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AVITY
Investment Management Inc.

INSIGHTS

Global Equity Primer:

Demystifying Foreign Stocks

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U.S. EXCEPTIONALISM

The U.S. benefits from key structural advantages

The U.S. benefits from distinct advantages relative to many foreign economies:

- Geopolitical stability
- Capitalism with rule of law and strong IP protection
- Flexible labor markets
- Consumption oriented economy
- Deep and liquid capital markets with global reserve currency

These unique characteristics have allowed the U.S. to attract talent and capital, incentivize research and development, and flourish as the epicenter of innovation. U.S. businesses have been at the forefront of major technological advances:

- Internet
- Cloud computing
- Health Care
- Semiconductors
- Space Technology
- Artificial Intelligence

GLOBAL EQUITIES

Demystifying valuation discrepancies across borders

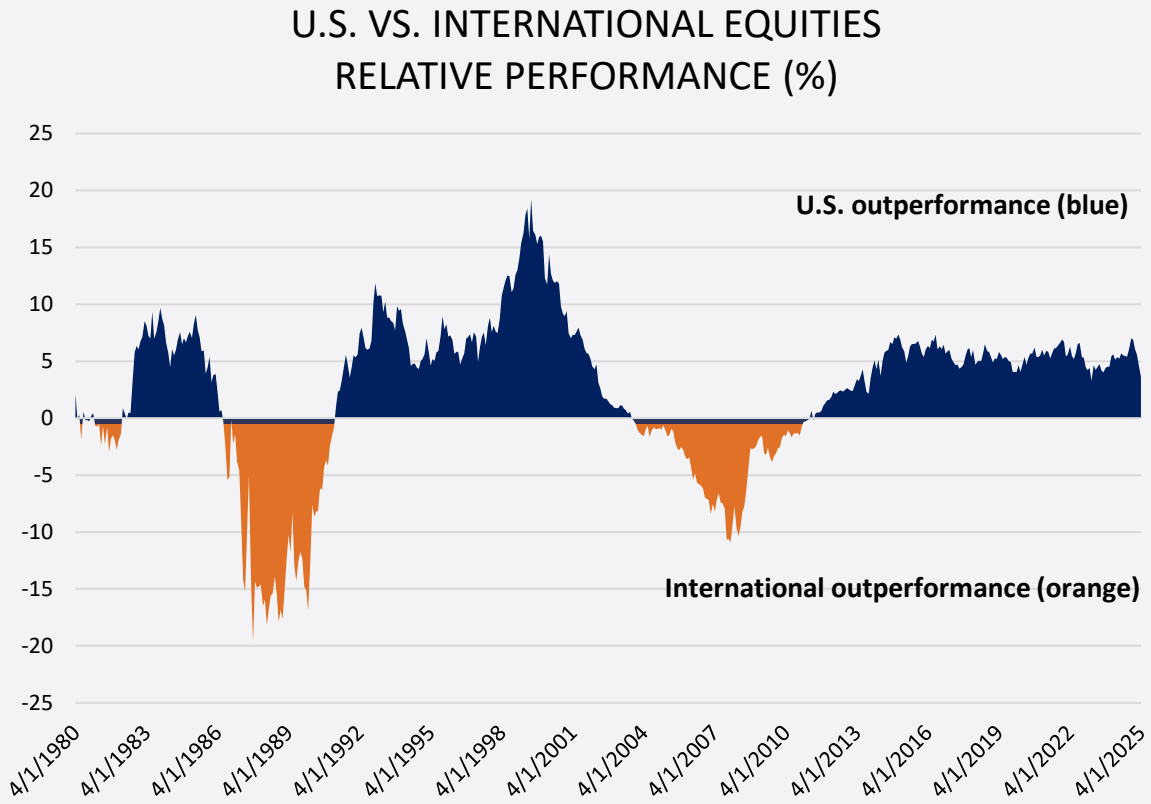
- U.S. stocks have outperformed international equities for several years, but the trend reversed in the first quarter of 2025. While the U.S. contemplates federal spending reductions and confronts a slowdown in activity, certain foreign economies are experiencing pro-growth policy shifts in reaction to deglobalization trends.
    - E.g., Germany shed its fiscal constraints to approve up to €1 trillion to modernize infrastructure and defense.
- This dynamic global landscape presents an opportunity for investors to reevaluate foreign stocks.
- International stocks are often cited as “cheaper” than U.S. equities.
- This is true at the index level, but not as clear at the security level.
- While there may be value to be found abroad, identifying opportunities requires bottom-up, fundamental analysis.

U.S. VERSUS INTERNATIONAL EQUITIES

U.S. equities have outperformed meaningfully since 2008

Relative performance between U.S. and foreign stock markets has progressed in cycles.

However, over the last 45 years, the **U.S. has outperformed 69% of the time** (*based on 5-year rolling returns*).



* U.S. represented by S&P 500 Index; International represented by MSCI World ex-U.S. Index. 5-Year Rolling Returns calculated monthly.

