



Chris Konstantinos, CFA

CHIEF INVESTMENT STRATEGIST,  
DIRECTOR OF INTERNATIONAL  
EQUITY

Rod Smyth

DIRECTOR OF INVESTMENTS

Doug Sandler, CFA

GLOBAL STRATEGIST

## Why We Are Not Throwing in the Towel on International Stocks

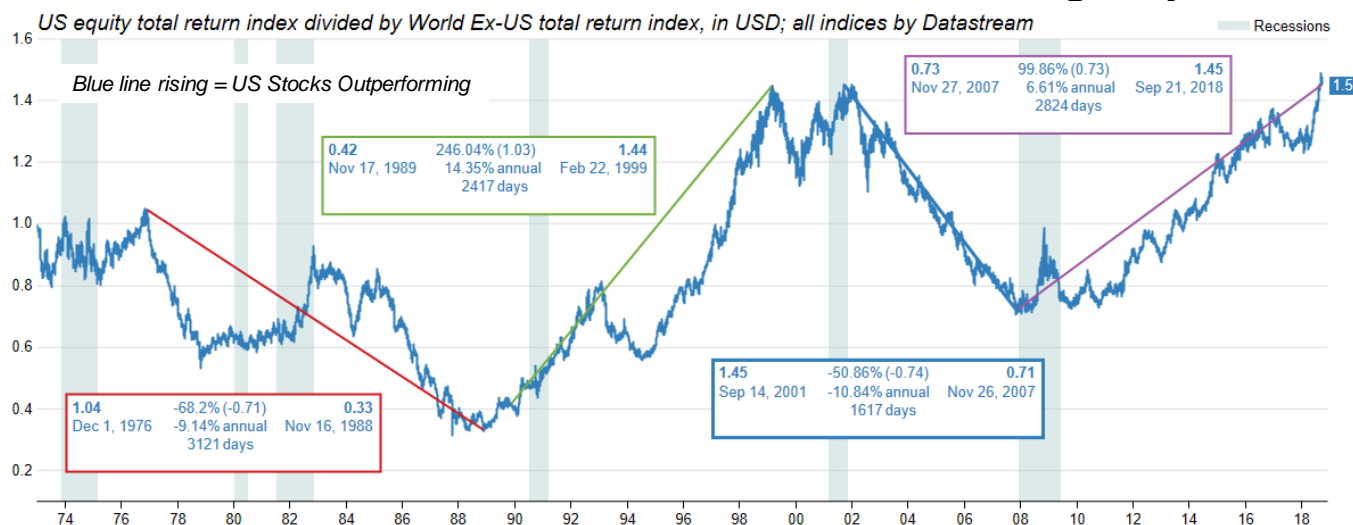
RiverFront’s asset allocation framework, based on the potential of long-term mean reversion, suggests that international equities are priced to offer significantly higher inflation-adjusted returns over the next 5-10 years than U.S. equities. However, we recognize the frustrations of global investors growing impatient for international’s relative outperformance to begin. Acknowledging that our asset allocation preference for international equities over the U.S. has hurt our performance this year, we maintain a significant allocation to international equities and remain constructive. Here we attempt to offer some perspective on why.

### RIVALRIES, STREAKS AND SLUMPS: LESSONS ON INVESTING FROM SPORTS

A fierce sports rivalry in the Mid-Atlantic is the basketball battle between the University of North Carolina (UNC) and Duke University. Since their first historic meeting in 1920, the two teams have played 248 times. While the head-to-head win percentage of each team is reasonably close to 50/50\*, the win ‘streaks’ occur in clusters that can span seasons, or even at times decades. The U.S. vs. international stock rivalry is no different. **While the yearly ‘win percentage’ of international versus the U.S. since the early 1970’s is identical in U.S. dollar terms, that history is punctuated by what we see as two long term ‘mega-streaks’ for each side, including the now decade-long hot streak the U.S. is currently riding (see chart, below).**

There are fundamental reasons why teams go on hot streaks, and the U.S. is no exception. Over the last decade, the U.S. has enjoyed a more productive economy, stronger corporate earnings, a faster clean-up of troubled banking assets after the financial crisis, a stronger currency, and more stable politics. However, all streaks come to an end eventually, and the U.S.’s current hot streak is about as long as any relative rally between the two in the last five decades.

