

# 360 Insights

Quarterly Investing and Financial Perspectives



## International Investing Rewards Patient Investors

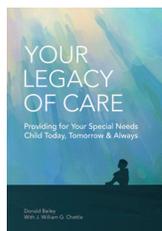
by **J. William G. Chettle**, VP, Loring Ward

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What a difference a few months can make.

Whether it was Brexit, Grexit, worries about China or “expert” predictions of imminent global financial collapse, many investors in the last few years turned away from investing internationally — or at least questioned if it really made sense for their portfolios.

In 2014, of the nine asset classes Loring Ward includes in its portfolios, the worst performers were all international: Emerging Markets Value, International Small Cap and International Large Value. 2015 and 2016 were only slightly better.

A *USA Today* article on January 16, 2015, asked: “Why invest in international funds? It’s a mystery.”

Even the esteemed John Bogle, founder of the Vanguard Group, has bluntly opined, “You don’t need to own international stock.”<sup>1</sup>

As so often happens with investing, conventional wisdom was not only wrong, it was potentially harmful to investors like Bogle who stayed out of international markets. In the first half of 2017, markets around the world came roaring back, rewarding many who had ignored the pundits and stayed invested internationally. The top performing asset classes were all international: International Small Cap, Emerging Markets Value and International Large Value. And in fact, from 2002 through June 30, 2017, Emerging Markets Value has been the top performing asset class, returning 10.6% annually.

All of this should have come as no surprise to students of history. International returns can stay negative for extended periods, but can also turn positive quickly as is happening now. This has happened several times in the last few decades, including in 2009, when the international market index (MSCI EAFE Index) went from a five-year loss of 10.44% ending March 2009 to a five-year gain of 3.36% ending April 2009.<sup>2</sup> It took only one month to turn five years of losses into five years of gains.

In recent years, international markets faced the headwinds of a strong dollar. Currency moves can have a greater impact than market moves on returns, and can wipe out a positive stock return or make a losing stock a winner. From 2010 through 2015, the cumulative impact of foreign-currency exposure on international value stocks was negative 18%. However, from 2000 to 2009, this impact of foreign-currency exposure was positive 29%.<sup>3</sup>

Recent declines in the dollar have provided a tailwind for international dollar-denominated investment performance and helped boost strong market results. For the first half of this year, the dollar has been the worst performing of all major currencies, down roughly -5.5%, fueled largely by investors feeling more bullish about economic recoveries in Europe and other parts of the developing world, as well as fearful of a U.S. slowdown.

See “International Investing Rewards Patient Investors” *continued on page 3*



# Fear the Fed?

by **Matthew Carvalho**, CFA, CFP®  
Director of Investment Research  
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Federal Reserve Eagle  
in Atlanta, GA

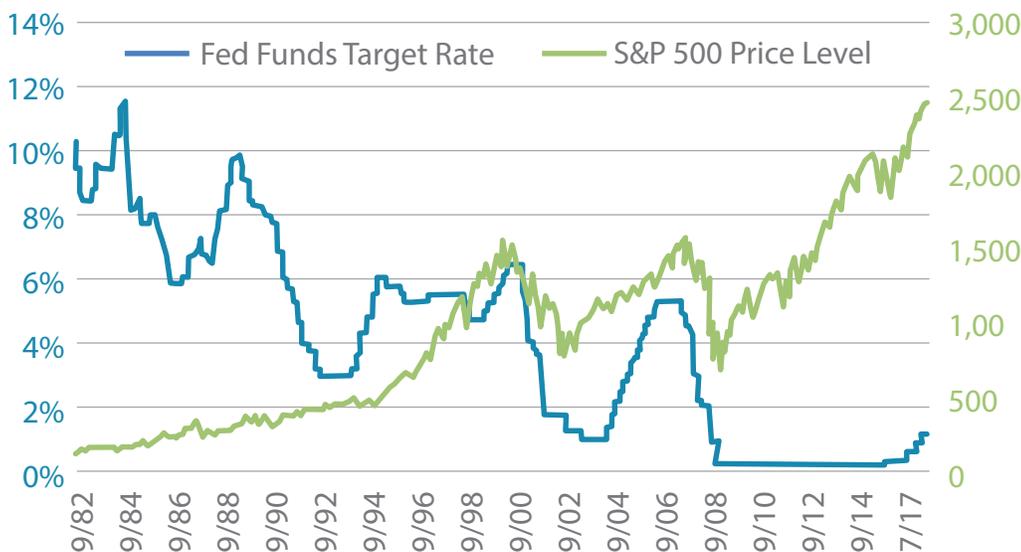
“The Fed’s rate hike could cause chaos in markets — and investors may not be ready.” While this could easily have been a headline from this year following Federal Reserve (Fed) rate hikes in March and June, this particular headline from Reuters came out in December 2015, just before the first rate hike in the years following the financial crisis.

