International Stocks – Should They Stay or Should They Go?

By Frank Garcia

After another tough year for international stocks, we're reminded of the popular Clash song from 1981 (Should I Stay or Should I Go). In 2019, investors may question the inclusion of international stocks in their investment portfolios.

Over the past 8 years (2011-2018), the S&P 500 has outperformed a globally diversified portfolio by an annualized return of 3.69%. Given the outperformance of domestic stocks during this recent timeframe, does it still make sense to have an allocation to international stocks? Should they stay in your portfolio, or should they go?

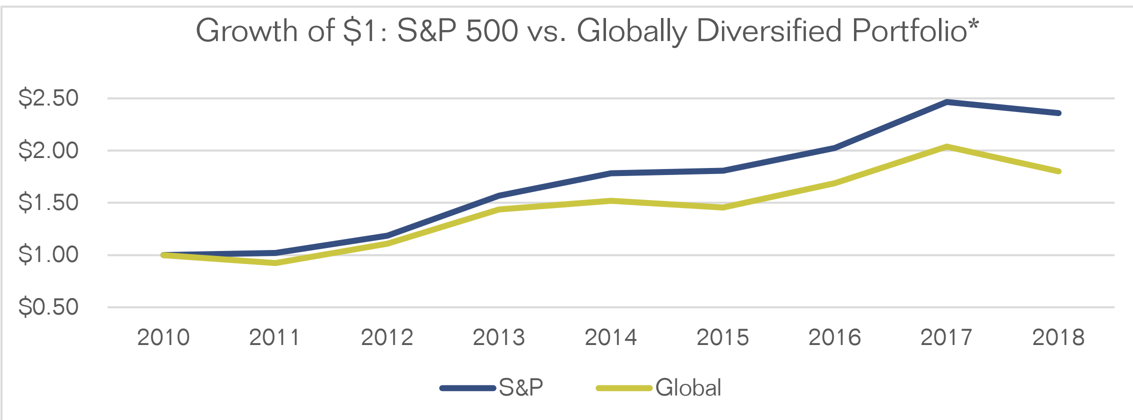

Chart 1

Part of the answer lies in the phrase, "recent timeframe." Those who are currently advocating the abandonment of international stocks may be suffering from recency bias. Recency bias is a behavioral finance phenomenon that convinces us that recent information is more valuable and more important than older information. Allowing recency bias to influence investment decisions can have damaging effects on portfolios designed to meet your long-term goals.

People tend to forget that between 2000 and 2007, a globally diversified portfolio outperformed the S&P 500 by an annualized rate of 8.03% per year. The S&P 500 had an annualized return of 1.66% per year (less than inflation) and a global portfolio had an annualized return of 9.69% per year. This period is commonly referred to as the "lost decade" for US stocks.

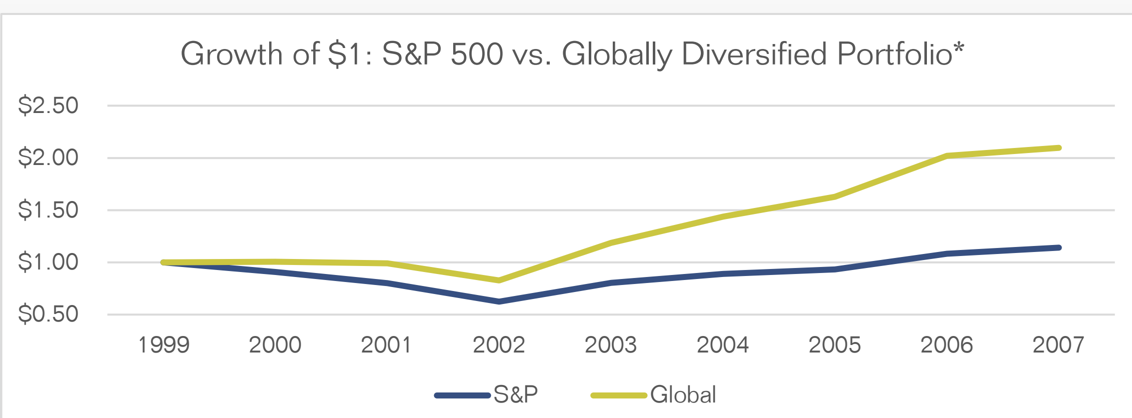

Chart 2

Surprisingly, the 8-year period prior to the lost decade for US stocks was eerily similar to the most recent 8 years. Between 1992 and 1999, the S&P 500 outperformed a global portfolio by an annualized return of 3.51%.

While no one can predict returns, there is a meaningful amount of academic data indicating current valuations are a good predictor of future returns. International stocks currently have one of the largest valuation "discounts" versus US stocks in decades. The last time valuation discounts were this large was ... you guessed it … the late 1990s.

We have no crystal ball to tell us what the next 8 or 9 years will look like. What we can say with certainty is that, since 1970, a globally diversified portfolio has outperformed the S&P 500.

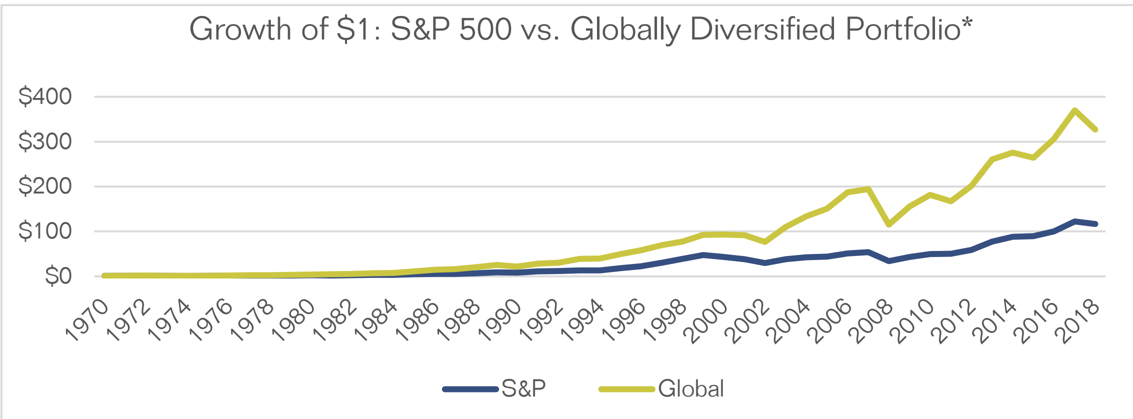

Chart 3

This data provides evidence that a globally diversified portfolio provides the highest probability of helping investors meet their long-term goals and reinforces our philosophy that international stocks should definitely **stay** in your portfolio.

* Source: Dimensional Fund Advisors, Inc. (DFA). US Large: Standard & Poor's 500®. US Large Value: Fama-French Large Value Research Index. US Small: Fama-French Small Cap Index. US Small Value: Fama -French Small Value Research Index. REITs: Wilshire US REIT Index. International Large: MSCI EAFE (net) Index. International Large Value: EAFE Value Index (net). International Small: DFA International Small Cap Index. International Small Value: DFA DFA International Small Cap Value Index from 1982-2018. Emerging Markets: Fama-French Emerging Markets from 1989-1999 and MSCI Emerging Markets Index (net) from 1999 -2018.

The Globally Diversified Portfolio is a hypothetical portfolio assuming 20% US Large, 20% US Large Value, 10% US Small, 10% US Small Value, 7% International Large, 10% International Large Value, 5% International Small, 5% International Small Value, 8% Emerging Markets and 5% REITs. This portfolio is presented for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Index performance does not reflect the expenses associated with the management of an actual portfolio.
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