### U.S. vs. International Stocks 1973-2018: Relative Strength Cycles



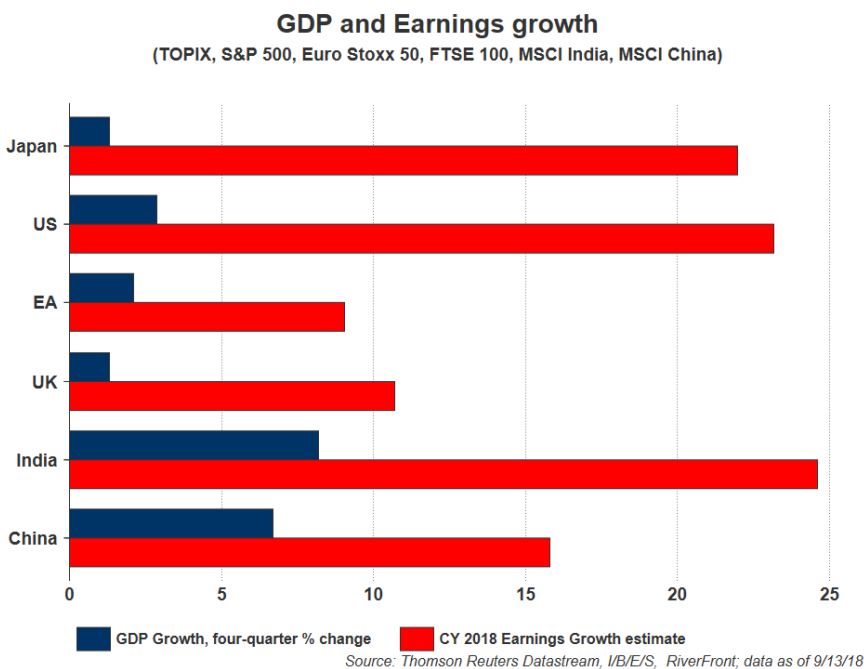
Source: Thomson Reuters Datastream, RiverFront; data to 9/21/2018

Past performance is no guarantee of future results. Shown for illustrative purposes only, not indicative of RiverFront performance.

\*(The Tar Heel on this staff wishes to state that the precise win percentage is ~ 55% UNC, 45% Duke— and that UNC has won 6 NCAA titles to Duke’s 5).

However, the advanced age of a trend is not necessarily a reason for it to end; shifts in relative fundamentals lead to relative shifts in performance, in our view. To this end, we believe ample reasons exist for relative strength to eventually turn in international's favor, including the following points:

**ACCOMODATIVE MONETARY POLICY:** Inflation trends in Europe, Japan and most major emerging markets are tepid compared to history, and economic trends globally are still positive (see blue bars in chart below). We believe this is a 'Goldilocks' scenario because spare capacity in these economies gives international central banks cover to maintain their accommodative policies. Historically, this has provided a positive underpinning for global stock markets.



**U.S. DOLLAR MAY HALT ITS SECULAR RISE:**

In addition to the 'Goldilocks' economic environment, we believe that the U.S. dollar is in the later-stages of its bull market that began in mid-2011, a topic we wrote about extensively two weeks ago in the *Weekly View*. If the USD can stop its ascension, emerging markets could stabilize and developed international stocks could deliver stronger USD-denominated returns.

**ECONOMIC AND EARNINGS GROWTH REMAIN POSITIVE:**

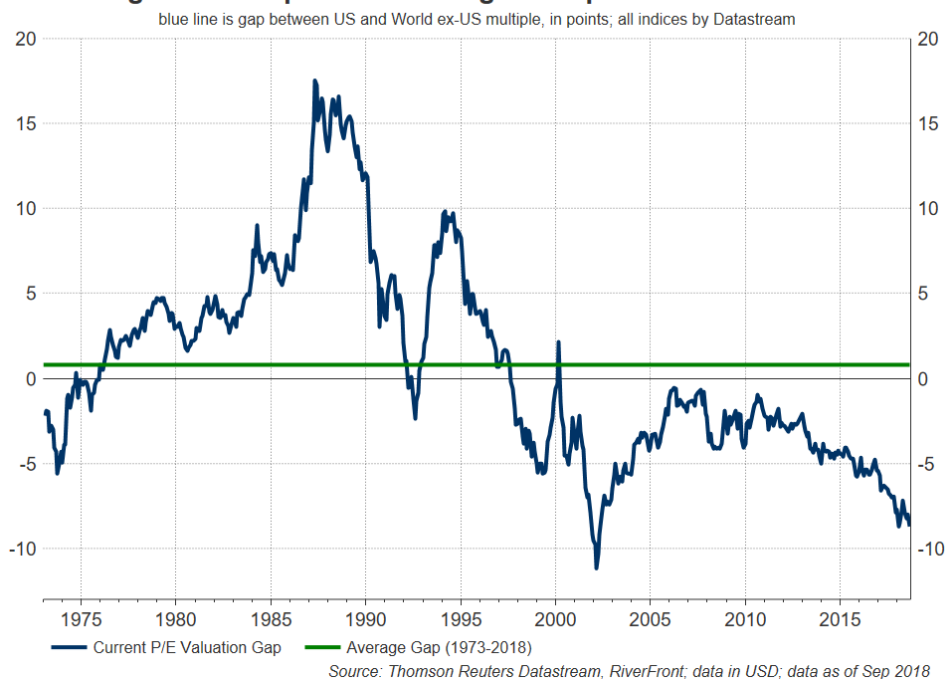
We believe we are in the early-to-mid stages of a positive corporate earnings cycle in Europe, Japan, and many major emerging markets as evidenced by their strong performance in 2017. This positive growth is expected to continue in 2018 and beyond (see red bars in chart to left). Over the long run, it is unusual for stocks to perform poorly in times when earnings growth is positive.

