The Case for Investing Outside the US

Artisan Partners International Value Team

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Insights

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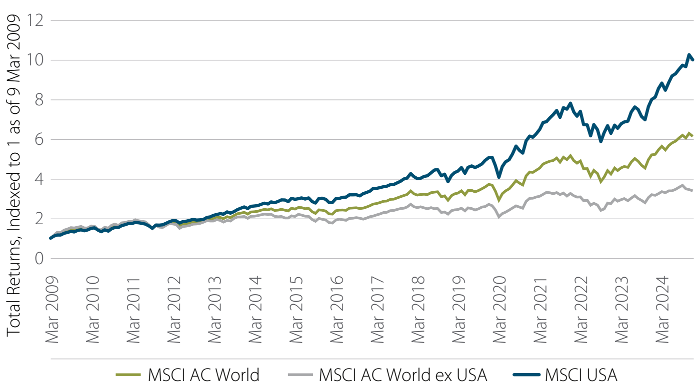
Investment Risks: Investments will rise and fall with market fluctuations and investor capital is at risk. Investors investing in strategies denominated in non-local currency should be aware of the risk of currency exchange fluctuations that may cause a loss of principal.

The Case for Investing Outside the US

Given US markets have outperformed most broad non-US indices since the 2008 global financial crisis (Exhibit 1), the question of whether non-US investing is still a worthwhile endeavor might seem a fair one—particularly given features of the US investing universe that weigh heavily in its favor.

Exhibit 1: MSCI USA, All-Country World and All-Country World, xUS Total Returns Indices, Current Bull Market (31 Mar 2009–31 Dec 2024)



Source: FactSet/MSCI. As of 31 Dec 2024. Past performance does not guarantee future results.

Critically, the US is a cohesive country, united by a common language, with a population of over 340 million relatively wealthy people. It has a solid system of property rights and is governed by the rule of law—key underpinnings of robust venture capital and private equity markets. Further, the steady, decades-long erosion and outsourcing of the country's manufacturing base has left an innovation- and service-oriented—and, therefore, a high-return—economy.

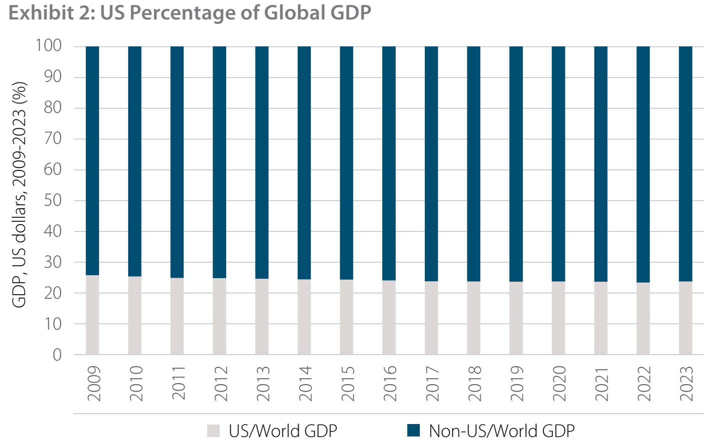
No other market of similar magnitude and scale possesses this full combination of attractive attributes. Europe has a single currency, but its member countries speak different languages and have varied political, economic and legal systems. Japan is cohesive but runs a narrow, mercantilist economy, has a shrinking population and remains culturally relatively isolated from the rest of the world. China has several similar advantages to the US—a cohesive country united by language, a large population—but its political and legal systems remain less free and seem unlikely to change materially in the near term. Most other countries are a combination of economically small, relatively poor and lacking in venture capital or private equity.

In one sense, the case for investing outside the US is extremely simple: Diversification beyond the US is purely a matter of broadening investors' opportunity set, allowing them to flexibly invest in mispriced asset classes and markets. This ability drives excess returns over time, wherever they may be. Conversely, restricting the investment universe to a single geography, currency or industry unnecessarily eliminates securities that could provide the opportunity for better long-term returns. As we've already acknowledged, looking at historical index returns, the case for investing outside the US seems challenged. But relying too heavily on recent index returns to make asset allocation decisions can lead investors to make a few cognitive errors.

