A Whole New World? Why International Stocks May Finally Shine

Higher interest rates and inflation may favor international investing going forward.

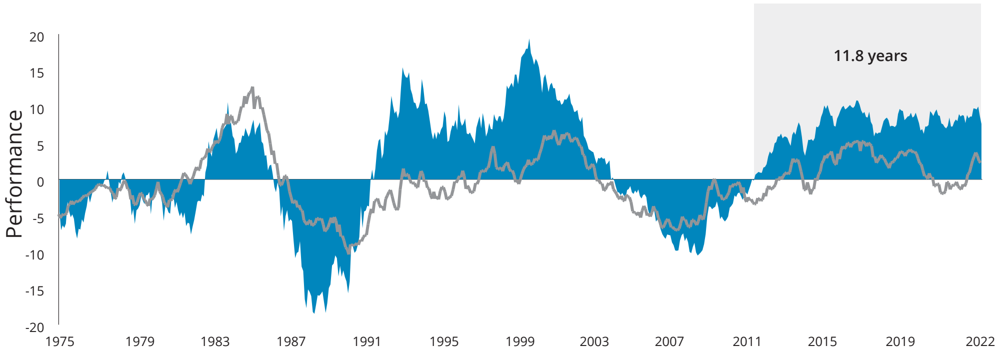
If it ain't broke, don't fix it, right? Since US stocks were crushing it for more than a decade, it seemed pointless to look anywhere else for return. But some of the advantages for US stocks may have shifted course, making now a good time to consider a more diversified approach going forward.

For years, interest rates and inflation were low, which favored growth stocks. Strong demand for smarter devices and online services also helped drive impressive outperformance for the tech-heavy US stock market—and for much longer than usual (**FIGURE 1**).

Then 2022 happened. Inflation hit multi-decade highs, and the Federal Reserve (Fed) raised US interest rates aggressively in response. This led to a rough year for markets, but it may have also hit the reset button on the investing world as we've known it. For the first time in many years, value stocks outperformed growth stocks, and international stocks outperformed US stocks.

Can this reset last? We think it could. For starters, inflation can be difficult to fight. While it has shown signs of slowing, it's still higher than desired and may take some time to control. Because of this, the Fed is expected to keep rates elevated for the near future as it tries to tame inflation.

FIGURE 1
US and International Stocks Have Traded Periods of Outperformance
US Equity vs. International Equity 5-Year Monthly Rolling Returns (%)



US Dollar Currency Index

As of 12/31/22. **Past performance does not guarantee future results.** The chart shows 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 the line is below 0, international stocks outperformed domestic stocks. The performance shown above is index performance and is not representative of any Hartford Fund's performance. Indices are unmanaged and not available for direct investment. Please see representative index definitions on page 4. For illustrative purposes only. Data Sources: Morningstar, Bloomberg, and Hartford Funds, 1/23.

Insight from Hartford Funds

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Key Points

- Low interest rates and low inflation favored growth stocks until 2022. This helped the tech-heavy US market outperform for an unusually long time.
- International markets may be poised to perform well going forward since inflation and interest rates are expected to remain elevated.
- Most investors are significantly underweight international equities and could benefit from evaluating their portfolio's domestic and international mix.

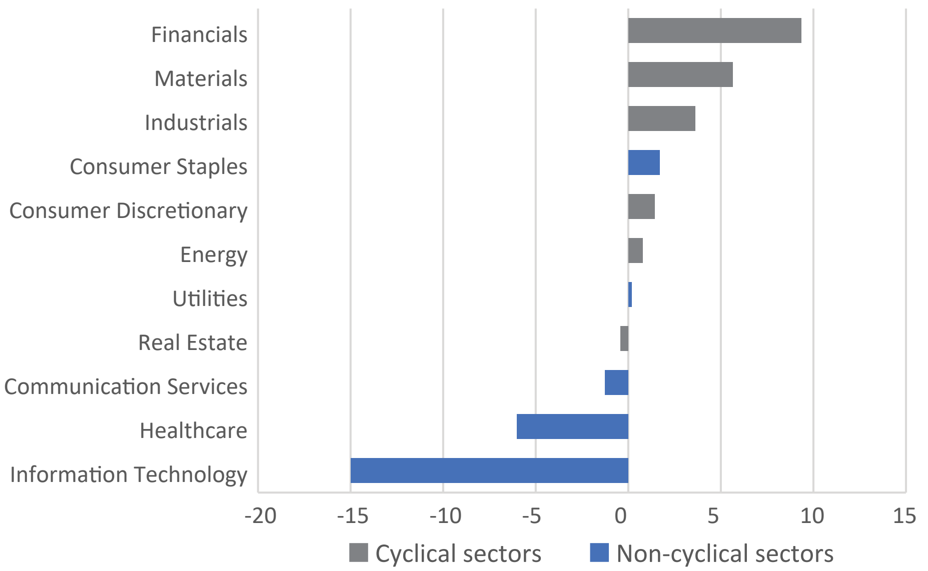
How could that help international stocks? International markets have a noticeably different composition than the US, with greater exposure to cyclically oriented sectors. The international market, as represented by the MSCI ACWI ex USA Index, favors value-oriented cyclical sectors such as financials, materials, industrials, and energy, which historically have been able to help offset inflation. If higher inflation and interest rates are the "new normal" going forward, this value tilt could put international markets in a beneficial spot.

