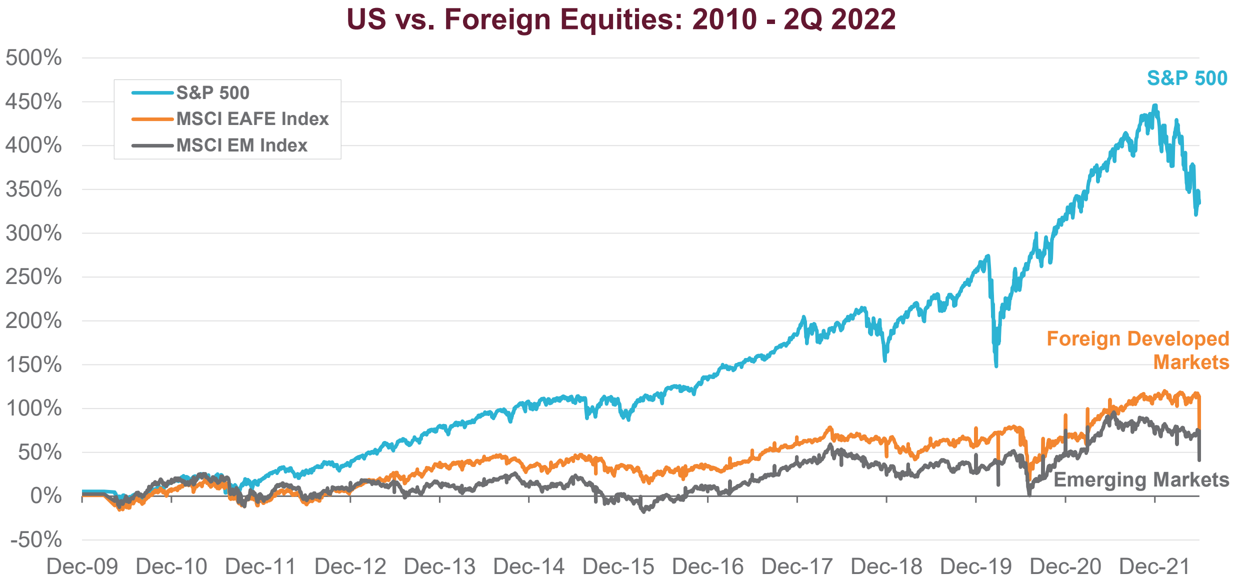
# The Case for Global Investing in the 2020s

By the LNWM Investment Team

No doubt, the 2010s were a spectacular decade for U.S. stocks. As the chart below shows, the S&P 500 has outperformed foreign developed markets and emerging markets since 2009 by a wide margin. So it is not surprising that U.S. investors recently had (on average) a high 80% allocation to U.S. equities. This is understandable given the bias toward strong past performance and what is familiar. But is this wise, from an investment perspective?

