NB PRIVATE WEALTH

INTERNATIONAL EQUITY TEAM

The International Moment

After years in the wilderness, are international stocks primed for a more sustained period of outperformance?

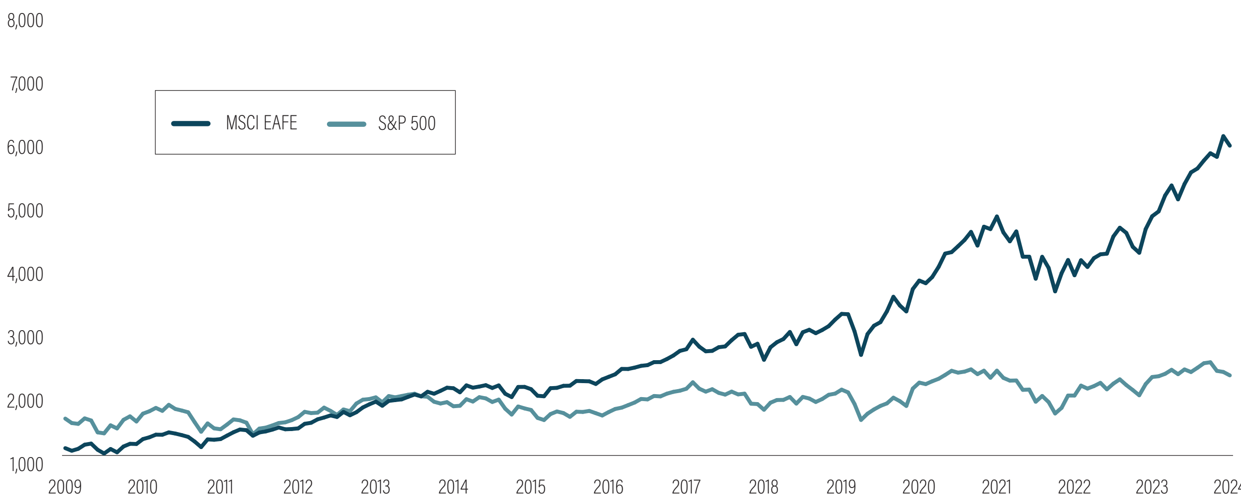
The traditional home market bias of U.S. investors has served them well in recent years, with domestic equities often substantially outperforming international peers. That said, no single country has ever (since World War II) been the top-performing market globally in consecutive decades, and such epochs have generally been followed by periods of weaker results. Examples include Japan's 253% cumulative return in the 1980s, followed by a 26% decline in the 1990s,[1] and U.S.'s 300% gain in the 1990s, followed by a -5% return in the 2000s (worsened by the Global Financial Crisis of 2008).[2]

Over the last 15 years, the S&P 500's 13.9% annualized return has dwarfed the 5.8% achieved by the MSCI EAFE index (the standard proxy for international equity markets). But we think seismic geopolitical and economic shifts could alter the investment landscape moving forward, and that investors are already beginning to calibrate these changes: Year-to-date, the MSCI EAFE has outpaced the S&P 500 by over 15 percentage points.[3]

In our view, the trends taking place warrant a rethink for U.S. investors on regional diversification. In this article, we lay out five key reasons we believe international equities may offer better return potential versus U.S. equities than they have since the Global Financial Crisis.

INTERNATIONAL STOCKS HAVE LAGGED FOR YEARS

MSCI EAFE vs. S&P 500 Performance Since 2010



Source: Bloomberg, data through December 31, 2024. U.S. stocks represented by the S&P 500. International stocks represented by the MSCI EAFE Index. **Past performance is not indicative of future returns.**

[1] Source: Bloomberg. Japan equities represented by the MSCI Japan Index.
[2] Source: Bloomberg. As represented by the S&P 500 Index.
[3] Source: Bloomberg, through June 15, 2025.

1. Monetary Policy: Europe Diverges From the U.S.

After aggressive interest rate hikes in 2022 – 23, the European Central Bank has been cutting rates faster than the Federal Reserve due to faster disinflation in Europe. In June, the ECB cut its base rate for the eighth time in 12 months to 2%, while the Fed has cut rates three times, with its fed funds rate now at 4.5%. The Fed has since been on pause for several meetings due to sticky core inflation, and is worried about the potentially inflationary effects of tariffs and tighter immigration policy. Meanwhile, Europe could benefit from falling gas prices with a glut of liquid natural gas coming onto the world market, and lower interest rates could also affect consumer wallets as European mortgage rates are often based on shorter-term fixed or variable rates rather than the 15- or 30-year fixed loans more common in the U.S.

