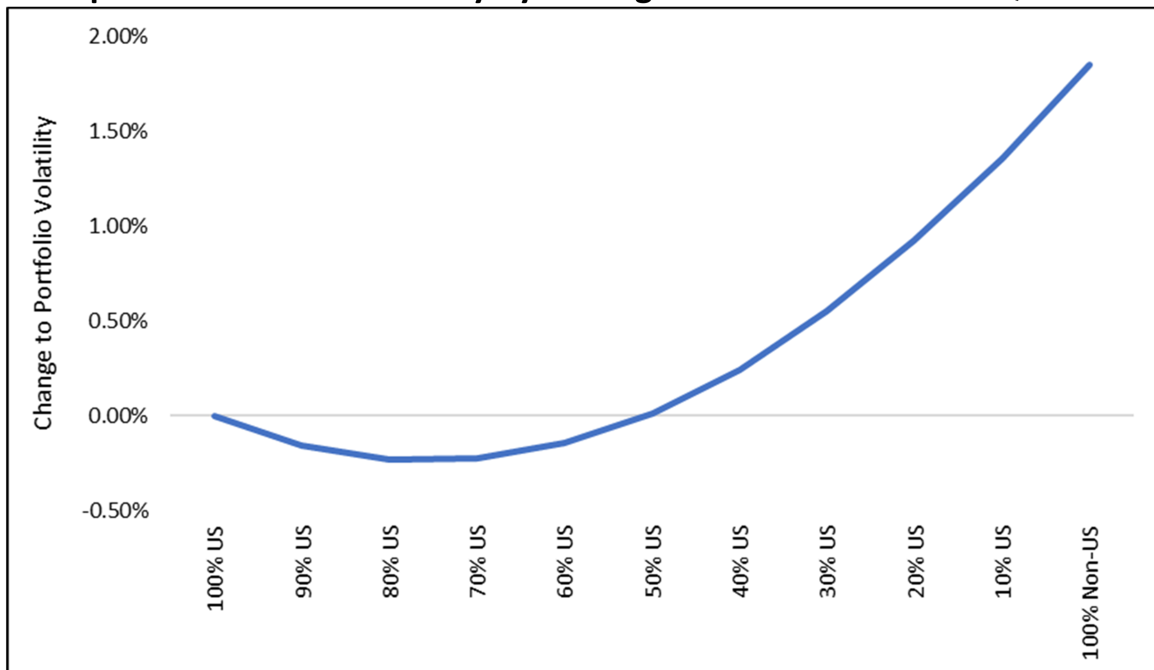
International Equity Allocations Revisited 2024

For years, diversification has been the primary rationale for investing in a globally diversified basket of stocks. Many have likely seen (or used) charts like the following to articulate the benefits of adding some non-US stocks to a US equity portfolio. Since 1988, a portfolio made up of 70% US stocks and 30% non-US stocks would have realized 23 basis points lower volatility annually than a 100% US equity portfolio.

Impact to Portfolio Volatility by Adding Non-US Stocks: 1988-Q1 2024

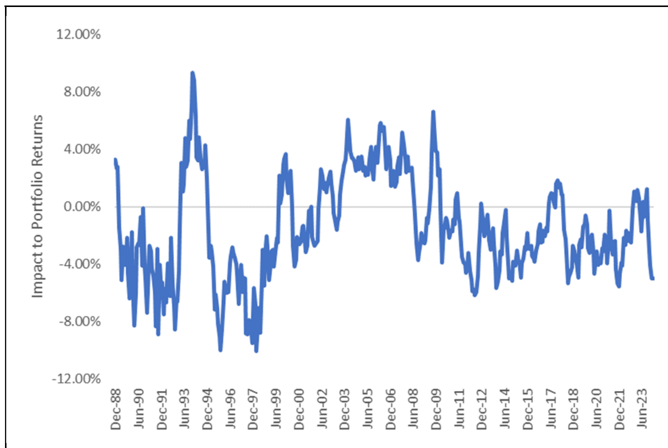


Notes: US stocks represented by the Russell 3000 Index. Non-US stocks represented by MSCI AC World Ex US Index from 1988 – 1998 and MSCI AC World Ex US (Net) since 1999. Portfolio volatility represented by the standard deviation of monthly returns.