As of March 31, 2025
Source: Bloomberg

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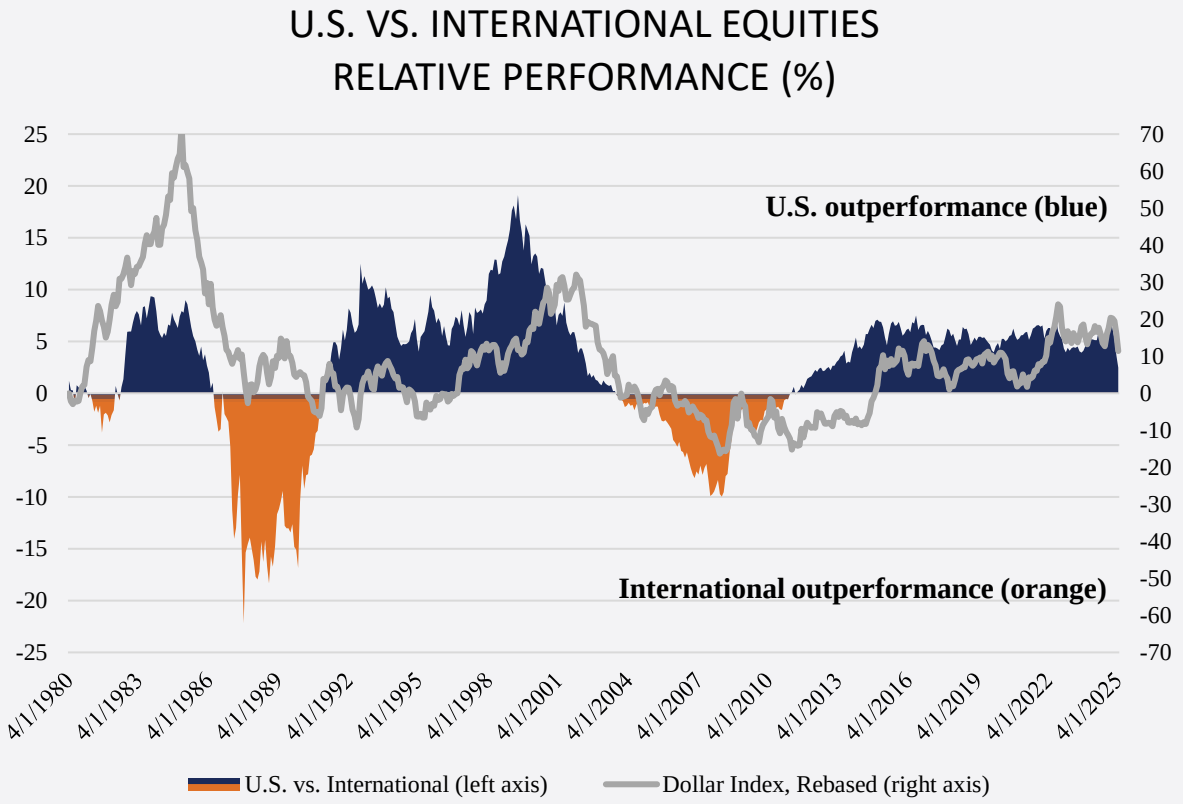
U.S. VERSUS INTERNATIONAL EQUITIES

U.S. equities outperformance has been correlated with U.S. dollar strength

U.S. equity outperformance has historically been correlated with the U.S. dollar, which has weakened in recent months.



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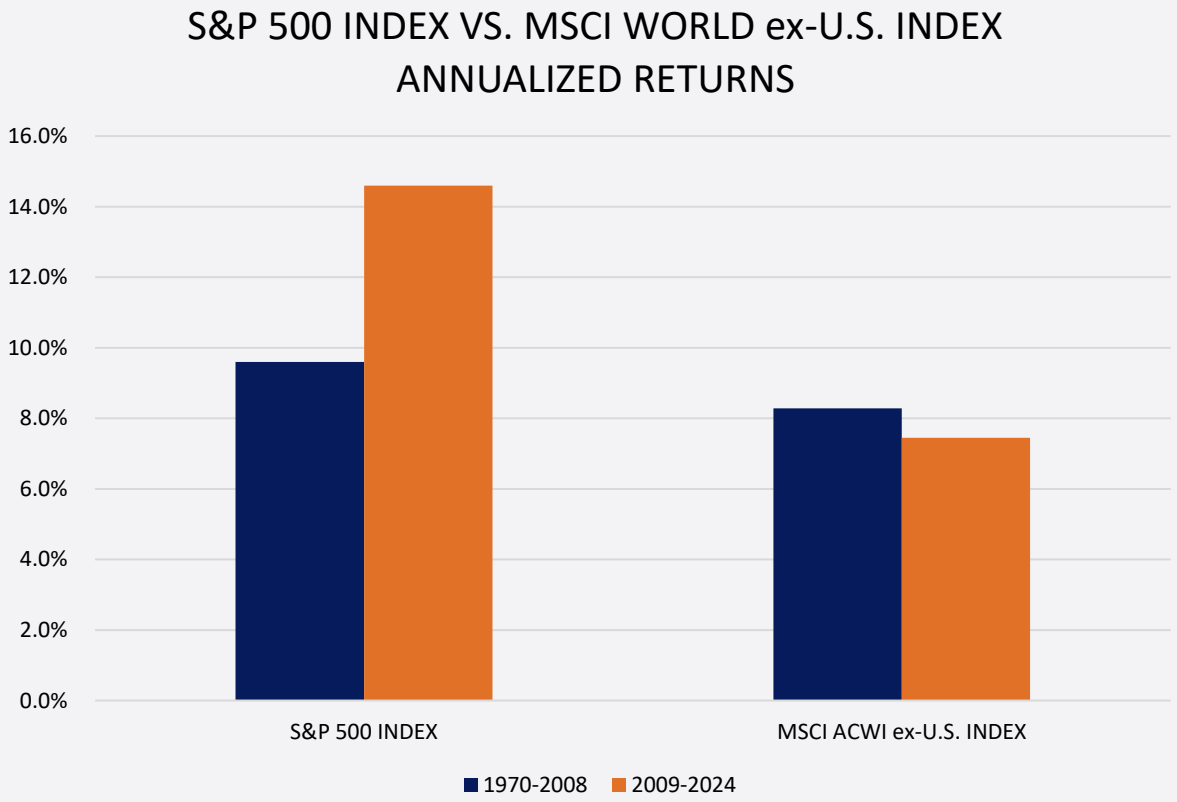
CORPORATE EARNINGS GROWTH

The U.S. has recorded significantly above average equity returns since 2008

U.S. equity leadership has been particularly pronounced since the GFC.

The S&P 500 has returned ~15% annually since 12/31/2008, well above its historic average of ~9.5%.



