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The present-day case for investing in international markets

Mark Hackett, CFA, CMT
Chief of Investment Research,
Nationwide Investment Management Group

Key takeaways

- Several years of strong U.S. stock outperformance have tilted investor portfolio weightings toward U.S. equities, creating a need for increased diversification.
- U.S. stock markets are significantly overvalued relative to international markets, increasing the likelihood of drawdowns and volatility.
- Several potential tailwinds are emerging for international economies, creating a more favorable backdrop for international equities.
- Investors should not ignore emerging markets, which may enter a phase of renewed opportunity in the coming years.

Introduction

U.S. equities have enjoyed a prolonged period of market leadership with the S&P 500® Index outperforming the MSCI World ex USA® Index for approximately 14.3 years, as measured by five-year monthly rolling returns. This sustained trend has likely shaped investor sentiment and influenced portfolio construction, particularly with respect to global diversification.

Yet, markets are dynamic. As macroeconomic and geopolitical forces evolve, early signs suggest a potential shift in leadership may be underway. After nearly 12 consecutive years of annual outperformance, U.S. equities are beginning to cede ground. Year-to-date through Aug. 22, the MSCI World ex USA Index has outpaced the S&P 500 by roughly 12%, signaling a possible inflection point in relative performance.

Against this backdrop, investors may find it timely to revisit their allocations to international equities. This reassessment can help ensure portfolios remain aligned with their long-term objectives while also capturing the potential benefits of a more globally balanced investment approach.

"Valuation differentials and shifting macro signals suggest global equity positioning may warrant a closer look by investors."

The need for diversification

Since 2011, U.S. equities have consistently outperformed their global peers, with large-cap technology stocks contributing significantly to this trend. The emergence of the "Magnificent 7" has amplified this effect, particularly from 2022-2024 when these companies contributed to the lion's share of the S&P 500's total return. Even more concerning, perhaps, is the increased concentration risk for the S&P 500. As of mid-2025, the top 10 S&P 500 stocks represent approximately 40% of the Index's market capitalization, a level of concentration that should cause many investors to pause.

The extended run for U.S. stocks has led many investors to overweight domestic equities, either in pursuit of innovation-led growth or through portfolio drift. However, the case for global diversification remains compelling. Non-U.S. equities account for more than one-third of the MSCI ACWI® Index (All-Country World Index), yet the average U.S. investor allocates less than one-quarter of their equity holdings internationally. (See the charts below.)

Chart 1a: Just over one-third of the MSCI ACWI Index is allocated to international stocks outside the U.S.

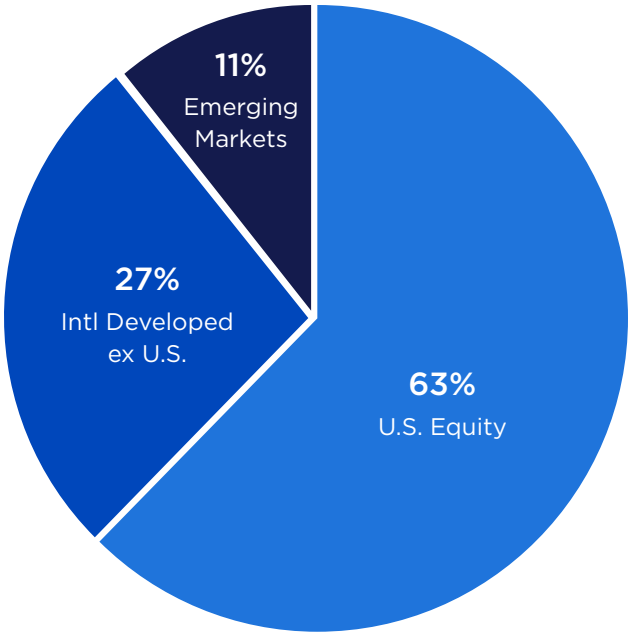
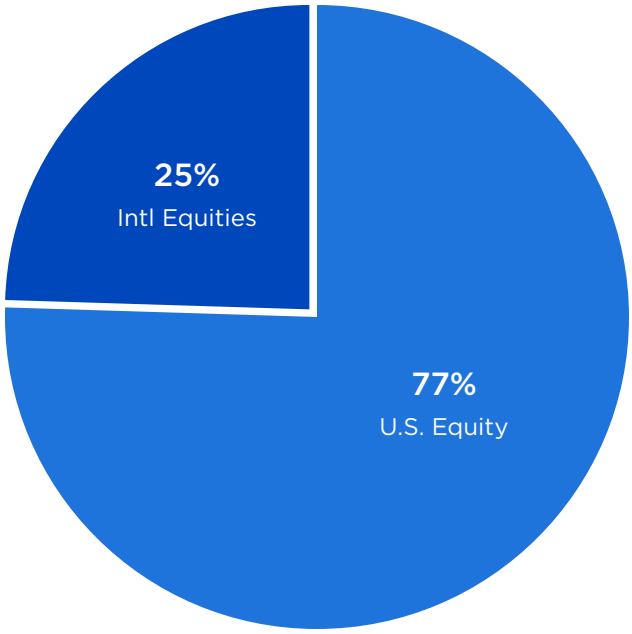