First, indices themselves can be flawed yardsticks for comparing performance—notably, they can obscure dramatic disparities in the magnitude of opportunity sets in different countries or regions. Consider: By several measures, the magnitude of the US investable universe dramatically trails that beyond its borders. For example, as of the end of 2024, the US market has far fewer listed securities (2,319) than non-US markets in aggregate (6,321). This matters because a higher number of constituents arguably moderates an index's performance relative to a narrower index's—particularly as winners in the latter continue running, as technology companies have in the US, for example.

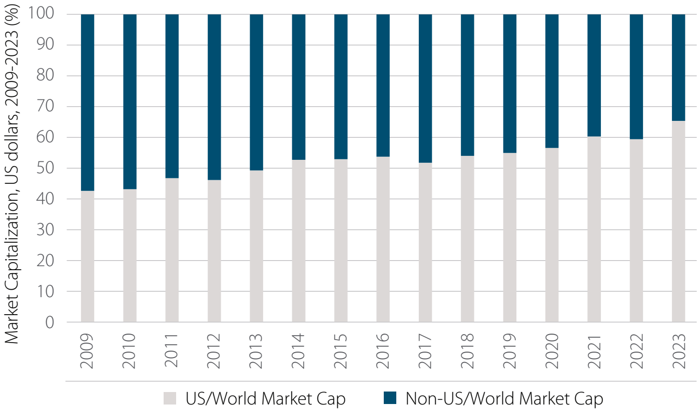
Indices can also obscure economic reality. For example, whereas the US currently generates less than a quarter of global annual gross domestic product (GDP), its market capitalization represents 65% of total global market capitalization—whereas non-US markets generate over three-quarters of global annual GDP and represent 35% of global market capitalization (all figures as of the end of 2023). Further, this gap has widened over time, as shown in Exhibits 2 and 3—as US GDP as a percentage of global GDP has declined, its market representation has increased meaningfully. Over time, the potential for this gap—between non-US economies' GDP and market capitalization contributions—to close or narrow introduces a meaningful opportunity for investors with the willingness and ability to invest well in non-US markets.

Exhibit 2: US Percentage of Global GDP



Source: World Bank. As of 31 Dec 2023. GDP at purchaser's prices is the sum of gross value added by all resident producers in the economy plus any product taxes and minus any subsidies not included in the value of the products. It is calculated without making deductions for depreciation of fabricated assets or for depletion and degradation of natural resources. Data are in constant 2015 prices, expressed in US dollars. Dollar figures for GDP are converted from domestic currencies using 2015 official exchange rates. For a few countries where the official exchange rate does not reflect the rate effectively applied to actual foreign exchange transactions, an alternative conversion factor is used.

Exhibit 3: US Percentage of Global Market Capitalization

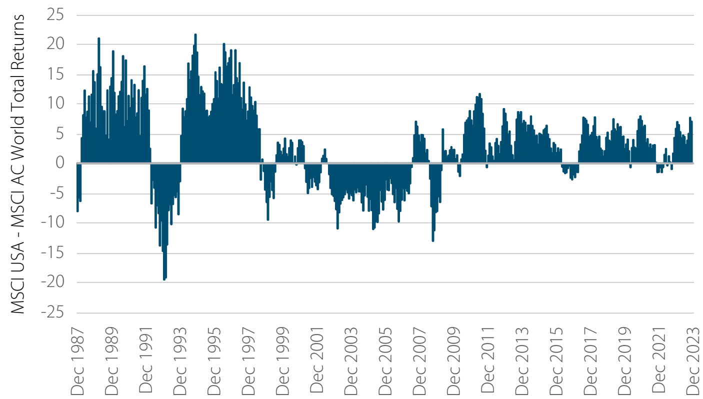


Source: FactSet. As of 31 Dec 2023. Data is in US dollars as of 31 Dec 2024.

Second, nothing lasts forever, and history is rife with evidence that leadership tends to rotate over time—though naturally with relatively little predictability. As US leadership has continued, it becomes easy to forget, for example, the early 2000s bull market was not led by the US. On the contrary, the US trailed not only emerging markets (Exhibit 4), but also developed markets coming out of the technology, media and telecom bubble as the US's heavy exposure to the very technology and telecommunications companies which precipitated the bubble's bursting dragged its market performance below that of less concentrated developed world peers (Exhibit 5).

