IMPACT OF TRADE WARS

While the phrase "trade war" is an unsettling topic these days, real-life trade disputes are relatively common. According to the World Trade Organization (WTO), the U.S. has already been involved in over 250 trade disputes year-to-date. Despite the rhetoric, the markets remain relatively indifferent despite pockets of heightened daily activity.

The potential changes to the current tariff structure could certainly have a negative impact on certain industries and relationships. But, much of the noise in the media is just that: noise. Actual trade negotiations take place in private discussion, and historically receive little publicity. The previously mentioned 250+ disputes already this year offer proof.

There are signs of a minor slowdown in global economic growth, but none that indicate recession. And even if certain tariffs are enacted, if their economic impact was too adverse they would most likely be quickly terminated.

It must also be noted that not all trade wars are negative. Europe and Japan just signed an agreement which will promote free trade, inevitably hurting other regions that are not included in the pact. Similarly, if the U.S. and China engage in an escalated trade war, it could benefit international companies that currently face high barriers to entry.

ECONOMIC CYCLE & GDP GROWTH

Historically, international economic cycles have lagged the U.S. by 1-3 years. However, it appears that these international economies are finally improving. Since 2015, Eurozone GDP has exceeded the United States. Foreign growth metrics are improving, and Eurozone leading economic indicators and sentiment are trending upward.

CREDIT CYCLES

A positive to investing in international equities is connected to the global credit cycle. Foreign central banks continue to take an accommodative stance by expanding the money supply to fuel their respective economies. Conversely, the U.S. is beginning to tighten on a relative basis. This should spur economic growth abroad.

A loosening of credit and monetary policies have historically been positive catalysts for economic growth in any economy, and both Japanese and European policymakers are continuing to utilize them.

RELATIVE VALUATIONS

Foreign equities continue to appear relatively cheaper than U.S. equities. Much of the U.S. outperformance over the past five years was related to multiple expansion, and the gap between U.S. and foreign equity valuations is now at its widest levels over the past decade. Looking at other metrics, U.S. valuation ratios are high across the board when compared to foreign markets. While no one can predict the future, the numbers seem to indicate there is an increasing probability that this gap will narrow in the coming years.

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Trent Capital Management

INVESTING INTERNATIONALLY

Experienced investors know the theoretical and real-life benefits of global diversification. The primary benefit is exposure to faster-growing economies and companies outside the U.S., which leads to a potentially better risk-adjusted return.

Many investors do not realize that the overall number of international companies dwarfs the amount of U.S. based companies. The World Bank estimates there are almost eight times as many non-U.S. stocks compared to U.S. stocks. Over the past decade, the number of U.S. companies listed on an exchange has decreased by 16%, while non-U.S. listings have remained almost flat. Additionally, the market capitalization of non-U.S. companies makes up almost half of the world's total investment universe, according to the MSCI ACWI index.

Based on the above, coupled with the fact that many investors tend to psychologically underweight international stocks, it is very plausible that foreign stocks are not as efficiently priced as U.S. stocks. This effect is commonly known as "domestic bias", which occurs when U.S. investors intentionally avoid foreign investments due to misconceptions or perceived risks that are either overblown or don't exist. There are unique risks to investing in foreign stocks (just as there is with domestic stocks), but they are often misunderstood.

U.S. and foreign markets tend to take turns "outperforming" each other, often without advance notice of when the shift will occur and how long it will last. Like many other things in life, markets move in cycles and valuations favor foreign markets (both developed and emerging) over domestic ones.