BURNEY COMPANY
INVESTMENT MANAGEMENT

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THE CASE FOR GLOBALLY DIVERSIFIED PORTFOLIOS

Why International Equities Shouldn't Be Ignored

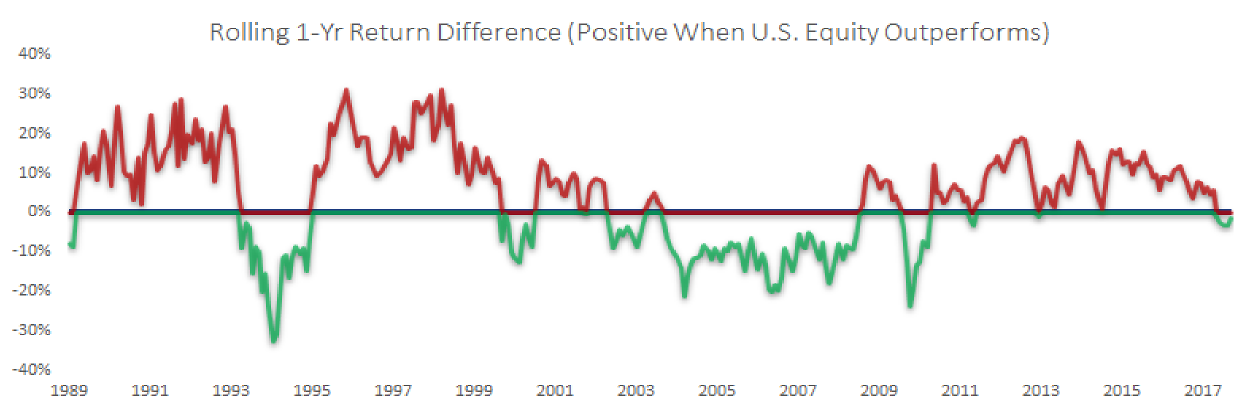
Executive Summary

Non-U.S. equities account for half of global market capitalization, offer diversification benefits across geographic regions, economic sectors and political regimes. For many reasons they should be considered for asset allocation despite their recent underperformance and high correlation with the U.S. equity.

The diversification benefit of non-U.S. equities isn't always evident in performance. Correlations between international equities and US equities steadily rose through the early 2000's before peaking in the aftermath of the 2008 Financial Crisis as stocks sold off worldwide. Global stock markets recovered more slowly than the US stock market after the Crisis, too, lagging 8% annually during the recovery. The resultant poor risk-adjusted return profile of international stocks post-crisis essentially guarantees that non-US equities are excluded from the efficient frontier when loaded into any mean-variance asset allocation tool.

However, viewing international stocks through this short period of time is problematic. First, return differentials between US and non-US equities is cyclical. There have been long periods when international stocks led US stocks, for example between 1993-1995 and for most of the 2000's. Periodic underperformance, therefore, is not a strong argument for excluding non-U.S. equities for asset allocation purposes.

Chart 1. Return Difference Between U.S. and Non-U.S. Equities is Cyclical

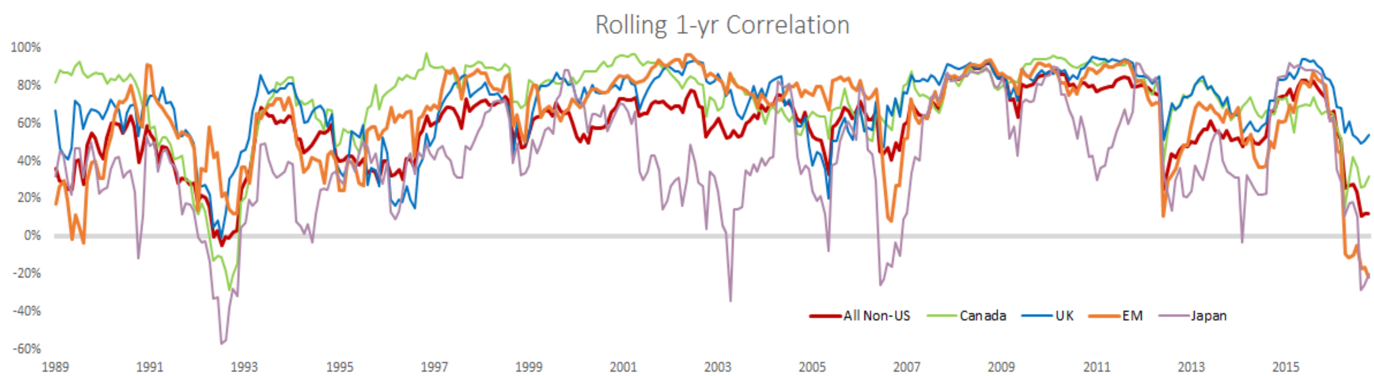


Note: Non-U.S.equities are represented by MSCI All Country World ex USA Index and U.S. equity is represented by MSCI US Broad Market Index after June 2003 and Russell 3000 before then.