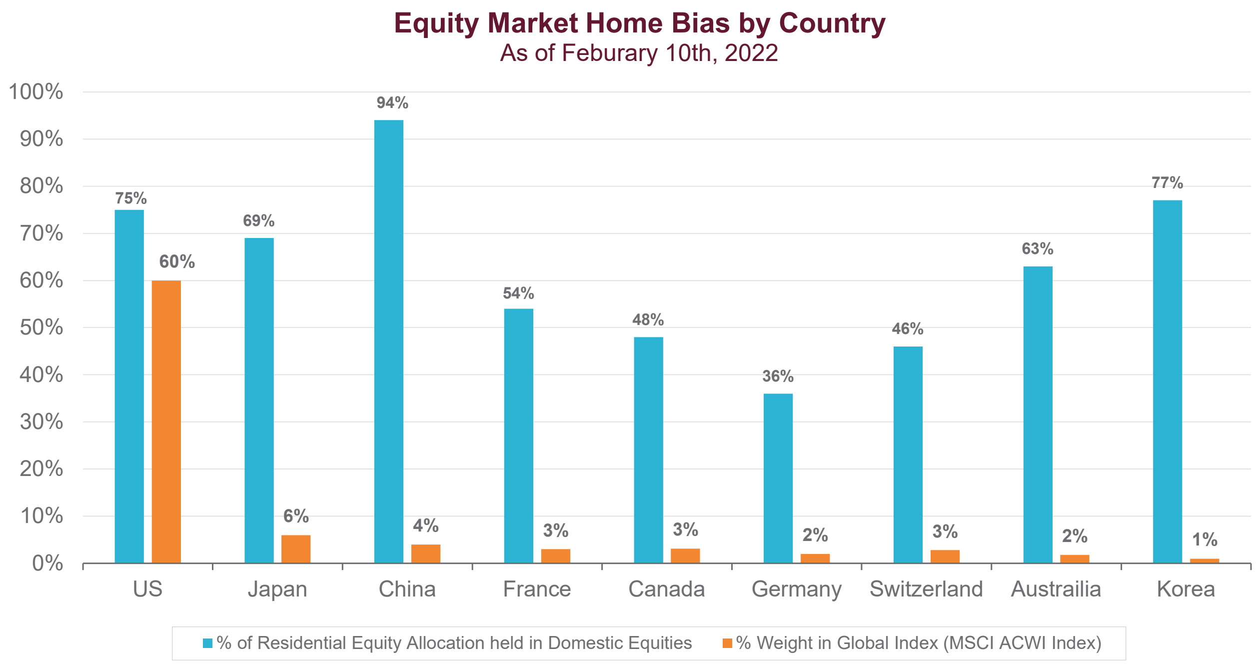



Source: Bloomberg.

At Laird Norton Wealth Management (LNWM), we think it is important to understand and counter biases when making investment decisions. This requires perspective and context, which we will attempt to provide in this paper on global investing. We also believe in expanding the opportunity set for our clients as a way to reduce risk and enhance return over a full market cycle (both up and down periods). Global diversification is a key part of that effort. To get started, let's take a look at the extent of home country bias around the world.

## Home Sweet Home

Despite the trend toward globalization, American investors continue to be mostly focused on the U.S., given the large size and characteristics of our markets. However, Australians, Canadians and the Japanese also tend to prefer their domestic markets, with the most surprising being the Canadians, given that their economy is relatively concentrated in materials, energy, and financials.

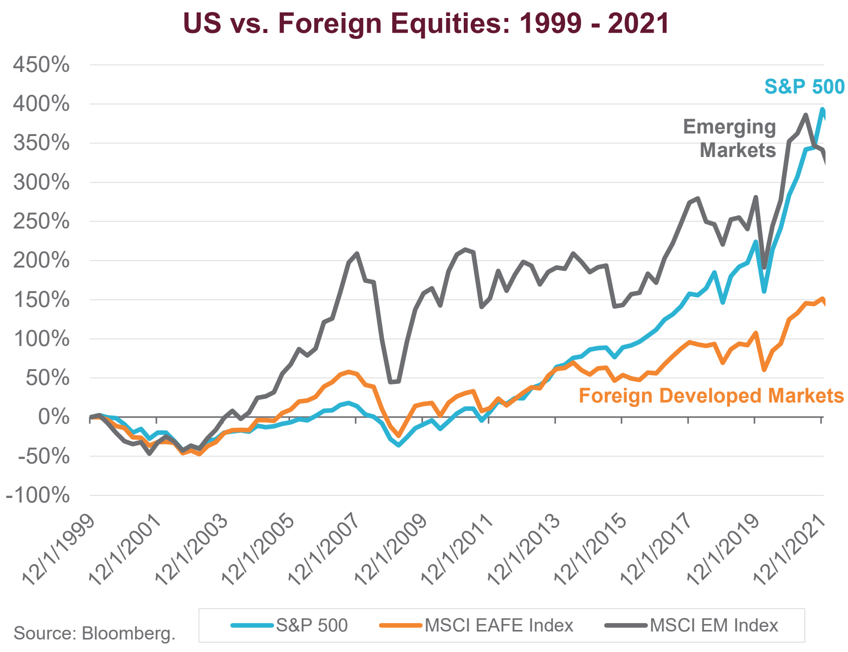



Source: Charles Schwab, Morningstar.