Chart 1b: The average investors allocated just one-quarter of their portfolio to international stocks



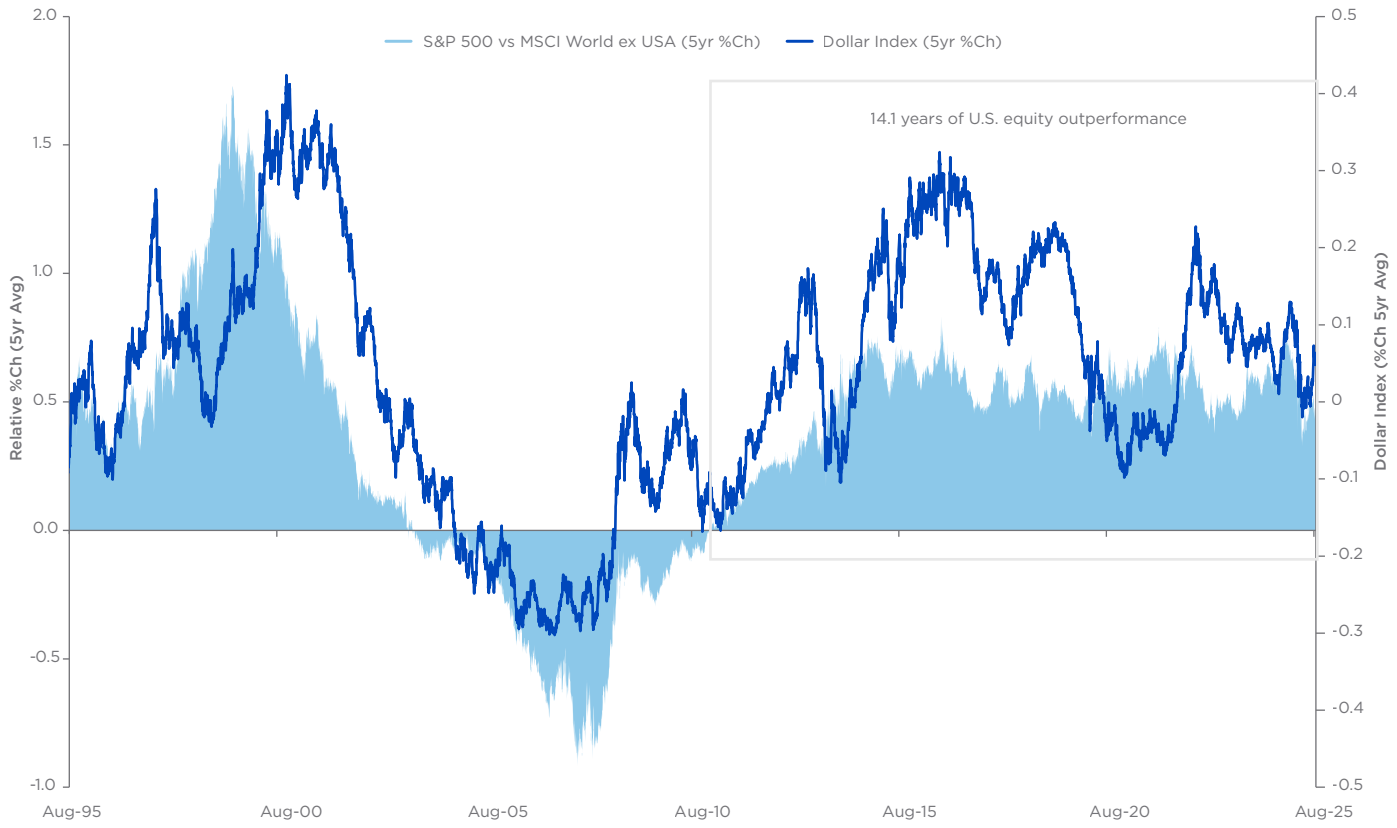
Source: As of 12/31/24. Data Sources: FactSet and Morningstar, 2/25. Ending values may differ from totals provided due to rounding.

