BostonPartners

AUGUST 2024

Three reasons to revisit an international equity allocation

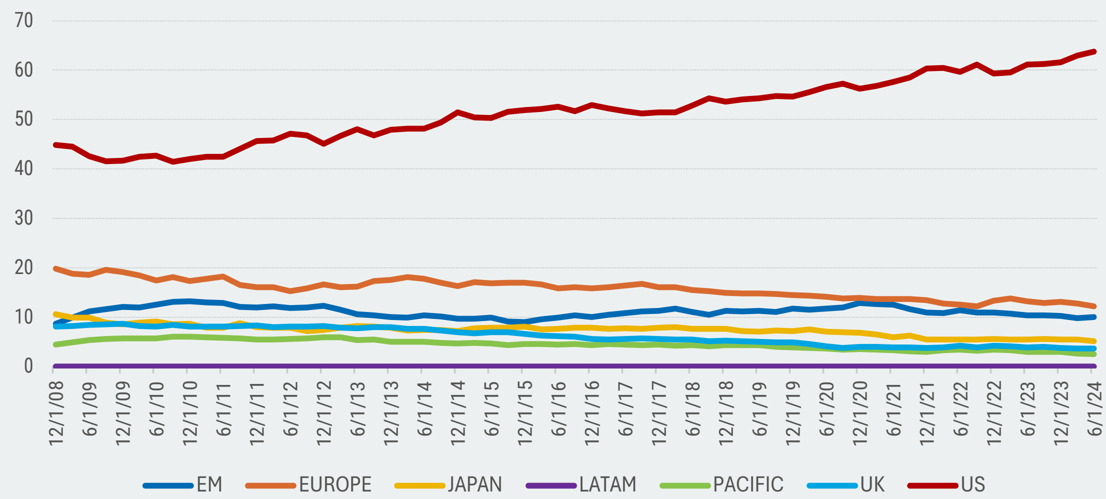
With solid fundamentals, rising earnings, and attractive valuations, we think international equities are worth a closer look — especially in light of today's heightened concentration risks.

Much has been written about the historic concentration risk in large-cap U.S. equities today—specifically, the outsize representation of the "Magnificent 7," which make up more than 30% of the S&P 500 Index. With the trajectory of the U.S. economy—and the hope for a soft landing—becoming more uncertain and volatility up sharply in the equity markets, it's important for investors to revisit just how diversified their portfolios really are.

What's not been as widely noted as the tech-fueled rally in U.S. stocks is the parallel trend that's been unfolding in the global equity markets at the country level. Consider that the United States now represents nearly two-thirds of the MSCI All Country World Index, up from just over 40% in the wake of the global financial crisis.

U.S. equities now represent a massive share of global stock indexes

Breakdown of MSCI ACWI by country/region (%)



Source: FactSet, as of June 30, 2024. See last page for index definitions. It is not possible to invest directly in an index. Past performance does not guarantee future results.

These two related trends have made building a diversified portfolio more challenging for equity investors of all stripes. Domestic-focused investors would be wise to mind the potential pitfalls associated with making a large allocation to a handful of tech-related securities. Global investors, meanwhile, face a similar challenge, with benchmark-oriented allocations now involving an unprecedented bias toward U.S. markets and, in turn, toward those same tech-focused companies. Casting a wide net isn't as useful a diversification tactic as it once was. Building a truly diversified portfolio in today's market requires a more targeted approach.

International equity allocations can play a vital role in diversifying a portfolio

Perhaps the simplest means for counteracting today's dual concentration risks is to dedicate a portion of a portfolio to non-U.S. strategies—and now could be a good time to consider such a move: There are three major reasons why we believe revisiting an international allocation looks attractive in today's market.

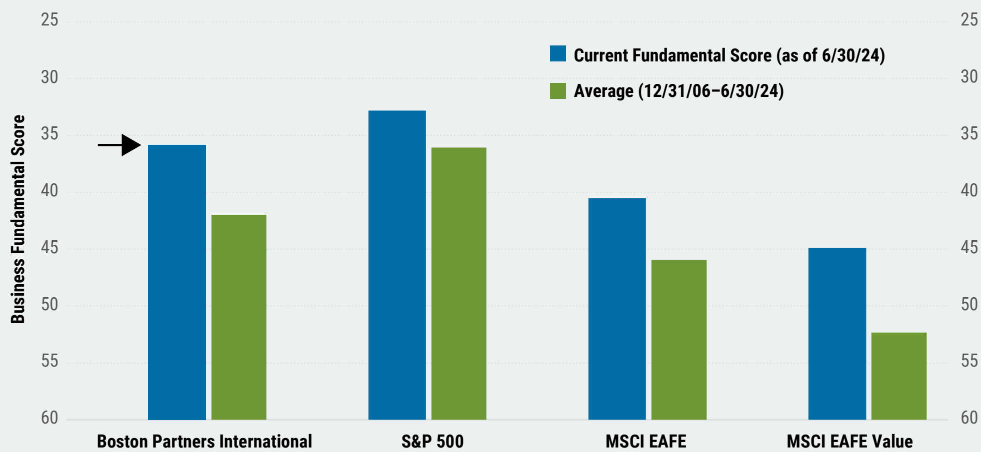
1. The fundamentals in non U.S. equities are solid across multiple dimensions