> In the "new normal" of higher inflation and interest rates, a value tilt could benefit international stocks.

FIGURE 2

International Markets Have More Value Exposure Than the US

International Sector Weights Minus US Sector Weights (%)



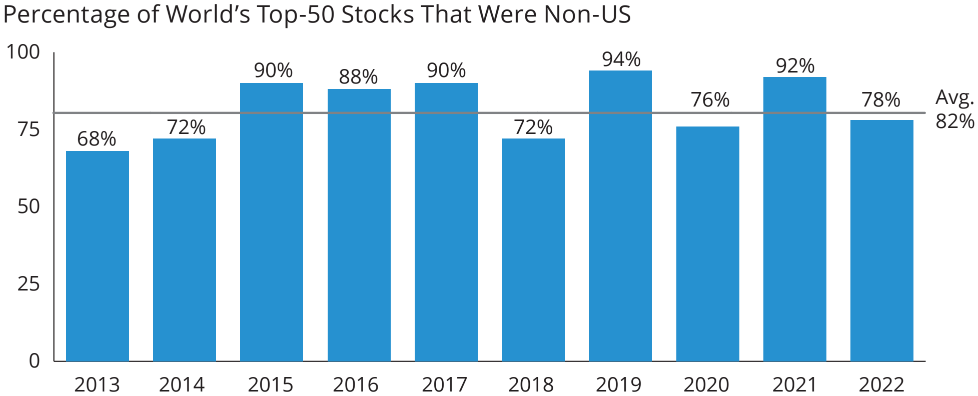
As of 12/31/22. International represented by the MSCI ACWI ex USA Index. US represented by the S&P 500 Index. Sources: FactSet and Hartford Funds.

And even though US stocks have outperformed for years, it doesn't mean international stocks weren't performing at all. As a group, international stocks were overshadowed by US stocks for the last decade. But on an individual basis, a significant majority of the best-performing companies in the world were already based outside the US during that same time frame (**FIGURE 3**).

FIGURE 3

The US Isn't Always Best

Percentage of World's Top-50 Stocks That Were Non-US



As of 12/31/22. **Past performance does not guarantee future results.** Based on the annual calendar-year returns of the 50 highest-performing stocks of the MSCI ACWI Index. For illustrative purposes only. Data source: FactSet, 1/23.

Where To Go From Here?

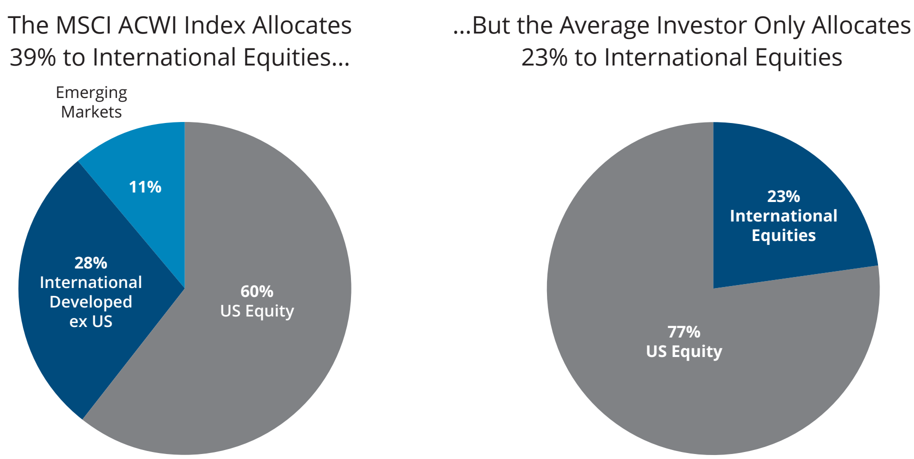
We're not predicting that US stock performance will fall off a cliff, just that international markets may look more appealing as some things shift. For the best risk/reward tradeoff, a mix of about 60-70% US and 30-40% international has historically been a good combination.

But since the US has outperformed for so long and by such a large margin, many investors may be particularly overweight US stocks and underweight international stocks today (**FIGURE 4**). This could not only leave investors under-exposed to potential opportunity, but overexposed to the highly concentrated US market.

FIGURE 4

US Investors Are Significantly Underweight International Stocks

MSCI ACWI Index vs. Average US Investor



As of 12/31/22. Data Sources: FactSet and Morningstar, 1/23.

Since the investing world was rattled so much in 2022, now may be a good time to re-evaluate your portfolio's stock exposure. In this new world of higher interest rates and higher inflation, maintaining a strategic international exposure with professional, active management could help you take advantage of the benefits international stocks may offer going forward.

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Talk to your financial professional about your portfolio's exposure to international stocks.

The US Dollar Currency Index (DXY) measures the relative value of the US dollar against a basket of other foreign currencies.

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

MSCI ACWI ex USA Index is a free float-adjusted market-capitalization index thatthat measures the performance of both developed and emerging stock markets, excluding the United States.

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

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

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Diversification and asset allocation do not ensure a profit or guarantee against loss.

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