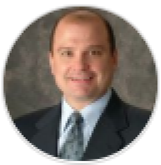
JUL 8, 2017 @ 09:00 AM    4,280

# Why International Stocks May Continue To Outperform In 2017



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When asked how he was able to be such a successful hitter, baseball great Willie Keeler famously responded “I hit them where they ain't!” In other words, he saw an opening that others weren’t watching, and he aimed for it. Applied to investing, that same philosophy can sometimes eventually pay off.

For example, consider international stock markets and the fact that they have lagged behind the U.S. stock market for the past five calendar years. The MSCI EAFE index (a major indicator of international stock performance) was negative in 2014 and 2015 and eked out a miniscule 1% return in 2016. These disappointing years for international markets occurred during a relatively strong period for U.S. stocks.

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This divergence between the U.S. and international market returns led many U.S. investors to have a "home-team" bias, favoring domestic investment and largely ignoring global opportunities. It's understandable: who wants to bet on the other team when the home team is doing so well? But when investors take a long-term approach, they often end up benefiting from a market adjustment that can reward areas of the markets that have been lagging.

Now, in the second half of 2017, "home-team investors" may now find themselves under-allocated in international stocks. In the first six months of 2017, the MSCI EAFE index is finally outperforming many U.S. indices including the S&P 500 and the Dow Jones Industrial Average. To continue the baseball analogy, because the European and other global markets have trailed for so long, their market recoveries appear to be in only the fourth or fifth innings, while the U.S. market is seeing a rally that may put us closer to the eighth or ninth innings.

To be sure, the U.S. stock market continues to exhibit strength through strong corporate earnings, a favorable regulatory regime, and hopes of tax reform. But here are three reasons why investors may score higher returns overseas in the second half of 2017:

1. Relative valuation. Investing is a relative value game. Based on their respective earnings, stocks in developed Europe are selling for less than their U.S. counterparts. For example, many major European Union (EU) stock markets trade at a lower “forward-earnings” (projected-earnings) multiple than the U.S. This is especially true if we look at the lofty multiple that the NASDAQ and small-cap Russell 2000 indices carry.

2. Stronger global corporate earnings. Overseas corporations are increasingly posting positive earnings surprises. Many analysts believe this presages an end to the economic malaise plaguing major developed-market economies, as noted by CNBC. This belief is supported by an uptick in economic activity and higher gross domestic product (GDP) for many EU economies thus far in 2017, according to Bloomberg. In fact, growth in the Eurozone may approach 2.0% in 2018. While this number may not seem noteworthy relative to some other expansions, it would represent a significant improvement over recent years.

3. Continued central bank easing. The European Central Bank (ECB) and Bank of Japan (BOJ) are on a course to continue a more accommodative (lower interest rate) monetary policy. Despite the stronger economic data, the ECB and BOJ will avoid any significant tightening of monetary policy, as that could threaten their economic and stock market recoveries. Furthermore, should the ECB or BOJ tighten monetary policy, it could also strengthen their currencies which, in turn, could hurt their exports. Therefore, we expect the EU and Japan to keep interest rates low. Should the U.S. complain that these Central Banks are deliberately manipulating their currencies by keeping interest rates low, the EU and Japan have only to say that they learned this strategy

from the U.S. and that they are just a few years—or a few innings—behind us.