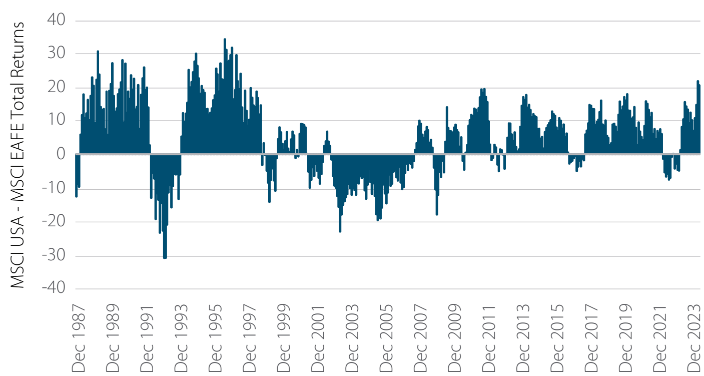
The US's advantages will advance and recede over time—as will those of non-US markets. Politics and regulation can weigh on commerce and, with it, market performance. Monetary policy can drive inflation, as it is doing in the US today. Fiscal profligacy can produce runaway debt. And of course, animal spirits can always inflate a bubble. Exhibits 4 through 6 show some of these historical cycles—which aren't intended to suggest we are consequently poised for a rotation today, but rather to show that even long cycles do eventually end.

Exhibit 4: US Minus Global Stocks:
Monthly Rolling Annual Returns, 1987–2023



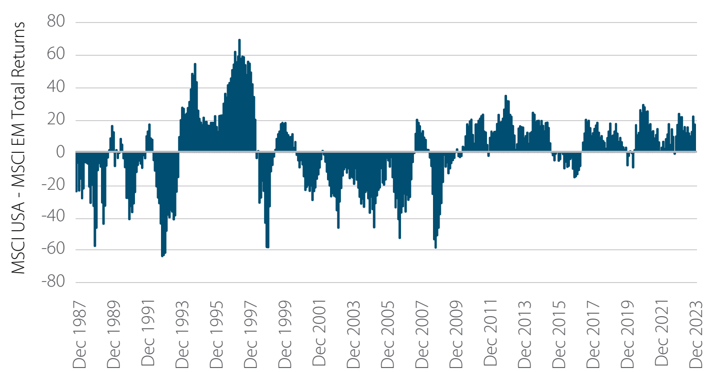
Source: FactSet/MSCI. As of 31 Dec 2024. Past performance does not guarantee future results.

Exhibit 5: US Minus Developed Stocks:
Monthly Rolling Annual Returns, 1987–2023



Source: FactSet/MSCI. As of 31 Dec 2024. Past performance does not guarantee future results.

Exhibit 6: US Minus Emerging Markets:
Monthly Rolling Annual Returns, 1987–2023



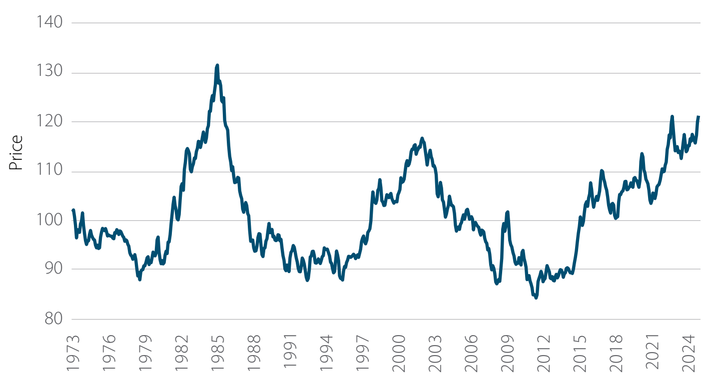
Source: FactSet/MSCI. As of 31 Dec 2024. Past performance does not guarantee future results.

There are currency considerations, too, in the recent history of US versus non-US market performance: A relatively strong dollar over the last few years has hurt returns for US dollar-denominated investors in foreign holdings (see Exhibit 5). That has made the outperformance of US stocks look even more attractive. But that, too, can be cyclical. Looking at the longer-term charts nearby (Exhibits 8 and 9), it is clear there are long periods of time where the dollar devalues relative to other currencies. Further, there are some currencies that have a long history of appreciating against the dollar, such as the Swiss franc and Singapore dollar (Exhibits 10 and 11). Any investment in those countries would provide a clear tailwind to US dollar-based returns.