In light of shifting market dynamics and valuation differentials, investors may benefit from reassessing their global equity exposure to ensure alignment with long-term objectives and risk tolerance.

While investors may easily assume that U.S. stocks are the perennial leaders in global equity markets, especially after a decade of exceptional returns, home bias may play a role in this tendency; U.S. companies are familiar names to U.S. investors and also get a lot of attention in the U.S. financial media. But history tells a more nuanced story: U.S. stocks have led global equity markets in the past, but market leadership is cyclical by nature.

For example, following the strong bull market for U.S. stocks in the 1990s, market leadership rotated toward non-U.S. stocks starting in 2001. Over the next decade, international stocks, as represented by the MSCI ACWI ex USA® Index, delivered a cumulative return of over 71%, compared to the modest 15% cumulative gain for the S&P 500 over the same period.

Chart 2: Relative outperformance of U.S. vs. international stocks has been cyclical



Source: Bloomberg. As of Aug. 18, 2025. **Past performance does not guarantee future results.**

While a concentration in U.S. stocks has helped elevate portfolio values and participation in tech-driven gains, it also increases the risk of losses when this leadership changes, which is a natural occurrence in cyclical markets. The cycle may be about to turn after more than 14 years of U.S. stock outperformance, a cycle that has historically averaged around eight years.[1] A well-diversified portfolio as the foundation of a disciplined investment strategy is an effective way for investors to manage this concentration risk.

The valuation gap

At the midpoint of 2025, U.S. equity valuations (as measured by the forward price/earnings ratio of the S&P 500) hovered near their historic highs at 22.2x, compared to the late-2024 peak of 22.6x. For some perspective, this value is in the 94th percentile approximately over the last 30 years of the S&P 500. Valuations for non-U.S. stocks, on the other hand, are more reasonable at 15x forward earnings for the MSCI ACWI, as of August 2025.[2]

[1]FactSet, National Bureau of Economic Research.