As of March 31, 2025
Source: Bloomberg

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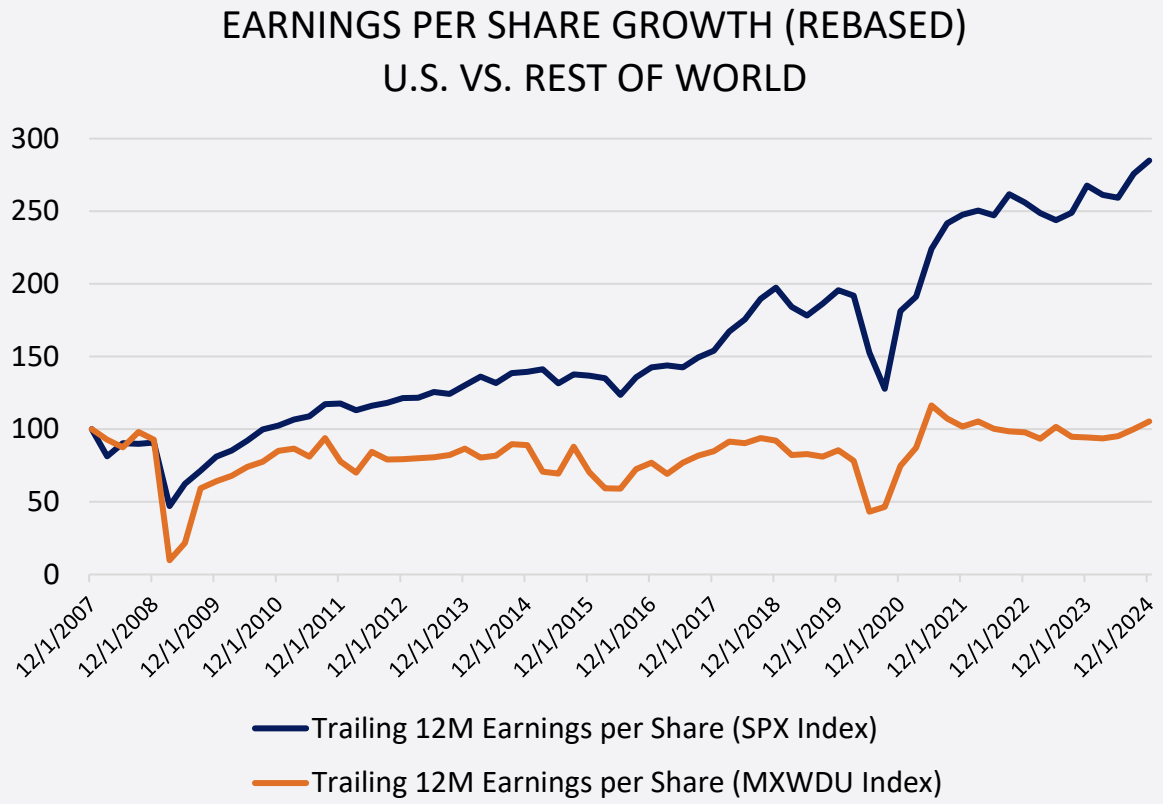
CORPORATE EARNINGS GROWTH

America's structural advantages have delivered superior corporate profit growth

U.S. firms have pushed the frontier in industries such as the internet, cloud computing, semiconductors, health care, space technology and artificial intelligence.

Corporate earnings have grown commensurately.



As of March 31, 2025
Source: Bloomberg

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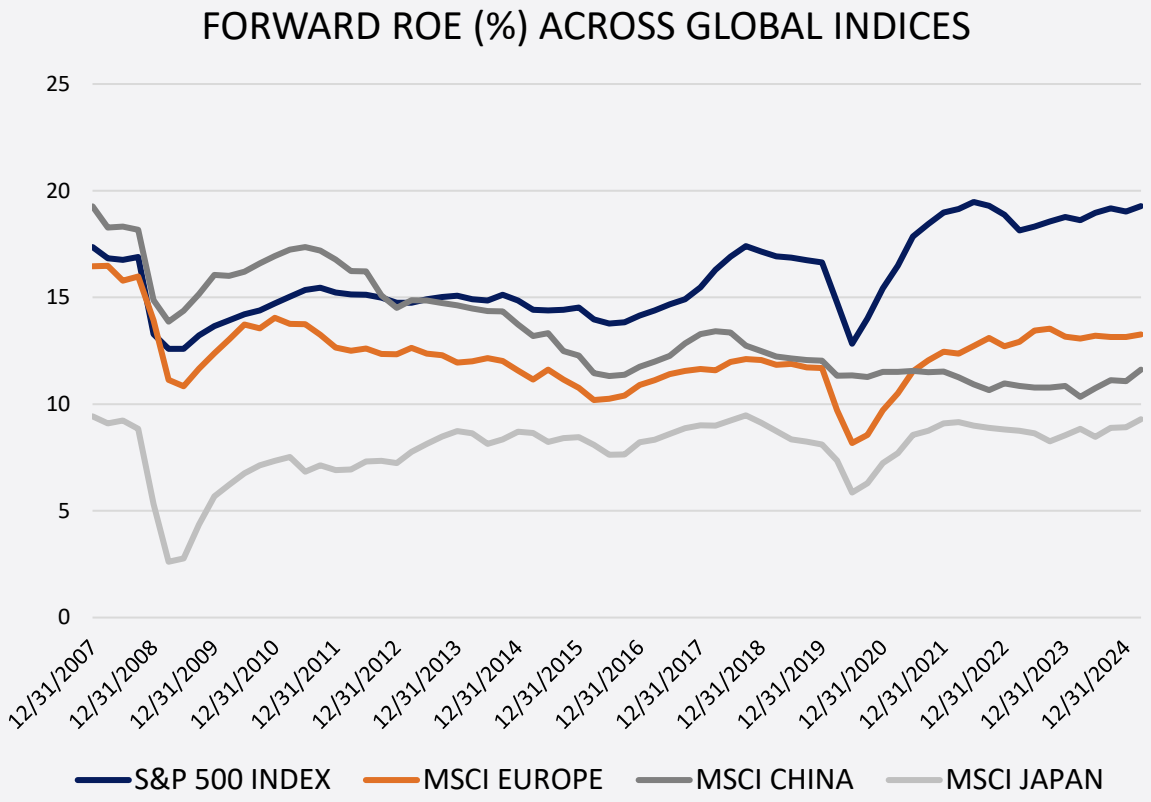
RETURN ON EQUITY

U.S. markets have a greater mix of more profitable businesses

Higher U.S. valuations can be justified given the higher profitability of U.S. businesses.