Global stock markets remained highly correlated until around 2012 when correlations started to unwind as the impact of the crisis died down and economies and central bank policies diverged.

The trend line clearly points to less correlation, offering more robust diversification benefits today than seen in the recent past.

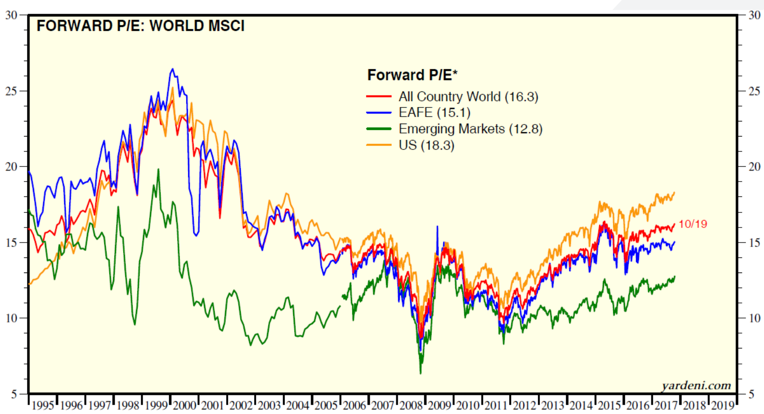
Chart 2. Correlations between U.S. and Non-U.S.Equities Appear to Decrease and Unwind



Note: MSCI country indices. "All Non-US" is the average pairwise correlation between U.S. and selective international markets including Canada, UK, Japen and emerging markets.

Perhaps the most attractive feature of non-U.S. equity markets are valuations. According to data compiled by Yardeni Research, the U.S. stock market's forward PE is 18 but the forward PE is just 15 for international developed markets and 13 for emerging markets, indicating international stocks are undervalued relative to the US.

Chart 3. International Equities Currently are Undervalued Relative to U.S.Equity



* Price divided by 12-month forward consensus expected operating earnings per share. Monthly through December 2005, weekly thereafter.
Source: Thomson Reuters I/B/E/S.

It is natural for US investors to harbor home bias towards US stocks and view international markets with skepticism and there are unfamiliar risks that can justify these feelings. On top of normal stock, company and geopolitical risks, international investing carries currency risk. Movement in the value of the US Dollar creates extra volatility that can either boost or dampen the return of foreign stocks. 7.7% of the year-to-date return of the ex-US MSCI All Country World Index is from U.S. Dollar movement. Currency fluctuations historically have been uncorrelated to movements in stock prices, however, and usually cancel out over long time horizons.

Table. Currency Impact Further Lower the Correlations between U.S. and Non-U.S. Equities

ANNUALIZED as of 9/30/2017	1 Mo	3 Mo	1 Yr	YTD	3 Yr	5 Yr	10 Yr	Since 12/29/2000
MSCI ACWI ex USA (Local)	2.2%	4.4%	19.1%	13.5%	7.8%	10.9%	2.9%	4.3%
MSCI ACWI ex USA (USD)	1.9%	6.2%	19.6%	21.1%	4.7%	7.0%	1.3%	5.1%
Return from US Dollar	**-0.3%**	**1.8%**	**0.6%**	**7.7%**	**-3.1%**	**-3.9%**	**-1.6%**	**0.8%**

Non-U.S. equities represent a large portion of the investable opportunity set, accounting for about half of global market capitalization. While fund inflows for non-U.S. equities are still lukewarm, international stocks have done well in 2017 with emerging markets leading the way, up almost 30% year-to-date. Still, international stocks look like a good deal compared to US domestic stock valuations and international stocks have been performing differently than the US and each other during the past few years. Given this, the case for globally diversified portfolios is likely to be much stronger going forward than it has over the past decade.

Data source: Dimensional Fund Advisors LP and MSCI unless otherwise stated.
Indices: U.S.equity: MSCI US Broad Market Index (gross div.) (Russell 3000 before 6/2003); Non-U.S.equities: MSCI All Country World ex USA Index, unless otherwise stated.
Disclaimer: past return doesn't guarantee future performance. This note is for information and education purpose. Investors are encouraged to talk to their financial advisors before investing.

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