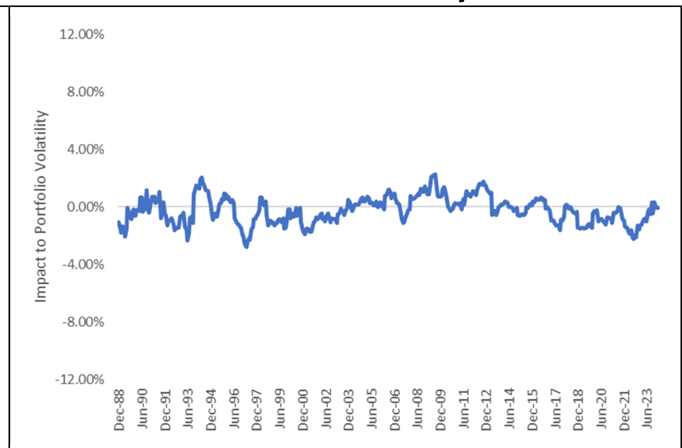
A key challenge however, is that since 2001, the diversification benefit has fallen to 4bps annually for that same 70% US 30% Non-US portfolio. To further complicate the arguments for diversification, the 70/30 portfolio would have underperformed the 100% US equity portfolio by 95bps annually since 2001 and 152bps annually for the full time period. In other words, in the pursuit of a more efficient portfolio, investors have given up significant long-term performance with only marginal benefits to portfolio volatility.

Over shorter windows the recent diversification challenge becomes clear – since 2008, a portfolio allocated 70% to US stocks and 30% to non-US stocks would have underperformed a US equity portfolio over trailing 12-month windows more often than not. And while the globally diversified portfolio has seen reduced volatility in more recent periods, the reduction in returns has overwhelmed the reduction in risk.

Impact of allocating 30% of equity portfolio to Non-US Stocks: Rolling 12-Month Total Returns



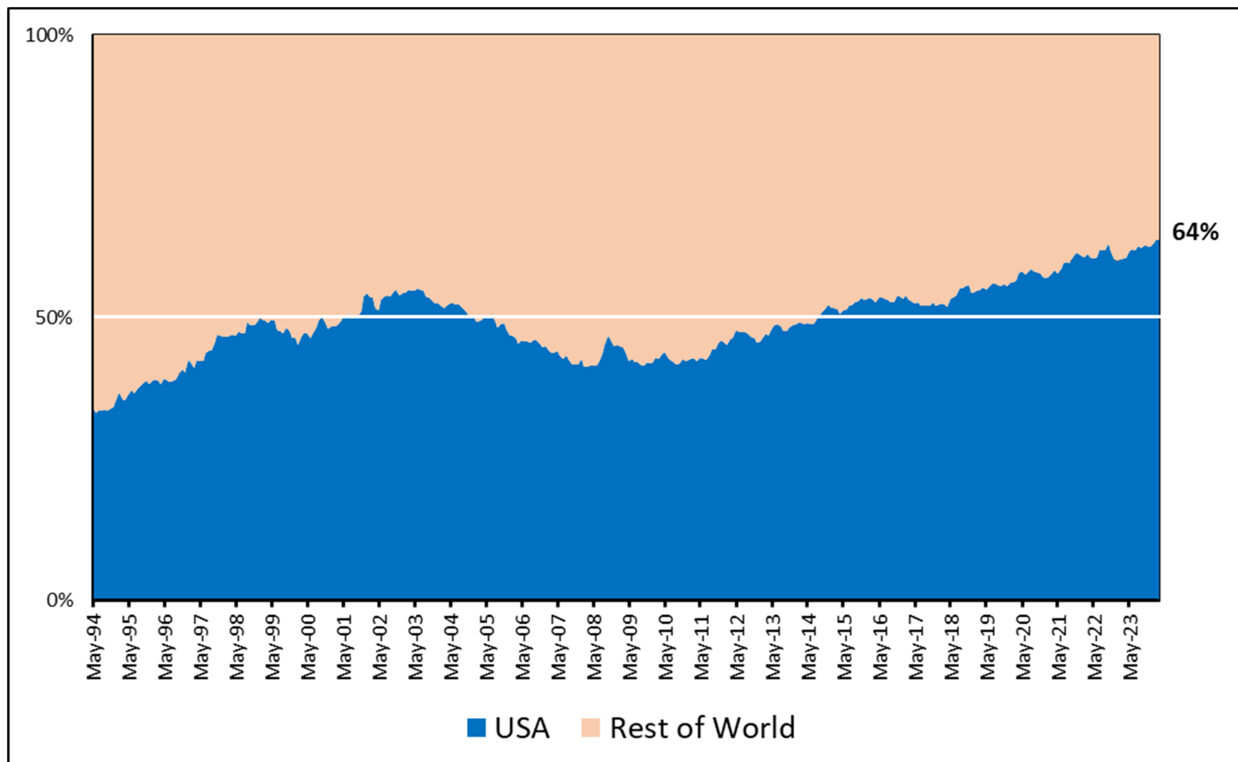
Impact of allocating 30% of equity portfolio to non-US Stocks: Rolling 12-Month Volatility