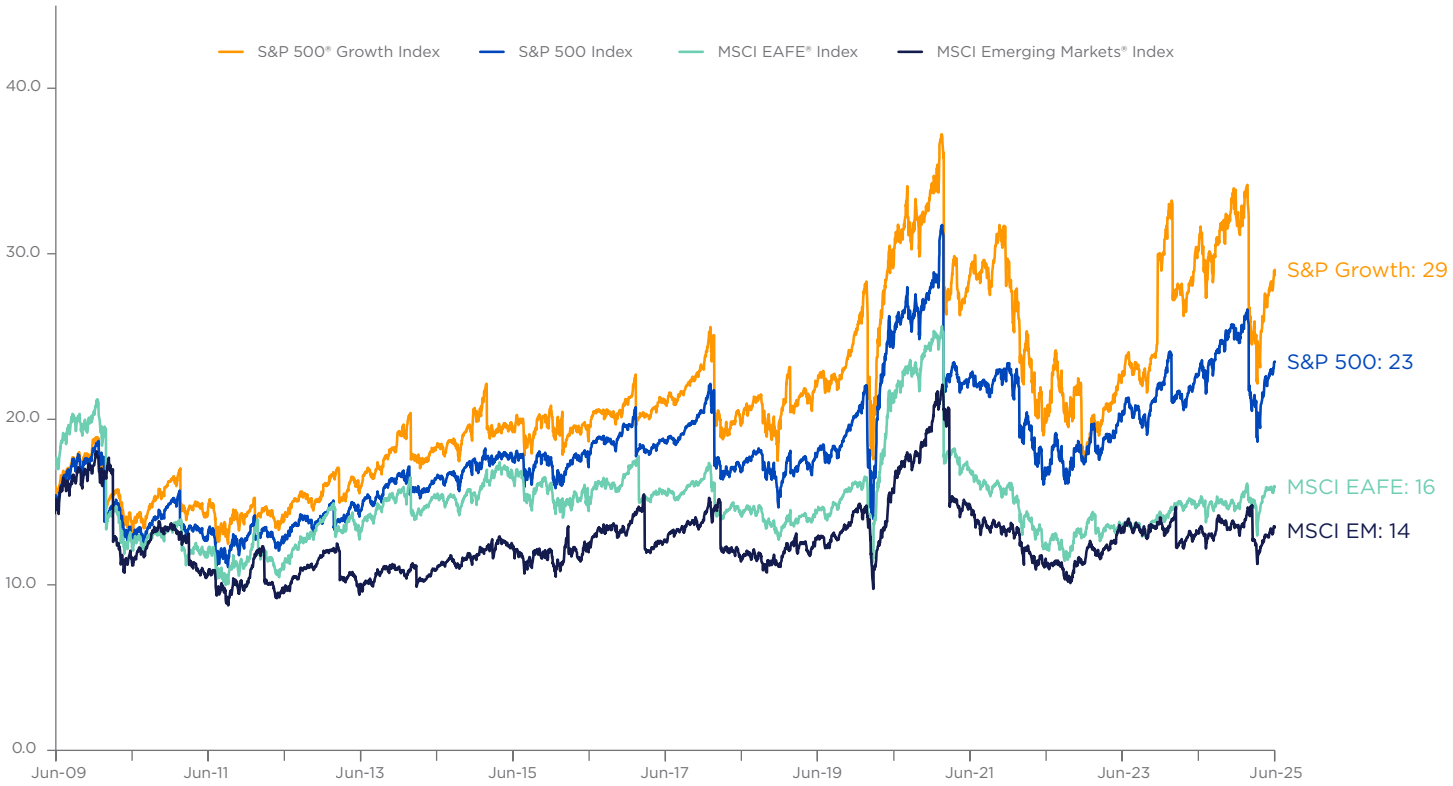
[2]FactSet.

This gap in valuations may offer a potential hedge against U.S. stock market volatility, providing diversification benefits and downside protection in the current uncertain market environment.

A closer look at regional global markets underscores the potential of the valuation gap. For instance, European stocks offer a significant valuation discount relative to U.S. equities, as measured by the forward P/E of the MSCI Europe® and the MSCI USA® Indexes. This has come even after the outperformance of European equities in the first half of 2025. (See the chart below.)

For investors wary of overextended valuations for U.S. stocks, this discount may offer stronger long-term return potential as the valuation gap gradually closes.

