

Five Factors Underpinning the Resurgence of International Stocks

1. International Equities Offer More Upside

The engine of global economic growth is accelerating just as the U.S. recovery is maturing. Attractive valuations in international markets coupled with strong earnings growth results in a compelling opportunity in international stocks by virtually any measure. The chart below tells the story.

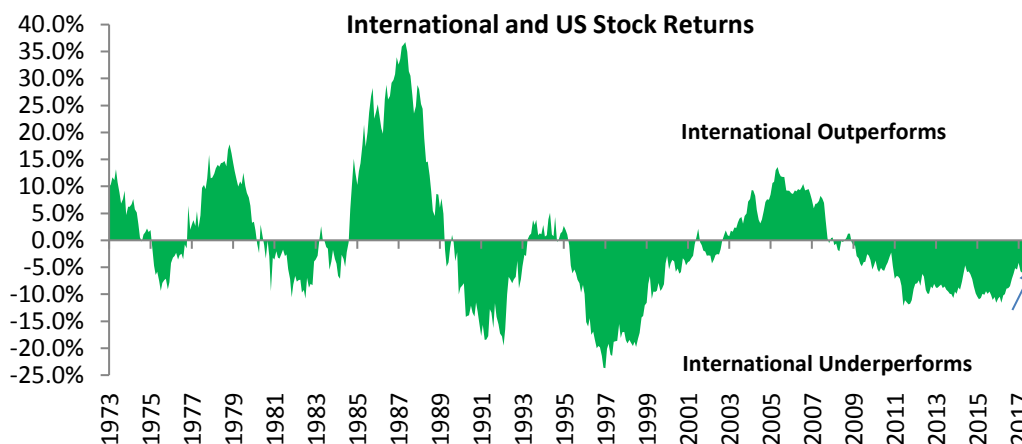
International vs US Valuation Differentials			
	S&P 500	MSCI EAFE	Difference
EV/Sales '18	2.4	1.5	-38%
Forward P/E '18	16.6	14.5	-13%
P/B '18	2.9	1.6	-45%
EV/EBITDA '18	11.3	8.7	-23%
FCF Yield	4.3%	4.4%	3%
FCF Yield - Treasury Yield Spread*	1.5%	3.7%	151%
Dividend Yield '18%	2.1%	3.4%	63%
EPS Growth '18 %	23.6%	18.7%	-21%

Source: Bloomberg Data and Contrast Capital Management

* For MSCI EAFE, we use 10 year German Govt Bond yield as a proxy for international treasury yields

2. Periods of Outperformance Normally Last Several Years

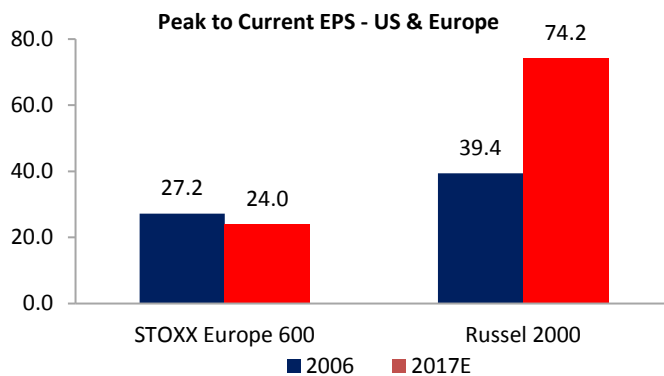
As can be seen from the following chart, performance of international and US markets is cyclical in nature with one outperforming the other for several years before the cycle rotates. After outperforming in 2017, international stocks appear to be in the early innings of the outperformance cycle, supported by favourable economic dynamics, earnings and valuations.



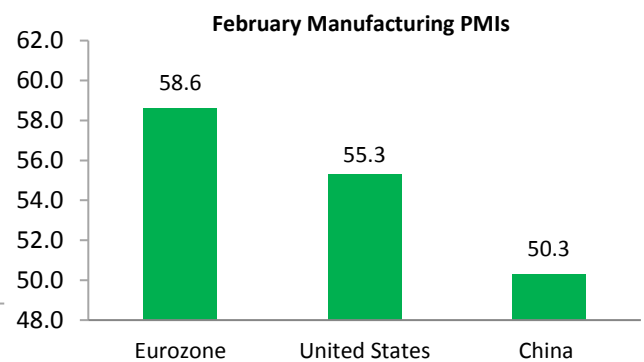
Source: Bloomberg, Contrast Capital. Rolling 36 months returns S&P 500 TR vs. MSCI EAFE TR Index.

3. Much More Room for Earnings Recovery

The improving economic and political climate in Europe coupled with an accommodative monetary environment is resulting in a large boost to earnings. In fact, a look at the Manufacturing Purchasing Managers Index (PMI) indicates that Eurozone is leading the world in terms of strength in manufacturing. Given that European earnings are still below prior peak in 2006, there is significantly more room for earnings recovery.



