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Insight

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5 Trends That Could Propel the Rotation Into International Equities

It’s no longer just a valuation story—these catalysts bring the potential for persistent non-US equity performance.

Insight from Hartford Funds

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Key Points

- AI competition in China could potentially reshape the global AI landscape that’s driven so much of recent US equity performance.
- While US stimulus is winding down, Europe and others are ramping up spending, especially on infrastructure and defense.
- New tariffs may hit US firms harder than international ones, giving international companies a relative edge.

International equities started 2025 on a strong note, in stark contrast to the US equity dominance that had been in place for the past decade. But is this a short-term shift in performance leadership, and merely a temporary response to current conditions? In my view, these five potential drivers could lead to persistently strong performance for international equities.

1. AI Reset: Markets were surprised in early 2025 when several Chinese firms claimed to have made breakthroughs in their AI capabilities. Up to that point, the consensus was that delivering competitive generative-AI solutions required access to cutting-edge chips and substantial electrical power.

   China’s Deepseek, and later Alibaba and Tencent, claimed they were able to produce competitive generative-AI systems despite having limited access to state-of-the-art semiconductors due to sanctions. Their solutions also required a small fraction of the power needed by their Western counterparts.

   If these claims prove true, it could ultimately lead to investors rethinking their outlook for big US tech players in the AI space, as well as firms down the AI value chain (such as data-center builders, wiring providers, and electric utilities, among others). The winners could expand beyond the handful of domestic companies to include many international players (FIGURE 1). Lower-cost AI solutions could be a key catalyst for democratizing the technology and rapidly expanding adoption, bringing its benefits to a broader audience and at a faster pace.

FIGURE 1

Major International Companies Driving AI Innovation

Company	Ticker	Country	AI Focus
Taiwan Semiconductor	TSM	Taiwan	Manufactures advanced AI chips used by NVIDIA, Apple, and others
ASML	ASML	Netherlands	Supplies extreme ultraviolet lithography machines essential for AI-chip production
Samsung Electronics	SSNLF	South Korea	Develops AI for mobile devices, semiconductors, and smart appliances
SoftBank Group Corp.	SFTBY	Japan	Major investor in AI startups and owns Arm Holdings, a key chip-architecture firm
Baidu, Inc.	BIDU	China	Operates large-language models, autonomous driving, and AI cloud services
Alibaba Group Holding Ltd.	BABA	China	AI in e-commerce, logistics, and cloud computing (Alibaba Cloud AI services)
Tencent Holdings Ltd.	TCEHY	China	AI in gaming, social media, and healthcare; operates its own AI lab
NEC Corporation	NIPNF	Japan	AI in public safety, biometrics, and enterprise solutions
Hitachi, Ltd.	HTHIY	Japan	AI in industrial automation, energy systems, and smart infrastructure

2. Changes in Fiscal Spending: The US employed expansionary fiscal policy after COVID-19, including roughly $1 trillion in funding from the Inflation Reduction Act. Outside the US, meanwhile, austerity was the prevailing policy during the same time frame. However, we've begun to see a reversal of that trend.

   In the US, much of the spending associated with the Inflation Reduction Act has already happened, and there's some question as to whether pledged-but-not-yet-allocated funding will occur. Couple that with the highly publicized roll-out of the Department of Government Efficiency and its heavy, targeted cuts to spending, and the fiscal outlook for the US is projected to be contractionary relative to recent levels.

   By contrast, the fiscal spending outlook elsewhere looks to be on the upswing: High-profile estimates for spending pledges on infrastructure and defense are in the $1.5 trillion range in Europe. The bulk of this proposed spending has come from Germany as part of significant changes to the debt-spending philosophy of the world's third-largest economy.

3. Tariff Perceptions: Given the emphasis on tariffs during President Donald Trump's campaign, their April roll-out shouldn't have been much of a surprise. Nevertheless, the sudden and unclear implementation seems to have been what caught markets off guard.

   The US market's volatility in response to tariff news supported a belief that foreign companies could be less impacted by tariffs than their domestic competitors. While companies worldwide have developed global supply chains over decades, foreign firms have the potential to shift their output to destinations outside the US to avoid some of the tariff impacts. Domestic producers, however, might find it harder to shift the impact of tariffs if they rely on foreign-sourced components to any extent. This could lead to domestic producers having to absorb the added cost, pass the costs on to consumers (with associated demand destruction), or some combination of the two.

