

TACTICAL INSIGHTS

LOOKING FOR VALUE? GO ABROAD

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Since the end of the financial crisis, the US has led the global equity market recoveries for over eight years. Table 1 shows the total returns of US and international equity market ETFs. The S&P 500 Index ETF (SPY) gained 303.8% after it bottomed on March 9, 2009, while the MSCI EAFE Index ETF (EFA) and MSCI Emerging Market Index ETF (EEM) only rose approximately 150%. As US stocks are hitting records day after day, many investors have become more and more concerned about the valuation of the market. The monthly Bank of America Merrill Lynch fund manager report found 83 percent of respondents saying US stocks are too overvalued, a record number since 1999. The widely-quoted Shiller PE Ratio has reached 30, much higher than the historical average of 16. So how can investors find value in equities?

Table 1: Global Equity Market Performance (%)

ETF	Name	YTD 2017	1-Year	3-Year	5-Year	Since 03/09/2009
SPY	SPDR S&P 500 Index ETF	11.4	15.8	34.6	93.7	303.8
EFA	iShares MSCI EAFE Index ETF	17.8	18.2	8.1	51.9	157.6
EEM	iShares MSCI EM Index ETF	25.7	22.6	5.0	21.3	141.5

Sources: Factset. As of July 31, 2017

Overseas may be the answer. International equities have picked up some momentum recently. On a year-to-date basis as of July 31, international equities performed much better than their US counterparts, with EM Index up by 25.7% and Developed Market Index up by 17.8% (see Table 1). Consequently, more and more investors are moving overseas. According to Investment Company Institute (ICI), the international equity funds had \$84.7 billion inflows while domestic equity funds had \$27 billion outflows in the second quarter.

The asset flows also make economic sense. International equities do offer better valuation and growth potential. Table 2 depicts the key financial ratios across the global equity markets. Both developed and emerging market equities are much more attractive than US equities from the standpoint of valuation metrics

like price-to-earnings, price-to-book and price-to-sales ratios. Furthermore, the earning growth rates are much higher for international equities.

Table 2: Global Market Key Financial Ratios

ETF	Name	P/E	P/B	Price/Sales	YOY Earning Growth
SPY	SPDR S&P 500 Index ETF	21.63	3.04	2.06	2.67%
EFA	iShares MSCI EAFE Index ETF	18.94	1.73	1.27	6.89%
EEM	iShares MSCI EM Index ETF	15.02	1.72	1.30	12.53%

Sources: Factset. As of June 30, 2017

In our opinion, investors should increase their allocations to international equities for their lower valuation and higher growth potential. As a word of caution, currency fluctuation and geopolitical events always pose additional risks for international investing. For example, North Korea’s aggressive nuclear and missile tests presented, and will continue presenting, tremendous risks to its neighboring countries like South Korea and Japan as well as the US. Investors should expect international equities to be more volatile than US equities.

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