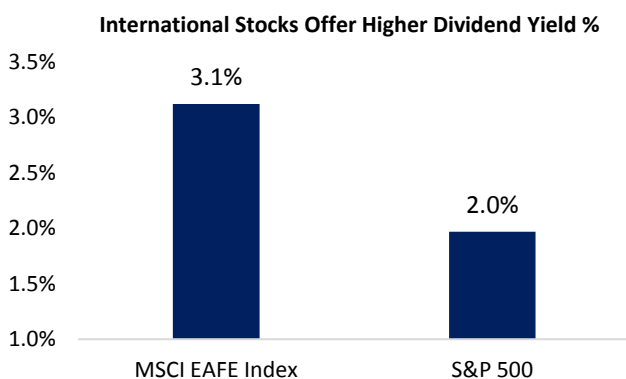
Source: Bloomberg, Nov 27th, 2017



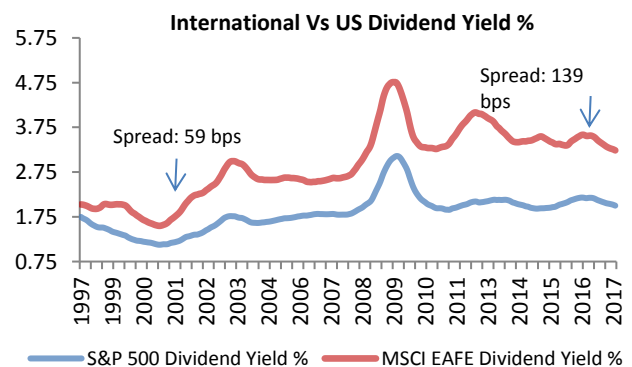
Source: Bloomberg, Mar 3, 2018

International Equities Offer Higher Dividend Yields

International equities offer a higher dividend yield and higher pay-out ratio compared to U.S. equities. The gap between international dividend yields and US dividend yields is hovering at a historical high, which again highlights their attractiveness.



Source: Bloomberg, Oct 11, 2017



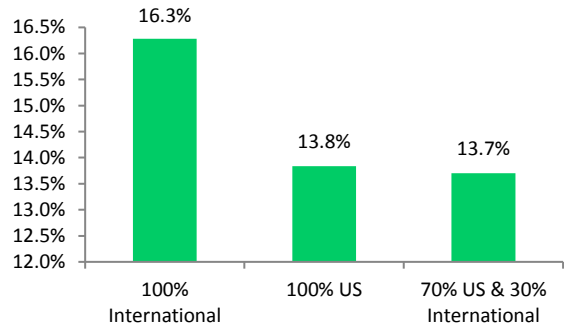
Source: Bloomberg, Nov 7th, 2017

In most cases, US investors can claim deductions or credit for any foreign taxes paid on dividends.

4. International Stocks Lower Portfolio Risk Slightly

The addition of international equities to an investor portfolio reduces risk slightly as measured by the variability of returns.

Index	Correlation with S&P 500
US Small Cap Index	0.92
Europe Small Cap Index	0.83
International Developed Market Index	0.82
International Small Cap Index	0.76
Emerging Market Index	0.73



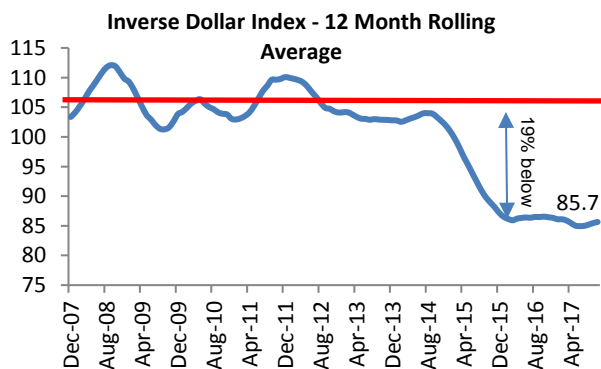
Source: Bloomberg; Indices used: Russell 2000 Index, Stoxx Europe 600 (USD), MSCI EAFE Index, FTSE Global Small Cap Ex. US Index (USD), MSCI Emerging Market Index. Date: Nov, 2017

Source: Bloomberg; MSCI EAFE Total Return Index and S&P 500 Total Return Index. Date: Nov, 2017

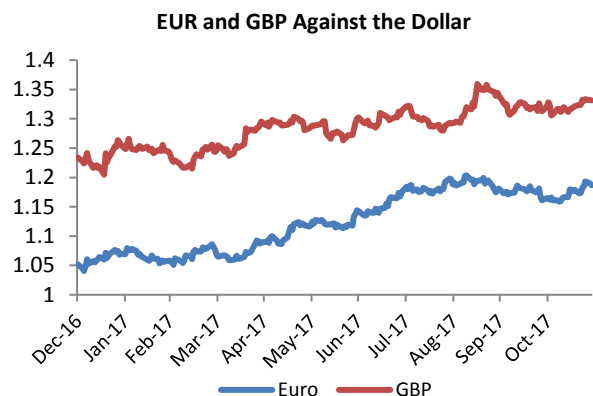
Portfolios that allocate a portion to international equities produce better risk adjusted returns historically. The chart shows that when international stocks are added to a portfolio of US stocks, the overall portfolio risk declines slightly. This occurs due to the potential diversification benefits of including international stocks and the imperfect correlation between markets.

5. Currency is no Longer a Headwind to International Performance

The U.S. Dollar has significantly outperformed international currencies during a substantial portion of the current business cycle. However, the dollar has begun to weaken as the international economies gain growth momentum and the US recovery matures.



Source: Bloomberg; Inverse of US Dollar Index. Nov, 2017



Source: Bloomberg, Nov 2017

We believe that the US dollar will likely remain fairly stable with slight risks to the downside, as US interest rate tightening will be more than compensated by stronger international growth.

Conclusion:

The strength of international dividend yields, when added to the attractiveness of stock valuations and the favourable macroeconomic environment present investors with a strong investment opportunity in international stocks. We have recently seen international stocks outperform. Historically, cycles of international outperformance last several years so we expect we are in the early stages of this cycle. International equities may not add risk if they are part of a multi-asset portfolio. Taking these factors under consideration, we have designed the Contrast International Equity Income strategy to provide an attractive and balanced way to gain exposure to the international equity opportunity. To learn more about the strategy click [here](#) or call **617-523-0104**

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