Nearly two years later you continue to hear noise about the Fed raising their target rate, which had been close to zero since December 2008. Will consumers and companies have trouble adjusting to interest rates above the dreary levels of recent years? As the Fed continues to raise rates, does it mean we should flee stocks?

We looked at what has happened historically after the Fed raised rates. As the chart shows, rates in general have fallen quite precipitously over the last 30 years, and while we’ve seen a few upticks since December 2015, we are still at low levels. At the same time, the stock market has continued to head higher. Does this mean that if rates start to rise, stocks will head in the opposite direction? The data would say no.

## Fed Fund Target Rate and S&P 500

September 1982 – July 2017



The Fed made 73 rate hikes between September 1982 and November 2015, and the average return on the S&P 500 during the 12 months after a rate hike was 11.3%. Three years after a rate hike, the index price rose by 10.4% annualized, and five years later rose 10.9%. More recently the S&P 500 is up 16% in price from the initial hike in December 2015 through July 2017.

This makes sense when you think about what often drives the Fed to increase rates — namely a healthy and expanding economy, which may lead to inflationary pressures. However, we would be wise to avoid reading too much into any one factor. After all, stock prices represent a collective view about the future, taking into consideration dozens of factors including earnings, the economy, inflation, politics, tax rates, demographics, currency exchange rates, consumer sentiment, etc. Focusing on just one factor, like the Fed decision, is likely to do more harm than good. And the collective view isn’t always right.

Instead, we believe that the best course of action is to review your portfolio with your financial advisor to see if your investment allocation still aligns with your financial plan. Fed statements and moves are sure

to command many headlines for the foreseeable future, but chances are that when we look back a few years from now, we’ll have forgotten what all the noise was about. 🌐

Source: Federal Reserve Bank of St Louis and Morningstar Direct. Fed Funds Target Rate and S&P 500 Price Return levels from 9/27/1982 to 7/31/2017. Indexes are unmanaged baskets of securities that are not available for direct investment by investors. Index performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results.

## Ranking of Stock Market Returns Around the World

Based on Ten-Year Performance in U.S. Dollars Annualized Returns — Year Ending December 31, 2016

1. Thailand	13. Australia	25. Israel	37. Spain
2. Peru	14. Switzerland	26. Chile	38. Hungary
3. Philippines	15. South Africa 	27. Japan 	39. Czech Republic
4. Qatar	16. Colombia	28. Brazil	40. Russia
5. Indonesia	17. Singapore	29. United Kingdom	41. Poland
6. USA	18. UAE	30. Mexico	42. Italy 
7. Denmark 	19. India	31. France 	43. Portugal
8. Hong Kong	20. Netherlands 	32. Turkey	44. Ireland
9. Malaysia	21. Canada	33. Finland	45. Austria 
10. New Zealand	22. Korea 	34. Belgium	46. Greece
11. Taiwan	23. Germany	35. Egypt	
12. China	24. Sweden 	36. Norway	

Source: Morningstar Direct 2017. Countries represented by their respective MSCI IMI (net div.). Past performance is not indicative of future results.

The declining dollar's impact has been substantial. In the second quarter of 2017 alone, it resulted in a 3.3% outperformance for the dollar-denominated MSCI World Ex-US index relative to the same index denominated in local currency.

Based on past experience, over the long term we expect the cumulative effects of foreign-currency changes to be zero.

In fact, if we look back at the relationship between U.S. and international stocks over the past 29 years through 2016, (that's how far back index data will take us), U.S. markets and international markets have outperformed each other an almost equal number of times. But there was no clear or identifiable pattern of when one market was ahead or behind.

This is why we believe it is important for investors not to try to time when to get in and out of international (or U.S.) markets, and instead be patient and stay invested.

The average U.S. investor has a portfolio made up of about 75% U.S. stocks. While that may seem like the patriotic thing to do, it can mean missing out on a world of opportunity. You might be surprised by the number of familiar companies and household brands that are internationally owned, such as Lego, Miller Beer, Samsung and even 7-Eleven.

We like to think of the U.S. as a world leader but over the past several decades, America has never even ranked

in the top five in annualized performance of global markets.

Over the last 10 years, the top performing markets were Thailand, Peru and the Philippines. Ten years from now, the top performers will almost certainly be very different, though unpredictable.