This is partially explained by the high profitability of mega-cap stocks, which dominate the index.



As of March 31, 2025
Source: Bloomberg

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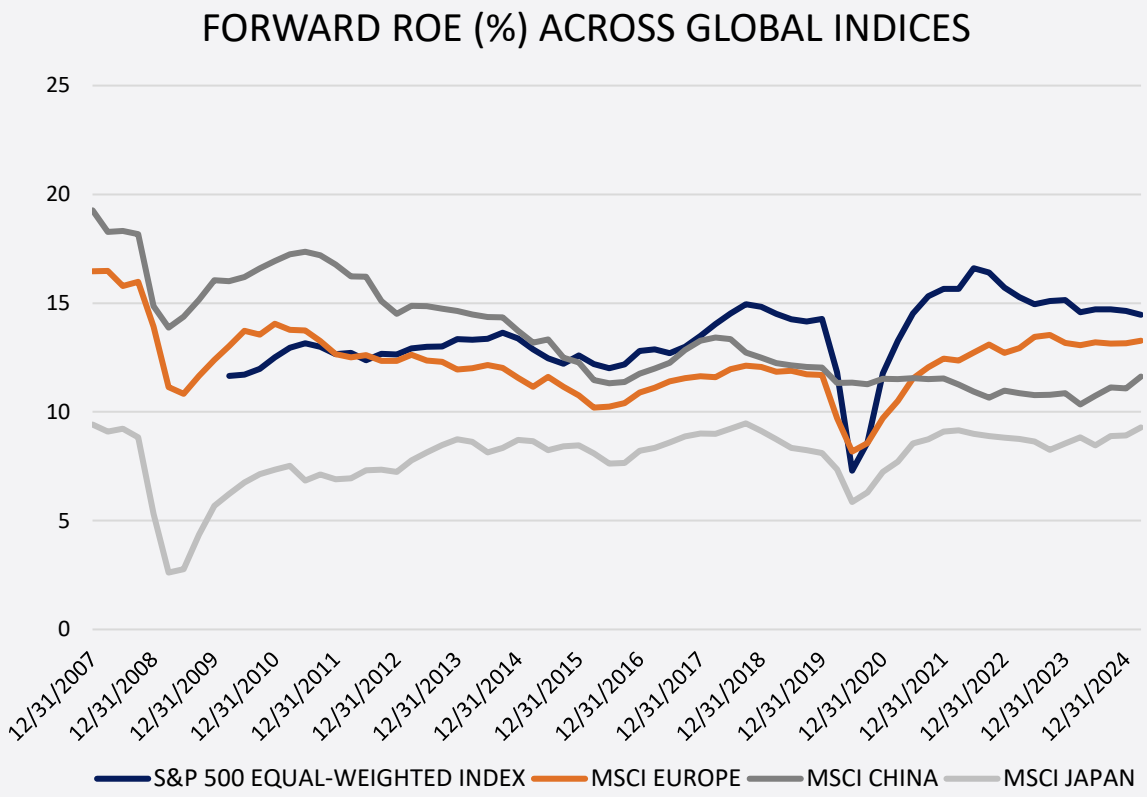
RETURN ON EQUITY

U.S. markets have a greater mix of more profitable businesses, even when excluding market-cap influences

Even the average stock in the S&P 500 (**represented by the equal-weighted index**) has superior ROE than foreign indices, which became particularly pronounced after COVID-19.



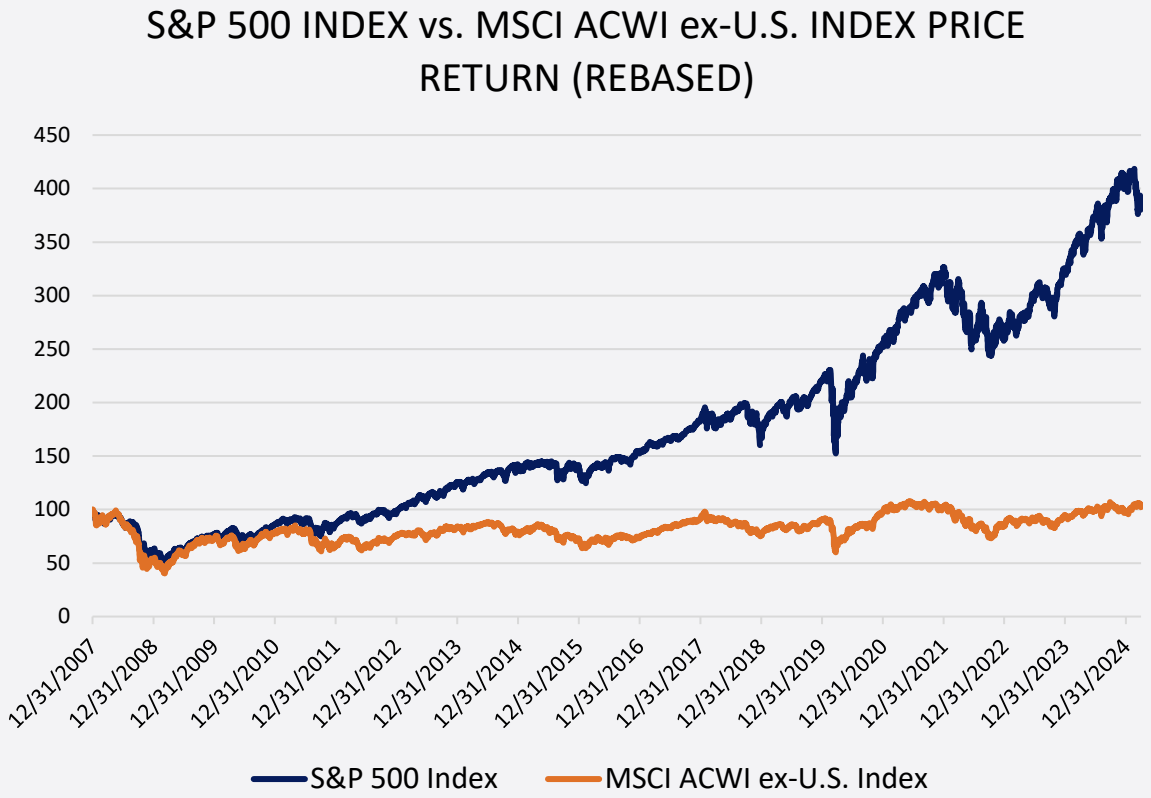
As of March 31, 2025
Source: Bloomberg

GLOBAL STOCK MARKET RETURNS

U.S. equities have trounced foreign markets since the Great Financial Crisis

Faster growth and higher ROEs have driven domestic equity outperformance.

