

Should Allocation Include International Equities?

I originally wrote this in Aug-98, when clients were questioning the wisdom of adding international equity to their portfolios. Since many are questioning that wisdom again, I thought it was worth updating the research.

The MSCI EAFE, a well-known index of international stocks, outperformed the S&P 500 Total Return Index, a well-known index of domestic stocks, only 3 times during the 1990s (1993, 1994, 1999). During that decade, the S&P 500's calendar-year return averaged 18.99% while the EAFE produced a dismal 6.59%. As a result, many investors and some investment professionals saw little reason to include international equities in their portfolio allocation.

Then international stocks rebounded. During the next decade (2000-2009), MSCI EAFE beat the S&P 500 seven times! Now, here we go again!

The international index has failed to beat the S&P 500 even one time since 2009, and investors are clamoring for reasons not to get out if foreign stocks altogether. Before making such a decision, both investors and investment professionals would be wise to consider the impressive boost that international stocks have given to overall portfolios in the not so distant past and likely future.

During the 47 years of the MSCI EAFE Equity Index (since 1970), it has beaten the S&P 500 Total Return Index 43% of the time (20 calendar years). That should get our attention. The better return is highlighted in green.

	S&P 500	EAFE		S&P 500	EAFE		S&P 500	EAFE		S&P 500	EAFE
1970	3.94	-14.13	1982	21.55	-4.63	1994	1.32	6.24	2006	15.79	23.47
1971	14.30	26.14	1983	22.56	20.91	1995	37.58	9.42	2007	5.49	8.62
1972	18.99	33.28	1984	6.27	5.02	1996	22.96	4.40	2008	-37.00	-45.09
1973	-14.69	-16.82	1985	31.73	52.57	1997	33.36	0.24	2009	26.46	27.75
1974	-26.47	-25.60	1986	18.66	66.80	1998	28.58	18.23	2010	15.06	4.90
1975	37.23	31.21	1987	5.25	23.18	1999	21.04	25.27	2011	2.11	-14.82
1976	23.93	-0.36	1988	16.61	26.66	2000	-9.10	-15.21	2012	16.00	13.55
1977	-7.16	14.61	1989	31.69	9.22	2001	-11.89	-22.61	2013	32.39	19.43
1978	6.57	28.91	1990	-3.10	-24.71	2002	-22.10	-17.52	2014	13.69	-7.35
1979	18.61	1.82	1991	30.47	10.19	2003	28.68	35.28	2015	1.39	-3.30
1980	32.50	19.01	1992	7.62	-13.89	2004	10.88	17.59	2016	11.96	-1.88
1981	-4.92	-4.85	1993	10.08	30.49	2005	4.91	10.86			

During those 20 calendar years in which international equities outperformed their domestic competitors, the EAFE averaged 20.49% while the S&P 500 returned 8.81%.

The EAFE has produced good benefits in multi-year timeframes. Of 41 separate 5-year rolling time periods, EAFE produced the better return 29% of the time, and it is *noteworthy that it primarily came in two distinct timeframe clusters* referenced in the following chart:

5- Years Ending	S&P 500 Total Return	MSCI EAFE Equity Index
1986-1990		
1986	19.87	25.31
1987	16.47	31.89
1988	15.31	33.12
1989	20.36	34.17
1990	13.19	16.44
2005-2009		
2005	0.54	2.40
2006	6.19	12.43
2007	12.83	18.79
2008	-2.19	-0.81
2009	0.42	0.85
AVG	10.30	17.46