Exhibit 7: US Fed Trade-Weighted Real Broad Dollar Index, 2014 through 2024

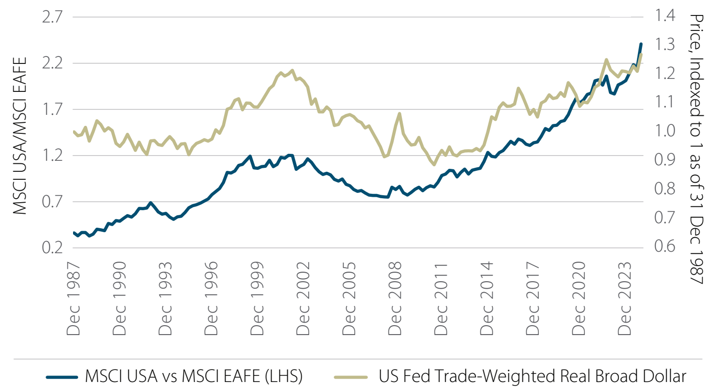
Source: Bloomberg. As of 31 Dec 2024. Past performance does not guarantee future results.

Exhibit 8: US Fed Trade-Weighted Real Broad Dollar Index, 1973 through 2024



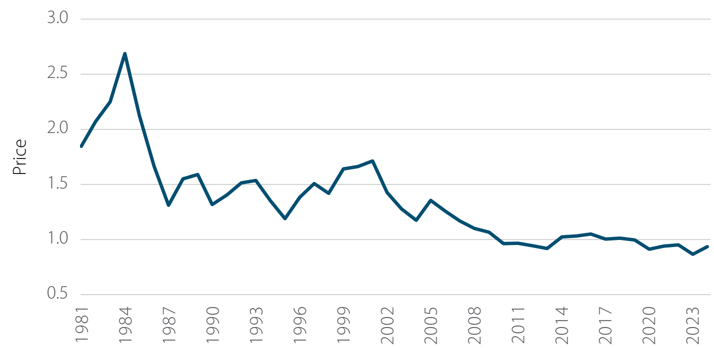
Source: Bloomberg. As of 31 Dec 2024. Past performance does not guarantee future results.

Exhibit 9: US vs Foreign Stocks and the US Fed Trade-Weighted Real Broad Dollar Index, 1987 through 2024



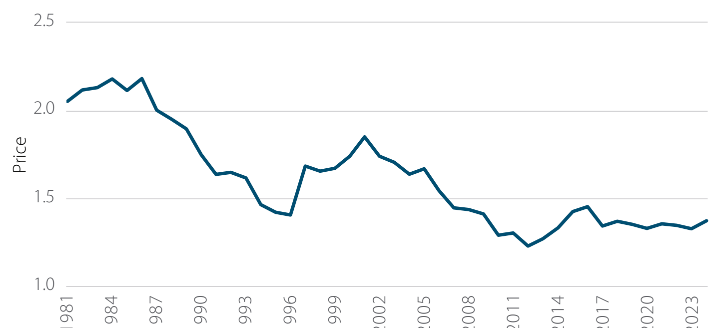
Source: Bloomberg. FactSet/MSCI. As of 31 Dec 2024. Past performance does not guarantee future results.

Exhibit 10: Value of 1 US dollar Relative to the Swiss franc, As of 31 Dec 1981 through 2024



Source: Bloomberg. As of 31 Dec 2024. Past performance does not guarantee future results.

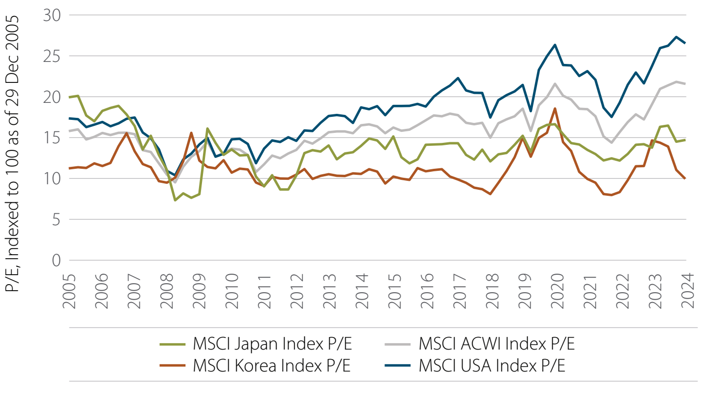
Exhibit 11: Value of 1 US dollar Relative to the Singapore dollar, As of 31 Dec 1981 through 2024



Source: Bloomberg. As of 31 Dec 2024. Past performance does not guarantee future results.