## Past Performance in Context

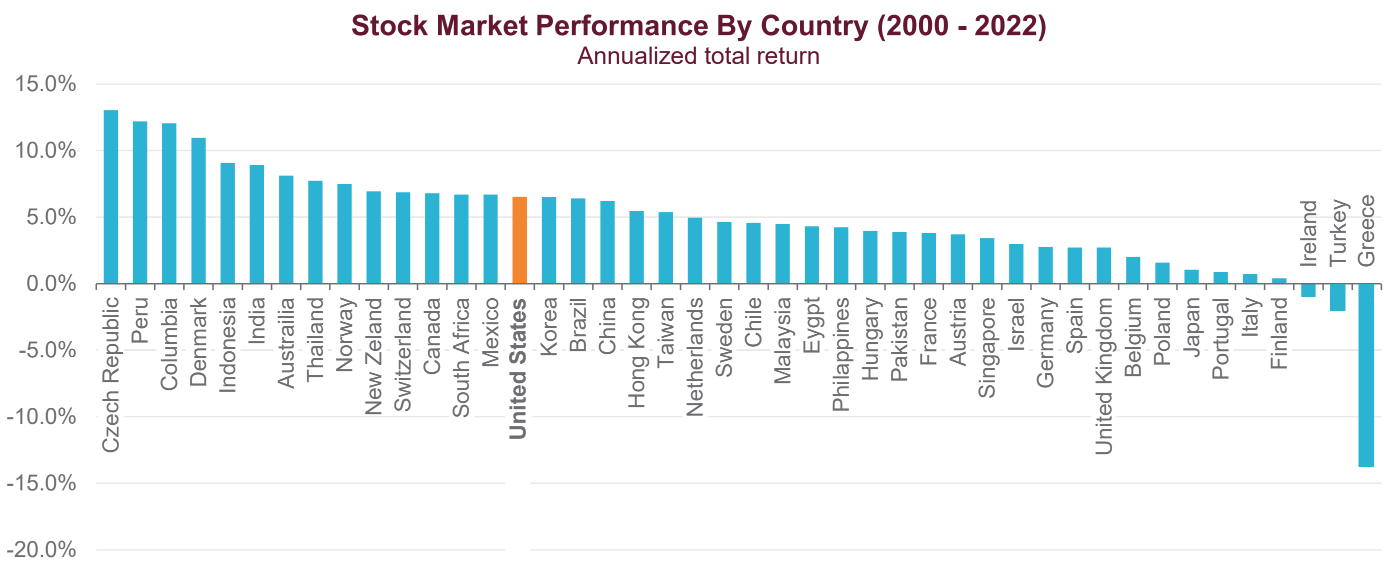
As long-term investors, we believe home country bias plus a focus on past performance is a dangerous combo. Together, these tendencies can concentrate a portfolio in one specific region while ignoring significant opportunities elsewhere. Over longer periods of time, this can reduce returns and increase risk.

Yes, U.S. equities finished on top from 1999-2021 (see chart on right). However, for most of the past 20 years, emerging market stocks had been the top performer by a pretty wide margin.




Source: Bloomberg.

The 1999-2009 decade was especially difficult for U.S. stocks, given the dot.com implosion in 2001 and the financial crisis of 2008. From 1999 through 2009, the S&P 500 lost 2.7% annualized (down almost 1% with dividends reinvested). Net job growth was zero as the U.S. lost more than a third of its manufacturing jobs. During this same period, emerging markets were up 9.8% annualized, on average. For additional perspective, consider that since from 2000 through the second quarter of 2022, U.S. equity performance ranked 15 out of 44 in the MSCI All Country World Index (see chart below).



Source: Bloomberg.

