# GLOBAL EQUITIES: INTERNATIONAL DIVERSIFICATION WITHIN OUR MODEL PORTFOLIOS

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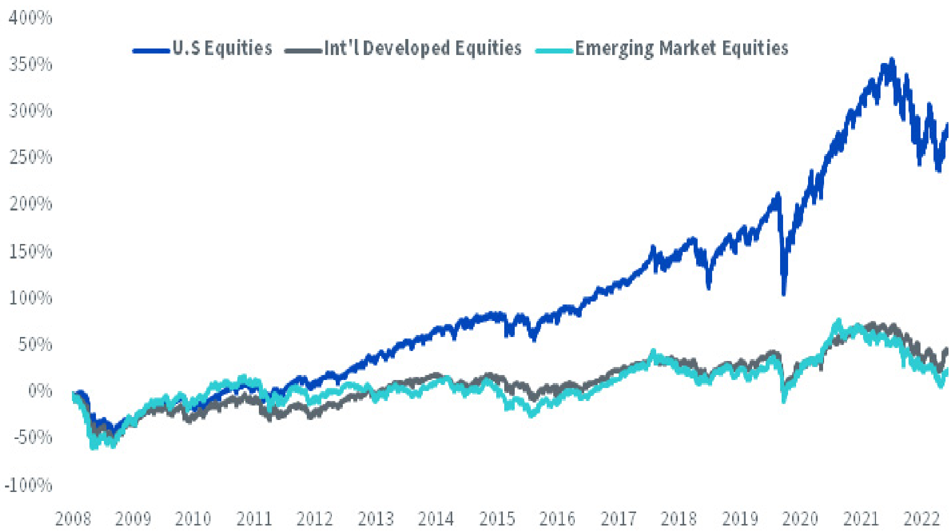
*This article is relevant to financial professionals who are considering offering Model Portfolios to their clients. If you are an individual investor interested in WisdomTree ETF Model Portfolios, please inquire with your financial professional. Not all financial professionals have access to these Model Portfolios.*

In the 10+ years following the great financial crisis, U.S. companies with high growth potential dominated global equity markets.

This was largely due to the prevailing macro environment, as steady economic growth, muted inflation and ultra-low interest rates facilitated the continued multiple expansion of U.S. stocks.

As a result, the more cyclical and value-oriented universe of stocks outside the U.S. lagged. From June 2008 to December 2022, the cumulative underperformance of international versus U.S. equities amounted to more than 200%.

**Cumulative Returns in USD (June 2008–December 2022)**




Sources: WisdomTree, FactSet, as of 9/30/22. U.S. Equity returns based on the MSCI USA Net Total Return USD Index. International Developed Equity returns based on the MSCI EAFE Net Total Return USD Index. Emerging Market Equity returns based on the MSCI Emerging Markets Net Total Return USD Index. Past performance is not indicative of future results. You cannot invest directly in an index.

Any diversification away from large U.S. growth stocks over this period generally detracted from overall returns. Some U.S. investors have responded by reducing or even eliminating their exposure to international stocks.

At WisdomTree, we believe this era of “deworsification” has come to an end. With an evolving macro backdrop and a renewed focus on balance sheet strength, margin resilience and the ability to return capital via dividends, diversification across both regions and factors may once again prove critical in generating enhanced returns.

This is reflected across our suite of strategic and outcome-oriented Model Portfolios, which incorporates globally diversified equity allocations with:

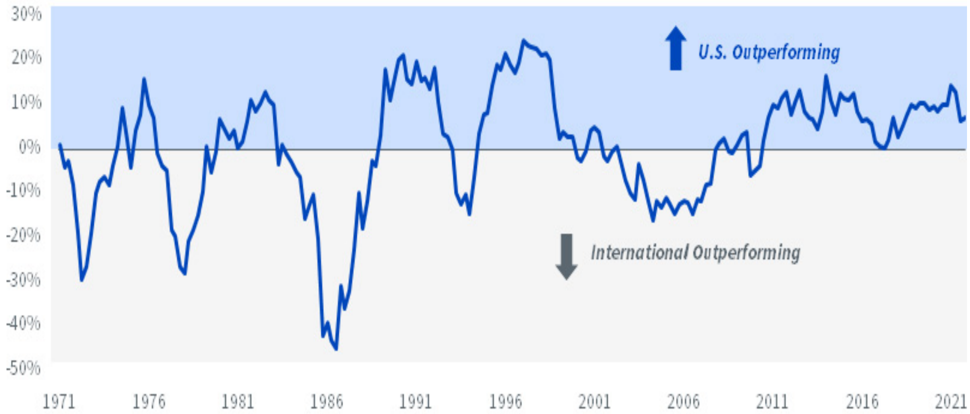
- Regional weights roughly aligned with the MSCI All-Country World Index (ACWI)
- Strategic tilts toward value, quality and dividend factors

Below, we outline the logic behind our conviction in global diversification and why valuation-focused investors might find international stocks particularly attractive in today's market environment.

