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On the Minds of Investors

What will drive international equity performance this year?

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International equities are likely to benefit this year from positive structural changes, a weaker dollar, and exciting governance changes.

Despite geopolitical risks and hard landing fears, 2023 was an excellent year for most global markets. The MSCI All Country World ex-U.S. Index returned 16.2%, with outperformance from the Eurozone +23%, Japan +21%, and EM ex-China +20% (in USD terms). 2024 will be a unique year as 40% of the world's population goes to the polls. Apart from the U.S., other elections this year include Taiwan, India, and Mexico. The reaction to Taiwan's election is key to monitor to gauge th volume of geopolitical tensions. Still, Taiwanese equities have returned 8% annually on average during the incumbent DPP party's tenure. In India, PM Modi anc the BJP party will likely be reelected, continuing the positive reform momentum in India. Lastly, the election in Mexico is likely to bring continuity for the ruling Morena party. While elections can drive short-term volatility, they typically do not have long-lasting market impacts. International equities are likely to benefit tl year from positive structural changes, a weaker dollar, and exciting governance changes.

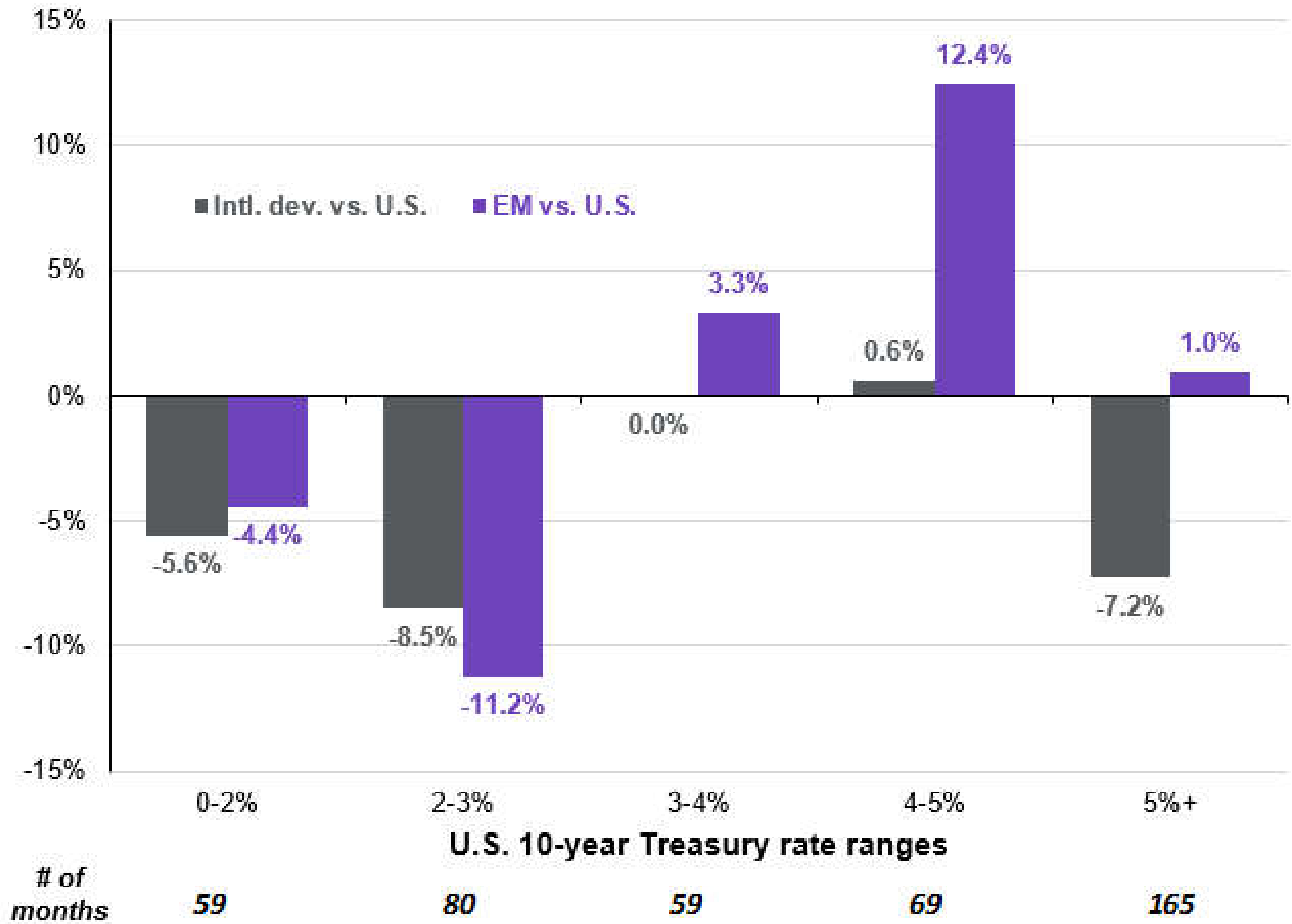
Positive drivers for international markets include:

- **Narrowing growth differentials:** Growth differentials between the U.S. and other countries are set to narrow this year as the U.S. economy grows a littl bit less, Japan and EM excluding China deliver positive growth, and the Eurozone and China bottom out.
- **End of low inflation and negative interest rates:** The return of inflation and positive interest rates in Europe and Japan is a significant contrast to the 2010s. Higher inflation also leads to better revenue growth and higher wages, which can boost consumption. The chart below shows how the change ir interest rate environment is a game changer for international performance. During periods when U.S. 10-year yields were between 3-5%, intl. either kep pace or outperformed the U.S. given the value style's dominance in these markets. Excluding Japan's "lost decade" in the 1990s would show strong outperformance in periods when yields were over 4%.
- **Weaker U.S. dollar:** Shrinking growth and interest rate differentials means the U.S. dollar should continue its decline that started after its peak in October 2022. U.S. dollar-based investors that invest unhedged would see an additional boost to returns. Mexico finished 2023 up 42% in USD terms wi 40% of the return attributable to the dollar weakening against the peso. In addition, emerging markets tend to do particularly well in weaker U.S. dollar environments.
- **Governance changes:** Currently, 27% of Japanese companies have a price-to-book ratio below 1x along with 19% of European companies and only 3% U.S. companies. Historically, this has occurred due to a low focus on shareholders, but this is quickly changing. Exchanges in Japan have implementec corporate governance reforms, which has boosted the number of share buybacks and independent board members.

While headlines this year are likely to be dominated by elections, investors should focus on positive tailwinds to international markets. Foreign Large Blend wa the Morningstar category with the fifth highest inflows last year, suggesting investors are taking notice, but deep underweights likely still exist in many portfolios.

International performance relative to the U.S. during different interest rate environments

U.S. 10-year, annualized avg. total return, USD, 1988-present



Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management. Intl. dev. = MSCI EAFE Index, EM = MSCI Emerging Markets Index, U.S. = S&P 500 Index. Data are as of January 18, 2024.

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