## So where does that leave us now?

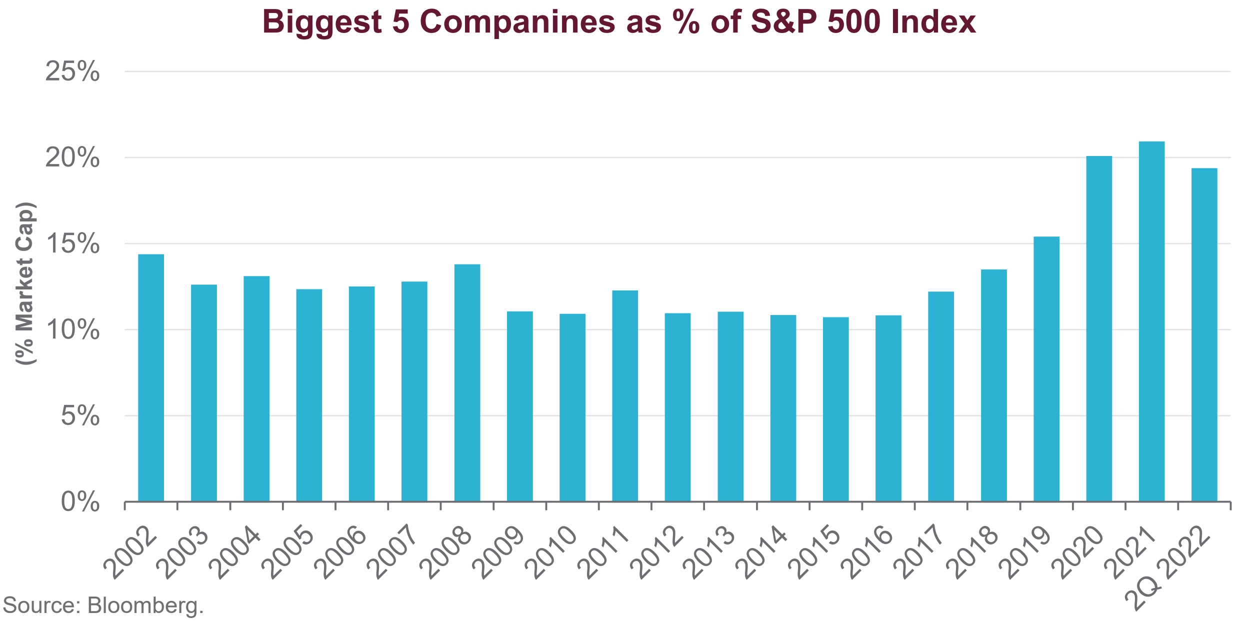
The biases toward home country investing and recent past performance would lead us to believe that the U.S. will continue to be the best place to invest, while emerging markets will continue to significantly lag over the next decade. The human tendency is to extrapolate trends into the future, but unfortunately this is not the best way to find opportunities and returns.

## Key Advantages and Risks of U.S. Markets

The largest U.S. companies do provide significant global exposure; around 30% of S&P 500 revenue is from abroad. However, this percentage had been fairly constant since around 2005, and it has started to decrease after the trade bottlenecks triggered by the global pandemic. U.S. companies with large international exposures now face stronger pushback and competition, be it India putting restrictions on Amazon and other foreign tech companies, China putting up barriers to foreign financial services providers, or Brexit limiting the free flow of trade between the UK and the Eurozone.

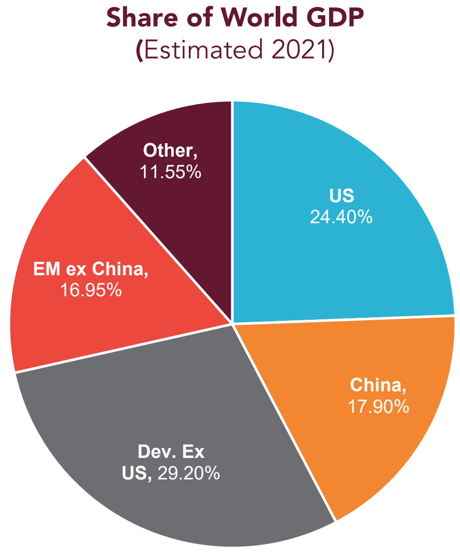
**We ask ourselves:** Are recent U.S stock market returns sustainable? Consider that at the end of 2021, five tech companies comprised 20% of the value of the S&P 500 Index, the highest level this century (see charts on next page).