At Boston Partners, we closely monitor the business fundamentals for thousands of publicly traded companies as part of our Three Circles process; our quantitative team assigns a score to each company they track, with lower scores indicating stronger fundamentals. Myriad factors go into those scores, from dividend growth to changes in debt levels, free cash flow (FCF), and rates of return on equity and assets. The results allow our team to quickly compare the relative strength of fundamentals across companies, geographies, and also across time.

We believe the current environment is remarkable in two ways. First, current fundamental scores for international indexes (and for our own portfolio) are significantly better than their averages over the past 18 years. But second, the gap in fundamentals between large U.S. companies and their international peers is quite a bit smaller than usual.

Fundamentals in international equities are better than average—and catching up to those of U.S. equities

Boston Partners' proprietary fundamental scores



Source: Boston Partners, MSCI.The chart above illustrates the weighted average Fundamental code of stocks in the Boston Partners International portfolio and select indexes. Fundamental codes are results generated by a Model and are achieved by means of a mathematical formula. Several metrics are used in scoring Fundamental characteristics and can differ depending on the industry and region. A stock receives Fundamental scores from 1 (good/attractive) though 100 (bad/unattractive). While we have been utilizing a derivation of this model since the firm's inception in 1995, significant model revisions went into effect on December 31, 2013. See last page for index definitions. It is not possible to invest directly in an index.

Publicly traded companies outside the United States in aggregate tend not to offer quite as strong a fundamental profile as U.S.-based companies do. There are a number of reasons why—from the regulatory environment and transparency to competitiveness factors and liquidity—but the bottom line is that U.S. stocks tend to trade with something of a built-in premium relative to their international counterparts. While that price gap between international and U.S. stocks still exists, the quality of company that investors are getting through an allocation to international large caps is significantly higher than average. Why?

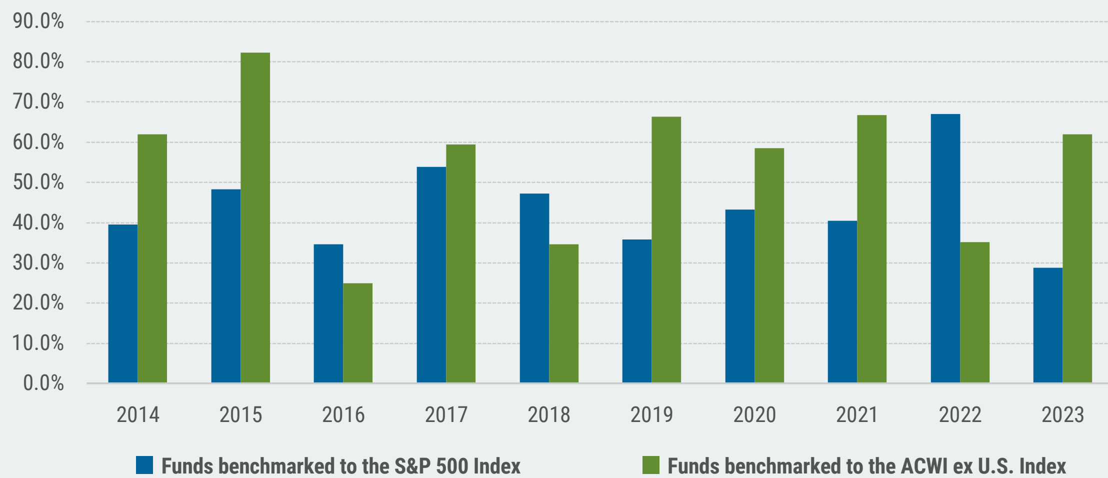
- **Higher absolute returns and higher margins.** We're seeing this is particularly true for certain "classic value" sectors like Energy, Materials, and Financials—specifically, in select European banks.
- **Higher free cash flow yields.** The additional capital being earned in these sectors in general hasn't been immediately redeployed through capital expenditures. That translates into higher levels of free cash flow and healthier balance sheets.
- **Better capital allocation.** When capital is deployed, more often than not it's going to shareholder-friendly initiatives—often in the form of higher dividend payments and/or stock buyback programs.

2. International stocks can be fertile ground for active managers

Despite a broadly attractive landscape in international equities, we believe the best way to pursue opportunities is through a targeted, active approach. The data bears this out: Consider that more than half of all actively managed large-cap international equity funds outperformed the MSCI All-Country World ex-U.S. Index seven times over the past 10 calendar years; meanwhile, a majority of large-cap U.S. funds have beaten the S&P 500 Index only twice.

