

Valuations show non-US equities at bargain prices. When the market rebounds, small caps should lead the way.

The key to outsized returns is low expectations.

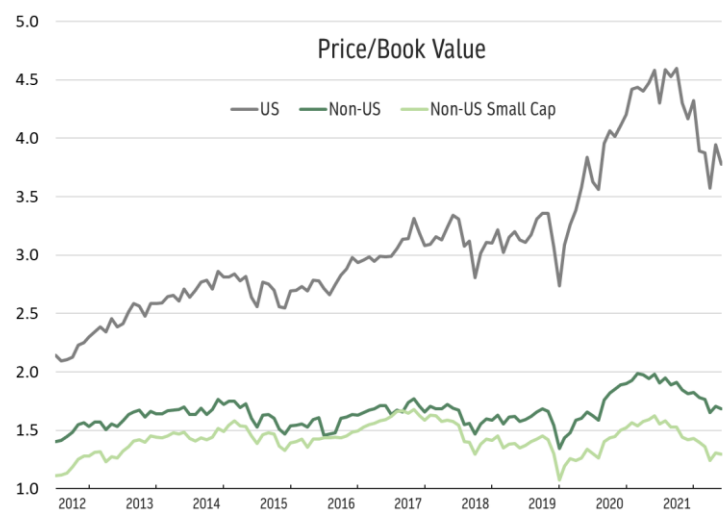
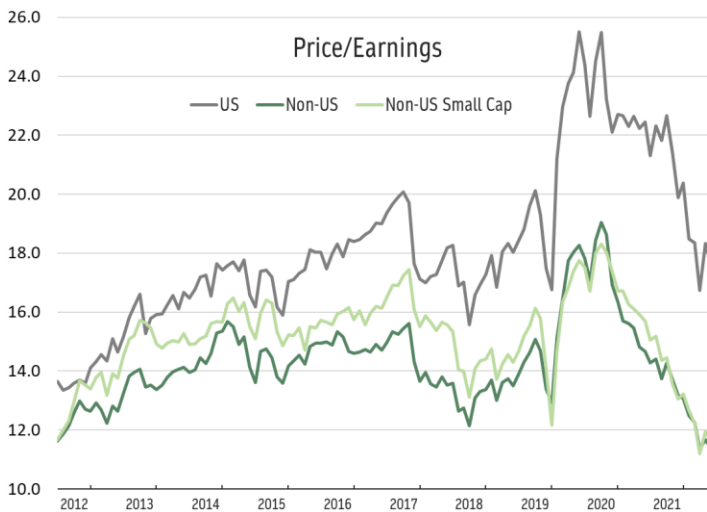
That's worth bearing in mind when considering allocations among global equities. While expectations for public equities have been slashed everywhere in 2022, expectations for equities outside the US have gone from bad to worse. Low prices and depressed valuations provide opportunity for non-US stocks, as not much is needed to go right for them to surprise to the upside and outperform. While we don't know when the tide will turn for non-US equities, history shows that when markets make a comeback, small cap should lead the way.

Non-US equity prices impound dreary expectations

So far this year there has been no shortage of reasons to be bearish. Global economic growth is on the decline, currencies are faltering, and inflation is rampant. The Eurozone is being crippled by war on its doorstep and an impending energy crisis. Meanwhile, the US dollar has eclipsed 20-year highs, which has been a key headwind for stocks outside the US. As such, US equities have fared better than in the rest of the world. The MSCI US Index (large/mid cap stocks) is down 13.5% for the trailing 1-year period ending in August, while the MSCI ACWI ex-US Index has lost an additional 600 basis points, falling 19.5% for the same period.

Looking at valuations, stocks in the US do typically trade at a premium to non-US stocks, however the valuation gap has widened to historic levels. On a price-to-earnings basis, US stocks are trading at a 3% discount to their 10-year average, while non-US stocks are making new lows, off 20% from their average for the same period. Non-US small cap stocks look even more attractive with their current P/E trading at a 24% discount to their 10-year average.

Non-US stocks are trading at a hefty discount relative to long-term averages, particularly small cap



FY1 P/E	MSCI US Index	MSCI ACWI ex-US Index	MSCI ACWI ex-US Small Cap Index
Current	17.60	11.37	11.58
5-Year Average	19.89	14.54	15.23
10-Year Average	18.22	14.29	15.15
% off recent high	-31%	-40%	-37%
% off 5-Year Average	-11%	-22%	-24%
% off 10-Year Average	-3%	-20%	-24%