Since 12/31/07, on a total return basis (dividends reinvested) the S&P 500 Index has returned **435% versus 76%** for the MSCI ACWI ex-U.S.



As of March 31, 2025
Source: Bloomberg

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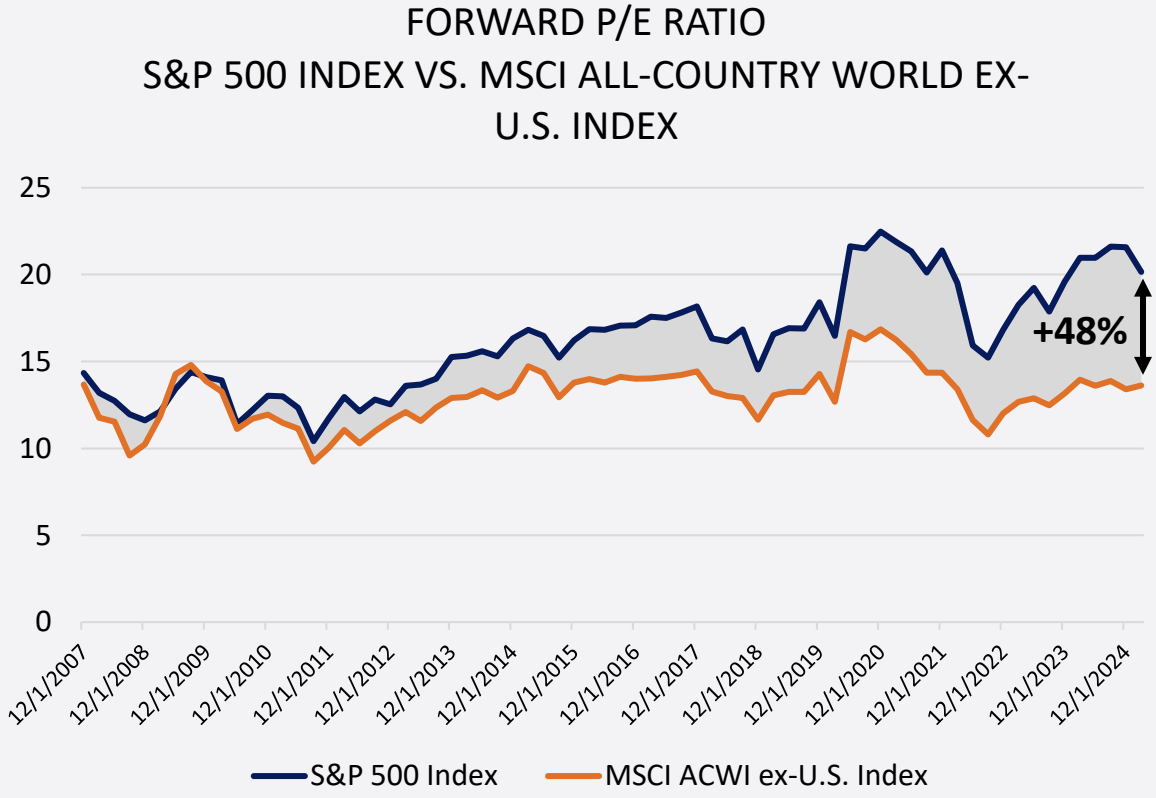
EQUITY VALUATIONS

U.S. stock indices trade at a substantial premium to foreign stocks

Emerging from the Great Financial Crisis, major global stock indices traded close to parity on a price-to-earnings basis.

Today, the S&P 500 commands a **48% premium** over foreign indices.



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Source: Bloomberg

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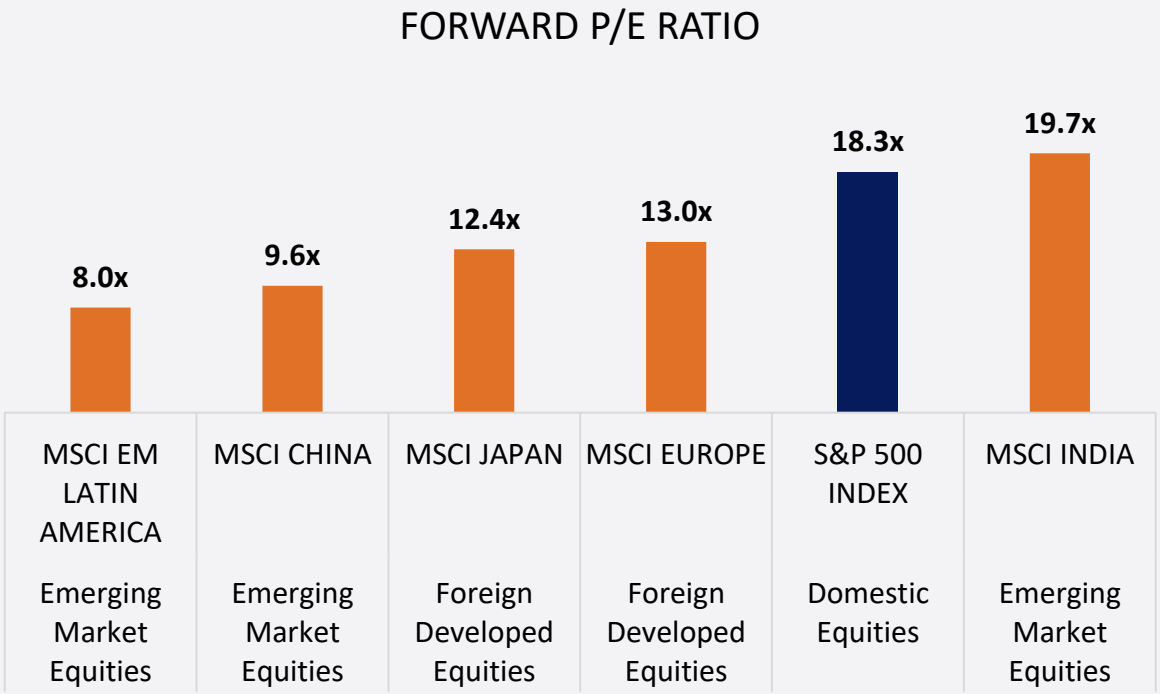
EQUITY VALUATIONS

U.S. stock indices trade at a substantial premium to foreign stocks

Even after international markets outperformed in Q1 2025, U.S. equities still trade at a premium to foreign markets (exception: India).