While U.S. tech companies are some of the world's most innovative, we question how much larger they can get and/or how much more their profits can grow before regulators seriously question and possibly inact legislation to reduce their dominance.



Source: Bloomberg.

Taking a broader look at the world, the U.S. produces about 25% of global GDP, but our equity markets are valued at more than double that: the U.S. accounts for 60% of total global equity valuations (the MSCI ACWI Index). Is this really sustainable? Note that in 1990, Japanese equities made up 45% of the global stock index, including eight of the 10 most valued companies in the world. A decade later, this percentage was down to 13% of the index and was recently at just 6%. Let's quickly look at the factors used to determine valuations, such as level of diversity, dynamism, maturity, innovation and rule of law.



Source: IMF, Visual Capitalist.
Note: Data from 2020 was used where 2021 data was not available.

On all of these factors, the U.S. has very strong ratings, which explains the premium relative to other markets. Further, many of the largest U.S. companies have invested heavily in other countries over time and continue to benefit from GDP and population growth around the globe. However, do we believe that U.S. companies are worth 35 percentage points more than their share of global GDP? Perhaps for now. But over time, foreign markets, especially emerging markets where 85% of the worlds population live, are likely to command a larger share of global market capitalization.

## Allocating to Foreign Equity Markets

At LNWM, we believe that there is substantial opportunity over the next two decades for returns outside the US. Risks are generally higher abroad (see box). However, there is also greater opportunity in terms of both company and country selection given that foreign markets are highly fragmented and inefficient, with limited analyst coverage. We think the best way to find these opportunities is through actively managed funds run by highly experienced managers, as opposed to index funds whose allocations are static and driven by stock market valuations.

Let's take a closer look at the two major foreign stock indexes (see box below). Combined, they hold roughly 2,200 of the largest non-U.S. companies in terms of market capitalization, in proportion to the GDP of specific countries or regions. China, for example, is 30% of the MSCI Emerging Market Index. By contrast, the actively managed funds in LNWM portfolios have an additional 8,000 companies to choose from, either because these companies do not fit into MSCI's specific parameters or their home country is not included in these indexes.

LNWM's allocation to foreign equity markets has averaged 30% to 45% over time, and is currently on the higher end. Compared to the MSCI All-Country World Stock index, we are slightly underweight developed markets, including the US, and slightly overweight emerging markets (EM). We seek to invest through actively managed funds whose managers we are convinced can take advantage of pricing discrepancies and veer from the index country allocations as opportunity allows.

### Key Risks

Risks in foreign markets tend to be higher and should be analyzed carefully, including:

- Less diversified economies and markets
- Lower liquidity
- Higher government intervention
- Lack of transparency
- Corruption/rule of law
- Political uprisings, ethnic strife, warfare

### Foreign Stock Indexes

Foreign equity markets are categorized as either developed or emerging. Two key stock indexes, developed by MSCI, track each:

**DEVELOPED MARKETS**
**MSCI EAFE** (Europe, Asia, Far East) **Index**

**Countries:** 21 **Companies:** 797

*Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, United Kingdom.

**Largest Country Allocations:**

1. Japan: 21.8%
2. United Kingdom:15.6%
3. France: 11.8%

**Largest Companies** (% of Index):

1. Nestle (Switzerland): 2.3%
2. ASML Holdings (Netherlands): 1.6%
3. Roche (Switzerland): 1.6%

**EMERGING MARKETS**
**MSCI Emerging Markets Index**

**Countries:** 24 **Companies:** 1,386

*Argentina, Brazil, Chile, China, Columbia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Pakistan, Peru, Philippines, Poland, Qatar, Russia, Saudi Arabia, South Africa, Taiwan, Thailand, Turkey, United Arab Emirates.