International strategies have historically been more likely to generate alpha

Percentage of actively managed large-cap core equity funds outperforming their benchmark, by year



Source: Nasdaq, "Active Manager Outperformance 2014–2023," as of April 2024.

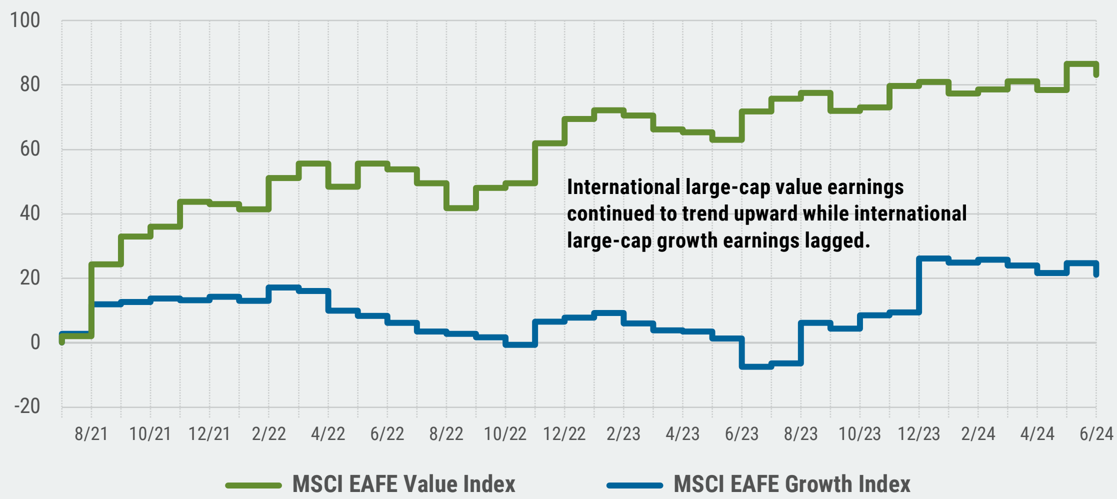
There are a number of potential explanations as to why this might be the case; for one, international companies don't receive quite the level of analyst coverage—and therefore scrutiny—as their U.S. counterparts. That means that earnings surprises, both positive and negative, generally happen more often. Having access to reliable research can be particularly valuable in helping to separate the market leaders from the laggards.

3. International value companies have been growing faster than growth names

In addition to taking an active approach, we think investors would benefit from considering value stocks specifically. Coming out of the COVID pandemic, earnings growth for international growth stocks has generally languished, moving more or less sideways over the past three years. Their value counterparts, meanwhile, have seen earnings steadily rise, climbing more than 80% over the same time period.

Over the last three years, Value earnings have grown faster than Growth

Earnings per share (EPS) growth, last 12 months (%)



Source: FactSet, as of June 30, 2024. See last page for index definitions. It is not possible to invest directly in an index. Past performance does not guarantee future results.

The best time to mend a roof is while the sun's still shining

Investors who may have taken on more concentration risk than they intended—either via exposure to mega-cap U.S. growth stocks or to the United States equity market in general—would be wise to revisit their portfolios before the next market downturn, whenever that may arrive. We believe international stocks not only represent a simple solution to this issue of concentration risk, but that the asset class has materially stronger fundamentals than usual—a reality not yet fully accounted for in their prices. We believe an active approach that targets traditional value sectors offers abundant opportunities in today's market—and has the added benefit of earnings tailwinds to support it.

About Boston Partners

Boston Partners is a value equity manager with a distinctive approach to investing—one that combines attractive valuation characteristics with strong business fundamentals and positive business momentum in every portfolio. The consistent application of this approach over nearly 30 years by an experienced and long-tenured team has created a proven record of performance across economic cycles, market capitalizations, and geographies.

Alpha measures the excess risk-adjusted return of a portfolio relative to a benchmark index. **The Magnificent Seven** refers to seven growth-oriented, tech-related companies: Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla. **MSCI All-Country World Index (ACWI)** tracks the performance of large- and mid-cap equities traded in developed and emerging markets. **MSCI ACWI ex U.S. Index** excludes U.S. securities. **MSCI EAFE Index** tracks the performance of large- and mid-cap equities traded across global developed markets, excluding the United States and Canada. **MSCI EAFE Growth and Value Indexes** are subsets of the MSCI EAFE Index that track securities with growth and value style characteristics, respectively. **S&P 500 Index tracks** the performance of the 500 largest companies traded in the United States. It is not possible to invest directly in an index.

BostonPartners

One Beacon Street | Boston, MA 02108 | tel: 617-832-8200 | bostonpartners.com

6935444.1