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6 Lessons Netflix Can Teach Us About International Investing

Diversification is vital, yet the average investor may be too heavily invested in US equities.

Remember when Netflix infuriated customers by trying to phase out mail-in DVDs in 2011? In the decade since, Netflix evolved into a digital entertainment powerhouse. After hooking us on bingewatching, Netflix realized it was unsustainable to rely solely on content from other providers, so they began diversifying and creating their own content, too.

Know what else stands out about 2011? That was the last time international equities outperformed US equities, which, like Netflix, have dominated for the last decade.[1] However, it may be unsustainable for investors to rely solely on continued US dominance, which may face challenges going forward—especially while international equities have become an increasingly attractive opportunity. But like DVD loyalists, it may take a little convincing to make the change.

Since Netflix was able to change how we view TV, we thought they could teach us a thing or two about shifting our investment mindsets, too. We think the following six lessons, paired with original Netflix hits, explain why it's time to consider increasing your portfolio's international allocation.

Key Points

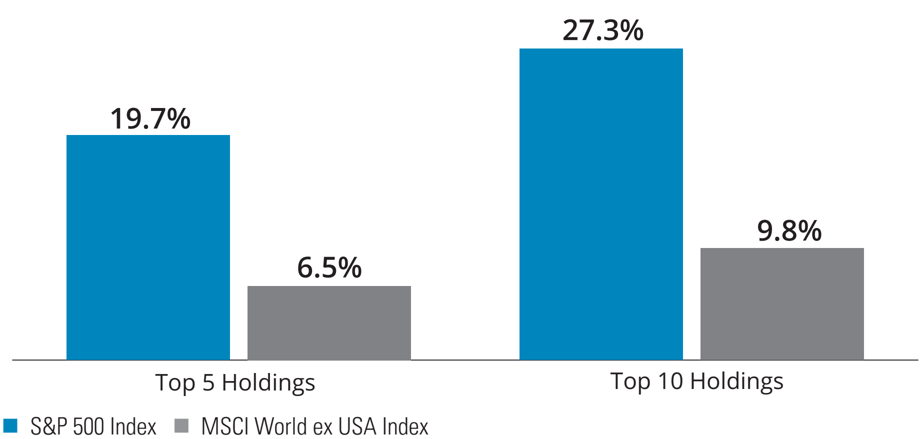
- Ongoing US dominance may be unsustainable after a decade of strong performance that has led to high concentration and expensive valuations.
- International stocks comprise a larger opportunity set than US equities and may have better growth prospects, too.
- Many investors are significantly underweight international equities and should consider increasing their allocation.

Lesson #1: Concentration Can Only Carry You So Far

The first season of the thriller "Bloodline" won over fans and even earned Emmy nominations, but the subsequent seasons failed to live up to the hype. As entertainment-guide Rotten Tomatoes summed it up: the "final season offers disappointing proof that a stellar cast can only carry a series for so long."

For investors, a stellar cast of just five companies—Facebook, Apple, Microsoft, Amazon, and Google/Alphabet—has been driving an outsized portion of US outperformance. How much longer can these stars carry the plot? International equities, on the other hand, are much less concentrated.

International Equities Are Less Concentrated Than US Equities
US vs. International Index Concentration



As of 12/31/20. For illustrative purposes only. Indices are unmanaged and not available for direct investment. See page 8 for index definitions. Sources: FactSet and Hartford Funds, 3/21

Lesson #2: Be Ready for Change

"Orange Is the New Black" not only centered on the lead character adapting from a comfortable upper-middle class lifestyle to life in prison, but was also widely acclaimed for shifting viewer perceptions by humanizing prisoners and covering serious topics such as race and inequality in engaging ways.

It may be time for investors to shift their perceptions, too. Growth-centric companies (think Lesson #1) were thriving pre-pandemic, when the global economy was slowing.

But cyclical sectors, which have historically driven growth during economic recoveries, may stand to benefit as demand ramps back up and the global economy accelerates. International indices tend to be more heavily weighted to cyclical sectors than the US.