**Largest Country Allocations:**

1. China: 30.4%
2. India: 14.9%
3. Taiwan: 14.4%

**Largest Companies** (% of Index):

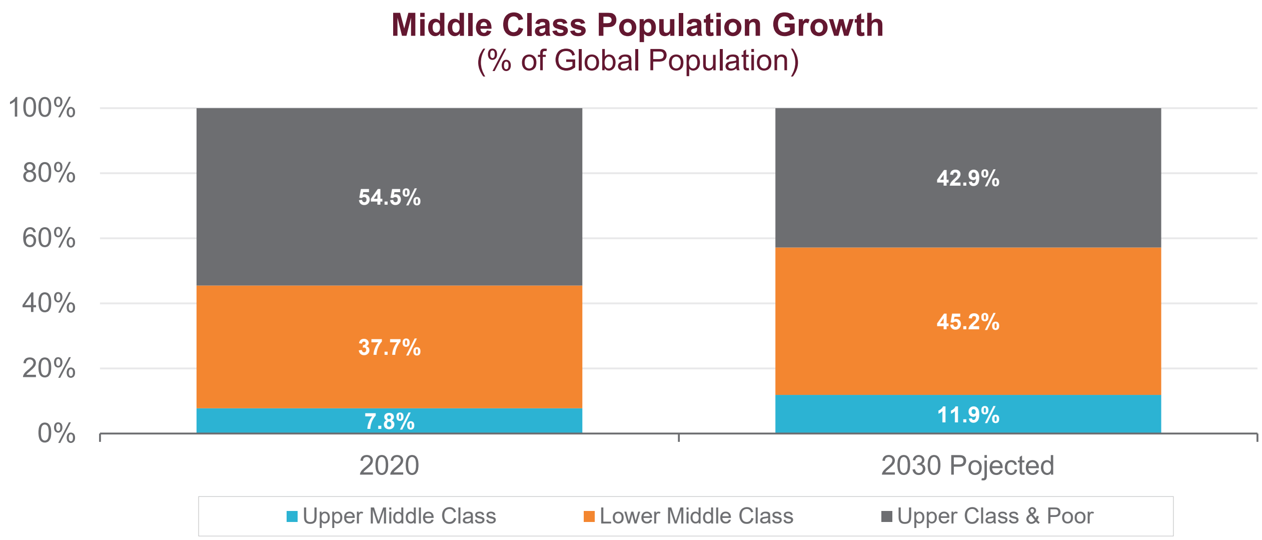
1. Taiwan Semiconductor (Taiwan): 6.2%
2. Tencent Holdings (China): 3.6%
3. Samsung Electronics (Korea): 3.5%