Nobody knows what the future will bring. But if you invest internationally and own a lot of companies around the world, you can worry less if any one company or even one country experiences losses. Nor do you need to be concerned about picking countries that might outperform or even how the U.S. is doing versus the rest of the world.

As 2017 has shown so far, international markets can be very rewarding, overcoming several down years in a short space of time. Investors who take a long-term perspective may be rewarded for their patience. 

International markets involve additional risks, including, but not limited to, currency fluctuation, political instability, foreign taxes, and different methods of accounting and financial reporting. As a result, they may not be suitable investment options for everyone. Diversification does not guarantee a profit or protect against a loss in a declining market. Indexes are unmanaged baskets of securities that are not available for direct investment by investors. Index performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results. All investments involve risk, including the loss of principal and cannot be guaranteed against loss by a bank, custodian, or any other financial institution.

<sup>1</sup>John Bogle says investors don't need to own international stocks," Investment News, 4/28/17

<sup>2</sup>Morningstar Direct 2/2016

<sup>3</sup>Morningstar Direct 2/2016

<sup>4</sup>Morningstar Direct; U.S. stock returns represented by Russell 3000 Index, international stock returns represented by MSCI All Country World ex USA Index (gross dividends)



## The Risk You Need vs. The Risk You Can Afford

by **Meir Statman**, Glenn Klimek Professor of Finance at Santa Clara University

Just as there is a difference between being able to afford a luxury car and actually buying a luxury car, there is a difference between being able to afford high-risk investments and choosing a high-risk investment portfolio. Indeed, there is much comfort in knowing that we can afford a luxury car while enjoying a modest one, and there is tranquility in knowing that we can bear high investment risk but only need a portfolio with low or moderate investment risk.

Our willingness to accept risk depends on the distance between our aspirations and our current circumstances. Aspirations are broader than goals and less specific. We aspire to financial security, but we do not necessarily specify “the number” to reach at retirement age.

A person might be assessed objectively as wealthy, among the top 1% of residents of her country. Yet status-seeking might lead her to perceive herself subjectively as lagging behind her aspirations. She might take risks for a chance to reach the top 0.1%, accepting potential losses that would knock her down to the bottom 20%.

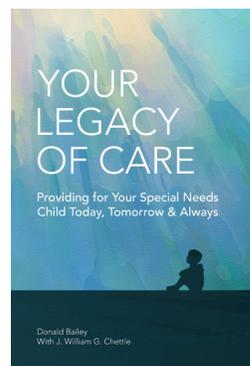
Conversely, a less status-seeking person might be assessed objectively as poor, with wealth placing him among the bottom 20%, yet does not perceive himself as lagging behind his aspirations. He might not be willing to take risks and accept potential losses because he has already reached his wealth and social-status aspirations.

Whether markets are up or down, it is always a good time to discuss your goals, aspirations and risk tolerance with your advisor. If you are far from your aspirations, you might wish to accept prudent investment risk that offers a good chance to take you closer to your aspirations. But if you are ahead of your plan or have reached your aspirations, you may choose to enjoy lower investment risk, even if you can afford high investment risk.

A word of caution about reacting to strong market returns — some investors may be tempted to take on

a higher risk profile or portfolio than is warranted for them because good times can mistakenly lead them to believe that they may be able to handle more risk than they really can or should. Some investors can forget that markets don't always go up.

Remember, proper risk taking may be key to weathering the volatility necessary for long-term returns. And the best portfolio is one that helps you achieve your goals... and even more importantly, stay invested. 🌐



## Your Legacy of Care

### Book Download Offer!

Loring Ward is pleased to introduce a new book, *Your Legacy of Care — Providing for Your Special Needs Child Today,*

*Tomorrow & Always*, a practical guide on how to address the lifelong financial and care requirements of a family member with a disability.

Because this is an area where many families seek and need guidance, we're happy to provide a complimentary PDF copy to readers of this newsletter. Simply go to [www.loringward.com/yourlegacyofcare](http://www.loringward.com/yourlegacyofcare) to download your copy.

Written by financial advisor Donald Bailey and Loring Ward's J. William G. Chettle, this book covers everything from the challenges and opportunities of everyday living to education to wills and trusts and ensuring a child's lifelong care. The book is designed to demystify the planning process by suggesting what questions to ask, what factors to consider for prioritization, and what steps to take now and in the future.

The views expressed are those of Loring Ward and are not intended as investment advice, or a forecast or guarantee of future results. All investments involve risk, including the loss of principal and cannot be guaranteed against loss by a bank, custodian, or any other financial institution.

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