KARPUS INVESTMENT MANAGEMENT

INTERNATIONAL EQUITIES

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Looking back three years as of the end of July 2022, domestic stocks (as measured by the S&P 500 Index (the S&P 500)) have returned a total of 45.6%, or 13.4% per year. For the same three-year time period, international stocks (as measured by the MSCI All-Country World ex. U.S. Index (ACWI ex. U.S.)) have lagged, returning a total of 9.0%, or 2.9% per year. Complicating matters further, few investors are happy with their investments' performance so far this year and distinct challenges face each of the world's economies.

Although the phrase "past performance does not predict future results" is popular in the finance industry, it is so for good reason. The U.S. may have fared better for the period noted above, but it is important to remember this has not always been the case. Using the same indices as above, if one were to look back at the 10 years ending July 2022, they would find that U.S. stocks outperformed internationals. However, for the 10 years prior to that, internationals outperformed the U.S..

Bringing the question to more recent times, recession risk, military aggression, increased global price pressures, inverted yield curves, and the reversal of quantitative easing all threaten the recent history of what are known as "v-shaped" recoveries – or recoveries that occur quickly after a sharp decline.

Given all of this, how do we think an investor should approach the question of global equity diversification within their portfolio?

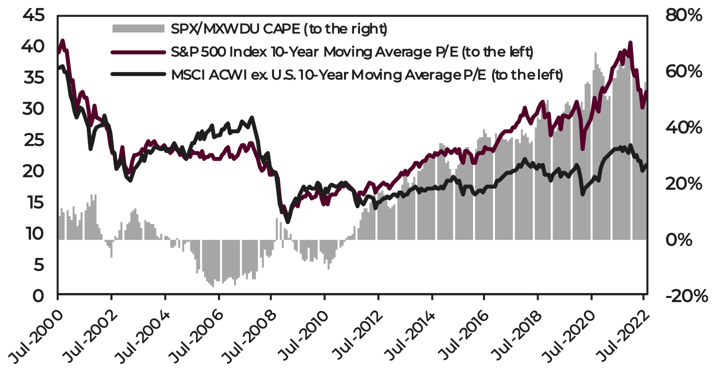
In today's deglobalization-tilted environment, geography can be a useful starting point. From a geographical standpoint, the U.S. is further insulated from Russian aggression and dependence on their exports than Europe. This, along with below-average energy stores for the winter makes Europe unusually vulnerable. What COVID and the invasion of Ukraine have shown are that Europe unifies the most when further cohesion is necessary.

As another example of an impact based on geographic locale can be seen in developed nations in Asia (e.g., Japan) that are within striking distance from hostile forces just as China shows amplified hostility in the Taiwan Strait. Further, the more success Taiwan earns, the more it undermines the values of the Chinese Communist Party, and Xi Jinping. As China is not known to be the bluffing type, any major escalations could box the world's largest military into a corner of action, forcing the West's hand as well. If and until then, it seems as though the U.S. is the only major nation with little to worry about from its geographic neighbors.

Moving on to valuations, the U.S. trades at a premium to many other countries. As of the end of July 2022, at 20.3 times its earnings, the S&P 500 exchange-traded fund (NYSE: SPY) is 68% more expensive per dollar of earnings than the MSCI All-Country World ex. U.S. exchange-traded fund (NYSE: ACWX) at 12.1. When smoothing earnings using the cyclically adjusted price-to-earnings (CAPE) ratio and looking back to the turn of the millennium, the U.S. is near an all-time comparative richness (see Chart 1). Although the price/earnings ratio is only one metric, the story remains the same with many others (e.g., price-to-book, price-to-cash flow).

While the U.S. has its share of flaws, its robust system of government, rule of law, currency, and economy are considered safe havens by many. When the dust settles and the world seems a bit more at ease, it is important to note that the tide can turn

Chart 1. S&P 500 Index vs. MSCI All-Country World ex. U.S. Cyclically Adjusted Price-to-Earnings Premium



Bloomberg Finance, L.P.

and shift toward higher perceived growth opportunities. As this shift occurs, potential opportunities can become more sought after than stability, and international equities can be poised to outperform.

What can be difficult and nearly impossible to predict is when these types of shifts can happen – let alone with any consistency. In the late 1990s, at the peak of the dot-com craze, it would have been heresy to suggest international stocks would have the edge. Yet they did, and by a margin.

While we would not suggest that investors bet against American business, it is important to remember that the United States was once an emerging market in the eye of the global powerhouse of Great Britain. Anything can happen, including constant change. International exposure dampens vicissitudes through vast streams of earnings from unrelated companies and countries.

Sources: Bloomberg Finance, L.P., Fortune, the International Energy Agency, The Wall Street Journal.

Index definitions: The S&P 500 Index is widely regarded as the best single gauge of large-cap U.S. equities and serves as the foundation for a wide range of investment products. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalizations as of 12/31/2021. The MSCI All-Country World ex. U.S. Index (MSCI ACWI ex. U.S.) is a market-capitalization-weighted equity index that captures large and mid cap representation across 22 of 23 developed market countries (excluding the United States) and 25 emerging market countries as of 12/31/2021. The Index return is net of withholding taxes and assumes daily reinvestment of net dividends thus accounting for any applicable dividend taxation. The Index is unmanaged and cannot be purchased directly by investors. Data provided by Bloomberg Finance, L.P.

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