Notes: US stocks represented by the Russell 3000 Index. Non-US stocks represented by MSCI AC World Ex US Index from 1988 – 1998 and MSCI AC World Ex US (Net) since 1999. Portfolio volatility represented by the standard deviation of monthly returns.

One tangible outcome of this performance disparity is that today, following more than a decade of outperformance, US stocks account for nearly 2/3 of the global market cap. For portfolios that have a fixed weight to non-US stocks (e.g. 40%), this means that an allocation that perhaps intentionally reflected a home bias as recently as 2015, likely now reflects a modest overweight to non-US stocks. Portfolios that aspired to be neutral to market cap with a 50/50 allocation in 2014, 2015 or 2016 may now be significantly tilted away from US stocks, relative to global market capitalization.

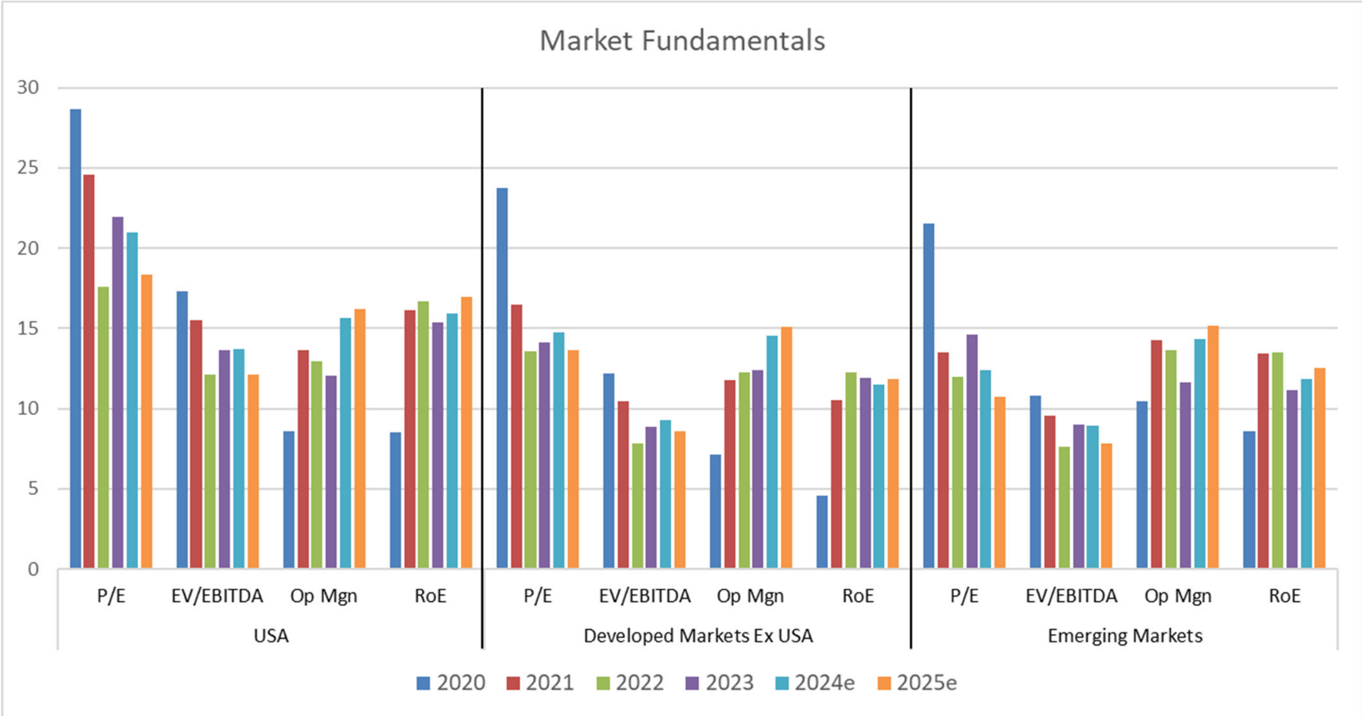
US vs Non-US stocks: MSCI ACWI Index



Notes: Country weight data provided by MSCI. Data starts in 1994 and includes all countries represented in the MSCI All Country World Index.

In light of this performance disparity, a key question faces investors – how to think about an allocation to global equities. Academics and practitioners alike have articulated the pros and cons of tilts to the US, tilts to Non-US as well as a neutral approach that weights allocations according to global market cap. In short, the arguments for tilting towards Non-US stocks focus on reversion to the mean, valuations, improving fundamentals and the potential for the US dollar to decline in value. Arguments for aligning to market capitalization focus on the inability to predict the future and therefore owning everything at neutral weights. Arguments for tilting towards US stocks focus on the relative advantages companies in the US face vis-à-vis, corporate governance, the breadth and depth of the job market, the breadth and depth of the capital markets, the strength of corporate earnings and the focus on sectors that have been more growth oriented.

Market Fundamentals



Notes: Data provided by Bloomberg as of Q12024.

Overall, we believe it is risky to completely eliminate Non-US stocks from a diversified portfolio. That said, we also believe that the relative advantages of the US means US stocks should hold a more prominent position in those same portfolios. For example, in the chart above, we use data from Bloomberg to assess the fundamentals of the global markets over the last four years as well as market estimates for 2024 and 2025. Overall market participants, in aggregate, expect US stocks to continue to trade at a premium