Five reasons to consider international equities as US elections draw near

By: Christopher M. Dyer, CFA | & Ian Kirwan | November 2, 2020

London - In view of US political and economic uncertainty, investors may want to evaluate their portfolios' allocations to international stocks, which offer an attractive counterpoint to US stocks. More geared to global economic recovery, non-US stocks also are less impacted by the long-term implications of high levels of US government debt, and trade at substantial discounts to US equities.

As we discuss below — greater European cohesion, US election uncertainty, a weaker US dollar, reform progress in Japan, and cyclical market rotation — all bolster the case for international equities.

Greater European cohesion

Europe represents roughly 66% of the international equity market, which trades at a multi-decade low valuation relative to the US. The newly established European Recovery Fund provides a new financing model for the region, dispersing European Union (EU) monies to individual countries, such as those hardest hit by the coronavirus crisis.

The European Recovery Fund should accelerate economic growth in Europe and aid in reducing the elevated equity risk premium applied to European companies, which would help narrow the significant valuation discount of European equities to the US. These influences would support what we believe is the very early stage of a multi-year period of outperformance by international stocks.

Election uncertainty and high US debt

The International Monetary Fund (IMF) projects that US government debt will be 43 percentage points higher than Eurozone debt coming out of the COVID crisis. In addition, the IMF projects the US budget deficit will be 7.1 percentage points higher.

An obvious way for the US to address its debt level is to increase corporate taxation and to spend less in the long-term, both of which will impede US economic growth and corporate earnings growth. A Democratic victory in US presidential and Senate elections would likely mean higher corporate tax rates and lower profits.

A weakening US dollar

The US dollar (USD) dropped to a two-year low on September 2, down 10% from its March highs, and further weakness appears likely. A weaker USD could potentially boost portfolio results for US-based international equity investors, where this currency conversion works in their favor.

Progress in Japan

Japan's recent path of governance and regulatory reform is on pace to be continued by new Prime Minister Yoshihide Suga, Shinzo Abe's successor and close ally. We believe this continued progress, coupled with a shift toward cyclical economic recovery, bodes well for Japan's markets and businesses. Additionally, those countries with a large export economy and big manufacturing base — like Japan and Germany — are best positioned to benefit from a global, cyclical economic recovery, which we believe is underway.

Cyclical market rotation

The significant outperformance of US equities has persisted for more than a decade, since the global financial crisis. We believe we may be entering an extended period of outperformance by international equities. Along with economic and political pressures on US markets — and high valuation levels — this turnover would be part of the natural geographical rotation of equity markets, which typically lasts for several years.

A Biden Presidential victory, in conjunction with a swing in control of the Senate to the Democrats, would likely lead to higher corporate tax rates and a greater emphasis on the environment and energy efficiency. We believe our portfolios are well positioned regardless of US political outcomes.

Bottom line: The outperformance of US equities has persisted for more than a decade. A range of factors now indicates a potential rotation of market leadership from US to international equities, where valuations stand at multi-decade lows. Advisors may wish to bring these factors to their clients' attention.

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a strategy may underperform those that do not utilize a responsible investment strategy.

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"We believe we may be entering an extended period of outperformance by international equities, particularly in Europe."

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