But are foreign equities actually cheaper?



* India's premium reflects attractive demographics, rapid technological adoption, and strong corporate governance relative to many other emerging markets.

As of April 7, 2025
Source: Bloomberg

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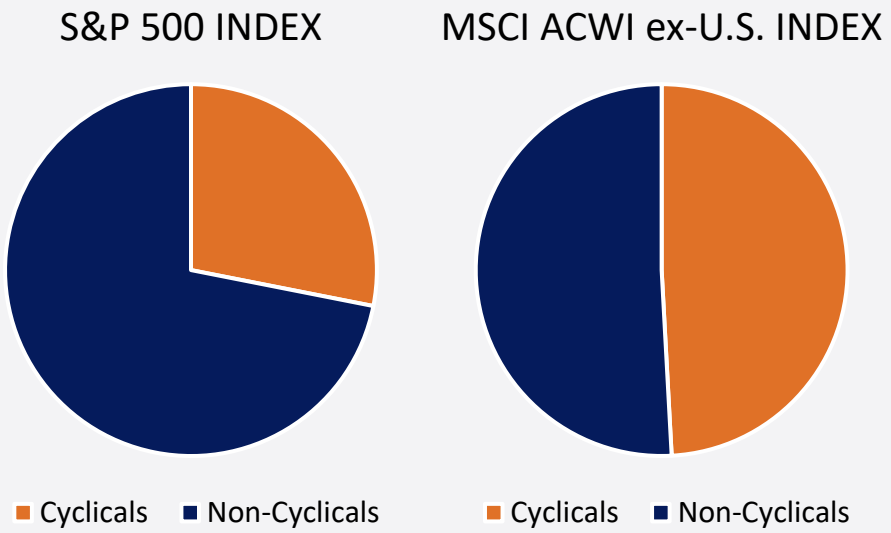
INDEX COMPOSITION

Foreign indices have greater exposure to cyclicals, which justify lower valuations

Index composition is largely responsible for the valuation gap.

U.S. indices have more exposure to less cyclical "growth" sectors, while foreign indices are more heavily skewed towards cyclical industries, which typically merit lower valuations.



* Cyclicals represented by Financials, Materials, Industrials and Energy as categorized by GICS. Non-Cyclicals include Health Care, Consumer Staples, Consumer Discretionary, Information Technology, Communication Services, Utilities and Real Estate

As of March 31, 2025
Source: Bloomberg

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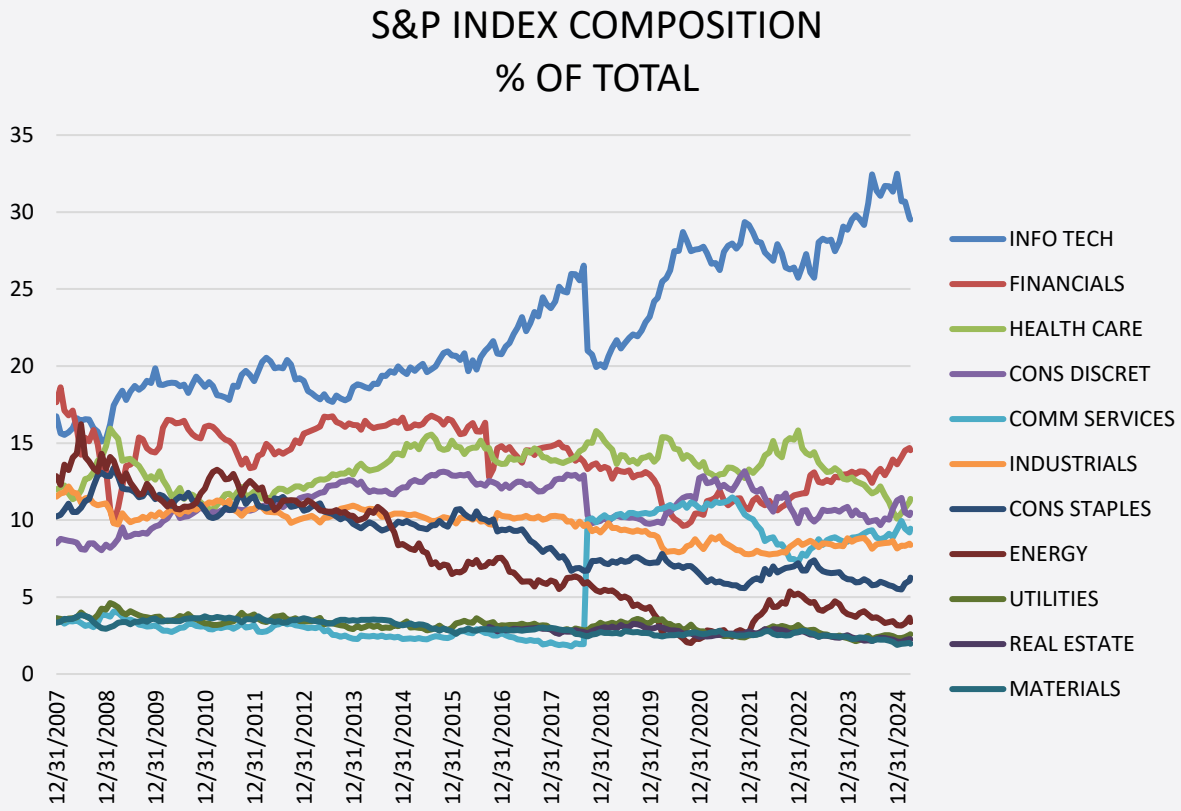
INDEX COMPOSITION

The growth of the technology sector has lifted the multiple for the index

The outsized growth of the U.S. technology sector, comprised of highly profitable and fast-growing companies, propelled market-cap weighted indices to near all-time high valuation multiples exiting 2024.