Chart 3: Price/earnings ratios (12-month forward)



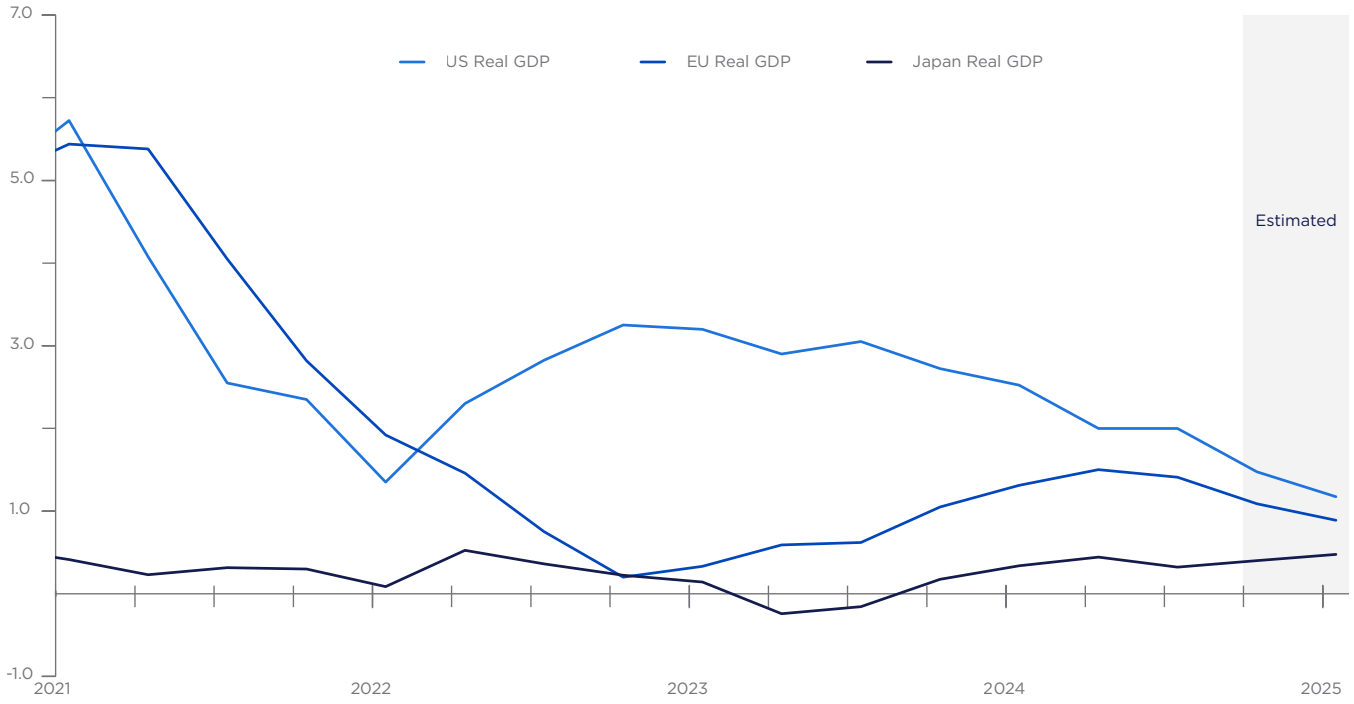
Source: Bloomberg as of June 30, 2025.

Economic tailwinds

Despite a downward revision in the global growth outlook for 2025, recession risks remain low across major economies, including the United States and China. Against this backdrop, several potential tailwinds are emerging for international markets.

These include increased infrastructure investment, pro-growth fiscal reforms across Europe, rate cuts for non-U.S. central banks and a decisive shift away from austerity in Germany.

Chart 4: Real GDP growth four-quarter averages



Source: Factset as of 8/31/25. Actual through 2Q25, estimated through 1Q26.

