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Rethinking International?

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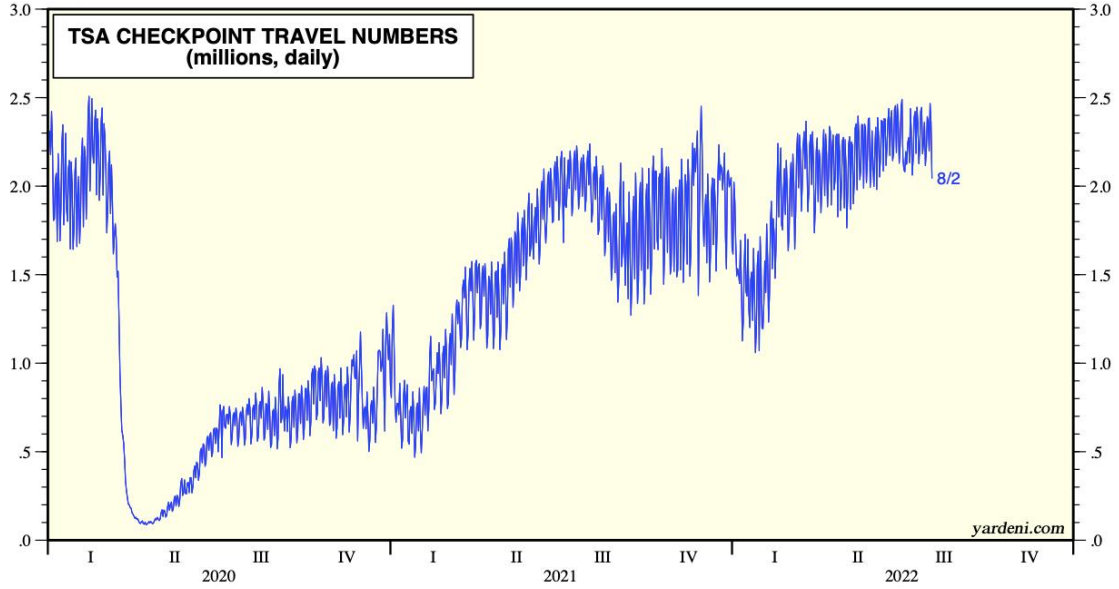
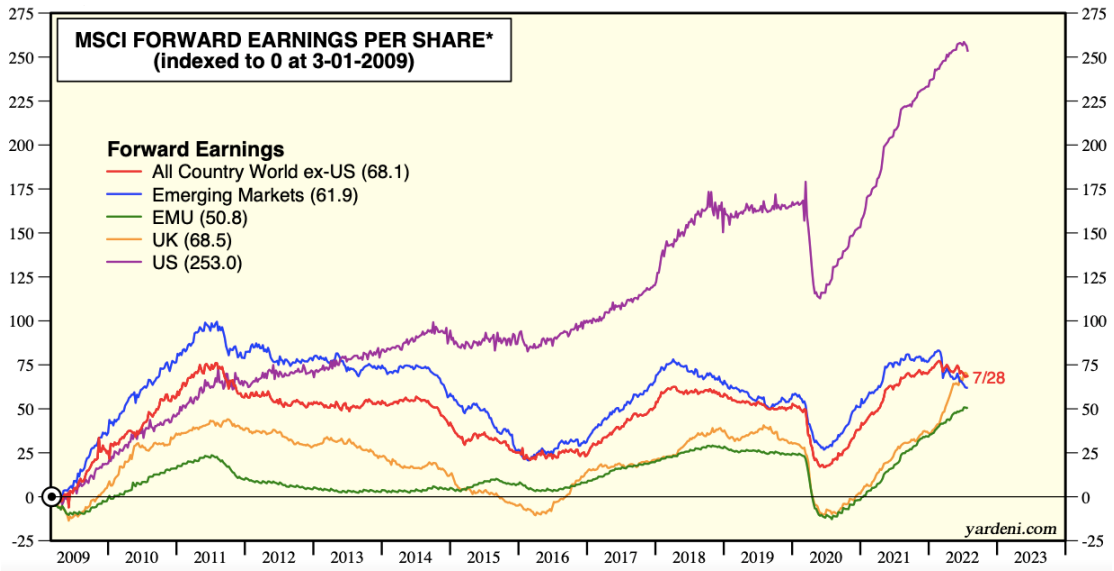
We often warn investors not to use anecdotal evidence to evaluate financial markets or the economy, unless it's our anecdotal evidence, then it's okay. It appears to us that many of you have been busy traveling this summer. Many of our outgoing emails are auto-returned letting us know "I will be out of the office until (insert date) with limited access to email." We are thrilled that so many of you are once again traveling and enjoying your much-earned time off.

