International Outlook

International equities have lagged this year amid stalled economic momentum in Europe, emerging-market turbulence and a rising U.S. dollar. Trade and geopolitical uncertainties pose headwinds, but an extended global expansion, ongoing central bank stimulus and discounted valuations support international portfolio allocations.

Global expansion isn’t exhausted – Upward momentum in the global economy stalled recently, with U.S. strength offset by a soft patch in Europe and China. Rebounds followed similar soft patches in 2012 and 2016, and positively, recent data are signaling some stabilization. Though we don’t anticipate a rebound as synchronized as in 2017, we think global growth remains supportive to international markets ahead.

Emerging markets fall, tariffs rise – Although the proposed trade agreement for Canada, Mexico and the U.S. has resolved some issues, we expect escalating trade tensions, dollar headwinds and emerging-market turmoil to continue to stoke bouts of volatility. We still don’t believe an all-out trade war will ensue, but recent global trade activity suggests tariff threats are taking a modest toll, and more retaliatory rhetoric and risks are likely before a compromise is reached. Headwinds remain, but a rebound in China’s growth or a lower U.S. dollar could be a catalyst for a rebound in emerging-market equities, which are more attractively valued after this year’s underperformance.

Still a compelling case for international exposure – While global risks remain, we believe many are already reflected in international equity markets. Developed-market stocks are trading at a 20% discount to the U.S., while emerging-market equities are at a 29% discount.* Lower valuations, along with fundamental help from still-stimulative global central bank policies and less mature economic and profit cycles, make international equity investments attractive, in our view.

Action for Investors
U.S. small- and mid-cap equities should continue to benefit from the relative strength of the domestic economy and less sensitivity to global trade and currency headwinds. We also recommend maintaining appropriate allocations to international developed-market large-caps and emerging-market equities.

*Sources: FactSet, forward P/E for the MSCI EAFE, MSCI Emerging Market and S&P 500 indexes.

Investing in equities involves risks. The value of your shares will fluctuate, and you may lose principal. Small- and mid-cap stocks tend to be more volatile than large company stocks. Special risks are inherent to international investing, including those related to currency fluctuations and foreign political and economic events.