As international governments scale up stimulus efforts, particularly in areas like national defense and infrastructure, that should help counterbalance ongoing political and geopolitical uncertainties. Together, these forces represent a constructive convergence of macroeconomic and policy tailwinds, creating a more favorable backdrop for international equities at a time when global economic uncertainty remains elevated.

The emerging-market opportunity

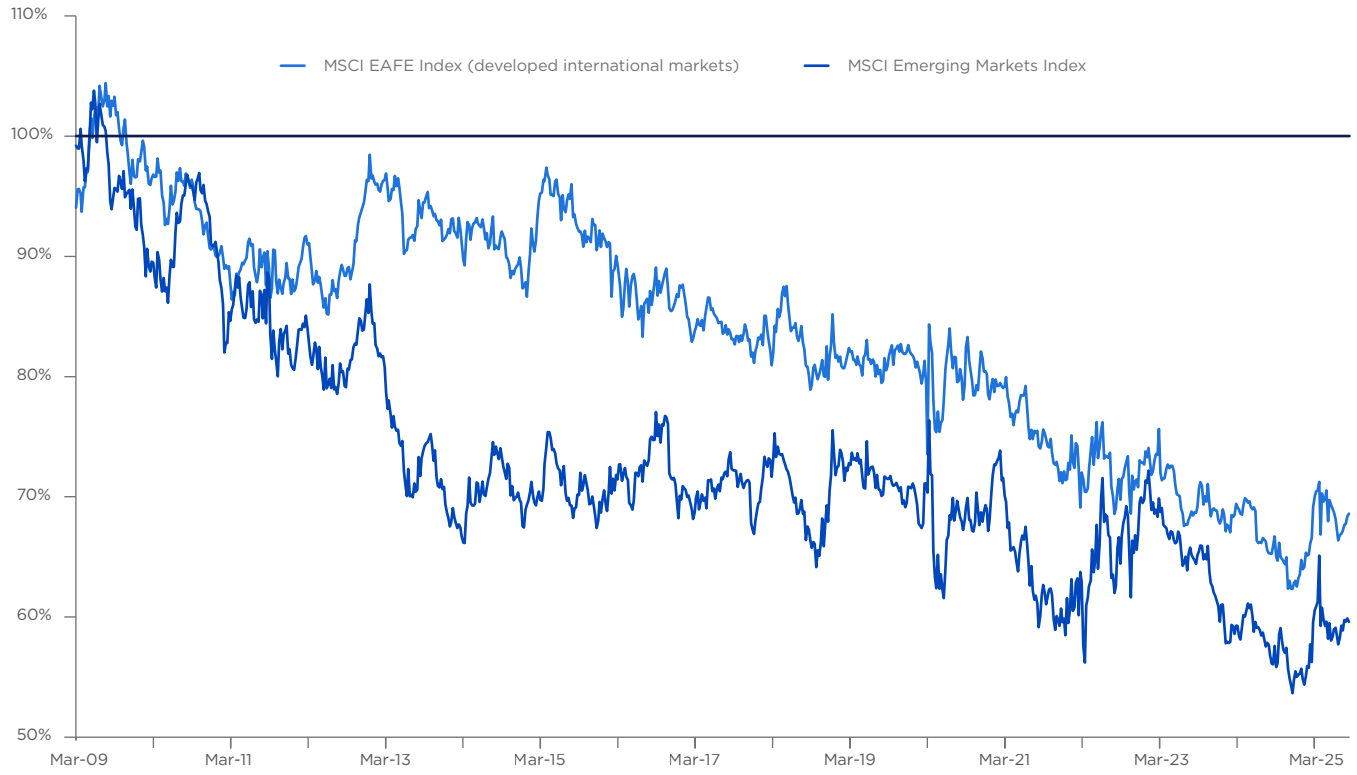
Just as developed international markets performed well in the first half of 2025, so too have emerging markets (EMs), outperforming U.S. indexes through the first six months of the year (as measured by the MSCI Emerging Markets® Index). While economic headwinds related to China present investment challenges, a confluence of constructive tailwinds is reshaping the broader emerging-market landscape.