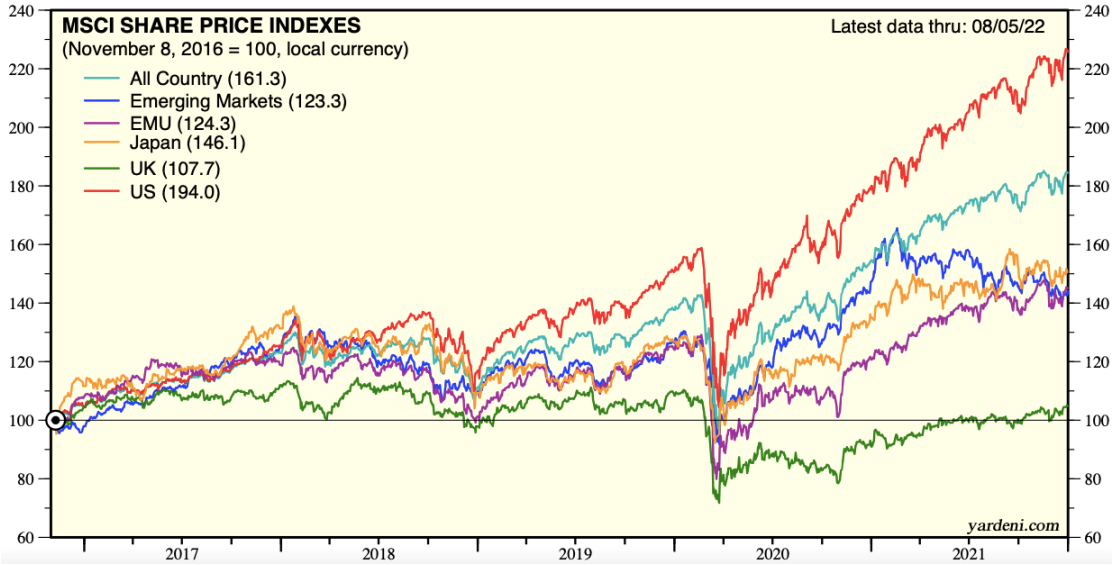
Recently our inboxes are starting to show some signs of life. Returning travelers are checking in and we are catching up on markets, the economy, and your travels. Several of you have told us about your wonderful European trips. (A notable caveat to the wonderfulness was that your trips were wonderful once the frustration of flight costs, delays, and lost luggage wore off.) The strong U.S. Dollar enabled you to dine like a king and stay at hotels fit for a queen, on a pauper's budget. You assured us that European economies were booming and pondered whether it was time to reinvest in International Stocks.

Before tackling international economies and markets, let's first address flight delays and lost luggage. The U.S. Government has a Bureau of Transportation Statistics (BTS). Its website is incredibly user-unfriendly and frustrating. It's somewhere between difficult and impossible to get useful data on whether the occurrences of lost luggage and flight delays have been higher than normal. We were able to observe TSA checkpoints are back to pre-pandemic levels while airline capacity remains well below pre-pandemic levels. We suppose that's consistent with gripes about travel experiences.



Our long-term strategic allocation has always held less international exposure than standard global portfolios. Most academic and industry literature argue for global portfolios. They recommend that portfolios are allocated based on global market capitalization. For example, if the United Kingdom makes up 11% of the world's financial market capitalization, investors should allocate 11% of their stock portfolio to U.K. stocks. We've always disagreed with this rationale for two reasons; When you purchase international investments, the purchase is made in local currency. This exposes non-local investors to foreign exchange risk. An investor needs to either hedge the currency risk, which is expensive, or accept the randomness of currency moves. Our second reason is more prone to bias. We believe that the U.S. economy and U.S. financial markets are more profit-oriented than international economies and financial markets. We believe this creates systematically higher domestic corporate earnings, which in turn leads to systematically better domestic stock performance.





We've been assured by many of our peers that our views on international investing are short-sighted. They argue, consistent with the consensus view, that global economies and global financial markets ebb and flow. Sometimes the U.S. will outperform and sometimes International will outperform. They maintain that U.S. outperformance is cyclical, not secular, and since U.S. markets have been outperforming the expectation is that International will likely outperform going forward. They further argue that global portfolios are critical to smoothing an investor's returns. During periods when the U.S. economy is faltering, international economies will be prospering, and vice versa. The argument somewhat makes sense. Therefore, we are somewhat sympathetic to it, but the numbers don't support it.

