RBA Richard Bernstein Advisors

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RBA Quick Insights

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Investors without borders

Hypothesis: In the long term, investors are better off staying in the US

We have been fielding an increasing number of emails cautioning against investing outside the US. It's first worth noting how dramatically the narrative has shifted from just ten years ago, when US investors were told that their lost decade of returns was the result of *home bias* and a lack of exposure to the long-term growth engine of the world, i.e. emerging markets. The crux of the current narrative is that international developed markets inherently offer lower returns than the US, and while emerging markets can provide higher returns, they are not high enough to justify the additional risk. This is admittedly a somewhat rational conclusion when looking at the past two decades of performance, but it seems to overlook a few critical details: (1) major regional leadership regimes — persistent periods of significant regional outperformance — have generally lasted a decade or more, so while 20 years sounds like a long time, it really only captures two leadership cycles, (2) an analysis of the longer-term history illustrates that opportunistic rotations between major regions can drastically improve potential returns, and (3) it fails to address the fundamental drivers behind the secular periods of under- and outperformance, and what those drivers suggest today.

It pays to broaden your horizons

The chart and table below outline the cumulative and annualized total returns for MSCI World Index[1] (which does not include emerging markets), US, international developed markets (DM) and emerging markets (EM) since 1969 from the perspective of a US investor. We have identified four major regional leadership regimes which are outlined in Table 1. The data show that (1) the best opportunities are not always in the US, and (2) the leadership in one regime tends to underperform significantly in subsequent periods. Had an investor owned all international developed market stocks 1969-1989, all US stocks 1989-1999, all emerging market stocks 1999-2010 and all US stocks since 2010, that investor could have realized cumulative returns of nearly 200,000%, or annualized returns of almost 16%. Simply investing only in the US over the same timeframe would have yielded cumulative returns that were an order of magnitude lower despite posting still-impressive returns of more than 12,000%, equating to annualized returns of close to 10%. While this example is intentionally extreme, it illustrates the immense opportunity cost of ignoring the rest of the world. But more important than the 'how much' is the 'why', which we discuss on page 2.

Chart 1: Cumulative regional returns since 1973

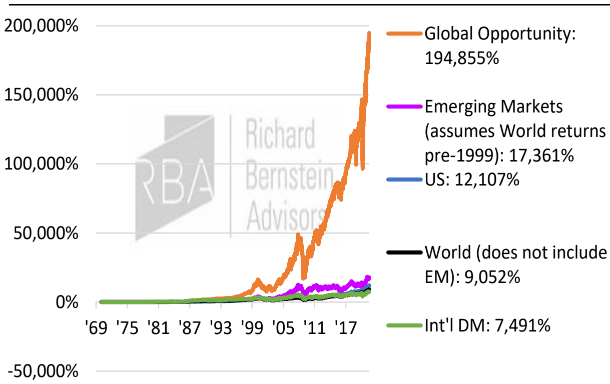

Table 1: Annualized regime returns by region

Period	World	US	Int'l DM	EM	Global Opp
Dec '69 - Feb '89	11.9%	8.5%	15.5%	N/A	15.5%
Feb '89 - Jan '99	10.7%	19.1%	5.3%	N/A	19.1%
Jan '99 - Oct '10	2.1%	0.3%	3.6%	14.7%	14.7%
Oct '10 - Jul '21	11.0%	14.8%	6.2%	4.2%	14.8%
Total	**9.2%**	**9.8%**	**8.8%**	**10.6%**	**15.8%**

Source: Richard Bernstein Advisors LLC, MSCI.
Note: Global Opportunity returns are based on the cumulative returns of owning the best-performing region during each of the four leadership regimes outlined in the table. As EM return data begins in 1999, returns of the MSCI World index are used prior to 1999. International developed = MSCI EAFE Index.

What drives leadership? Surprise…fundamentals matter

RBA emphasizes the importance of focusing on corporate profits, liquidity and sentiment when making investment decisions. Thus, it should not be surprising to see that in each leadership regime, the region with the fastest earnings growth saw the largest returns, which in most cases also started off as the most out-of-favor region — as indicated by having the cheapest valuations (Table 2). Investors attempting to position for the next potential leadership regime should consider that the valuation premium of US stocks over the rest of the world recently hit the highest in the data history back to 1973. This suggests that the bar for earnings growth required for US stocks to outperform is exceptionally high, so unless one has a high degree of confidence that US earnings growth is going to blow away that of the rest of the world, it may be time to start thinking more globally.

Note: The performance data is derived from MSCI indices, but the valuation and EPS data series are based on Datastream Global Indices, which begin in 1973. Thus, the returns for the first regime reflect the period December 1969 – February 1989, while the starting P/E and EPS growth data reflect the period January 1973 – February 1989.

Table 2: Starting P/E ratios and annualized EPS growth for the global leadership regimes since 1973

	Starting P/E ratio				Annualized EPS Growth			
Global Regime	World	US	Int'l DM	EM	World	US	Int'l DM	EM
Dec '69 - Feb '89	21.9	24.2	20.4	N/A	10.2%	9.8%	11.9%	N/A
Feb '89 - Jan '99	21.2	12.4	29.4	N/A	5.8%	8.2%	4.9%	N/A
Jan '99 - Oct '10	24.9	27.9	23.9	12.0	6.9%	4.7%	6.7%	11.7%
Oct '10 - Jul '21	15.9	16.9	15.0	15.5	2.8%	6.2%	0.9%	-1.3%
Jul '21	24.6	31.6	21.3	18.6	?	?	?	?

Source: Richard Bernstein Advisors LLC, Datastream/Refinitiv
Notes: The valuation and EPS data reflect Datastream Global Equity Indices

[1] The MSCI World Index captures large and mid cap representation across 23 Developed Market countries, covering approximately 85% of the free float-adjusted market capitalization in each country. Indices are not actively managed and investors cannot invest directly in the indices.

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