to foreign stocks, but also to generate greater margins and a significantly higher return on equity. As a result, for investors that have drifted away from their target allocation, or for those who find themselves overweight Non-US stocks, consider evaluating whether the current allocation continues to fit your objectives. For those with a tilt towards US stocks, consider monitoring the global landscape in the event the thesis supporting the tilt changes.

Past performance is not indicative of future results.

Index performance returns do not reflect any management fees, transaction costs, or expenses. Indices are unmanaged and cannot be invested in directly. Current performance data may be higher or lower than actual data quoted. Performance for periods greater than 1 year is annualized.

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The Russell 3000® Index measures the performance of the largest 3,000 US companies representing approximately 96% of the investable US equity market, as of the most recent reconstitution. The Russell 3000 Index is constructed to provide a comprehensive, unbiased and stable barometer of the broad market and is completely reconstituted annually to ensure new and growing equities are included.

The MSCI ACWI ex USA Index captures large and mid cap representation across 22 of 23 Developed Markets (DM) countries (excluding the US) and 24 Emerging Markets (EM) countries. With 2,228 constituents, the index covers approximately 85% of the global equity opportunity set outside the US.

The MSCI AC World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets that does not use leverage or short sales. It consists of 49 country indexes comprising 23 developed and 26 emerging market country indices. With 3,040 constituents, the index covers approximately 85% of the global investable equity opportunity set.

The MSCI EAFE Index is a free float-adjusted market capitalization index that is designed to measure the performance of large and mid-cap securities across 21 developed markets, including Europe, Australasia, and the Far East, excluding the US & Canada. The Index is available for a number of regions, market segments/sizes and covers approximately 85% of the free float-adjusted market capitalization in each of the 21 countries.

The MSCI Emerging Markets Index captures large and mid cap representation across 24 Emerging Markets (EM) countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

Indices referenced are unmanaged and cannot be invested in directly. Index returns do not reflect any investment management fees or transaction expenses.