4. Increased Focus on Shareholder Returns: As a means of encouraging both domestic and foreign investment in Japanese equities, the Tokyo Stock Exchange instituted reforms in 2023 aimed at improving corporate governance. These reforms encouraged firms to focus on improving their price-to-book ratios (which for many companies on the exchange were below 1.0), as well as an increased emphasis on improving shareholder returns. These reforms have had a positive impact thus far, not only in terms of increased share buybacks and dividends, but also through rising share prices.

   On the heels of this program's success in Japan, exchange operators in South Korea enacted a similar program in 2024, while further reforms were announced earlier this year. Though the positive results there haven't yet materialized, it's still relatively early.

5. Valuation Gaps: Pundits have been beating the drum for valuation gaps as the justification for "why international" for years. And while their assertion was correct—valuation gaps were at noteworthy levels relative to history—the unfortunate reality is that it hasn't been unusual for international equities to trade at a discount to their US peers (FIGURE 2).

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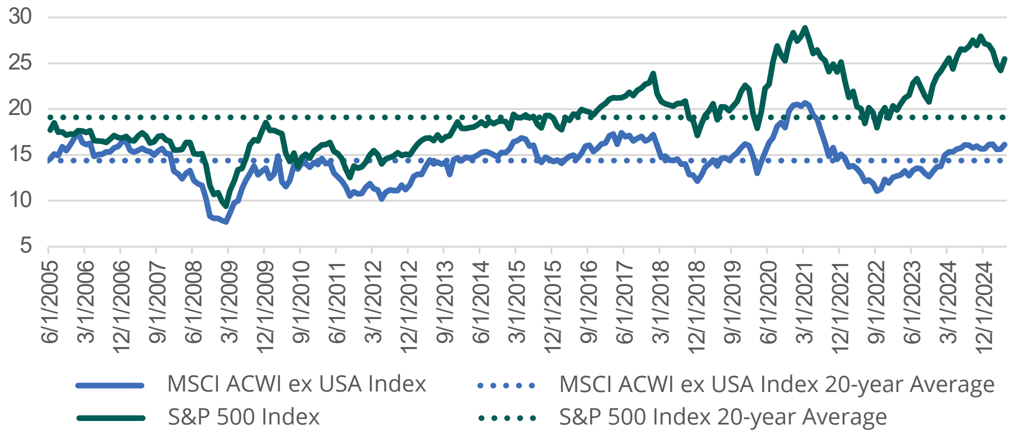
FIGURE 2

The Valuation Gap Between US and International Equities Is Near its Widest

Trailing 12-month Price/Earnings for MSCI ACWI ex USA Index vs. S&P 500 Index



As of 5/31/25. The price-to-earnings ratio measures a company's share price relative to its earnings-per-share and helps assess the relative value of a company's stock. Indices are unmanaged and not available for direct investment. Please see below for index definitions. Data Source: Morningstar, 6/25.

Though we don't necessarily see this valuation gap alone as a catalyst for international equities to outperform, its breadth leaves plenty of room for international-equity valuations to become richer while still remaining cheap relative to US markets.

Even with their recent performance advantage, international markets continue to be attractively valued relative to US equities. Through May 31, 2025, the MSCI ACWI ex USA Index was trading at a roughly 35% discount to the S&P 500 Index.

The bottom line: For years, we've been reminded of the diversification benefits brought by allocating to international equities, with hopes that mean reversion could drive returns due to cheap valuations. What we've seen is that those low valuations have been a prerequisite, but weren't enough to generate competitive relative returns alone. However, these five trends might just be the catalysts we've been waiting for to spur outperformance from international equities.

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

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

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

Important Risks: Investing involves risk, including the possible loss of principal. • Foreign investments may be more volatile and less liquid than US investments and are subject to the risk of currency fluctuations and adverse political, economic, and regulatory developments. These risks may be greater, and include additional risks, for investments in emerging markets or if a fund focuses in a particular geographic region or country. • Diversification does not ensure a profit or protect against a loss in declining market.

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