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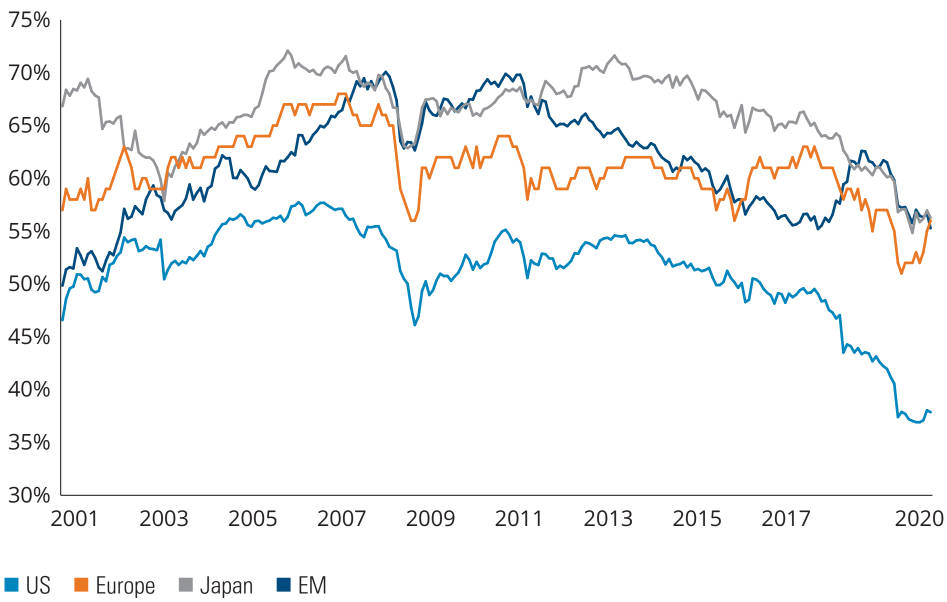
International Equities May Be Poised to Outperform in a Cyclical Recovery

Cyclical sector exposure



As of 12/31/20. Cyclical includes energy, industrials, materials, financials, real estate, and consumer discretionary sectors. Regions are represented by the following indices: US (MSCI USA), Europe (MSCI Europe), Japan (MSCI Japan), Emerging Markets (MSCI Emerging Markets), For illustrative purposes only. Sources: Datastream, Refinitiv, and Schroders, 1/21.

Lesson #3: Know Your Worth

Netflix regularly increases their subscription price without losing viewers because they know (and deliver) what people want. For example, shows such as "The Crown" feed both our curiosity about the British royal family as well as our collective obsession with celebrity lifestyles.

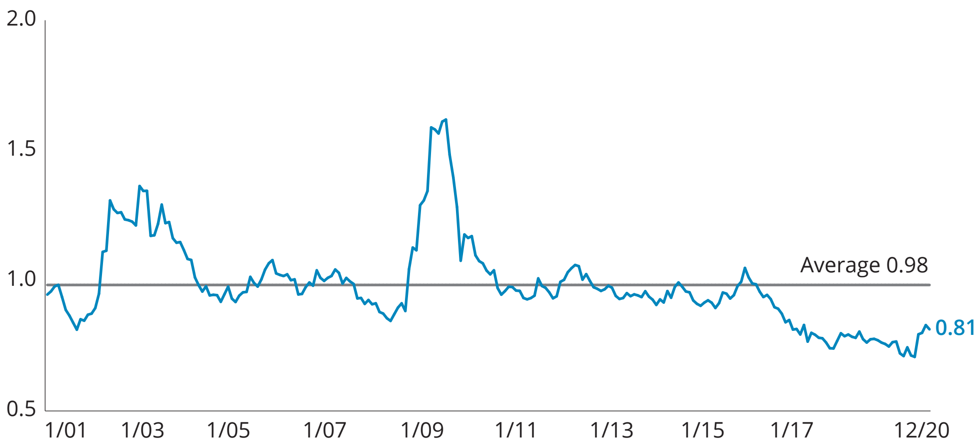
But are investors getting their money's worth at home? US equity prices may be fit for royalty, which could make it more difficult for companies to continue replicating the sky-high growth they've notched in recent years.

On the other hand, international stock valuations are below their historical average, which suggests there may be greater room to run—and that they may be at a good entry point for long-term investors.

Many portfolios could be overweight US equities, potentially subjecting investors to higher risk than intended.

International Equity Valuations May Be More Attractive Than US Valuations

International equity trailing 12-month price/earnings ratio relative to US equity



Past performance does not guarantee future results. Investors cannot directly invest in an index. As of 12/31/20. International Equity is represented by the MSCI ACWI ex USA Index; US Equity is represented by the S&P 500 Index. For illustrative purposes only. Price/earnings ratio is the ratio of a stock's price to its earnings per share. Data sources: FactSet and Hartford Funds, 3/21.

Lesson #4: Think Ahead

Netflix even influences which topics are cool; this now includes chess thanks to "The Queen's Gambit." Even those who have never played chess were intrigued by how professional chess players can win by visualizing the game several moves ahead.