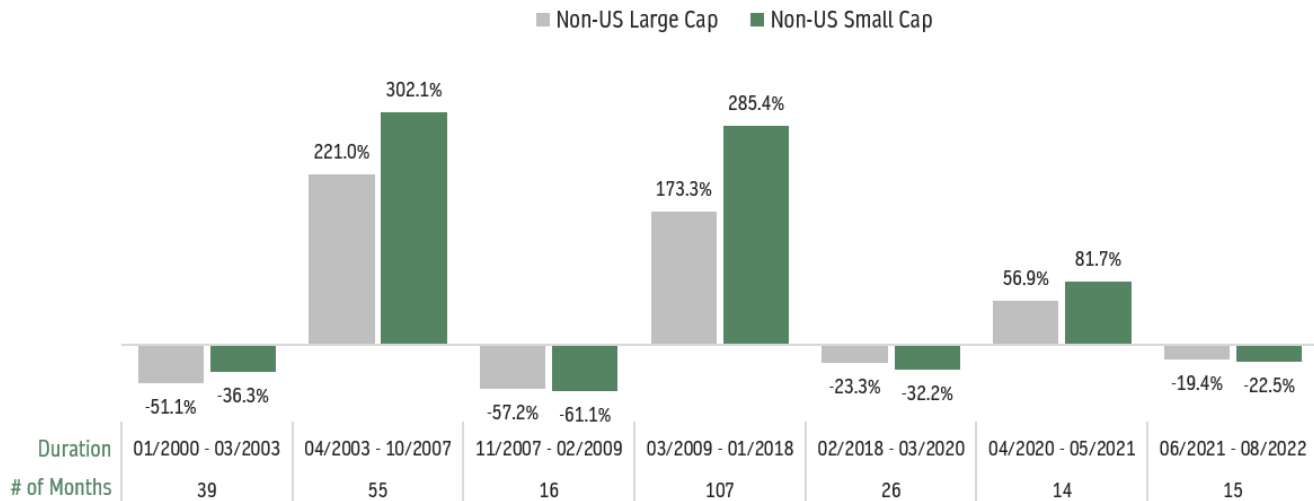
P/B	MSCI US Index	MSCI ACWI ex-US Index	MSCI ACWI ex-US Small Cap Index
Current	3.78	1.68	1.30
5-Year Average	3.57	1.70	1.45
10-Year Average	3.10	1.65	1.43
% off recent high	-18%	-15%	-20%
% off 5-Year Average	6%	-1%	-10%
% off 10-Year Average	22%	2%	-9%

Source: MSCI, Factset Monthly data for the trailing 10 years through August 31, 2022.

Small caps triumph when equities recover

It should be no surprise that small cap stocks have taken the brunt of the selling in the recent downturn as investors have shied away from perceived riskier assets. Non-US small cap stocks are down 22.5% from their high in May 2021 through August 2022, underperforming non-US large cap stocks by 300 basis points. In rebound periods however, small cap stocks tend to outperform and by significant margins. In the past three bull markets for non-US stocks, small caps have outpaced large caps by an average of 15 percentage points annualized!

Drawdown Periods of >20% and the Subsequent Rally



Source: MSCI. Monthly returns ending August 31, 2022 for the MSCI ACWI ex-US Small Cap Index and MSCI ACWI ex-US Large Cap Index since inception in June 1994.

Non-US small cap's dominance in rising markets and historical superiority underscores its importance as part of a diversified equity portfolio. Since inception of the MSCI ACWI ex-US Small Cap Index in June 1994, small caps have outperformed large caps in 83% of rolling 5-year periods, and 95% of rolling 10-year periods.

Non-US small cap stocks have outperformed large cap over time

	1-Year	3-Year	5-Year	10-Year
% of periods non-US small cap outperforms large cap	61%	66%	83%	95%
Average outperformance (bps)	172	137	194	260

Source: MSCI. Monthly rolling periods ending August 31, 2022 for the MSCI ACWI ex-US Small Cap Index and MSCI ACWI ex-US Large Cap Index since inception in June 1994.

Opportunity knocks

This year has been a challenging environment for equities, but particularly so for non-US small cap stocks. However, similar drawdown periods in the past have been followed by periods of significant outperformance for the asset class. The consistency of non-US small cap's long-term outperformance, coupled with current depressed valuations may mean now is an opportune time to increase exposure.

Important Disclosures:

Past performance does not ensure future results, and there is no assurance that the portfolios will achieve their investment objectives.

The information provided here is for general informational purposes only and should not be considered an individualized recommendation or personalized investment advice. The investment strategies mentioned here may not be suitable for everyone. Each investor needs to review an investment strategy for his or her own particular situation before making any investment decision. All expressions of opinion are subject to change without notice in reaction to shifting market conditions. Data contained herein from third-party providers is obtained from what are considered reliable sources. However, its accuracy, completeness or reliability cannot be guaranteed. Supporting documentation for any claims or statistical information is available upon request. Investing involves risk including loss of principal. Past performance is no guarantee of future results and the opinions presented cannot be viewed as an indicator of future performance.

Neither MSCI nor any other party involved in or related to compiling, computing or creating the MSCI data makes any express or implied warranties or representations with respect to such data (or the results to be obtained by the use thereof), and all such parties hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability or fitness for a particular purpose with respect to any of such data. Without limiting any of the foregoing, in no event shall MSCI, any of its affiliates or any third party involved in or related to compiling, computing or creating the data have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) even if notified of the possibility of such damages. No further distribution or dissemination of the MSCI data is permitted without MSCI's express written consent.