A final point on the value of investing outside the US: Investors willing to diversify open themselves to the possibility of participating in the periodic unwinding of meaningful country discounts. For example, Korea and Japan have both experienced long periods of significant undervaluation relative to their global competitors and peers—and they've also benefited from periods during which valuations improved to what many would consider more normal levels.

Exhibit 12: Valuations for Japan and Korea vs. Global Peers, 2005–2024



Source: FactSet/MSCI. As of 31 Dec 2024. Past performance does not guarantee future results.

Not only does this speak to the potential rewards diversification offers, it also highlights the importance of risk/reward calculations, which can point investors toward situations where the risks are relatively low given the valuation environment, and the potential rewards are consequently higher than those to be found in higher-valued peers or neighbors.

The Non-US Investing Universe Has Some Meaningful Competitive Advantages

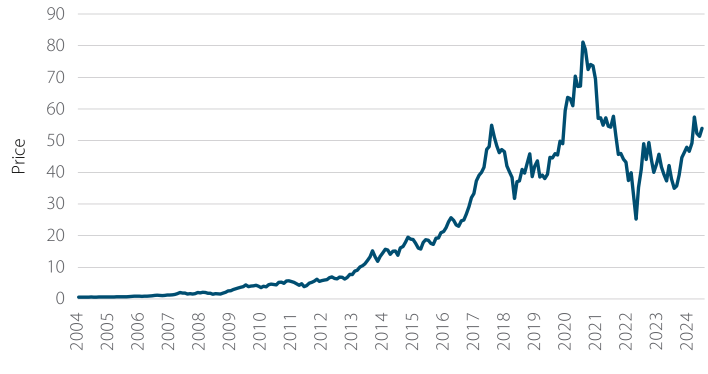
Thus far, we've largely defended the idea of investing outside the US. But there is an offensive case for investing outside the US, too, given various competitive advantages some non-US countries possess. It's worth highlighting some of these competitive advantages and how they might impact investors' risk/reward calculus.

Emerging Markets Versus Developed Markets

The well-known potential for fast economic growth to translate into faster compounding for emerging markets is a tailwind that simply doesn't exist in the developed world. The most recent example is China, but it is hardly the only example—China was preceded in the 1960s by the Four Tigers (Singapore, Hong Kong, Korea and Taiwan)—and will no doubt be followed by others.

China's rapid economic growth over the course of the millennium has propelled nearly 90 million people out of poverty, improving their quality of life and enabling them to participate in the global economy in a way previously inconceivable. Further, the development of China's market has been supported by robust private equity and venture capital markets, as evidenced by the market performance of companies such as Tencent (Exhibit 13).

Exhibit 13: Tencent, Price Chart from IPO through 31 Dec 2024 (in dollars)

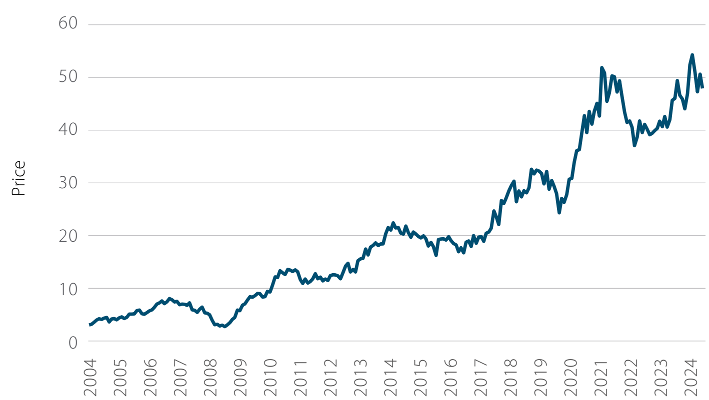


Source: FactSet. As of 31 Dec 2024. Past performance does not guarantee future results.

Nor is China alone. During the 2000s bull market, which was led by emerging markets, the BRIC countries, Brazil, Russia, India and China (and later, the BRICS—which added South Africa) received significant investor attention as the next areas of the world to develop and capitalize on the potential to narrow the gap between their economies and those of more developed countries. Each country was home to companies that delivered tremendous returns as they capitalized on this rapid growth.

Further, it's not just the potential for rapid economic growth that makes emerging markets attractive—some emerging economies also offer advantages like the existence of highly educated populations, which allow companies to hire a high-quality workforce at a significantly lower cost than would be possible in a developed economy. Tata Consultancy, an India-based global consulting firm, is just one example of a company that has capitalized on this advantage (Exhibit 14).