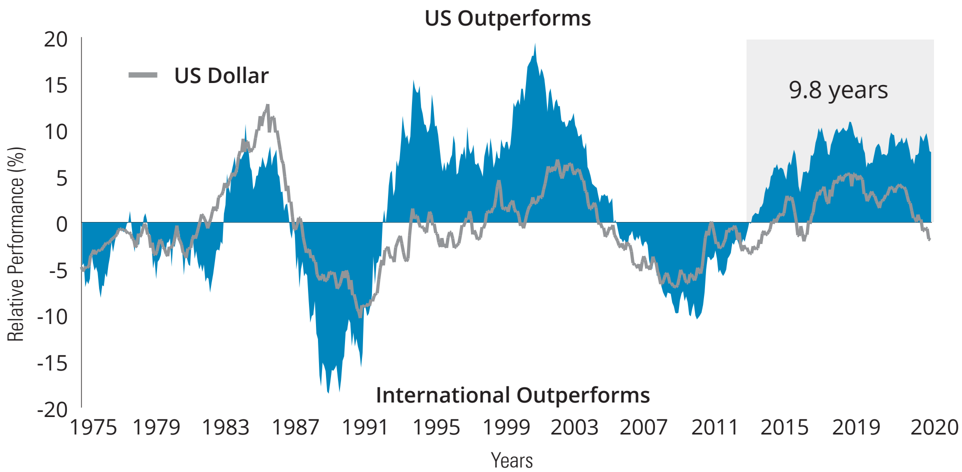
It's impossible to time the market, but sometimes there are hints at what's coming. A weakening US dollar may be a clue: A declining dollar can favor international equities and has tended to correlate with international outperformance.

Additionally, chess moves often involve calculated risks: sacrificing pieces for a subsequent advantage. The US outperformance cycle has lasted well beyond the average of 7.7 years; this has likely resulted in many investors having concentrated allocations to US equities.

For example, without rebalancing, a 70% US equity/30% international equity allocation at the start of 2010 would have shifted closer to 84% US/16% international as of 12/31/20.[2] That may leave many portfolios subject to much more risk relative to the potential reward.

US Equity Outperformance Has Lasted Well Beyond the Average 7.7 Year Cycle

US equity vs. international equity 5-year monthly rolling returns



Past performance does not guarantee future results. Investors cannot directly invest in an index. US Equity is represented by S&P 500 Index. International Equity is represented by MSCI World ex USA Index. The chart shows the values of the S&P 500 Index's returns minus the MSCI World ex USA Index's returns. When the line is above 0, domestic stocks outperformed international stocks. When it is below 0, international stocks outperformed domestic stocks. For illustrative purposes only. Sources: Morningstar, Bloomberg, and Hartford Funds, 1/21.

The US has outperformed overall over the last decade, but not on an individual company basis.

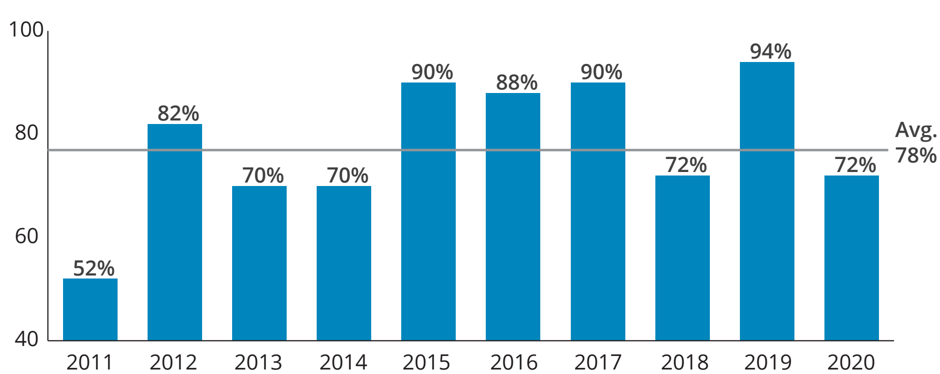
Lesson #5: Look Beneath the Surface

Netflix has also expanded into reality game shows such as "The Circle." Contestants in isolation communicate solely via social media, trying to win everyone over as themselves—or by making up a persona they think others will like. In other words, appearances aren't always what they seem.

Though the US has outperformed overall for the last decade, this dominance isn't entirely what it seems, either. On closer examination, many of the top-performing businesses in the world are international companies—and have been for years.

Even Today, the US Isn't Necessarily the Best

Percentage of world's top 50 stocks that are non-US



Past performance does not guarantee future results. Investors cannot directly invest in an index. As of 12/31/20. Based on the annual calendar year returns of the 50 highest-performing stocks of the MSCI ACWI Index. For illustrative purposes only. Source: FactSet, 1/21.