**The Benefits of Global Diversification**

First, it is important to view the most recent example of U.S. outperformance in a historical context, as it only represents one period in what has historically been a cyclical relationship. There are numerous examples of European, Japanese and emerging markets having their own "moments in the sun."

**Rolling 2-Year Annualized Relative Returns of U.S. vs. International Equities (1969–2022)**



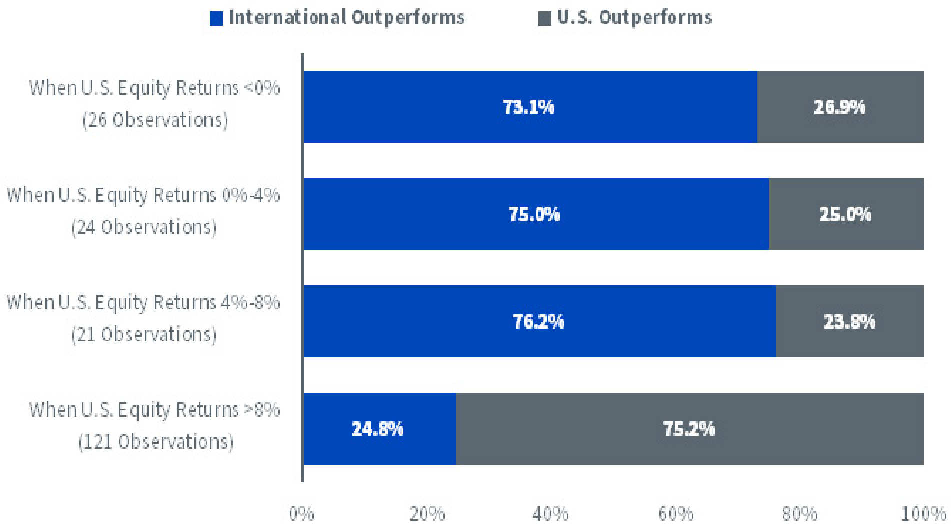

Sources: WisdomTree, FactSet, as of 9/30/22. U.S. Equity returns based on the MSCI USA Net Total Return USD Index. International Equity returns based on the MSCI EAFE Net Total Return USD Index from 1969–1998 and the MSCI ACWI Ex USA Net Total Return USD Index from 1999–2022. Past performance is not indicative of future results. You cannot invest directly in an index.

Even after this recent prolonged cycle of U.S. outperformance, long-term cumulative dollar returns across global regions do not differ significantly. Put simply, we don't believe global diversification sacrifices long-term return potential.

However, imperfect correlations of returns across regions can help protect portfolios on the downside, particularly in periods of poor

U.S. equity returns.

**Rolling 5-Year Returns, U.S. vs. International (1970–2022)**




Sources: WisdomTree, FactSet, as of 11/30/22. Based on quarterly observations of rolling five-year returns. U.S. Equity returns based on the MSCI USA Net Total Return USD Index. International Equity returns based on the MSCI World Ex-USA Net Total Return USD Index. Past performance is not indicative of future results. You cannot invest directly in an index.

This was the case in 2022, as international equities, as measured by the MSCI All-Country World Ex-USA Index, were down approximately -16.0% compared to the -18.5% return on the S&P 500 Index. Local returns of international equities were even more resilient, with the MSCI EAFE and MSCI Emerging Markets (Local) Indexes down only -7.0% and -15.5%, respectively.[1]

A global approach to equity investing can also help enhance sector diversification.

Even with several large, tech-focused U.S. firms now in the Communication Services (Meta, Alphabet) and Consumer Discretionary (Tesla, Amazon) sectors, U.S. equities are still much more concentrated in the Technology sector than international indexes.