These next few charts and tables are a bit clunky. They are from our optimization program which is designed for portfolio construction purposes more so than external communication. Our optimization process compares the long-term risk and returns numbers of asset classes and then combines these asset classes to form the optimal portfolio for each client's specified risk profile. The table below shows returns since 1980 for U.S. Stocks and International Stocks. The first two columns show the current value of $1 invested in 1980. The numbers circled in red are the average annual returns and the numbers circled in black are the average annual volatility since 1980.

Portfolio	Initial Balance	Final Balance	CAGR	Stdev
US Stock Market	$1.00	$38.47	10.49%	15.50%
Intl Developed ex-US Market	$1.00	$10.76	6.71%	17.48%

Both long-term and short-term, International Stocks continue to deliver significantly lower returns and higher volatility than U.S. Stocks. On average, International Stocks have underperformed U.S. Stocks by almost 4% a year since 1980. That's a lot! Our optimization process looks at various investment horizons and examines all rolling periods. Simply put, it is very rare for International Stocks to outperform U.S. Stocks.

	US Stock Market			Intl Developed ex-US Market		
Roll Period	Average	High	Low	Average	High	Low
1 year	11.89%	62.57%	-43.18%	8.14%	78.27%	-49.95%
3 years	10.76%	30.70%	-16.27%	5.72%	38.88%	-19.64%
5 years	10.43%	26.84%	-6.23%	5.17%	23.71%	-7.13%
7 years	10.12%	20.35%	-3.02%	5.08%	13.73%	-2.53%
10 years	9.88%	18.89%	-2.57%	5.07%	12.14%	-0.39%
15 years	8.66%	14.88%	4.25%	4.86%	10.50%	0.53%

As investment managers, we are often asked the proverbial question "what is keeping you up at night?" Sometimes people suggest we worry about the “End of the World”. So, since we love research, in August we sent Jon down to the “End of the World”, the southernmost city on earth (Ushuaia, Argentina), to check it out. It turns out it’s pretty nice down there and no longer on our worry list!

In all seriousness, our guess is most investors expect us to reference wars, inflation, earnings, etc. Given the spirit of that question, the most appropriate answer may be our lack of international exposure. The foundation of our investment process is that historical relationships will repeat themselves. Based on this, our frameworks systemically have far less international exposure than the average investment portfolio. Currently, we have none. We continue to believe this is in the best interest of our investors, yet we recognize most of the investment industry disagrees with us. There is comfort in conforming, however, we prefer to remain uncomfortable. The table below shows asset class returns sorted from high to low over the last 5 years.

Asset Class	MTD	QTD	YTD	1 Year	3 Year*	5 Year*
U.S. Large Cap Growth	0.85	13.71	-17.61	-9.23	16.53	15.69
U.S. Mid Cap Growth	2.70	14.77	-20.70	-16.77	11.25	12.02
U.S. Small Cap Growth	1.02	12.81	-13.90	-9.96	10.90	10.12
U.S. Large Cap Value	-0.36	5.49	-6.55	-1.21	10.61	9.10
U.S. Small Cap Value	0.25	8.78	-6.49	-2.15	12.14	8.85
U.S. Mid Cap Value	-0.06	7.54	-6.50	-0.37	10.81	8.40
Asian Equity	-0.98	4.71	-13.27	-14.36	3.55	2.68
European Equity	-0.80	4.31	-17.50	-17.32	4.69	2.51

