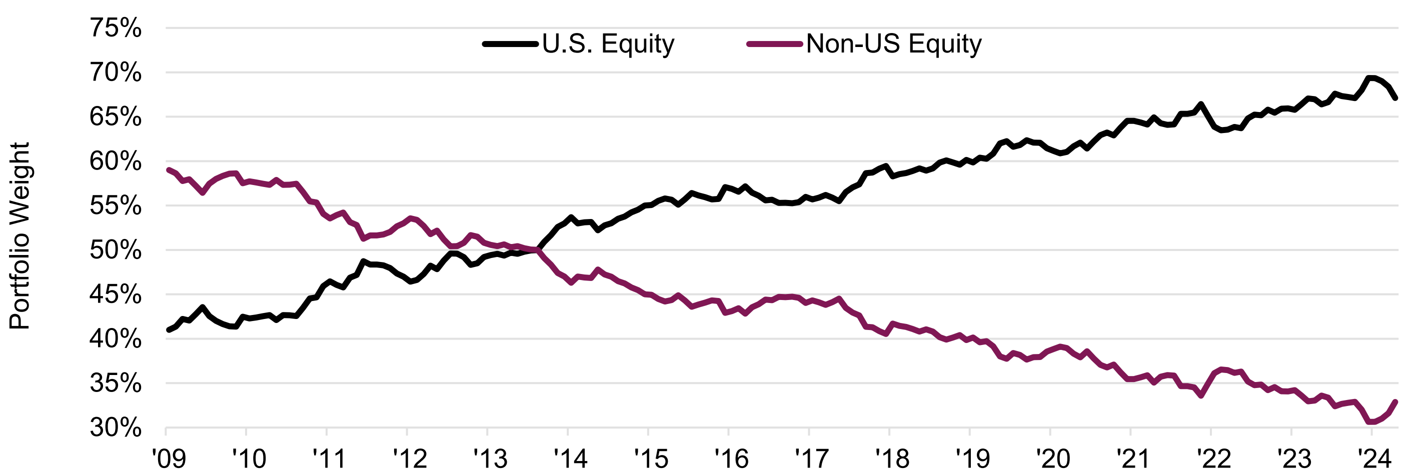


Source: Purpose Investments, Morningstar Direct

But now we have to ask, is this the right portfolio positioning for what lies ahead? Just because global market caps favour more U.S. these days doesn't mean it's right. In fact, focusing too much on global markets caps is literally backward looking.

There's now more than $1.1 trillion invested in global equity mutual funds across North America. That's a massive pool of mostly active capital tilted toward a region that has already had a historic run. And while the past decade rewarded U.S.-heavy allocations, the next one may not. Valuations are elevated. Market leadership is narrow. And global monetary and economic conditions are diverging in ways we haven't seen in a very long time.

What If You Let the U.S. Run?
Implied US Weight from Passive Market Growth



Source: Purpose Investments, Bloomberg

Final thoughts

Today, we are larger fans of international markets compared to U.S. equities. Valuations help a little but it is more from a risk/reward perspective. The U.S. equity market is awesome and it could outperform in the years to come. Still, after this relative run (plus the fact that it is possibly over-owned by investors), it would take even more exceptionalism to continue the dominance. Japan and Europe are like fixer uppers. Even minor improvements go a long way after underperforming for so long. And they are starting to make improvements while one could argue the U.S. is doing the opposite.

Source: Charts are sourced to Bloomberg L.P., Purpose Investments Inc., and Richardson Wealth unless otherwise noted.

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*This report is authored by Craig Basinger, Chief Market Strategist at Purpose Investments Inc. Effective September 1, 2021, Craig Basinger has transitioned to Purpose Investments Inc.