Exhibit 14: Tata Consultancy, Price Chart from IPO through 31 Dec 2024 (in dollars)



Source: FactSet. As of 31 Dec 2024. Past performance does not guarantee future results.

Other countries are rich in natural resources critical to today's economies, like lithium, rare earths metals and others. Relative to developed world countries, these resources can be extracted more economically (in terms of both exploration and production costs as well as political costs) in countries like China and Chile.

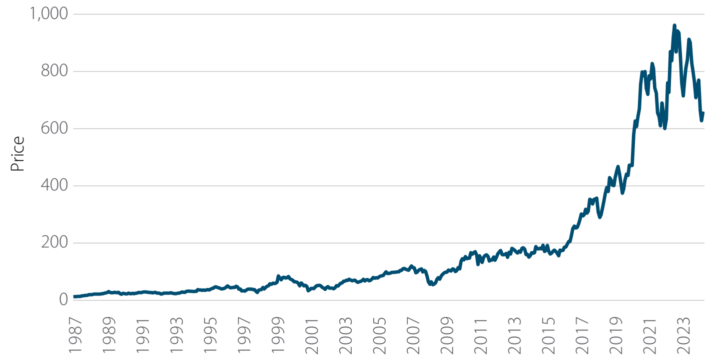
Finally, there are great companies with great products developed and refined in emerging markets that can be exported to the developed world to achieve very good economics. One such company is Samsung Electronics, a global powerhouse manufacturer of memory semiconductors and cell phones.

While growth has undoubtedly been uneven in emerging economies, and the political and economic risks tend to be higher, investors would be ill-advised to ignore altogether the return potential that still exists in many emerging markets—though they should simultaneously address higher risks via higher hurdle rates. This approach allows investors the opportunity to participate in explosive growth companies that are characteristically different from those in developed markets.

Developed Non-US Markets Versus the US

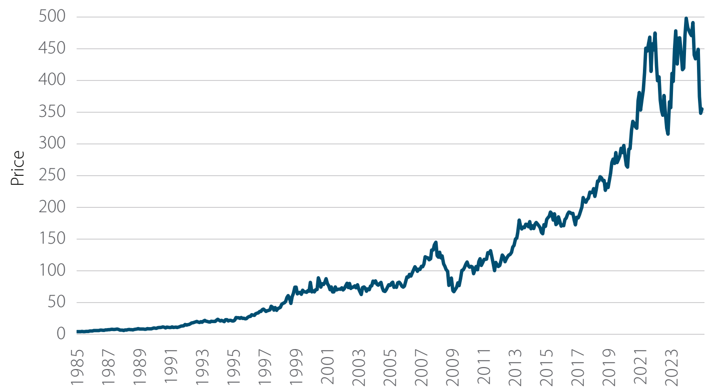
Just as among emerging markets, there are competitively advantaged developed countries outside the US whose environments have produced companies capable of delivering superior returns to investors over time. Some of the clearest examples are the luxury goods companies—e.g., LVMH, L'Oréal and others—which excel at manufacturing and selling uniquely European products. Not only have such companies capitalized on the absence of adequate competitors in other wealthy, developed economies, but they have increasingly opened emerging economies as populations like China's have become wealthier with sufficient disposable income to purchase luxury goods. Would-be competitors elsewhere in the world are highly unlikely to reproduce such success—and well-positioned investors have benefited as a result (Exhibits 15 and 16).

Exhibit 15: LVMH, Price Chart from IPO through 31 Dec 2024 (in dollars)



Source: FactSet. As of 31 Dec 2024. Past performance does not guarantee future results.

Exhibit 16: L'Oréal, Price Chart from IPO through 31 Dec 2024 (in dollars)



Source: FactSet. As of 31 Dec 2024. Past performance does not guarantee future results.

Another area in which many developed markets (and a few emerging markets) are advantaged relative to the US is corporate governance. One of the most common adverse features of US corporate governance standards is the prevalence of combining the roles of chairman and CEO. This arrangement vests supervisory and management responsibilities in an individual and introduces the potential for conflicts of interest. Good governance practice would separate the chairman and CEO roles, making the chairman answerable to the shareholders for effective management oversight, and the CEO responsible for the business's operation.