* The sharp drop in Information Technology in 2018 reflects Communication Services being carved out into its own sector.

As of March 31, 2025
Source: Bloomberg

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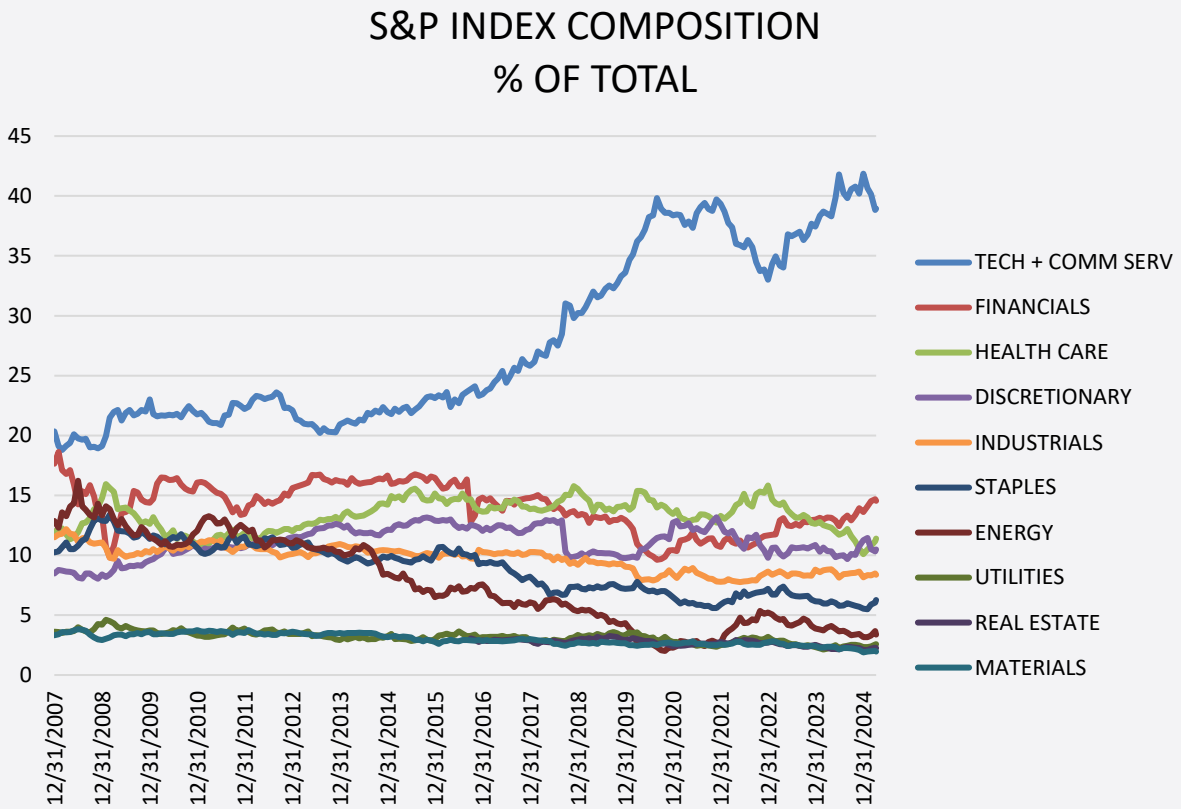
INDEX COMPOSITION

The growth of the technology sector has lifted the multiple for the index

Tech's growth is even more pronounced when combining Information Technology with Communication Services (e.g., Alphabet, Meta Platforms, Netflix) which became its own sector in 2018.

Tech firms are also hidden across other sectors, such as Consumer Discretionary (e.g., Amazon) and Industrials (e.g., Uber).



As of March 31, 2025
Source: Bloomberg

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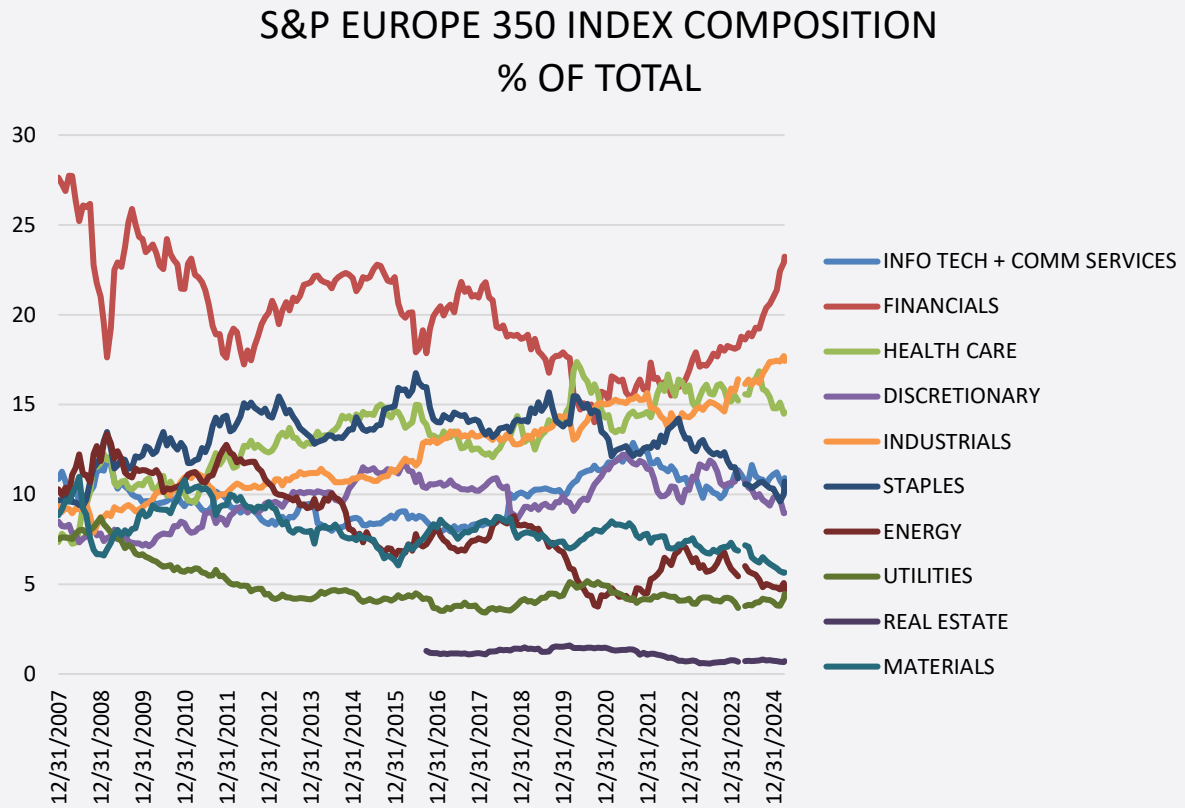
INDEX COMPOSITION

