US Equities Win Again – Time to Abandon Non-US Equities?

February 2022

OVERVIEW

- **US large caps have outperformed non-US equities over the past decade, fueled by sector concentration and a small subset of stocks.**
- **For long-term investors, attractive relative valuations (vs. US) along with potential catalysts favor non-US equities over US equities.**
- **Diversification can appear dilutive during periods of discrete market leadership – often a long-term view is rewarded.**

Background

The benefits of a diversified portfolio are well documented and for the most part largely adopted by investors as a portfolio management and risk mitigation tool. Unfortunately, the trick with diversifications is – you never own enough of your highest returning assets. Over the past decade, this has been US large caps which have benefited from sector and stock concentration.

10 Year (Ending 12/31/2021)	Index Return	Largest Sector Weight	Sector Return
S&P 500	17%	Tech (29%)	24%
MSCI ACWI ex US (Net)	7%	Financials (19%)	17%

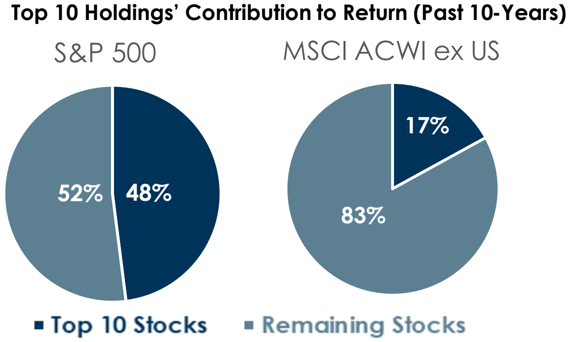
Source: ACG Research, MSCI, Standard & Poor's

US large caps (S&P 500) outperformed non-US equities (MSCI ACWI ex US) by more than a 2:1 margin over the past ten years. A driving tailwind behind the outperformance was the increasingly concentrated sector position of information technology (the best performing sector) which ended the decade at 29% weight. Conversely, the non-US equity benchmark is more diversified across sectors with no sector representing more than 20% of the index.

Narrow Leadership

The S&P 500 and MSCI ACWI ex US are market cap weighted indices. As a result, stocks/sectors that are in favor represent a larger and larger weight of the index (momentum). As stocks gather momentum they become an increasing portion of the index. Over the past decade it was not just information technology but a handful (top-10) of stocks that represented almost half of the return of the S&P 500. Said another way, did you want to own the S&P 500 or just the top 10?

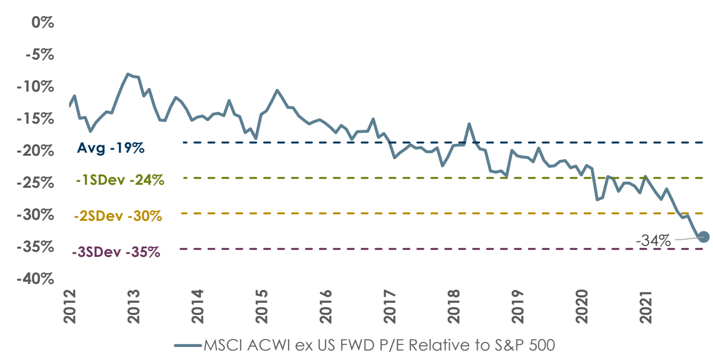
Top 10 Holdings' Contribution to Return (Past 10-Years)



Relative Valuations

Given the relatively narrow run up in the S&P 500 over the past decade, non-US equities are now trading near a 3x standard deviation valuation discount to US stocks on a forward-looking basis.

MSCI ACWI ex US Fwd. PE vs. S&P 500



Source: ACG Research, Bloomberg

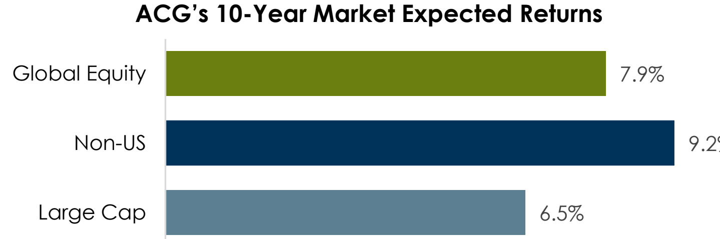
Potential Catalysts for Non-US

Investors and allocators alike are faced with the question – what needs to happen for non-US equities to outperform US equities? Here are a couple of potential catalysts we are monitoring – multiple compression in US markets, rise in US rates, change in tech leadership, and improved cyclical growth globally. If any of these factors play out it should disproportionally benefit non-US equities as they are undervalued (relative to US), less sensitive to interest rate changes, have less exposure to tech, and benefit from improved cyclical growth.

Outlook

Given the steep discount to current valuation levels, non-US equities have higher 10-year expected returns going forward from a capital markets perspective.

ACG's 10-Year Market Expected Returns



Source: ACG Research

ACG's Position

Diversification is an easy concept to adopt but a hard concept to maintain, particularly when you have extreme periods of concentrated market leadership. We firmly believe that globally diversified portfolios help clients achieve their long-term goals. In our view, it is not time to abandon non-US equities, instead we believe that non-US equities play a key role in enhancing diversification and look attractive relative to US markets.

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