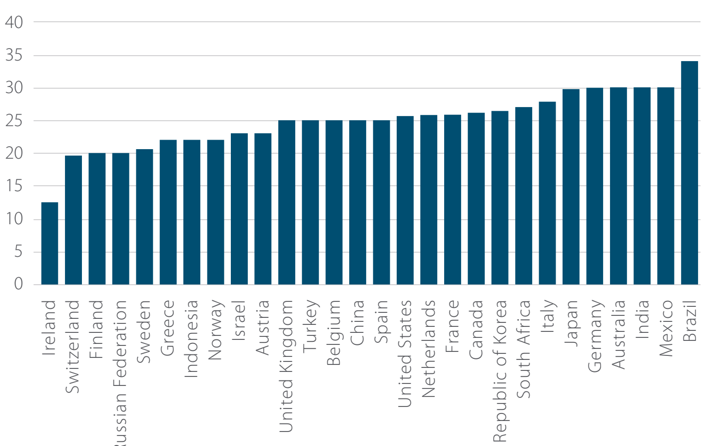
This separation of responsibilities isn't uncommon outside the US, primarily in public markets whose founding was influenced by the UK—namely Canada, Australia, New Zealand, South Africa, Singapore and, naturally, the UK itself. In these markets, shareholders' interests tend to be better represented on the board of directors, making investments there, all else equal, more attractive than equivalent investments in US companies.

The corporate governance landscape outside the US is both highly complex and localized. Some countries' legal systems and structures are advantageous for minority shareholders—creating a competitive advantage for companies domiciled there. Conversely, some systems are convoluted and tend to tip the scale in favor of controlling families and the government. Investors should be aware of these nuances and the ways in which they may affect the return potential of any company in which they invest. For example, the possibility that a country with a highly detrimental corporate governance system improves rapidly and dramatically introduces the possibility, again, for a meaningful unwinding of valuation discounts.

Tax Regimes

A brief word on tax regimes—a consideration which spans both the developed and the emerging landscapes. Taxes diminish the profits otherwise available to shareholders, so corporate tax regimes are a critical variable in calculating the relative attractiveness of what otherwise may be substantially similar companies domiciled in different countries. The US has one of the world's highest corporate tax regimes (Exhibit 17), rendering some of its companies unable to compete with high-quality peers in lower-tax jurisdictions. All else equal, a company domiciled in a country that levies a 15% tax rate is more attractive than a company in a country levying a 35% corporate tax rate. This introduces a significant opportunity for many non-US countries—both emerging and developed—to create a highly conducive tax environment in which well-run, high-quality companies can thrive relative to their higher taxed competitors and peers.

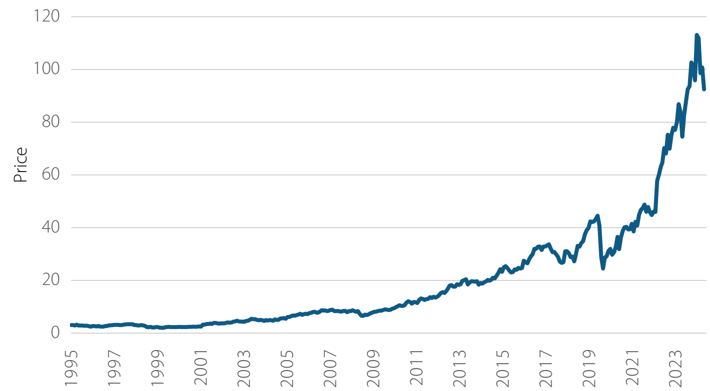
Exhibit 17: 2024 Corporate Tax Rates by Country (%)



Source: Tax Foundation. 2024.

For example, Arch Capital, a Bermuda-based insurance company, sells effectively the same product as competitors domiciled in higher-tax jurisdictions, but because it pays zero corporate taxes, it has offered investors the ability to compound returns faster over time (Exhibit 18).

Exhibit 18: Arch Capital, Price Chart from IPO through 31 Dec 2024 (in dollars)



Source: FactSet. As of 31 Dec 2024. Past performance does not guarantee future results.

Conclusion

Investing outside the US is more than a matter of diversification for purely mathematical reasons—it is a matter of expanding the opportunity set such that enterprising investors can identify the best investment opportunities. Country- and jurisdiction-specific considerations, rather than universal negatives, are best considered in the research process as variables that are either benign or that add complexity in determining business value. Given that, ignoring the full opportunity set means possibly leaving significant return potential on the table—and conversely, effectively capitalizing on the full opportunity set means increasing long-term potential portfolio returns.

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