Europe has much lower technology exposure and much greater financials exposure

For comparison, Europe's market capitalization is dominated by Financials, Health Care and Industrials, while Info Tech and Communication Services together represent just ~10%.



As of March 31, 2025
Source: Bloomberg

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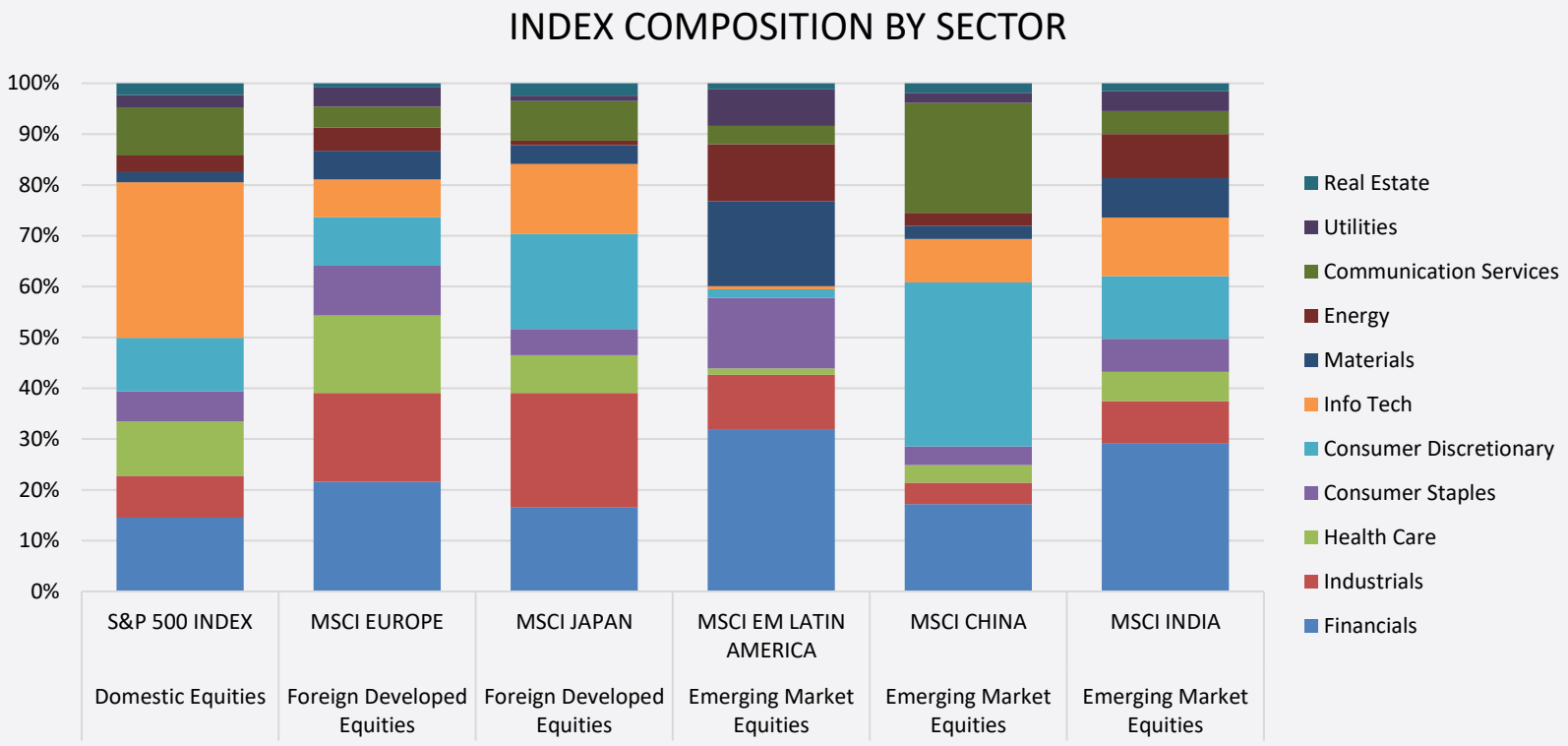
INDEX COMPOSITION

Composition of global benchmarks varies widely

Contrasting the valuation of stock market indices across borders is of limited utility given the drastic differences in composition. Comparing the valuation of international benchmarks is akin to valuing a software company relative to a bank – they are not "apples to apples".



As of March 31, 2025
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VALUING FOREIGN STOCKS

Identifying value abroad requires bottom-up, fundamental analysis

Valuing equities across borders must contemplate both macro economic **and** stock-specific factors. When analyzing valuation multiples across geographies, investors should consider:

Company Specific Variables

- Revenue and earnings growth
- Return on invested capital (ROIC)
- Valuation multiples
- Growth-adjusted valuations
- Geographical revenue exposure

Country Risk Premium

- Monetary and fiscal policy
- Currency and inflation backdrop
- Geopolitical stability
- Rule of law
- Market liquidity
- Potential GDP: demographics and productivity