Lesson #6: Go Beyond US Borders

In 2020, Netflix's subscriber base surpassed 200 million for the first time, with nearly two-thirds of its customers outside the US and Canada. This international growth has been bolstered by producing regional, non-English shows. To date, the French-language heist series, "Lupin," has been one of their most successful shows ever in multiple countries, including the US.

The lesson here is that there's a lot of world—and a lot of opportunity—outside the US. In fact, there are 4x more publicly traded international equities than US equities.

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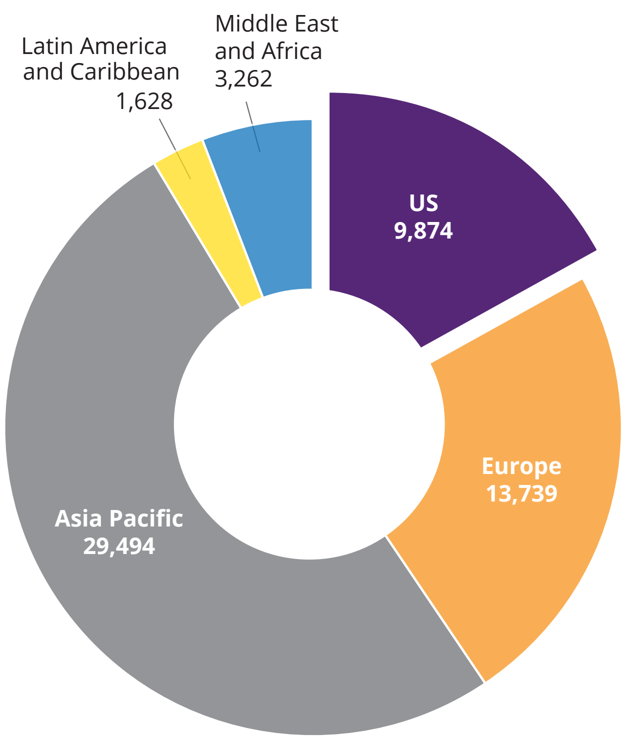
While many companies in the US are growing via mergers and acquisitions, new international companies may be taking root as they seek to meet changing demographic demands or solve for new societal challenges.

Additionally, it's predicted that nine out of 10 of the next *billion* consumers will come from Asia,[3] where a vast group of newly middle-class consumers is ready to flex its purchasing power. The region already accounts for 51% of the world's publicly traded companies as of 12/31/20. This projected growth presents an enormous opportunity, particularly for professional active managers with the resources to research foreign companies and markets.

Asia and Europe Account for Higher Shares of Public Companies Than the US
Number of publicly listed companies per exchange



As of 12/31/20. Source: Bloomberg, 3/21

Putting It All Together

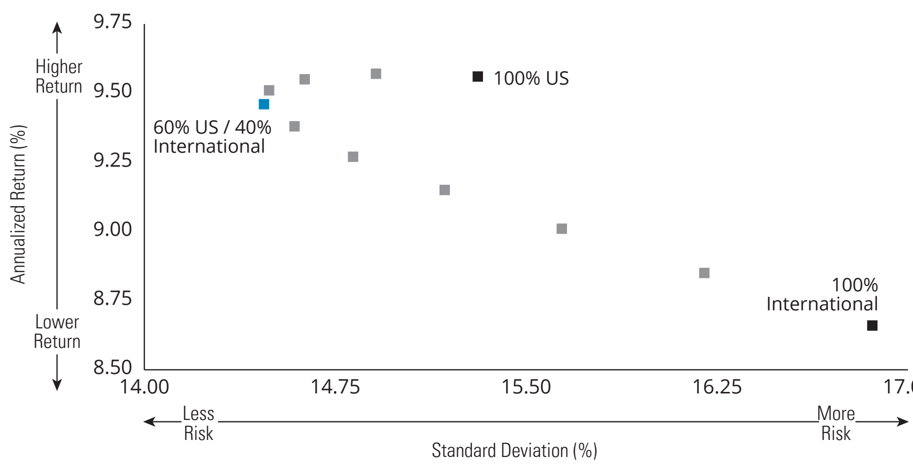
In short, while a heavy US equity allocation has benefited investors over the past decade, it may not continue doing so going forward. But outperformance is relative, not a zero-sum game, which is why being properly diversified—the overall lesson Netflix has taught us—can be so critical.