The strategic reconfiguration of global supply chains, driven by major economies seeking resilience and diversification, combined with increasingly supportive fiscal frameworks and a gradual stabilization of political conditions in key EM regions, is laying the groundwork for sustained economic momentum. These dynamics suggest that, despite pockets of uncertainty, emerging markets may enter a phase of renewed opportunity in the coming years.

Present-day conditions in the global economic climate may also support the emerging-markets opportunity. The weakness seen in the U.S. dollar in 2025 helps lower a long-standing obstacle, which may unlock greater capital flows into EM assets. At the same time, improving credit conditions in China, enhanced monetary policy flexibility across key economies and a broader shift toward pro-growth fiscal strategies from EM governments are also reinforcing the investment case.

In addition, valuations remain compelling; as of Aug. 15, the MSCI Emerging Markets Index was at 13x forward earnings, near its 25-year average, offering investors both value and growth potential. Moreover, earnings growth for the EM Index is projected to accelerate to 14% in 2025, up from 10% in 2024, underscoring the possibility of improving fundamentals that could drive EM equity performance in the months ahead.

Chart 5: Relative P/E (next 12 months) of the emerging and development markets



Source: Factset as of 08/25/2025.

In navigating volatile markets, investors are best served by maintaining a disciplined focus on global diversification rather than reacting to transient headlines. Consider 2018, when the imposition of tariffs on China during President Trump's first term ignited a trade war that unsettled markets and dominated the global news cycle, echoing the trade tensions seen today. Amid rising concerns over a synchronized global slowdown and persistent inflationary pressures, the S&P 500 declined 5% for the year. Yet, as negotiations advanced and consumer demand proved resilient, sentiment shifted markedly. U.S. equities staged a powerful recovery in 2019, with the S&P 500 surging 30% by year-end, underscoring the market's capacity to rebound in the face of geopolitical uncertainty. Emerging markets followed a similar trajectory, falling 15% in 2018 before rebounding 18% the following year.

Conclusion

As investors move past peak uncertainty and tariff-related headwinds, global opportunities are coming into sharper focus. While U.S. equities remain supported by innovation and AI-driven growth, elevated valuations and rising concentration risk suggest it's time to reassess geographic exposure.

International markets are showing signs of recovery. Europe is gaining cyclical momentum, China's tech sector is rebounding, and a softer dollar is supporting non-U.S. assets. These shifts mark a departure from the past decade, when diversification was often advised but rarely rewarded.

In today's environment of stretched valuations and evolving macro conditions, international equities offer a differentiated risk-reward profile. While geopolitical, currency, and liquidity risks remain, active management can help navigate these complexities. A globally diversified portfolio—thoughtfully constructed—may offer greater resilience and a more balanced path forward.

About the author: Mark Hackett

Mark Hackett serves as Chief of Investment Research. As a leader for Nationwide's capital markets analysis, Mark develops content to educate financial advisors and their clients on financial markets and implications for investors. In this role, he is responsible for asset class research, market commentary, white papers and topical market pieces. He has been featured in numerous financial publications and webinars.

Mark brings more than 20 years of experience in the asset management industry, including roles in research for both Nuveen and Vanguard Group and as a portfolio manager for Nuveen. He began his investment career at the Vanguard Group as a research associate in the fixed income group.

Mark has been interviewed by and quoted in numerous media outlets, including The Wall Street Journal, CNBC.com, CNN Money, The Associated Press Money and several others. He also contributes weekly market commentary to the Nationwide® Advisor Advocate Blog.

He earned his Bachelor of Science in Business Administration with concentrations in Finance and Economics at the University of Richmond, holds Chartered Financial Analyst (CFA) and Chartered Market Technician (CMT) designations and is a member of the CFA Institute.

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