MARKET OBSERVATIONS
MAY 2025

SCHLINDWEIN ASSOCIATES
INVESTMENT COUNSEL

Rest-of-the-World

A common diversification strategy involves setting the allocations between U.S. stocks and stocks domiciled in the rest of the world. Parameters used to determine this relative allocation include expected returns, expected risks (volatility of returns), stock valuations (e.g., price/earnings and price/book ratios), and currency expectations. Return, risk and valuation parameters are common diversification strategy parameters, but currency comes into the mix when investments are made outside of an investor's home country. The perspective here provides some basic information that can be useful for making diversification decisions between U.S. stocks and those of the rest-of-the-world.

PERSPECTIVE

Rates of return from U.S. stocks and stocks from the rest-of-the-world ("ROTW") have varied widely over long periods of time. Chart I shows three-year rolling total rates of return (dividends + price appreciation) for both U.S. stocks and ROTW stocks. The latter have recorded some notable out-performance at times, but the former have shown greater out-performance persistence. This persistence was evident for most of the 1990s and again from the 2010s on. With the exception of the mid-1990s, ROTW under-performance was not during periods of outright losses. Returns in Chart I are in U.S. dollar terms for both U.S. and ROTW. ROTW diversification most commonly is accomplished by selling U.S. dollar assets and making ROTW purchases in the respective local currencies.

Currency plays an integral role in implementing diversification allocations between U.S. and ROTW stocks. Chart II shows three-year rolling rate of total return differences between the U.S. dollar and other major currencies. The pattern is one of long runs of dollar strength punctuated by sharp but briefer periods of dollar weakness. Periods of dollar strength can enhance relative returns from U.S. stocks. Periods of dollar weakness can enhance relative returns from ROTW stocks, especially when dollar-based assets are sold to purchase such stocks. When making asset allocation decisions between U.S. and ROTW stocks, it is important to understand how currency weighs in this strategy decision. The overriding consideration should be expected returns relative to risks. A strategy dependent primarily on currency expectations may be best implemented through non-stock assets.

Investment returns come with many risks, notable of which is return volatility. Chart III shows pairings of return and risk for U.S. stocks, ROTW stocks and the U.S. dollar over almost fifty years. Relative to ROTW stocks, U.S. stocks provided higher return (+11.9% versus +9.6% with lower risk (±8.6% versus ±12.3%. Both return (+3.0%) and risk (±4.4%) for the U.S. dollar relative to other major currencies are much lower.

INVESTMENT IMPLICATIONS

Diversification remains a core principle of prudent investing. Within stock allocations, a frequent diversification strategy involves changes in the weightings of U.S. stocks relative to ROTW stocks. Success with such a strategy will turn on an understanding of what parameters drive these relative returns. Interest in higher portfolio allocations to ROTW stocks relative to U.S. stocks has risen concurrent with U.S. policy uncertainties, especially regarding tariffs and trade. Supporting this interest are current lower valuations for ROTW stocks and expectations that a recent downtrend in the U.S. dollar will continue. Stay tuned.

CHART I

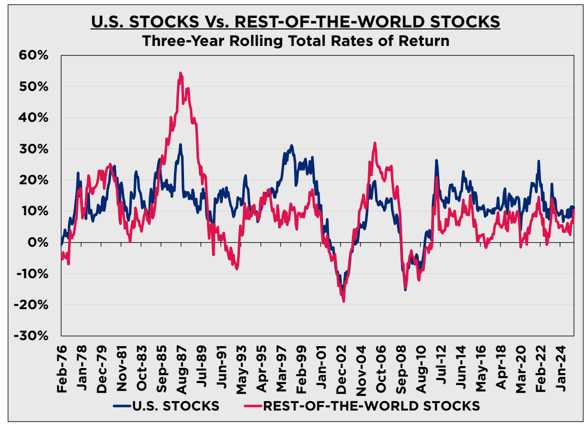

CHART II

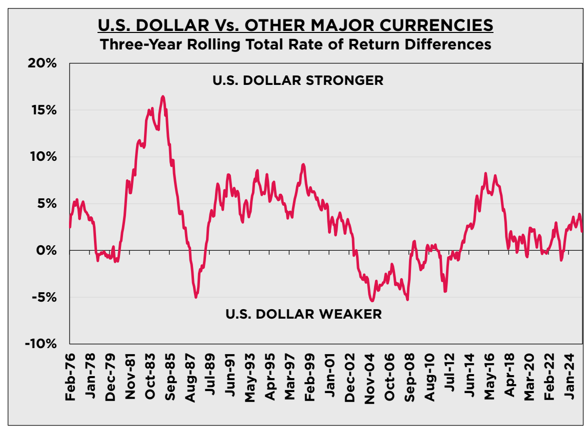

CHART III