**Sector Exposures—U.S. and International Equity Indexes**

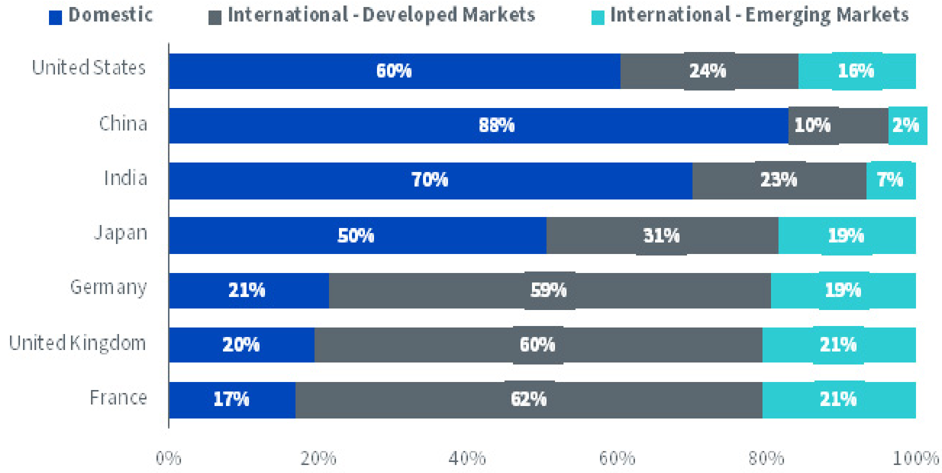
| Sector | S&P 500 Index | MSCI EAFE Index | MSCI Emerging Markets Index |
|---|---|---|---|
| Communication Services | 7.50% | 4.50% | 9.30% |
| Consumer Discretionary | 10.40% | 11.40% | 13.40% |
| Consumer Staples | 7.00% | 10.50% | 6.30% |
| Energy | 5.10% | 5.10% | 5.10% |
| Financials | 11.60% | 18.00% | 22.20% |
| Health Care | 15.20% | 13.40% | 4.00% |
| Industrials | 8.40% | 15.20% | 6.00% |
| Information Technology | 26.40% | 8.20% | 19.60% |
| Materials | 2.70% | 7.70% | 9.10% |
| Real Estate | 2.70% | 2.60% | 2.10% |
| Utilities | 3.00% | 3.40% | 3.00% |

Sources: WisdomTree, FactSet, as of 11/30/22. U.S. Equity exposures based on the S&P 500 Index. International Equity exposures based on the MSCI EAFE Net Total Return USD Index and MSCI Emerging Markets Net Total Return USD Index (as labeled). You cannot invest directly in an index.

We also believe a regionally diversified equity portfolio is necessary to gain exposure to today's global economy.

Despite calls for the "end of globalization," U.S. annual imports have only accelerated in recent years,[2] and U.S. companies in the MSCI USA Index now generate approximately 40% of their revenues from overseas.[3]

**Geographic Revenue Exposure for MSCI Country Indexes**




Sources: WisdomTree, FactSet, as of 11/30/22. United States data based on MSCI United States Index. China data based on MSCI China Index. India data based on MSCI India Index. Japan data based on MSCI Japan Index. Germany data based on MSCI Germany Index. United Kingdom data based on MSCI United Kingdom Index. France data based on MSCI France Index. You cannot invest directly in an index.

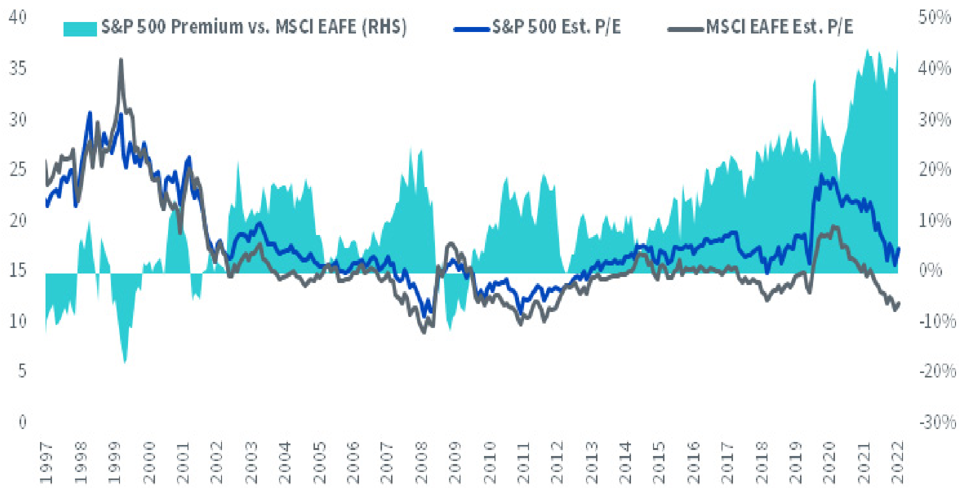
Senior Investment Strategy Advisor to WisdomTree, Professor Jeremy Siegel, and Global CIO Jeremy Schwartz argue in the latest edition of *Stocks for the Long Run* that the current definition of a company's domicile based on the location of its headquarters may become increasingly arbitrary in today's globally interconnected world.[4]

**Current Valuations Support an Allocation to International Equities**

Beyond the strategic arguments for global diversification, current valuations of international equities make a compelling opportunistic case for their inclusion in portfolios.

The price premium on U.S. equities, based on the estimated price-to-earnings (P/E) ratio, is now near an all-time high.