So what level of international diversification might make the most sense for long-term investors? To find the optimal balance between risk and reward, i.e., the "efficient frontier," we reviewed US and international equity combinations from 100% US/0% international to 0% US/100% international over the last 50 years.

Investors would have earned the most balanced risk/return by maintaining a 60-70% US/30-40% international allocation, despite periods of international underperformance. Yet a typical US investor has only 15% international exposure, which means investors could miss out if the cycle turns.[4]

International Stocks Enhance Long-Term Risk/Reward Outcomes

Finding the optimal risk/reward balance between international and US equities



Past performance does not guarantee future results. Investors cannot directly invest in an index. As of 1/1/70-12/31/20. US is represented by the MSCI USA Index; International is represented by the MSCI EAFE Index. Allocations annually rebalanced. For illustrative purposes only. Risk is represented by standard deviation, a measure of how much an investment's returns can vary from its average return. It is a measure of volatility and, in turn, risk. Sources: Hartford Funds and Morningstar, 3/21.

Though it seemed absurd for Netflix to phase out DVDs a decade ago, we certainly don't miss mailing those red envelopes back. It's a great reminder that what meets our needs—whether entertainment or investing—shifts over time. And by realizing a shift was on the way, Netflix has more than proven the benefits of adapting proactively.

Today, like the shift from DVDs to digital streaming, we think we're on the cusp of an equity-market regime change. Unfortunately, many portfolios may be too US-focused to take advantage of it. As international equities look increasingly attractive, investors still have time to potentially capitalize on this shift by improving diversification with a more risk-balanced allocation to international equities.

Hartford Funds 4- and 5-Star Overall-Rated Global and International Equity Funds*

	Morningstar Category	Overall Rating	# of Funds	3-Year Rating	# of Funds	5-Year Rating	# of Funds	10-Year Rating	# of Funds
Hartford Schroders International Multi-Cap Value Fund (SIDNX)	Foreign Large Value	★★★★	317	★★★	317	★★★	269	★★★★	180
Hartford International Opportunities Fund (IHOIX)	Foreign Large Blend	★★★★	691	★★★★	691	★★★★	591	★★★★	397
Hartford Schroders International Stock Fund (SCIEX)	Foreign Large Blend	★★★★★	691	★★★★★	691	★★★★★	591	★★★★★	397
Hartford International Value Fund (HILIX)	Foreign Large Value	★★★★	317	★★	317	★★★	269	★★★★★	180
Hartford Multifactor Diversified International ETF (RODE)	Foreign Large Value	★★★★	317	★★★★	317				

Past performance does not guarantee future results. Ratings based on Class I shares and ETFs. Ratings of other share classes may differ. As of 9/30/21. Source: Morningstar, 10/21. * For a full list of Hartford Funds, please visit hartfordfunds.com.

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Talk to your financial professional about finding the right balance of US and international equity exposure for your portfolio.

[1] Based on monthly returns, the MSCI World ex USA Index last outperformed the S&P 500 Index in February 2011. Data sources: Morningstar and Bloomberg, 5/21. **Past performance does not guarantee future results.** Investors cannot directly invest in an index.

[2] Morningstar as of 12/31/20

[3] Brookings Institute, "A Global Tipping Point: Half the World Is Now Middle Class or Wealthier," 9/27/18

[4] Morningstar as of 3/31/21

MSCI ACWI Index is a free float-adjusted market capitalization index that measures equity market performance in the global developed and emerging markets, consisting of developed and emerging market country indices.

MSCI ACWI ex USA Index is a broad-based, unmanaged, market capitalization weighted, total return index that measures the performance of both developed and emerging stock markets, excluding the US.

MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted capitalization index that is designed to measure developed market equity performance, and excludes the US and Canada.

MSCI Emerging Markets Index is a free float-adjusted market capitalization-weighted index that is designed to measure equity market performance in the global emerging markets.

MSCI Europe Index captures large and mid cap representation across 15 Developed Markets (DM) countries in Europe.

MSCI Japan Index is designed to measure the performance of the large and mid cap segments of the Japanese market.

MSCI USA Index is a free float-adjusted market capitalization index that is designed to measure the performance of the large and mid cap segments of the US market.

MSCI World ex USA is a free float-adjusted market capitalization index that captures large- and mid-cap representation across developed markets countries, excluding the US.

S&P 500 Index is a market capitalization-weighted price index composed of 500 widely held common stocks.

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Investors should carefully consider a fund's investment objectives, risks, charges and expenses. This and other important information is contained in a fund's full prospectus and summary prospectus, which can be obtained by visiting hartfordfunds.com. Please read it carefully before investing.

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