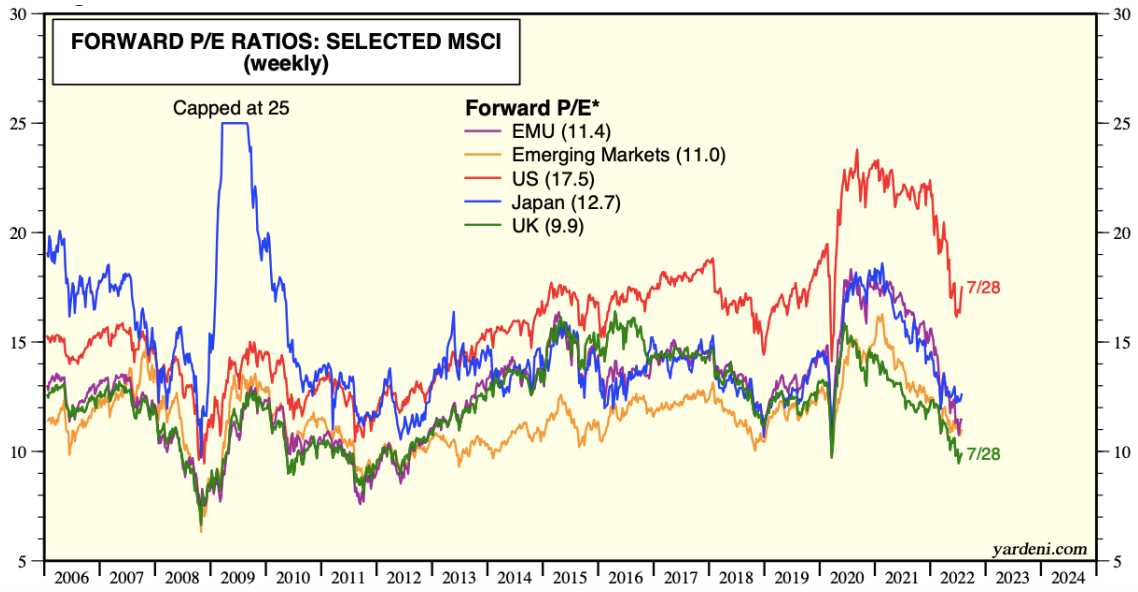
*annualized

Before moving on from international investing, we should also address Emerging Markets. We have rarely invested in Emerging Markets and may never in the future. This too is inconsistent with the consensus investment industry view. The standard argument has always been that Emerging Market economies are growing faster than Developed Market economies. Investors need to own Emerging Market Stocks to protect themselves against aging and outdated Developed Market economies. Once again, we are somewhat sympathetic to the argument but the numbers don't support it. Emerging Markets have been and continue to be a disaster for investors. Low returns with high risk. When we run our optimizer, it unemotionally and understandably recommends a zero percent allocation to Emerging Markets. They average about half the annual return of U.S. Stocks with 50% more volatility.

Portfolio	Initial Balance	Final Balance	CAGR	Stdev
US Stock Market	$1.00	$14.53	10.19%	15.59%
Emerging Markets	$1.00	$4.42	5.53%	22.17%

Although there are individual Emerging Market countries that have done well from time to time, a few bad apples consistently crush broad asset class returns. Russia, Ukraine, China, and Venezuela to name a few. It's simply too unstable for our palate.

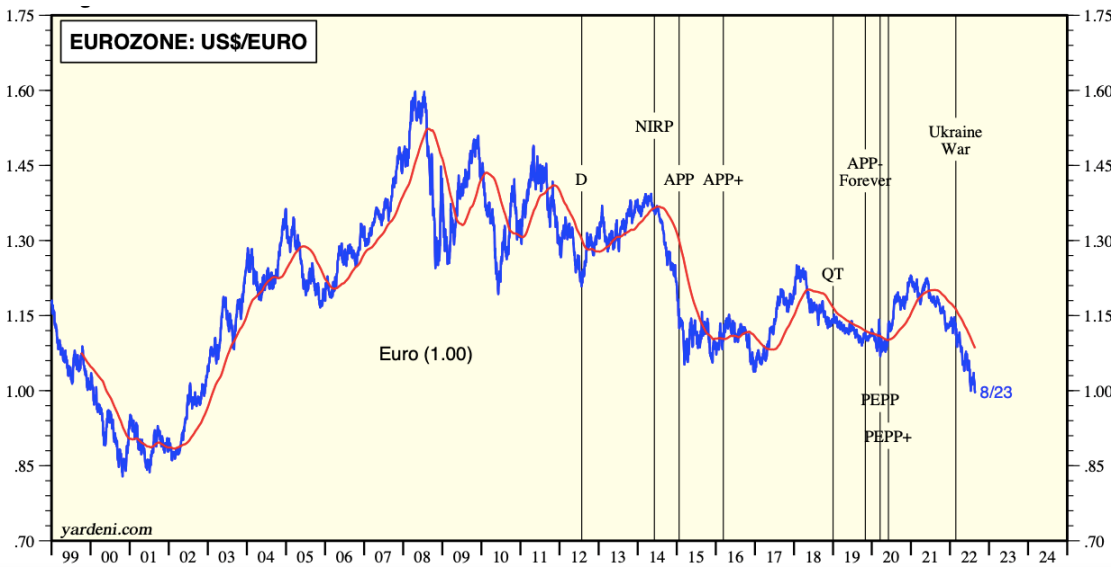
We will likely reenter Developed International Stock Markets at some point, but it's highly unlikely we will ever invest in Emerging Markets. Developed International Markets are currently cheaper than U.S. Markets from a valuation perspective. The million-dollar question is why? Do the lower International P/Es reflect a great bargain, or are they simply acknowledging that the growth rate of international corporate earnings is expected to be lower than the growth rate of U.S. corporate earnings? We'd argue the latter.