**Historical Estimated Price-to-Earnings (P/E) Ratios**




Sources: WisdomTree, FactSet, as of 11/30/22. U.S. Equity valuations based on the S&P 500. International Equity valuations based on the MSCI EAFE Net Total Return USD Index. You cannot invest directly in an index.

The relative valuation discounts on international stocks can also be seen in current dividend yields. As of December 31, 2022, the MSCI EAFE and Emerging Markets Indexes offer dividend yields of 3.23% and 3.36%, respectively, versus the 1.69% dividend yield of the S&P 500 Index.[5]

### Relative Strength of the U.S. Dollar

As most U.S. investors do not hedge foreign currency exposure within international equity allocations, another important factor in relative performance versus domestic equities is the strength of the U.S. dollar.

Historically, a stronger USD has generally been associated with U.S. equity outperformance, while a weaker USD has generally been associated with international stocks outperforming U.S. equities.

**Rolling 2-Year Annualized Relative Returns**

While the dollar recently took a breather from the relentless strengthening seen throughout 2021–2022, it is still more than one standard deviation above long-term averages.

**U.S. Dollar Index**

Should this trend of USD weakness continue, it may present an additional tailwind for international stocks.

**Conclusion**

While recent U.S. equity outperformance has led some investors to question the role of international stocks, we are strong believers in the potential long-term advantages of global equity investing:

[1] Sources: WisdomTree, FactSet, as of 12/31/22.

[2] Source: Bloomberg, as of 10/31/22.

[3] Sources: WisdomTree, FactSet, as of 11/30/22. United States data based on MSCI United States Index.

[4] Source: Jeremy J. Siegel with Jeremy Schwartz, Stocks for the Long Run: The Definitive Guide to Financial Market Returns and Long-Term Investment Strategies (6th ed.), New York: McGraw-Hill.

[5] Sources: WisdomTree, FactSet, as of 12/31/22.

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You cannot invest directly in an index.

## DEFINITIONS

**The Global Financial Crisis** : Refers to the period of extreme stress in global financial markets and banking systems between mid 2007 and early 2009.

**Macro** : Focused on issues impacting the overall economic landscape as opposed to those only impacting individual companies.

**Growth** : Characterized by higher price levels relative to fundamentals, such as dividends or earnings. Price levels are higher because investors are willing to pay more due to their expectations of future improvements in these fundamentals.

**Inflation** : Characterized by rising price levels.

**Interest rates** : The rate at which interest is paid by a borrower for the use of money.

**Value** : Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over tim.

**Balance sheet** : refers to the cash and cash equivalents part of the Current Assets on a firms balance sheet and cash available for purchasing new position.

**Margins** : Focused on issues impacting the overall economic landscape as opposed to those only impacting individual companies.

**Dividend** : A portion of corporate profits paid out to shareholders.

**Diversification** : A risk management strategy that mixes a wide variety of investments within a portfolio.

**MSCI All Country World Index** : a broad global equity benchmark that represents large and mid-cap equity performance across 23 developed and emerging market countries.

**Quality** : Characterized by higher efficiency and profitability. Typical measures include earnings, return on equity, return on assets, operating profitability as well as others. This term is also related to the Quality Factor, which associates these stock characteristics with excess returns vs the market over tim.

**Emerging market** : Characterized by greater market access and less potential for operational risks when compared to frontier markets, which leads to a larger base of potentially eligible investors.

**MSCI ACWI ex-U.S. Index** : A free-float adjusted market capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets excluding companies based in the United States.

**MSCI EAFE Index** : is a market cap-weighted index composed of companies representative of the developed market structure of developed countries in Europe, Australasia and Japan.

**MSCI Emerging Market Index** : The MSCI Em (Emerging Markets) Index is a free-float weighted equity index that captures large and mid cap representation across Emerging Markets (EM) countries.

**Estimated P/E ratios** : Share price divided by estimated 12-month earnings per share. Lower numbers indicate an ability to access greater amounts of estimated 12-month earnings per dollar invested.

**Dividend yield** : A financial ratio that shows how much a company pays out in dividends each year relative to its share price.

**S&P 500 Index** : Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

**Foreign Exchange (FOREX, FX)** : The exchange of one currency for another, or the conversion of one currency into another currency.

**USD (United States Dollar)** : The USD (United States dollar) is the official currency of the United States of America. The United States dollar, or U.S. dollar, is made up of 100 cents. It is represented by the symbol $ or US$ to differentiate it from other dollar-based currencies.

**Standard deviation** : measure of how widely an investment or investment strategy's returns move relative to its average returns for an observed period. A higher value implies more "risk", in that there is more of a chance the actual return observed is farther away from the average return.