**TRADE TENSIONS SEEM NOW**

**LARGELY PRICED IN:**

On a trailing P/E basis, the valuation gap between U.S. and non-U.S. stocks remains close to the widest levels in 45 years. (Note: the only lower low historically was in 2002, which corresponded to the beginning of one of international's 'hot streaks' featured on page 1). We see negative market sentiment related to protectionist trade policy as the primary contributor to this valuation gap this year. While trade uncertainty relating to China is likely to stay with us for a while, we believe it is possible that we get positive resolution to trade issues between the U.S., NAFTA and the EU in 2018. Eventually, we believe that the longer term, the structural imbalances in China's economy and the unequal amount of trade leverage that the U.S. exercises over China (the U.S. imports over 3x as much from China as China imports from the U.S.) will lead to a resolution, no matter how ugly the negotiations appear in the meantime.

**Trailing 12 month price-to-earnings multiples: US vs International**



## **Important Disclosure Information**

*Past results are no guarantee of future results and no representation is made that a client will or is likely to achieve positive returns, avoid losses, or experience returns similar to those shown or experienced in the past.*

*The comments above refer generally to financial markets and not RiverFront portfolios or any related performance. Past results are no guarantee of future results and no representation is made that a client will or is likely to achieve positive returns, avoid losses, or experience returns similar to those shown or experienced in the past.*

*Information or data shown or used in this material is for illustrative purposes only and was received from sources believed to be reliable, but accuracy is not guaranteed.*

*Investing in foreign companies poses additional risks since political and economic events unique to a country or region may affect those markets and their issuers. In addition to such general international risks, the portfolio may also be exposed to currency fluctuation risks and emerging markets risks as described further below.*

*Changes in the value of foreign currencies compared to the U.S. dollar may affect (positively or negatively) the value of the portfolio's investments. Such currency movements may occur separately from, and/or in response to, events that do not otherwise affect the value of the security in the issuer's home country. Also, the value of the portfolio may be influenced by currency exchange control regulations. The currencies of emerging market countries may experience significant declines against the U.S. dollar, and devaluation may occur subsequent to investments in these currencies by the portfolio.*

*Foreign investments, especially investments in emerging markets, can be riskier and more volatile than investments in the U.S. and are considered speculative and subject to heightened risks in addition to the general risks of investing in non-U.S. securities. Also, inflation and rapid fluctuations in inflation rates have had, and may continue to have, negative effects on the economies and securities markets of certain emerging market countries.*

*RiverFront Investment Group, LLC, is an investment adviser registered with the Securities Exchange Commission under the Investment Advisers Act of 1940. The company manages a variety of portfolios utilizing stocks, bonds, and exchange-traded funds (ETFs). RiverFront also serves as sub-advisor to a series of mutual funds and ETFs. Opinions expressed are current as of the date shown and are subject to change. They are not intended as investment recommendations.*

*RiverFront is owned primarily by its employees through RiverFront Investment Holding Group, LLC, the holding company for RiverFront. Baird Financial Corporation (BFC) is a minority owner of RiverFront Investment Holding Group, LLC and therefore an indirect owner of RiverFront. BFC is the parent company of Robert W. Baird & Co. Incorporated ("Baird"), a registered broker/dealer and investment adviser.*

*These materials include general information and have not been tailored for any specific recipient or recipients. Accordingly, these materials are not intended to cause RiverFront Investment Group, LLC or an affiliate to become a fiduciary within the meaning of Section 3(21)(A)(ii) of the Employee Retirement Income Security Act of 1974, as amended or Section 4975(e)(3)(B) of the Internal Revenue Code of 1986, as amended.*

### *Index Definitions:*

*Standard & Poor's 500 Index (S&P 500) measures the performance of 500 large cap stocks, which together represent about 80% of the total US equities market. It is not possible to invest directly in an index.*

*The MSCI EAFE Index is designed to represent 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.*

*TOPIX is a free-float adjusted market capitalization-weighted index that is calculated based on all the domestic common stocks listed on the TSE First Section.*

*The Euro STOXX 50 Index is a market capitalization weighted stock index of 50 large, blue-chip European companies operating within Eurozone nations.*

*The FTSE 100 is an index composed of the 100 largest (by market capitalisation) companies listed on the London Stock Exchange (LSE)*

*The MSCI India Index is designed to measure the performance of the large and mid cap segments of the Indian market.*

*The MSCI China Index captures large and mid cap representation across China H shares, B shares, Red chips, P chips and foreign listings.*

*Copyright ©2018 RiverFront Investment Group. All Rights Reserved. 612004*