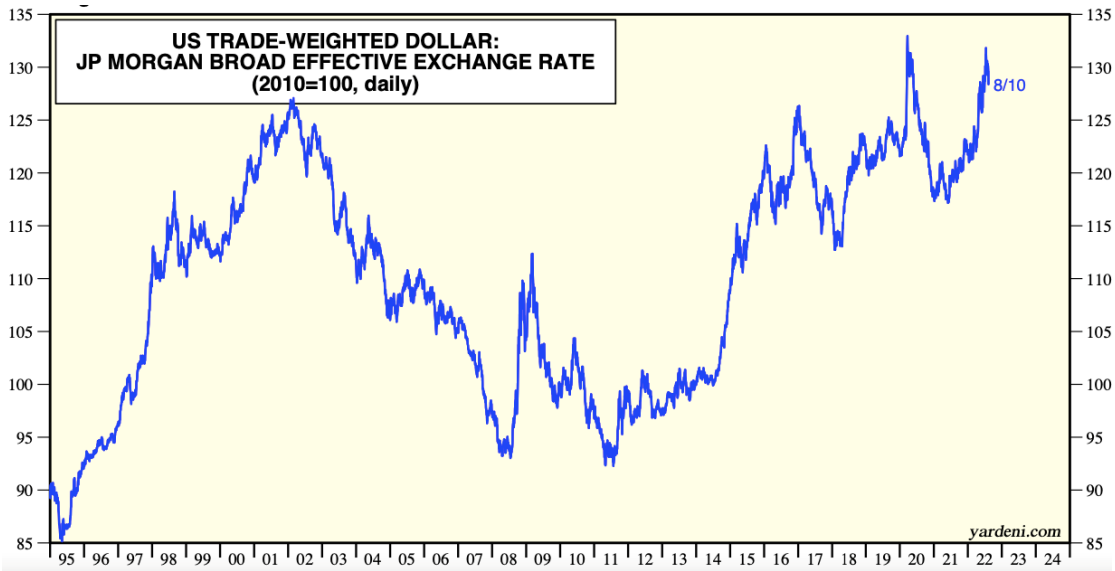


We think it is far more likely that Core Europe, in particular Germany, will fall into a significant recession than it is that the United States will. In Mark Twain's *Following the Equator: A Journey Around the World,* he famously quipped: "Truth is stranger than fiction". The second part of his idiom is less famous, "it is because fiction is obliged to stick to possibilities". This describes Europe today.

European Union countries despise Russia and the war they are raging on Ukraine. They have imposed sanctions on Russia, sort of. Russia is funding a large portion of this war through the sale of energy to the European Union. 40% of Europe's natural gas is supplied by Russia. In retaliation for EU sanctions, Vladimir Putin has slowed the flow of natural gas to Europe. EU leaders are outraged. High energy prices are hurting the EU economy. Germans may not be able to heat their homes this winter. The EU is insisting that Russia continue to supply them with natural gas, at least until they can reduce their dependence on Russian energy, which will take years. Truth is indeed stranger than fiction. Our soon-to-be-famous idiom is this: "Europe is a nice place to visit, but I wouldn't want to invest there".

Lower inflation and a less hawkish Federal Reserve might eventually start to weaken the strong U.S. Dollar, which would be a positive for U.S. Investors investing internationally. The tailwind of strengthening foreign currencies may make us reconsider investing internationally but for now, we are happy staying at home. Yesterday, the U.S. Dollar reached a 2-decade high against the Euro. This is great news for Americans vacationing in Europe, but not so great for Americans that own European Stocks.





You will be the first to know about any changes to our travel plans. Unless there are major changes in the global landscape, our motto will likely remain, "there's no place like home".

The MMFS Team

Jon C Mommaerts, CFP®: Jon is a Principal of Mommaerts Mahaney Financial Services, Inc. He has over 30 years of experience working with professionals and those about to retire. He is a member of the Financial Planning Association, as well as a member of the Preferred Financial Advisors.

J. Matthew Tuccini, CFP®: Matt has over 17 years of experience working in the financial services industry with vast experience in retirement planning, tax strategies, and financial planning.

Robert Kea, CFA: Bob has over 30 years of experience in portfolio management. He was a founding member and Co-Head on Putnam's Asset Allocation Group, which managed $12Bn in both retail and institutional assets.

Jason Rolling, Financial Advisor: Jason has been in the financial services industry for the past 15 years. His financial experience includes retail banking, consumer & commercial lending, bank management at the local, regional and SVP level, wealth management, and financial planning.

FPA FINANCIAL PLANNING ASSOCIATION PROUD MEMBER

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