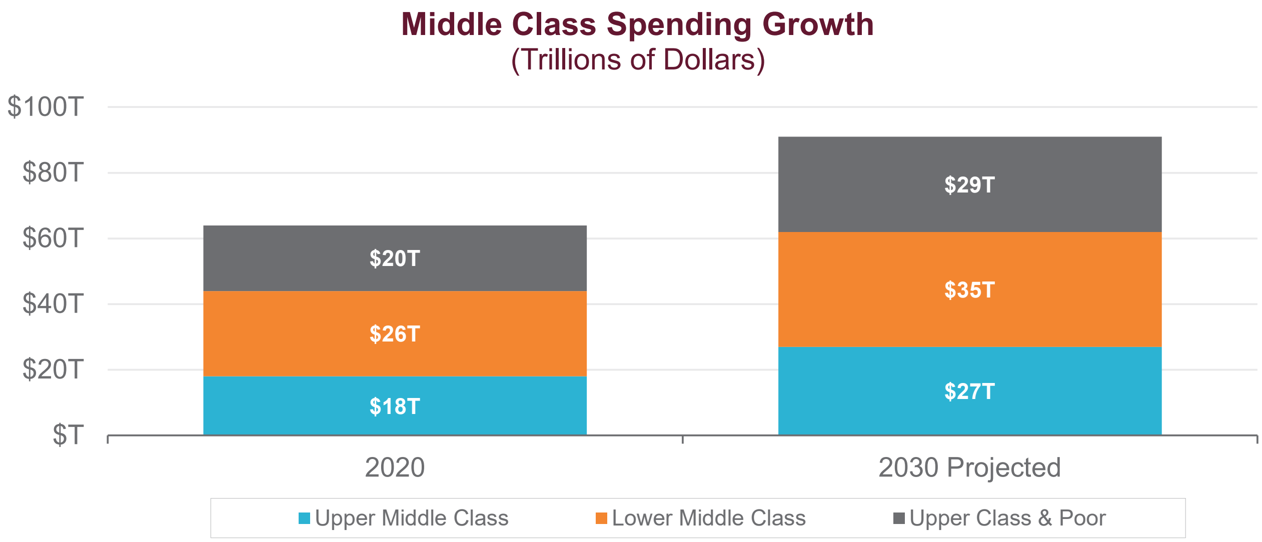
## Why Emerging Markets

The greatest pricing inefficiencies — and we think opportunities — are in countries undergoing dynamic change, such as China, India, Indonesia, and the Phillipines, allowing for leaps in productivity and rapid growth in the middle class over the next two decades.

What is the middle class? It's typically defined as the middle 60% in terms of income (with 20% on either end), or as households making 65% to 200% of the country's median income. A 2021 Brookings Institute study estimated that 900 million people will have entered the middle class globally by 2030, the majority of them in Asian emerging markets.

Additionally, middle class spending in the Asia Pacific region is expected to triple from 2015 - 2030, to $36.6 trillion. Compare this with the 8% estimated increase in North American middle class spending (to $6.7 trillion). If growth in global middle class spending continues as anticipated, the asset managers in our portfolios should be able to find many more opportunities for strong returns.



## Why Developed Foreign Markets

A question we regularly get is: Why invest in companies based in the slow-growing economies of Europe and Japan? There are three main reasons:

1. **Access to Global Exporters:** European and Japanese companies are leading exporters, with products and services sought after in markets around the world. Consider that the top selling foreign car brand in China is Volkswagen. In this group are companies like Ireland's Accenture (consultancy) and Roche Holdings of Switzerland (pharmaceuticals).
2. **Innovative Products:** Sweden's Spotify or UK retailer NEXT. These and other European and Japanese companies have developed new products and/or services in high demand globally.
3. **Compelling Valuations:** Analyst coverage of European and Japanese stock markets is less than it used to be. As such, there is greater opportunity to find good deals that will hopefully be realized by the market over time.

## The Long View

In the coming decade, we believe that maintaining a significant allocation to foreign equities, especially in the emerging markets, will allow us to benefit from the higher growth and lower valuations available outside the U.S. As Warren Buffett says: "Be fearful when others are greedy and greedy when others are fearful." For a long while now, investors in general have "feared" foreign equities. When will they get greedy? It's hard to say and we are not market timers but long-term investors. What we do know is that valuations, especially in emerging markets, do not reflect decade-long improvements in creditworthiness, corporate governance and new market opportunities. To position portfolios, we have invested in actively managed foreign equity funds we think are among the best-prepared to deliver strong risk-adjusted returns over a full market cycle.

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Laird Norton Wealth Management ("LNWM") has long partnered with its clients to help them achieve their greatest impact through their investments, legacy planning and philanthropy. Founded in 1967, LNWM is both an RIA (registered investment advisor) and trust company, providing comprehensive and integrated wealth planning to individuals, families, business leaders, private foundations and nonprofit organizations nationwide. -- 801 Second Avenue, Suite 1600, Seattle WA 98104 206.464.5100 800.426.5105 lairdnortonwm.com

The investment team resulting from the combination of Laird Norton Wealth Management and Wetherby Asset Management is comprised of 12 analysts and strategists working together to design and implement investment solutions for client portfolios. Six analysts at the firm hold the Chartered Financial Analyst® designation, with expertise spanning macroeconomics, public and private asset classes across the global capital markets, and impact investing. Collaborating with each other and with client advisors, the investment team's overarching goal is to help clients and their families preserve and grow their wealth over many generations.

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