In essence, we believe Europe is entering a "Goldilocks" zone of monetary policy: cooling inflation and easing by the central bank, but with plenty of slack in the region's economy, which should keep a lid on inflation and prevent a policy reversal. This contrasts with the U.S., where policy will likely be tighter for longer. The ECB's more dovish stance should help cap borrowing costs, stimulate spending and investment, and underpin equity valuations.

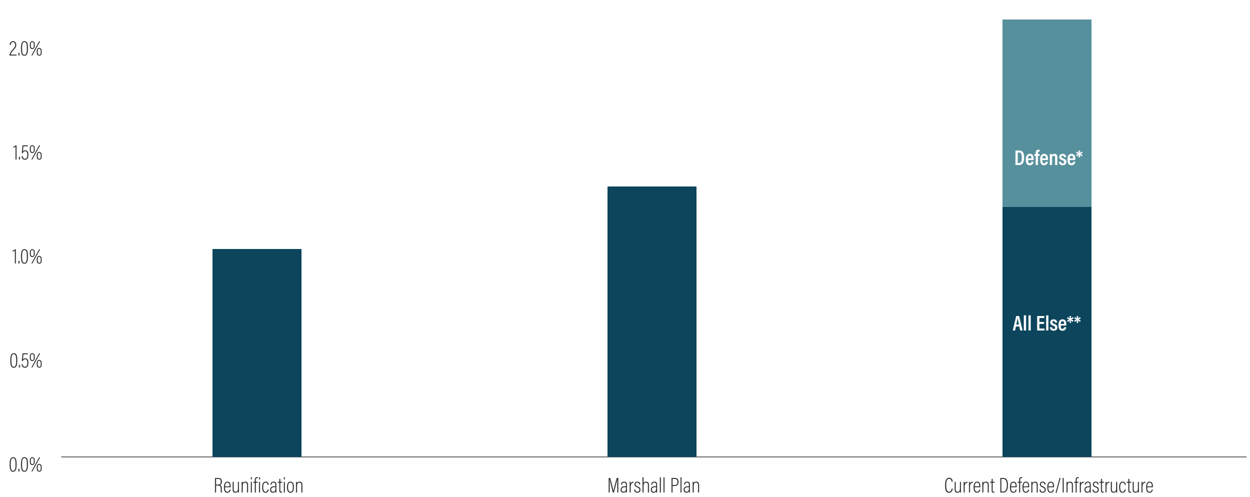
2. Fiscal Policy: From Austerity to Stimulus

Europe is on the cusp of a historic pivot from fiscal austerity to expansion. In the post-Global Financial Crisis period, many European countries were constrained by debt crises and budget discipline, which dampened growth. Germany, for example, adhered to a self-imposed "debt brake," running minimal deficits despite ample capacity. This era of belt-tightening kept European economic growth anemic and weighed on corporate earnings. Now, fiscal policy is becoming more expansive across the continent, providing a much-needed demand stimulus and investment boost. In response to extraordinary events—the pandemic, geopolitical threats and aggressive U.S. spending—European leaders are finally "opening the tap" on public spending, with Germany leading the way.

Drilling down, traditionally frugal Germany has approved a €100 billion special fund for defense and about €500 billion for infrastructure and green investment over the coming decade. Altogether, this equals nearly 20% of Germany's GDP—comparable in scale to the country's post-WWII Marshall Plan. It marks a new era for German policymakers, who are now prioritizing military and economic security. The impacts will likely be significant in Germany (adding about 2% to GDP), but could also spill over to the rest of Europe, with potential beneficiaries in the Industrials, Materials and Financials sectors (and across sub-sectors such as capital goods, machinery, electrical equipment, banks, and aerospace and defense). These are sectors in which international markets have more opportunities than the technology-heavy U.S. market, and commonly sell at steep discounts to U.S. peers.

GERMANY OPENS ITS CHECKBOOK

Historical Comparison of Major German Fiscal Plans, Annual Outlays as % of GDP



Source: Bloomberg, as of March 18, 2025.
* Virtually uncapped. At €400 billion in 10 years (i.e., meeting a 3% NATO target), annual defense spending would be about 0.9% of GDP.
**€500 billion in 10 years.

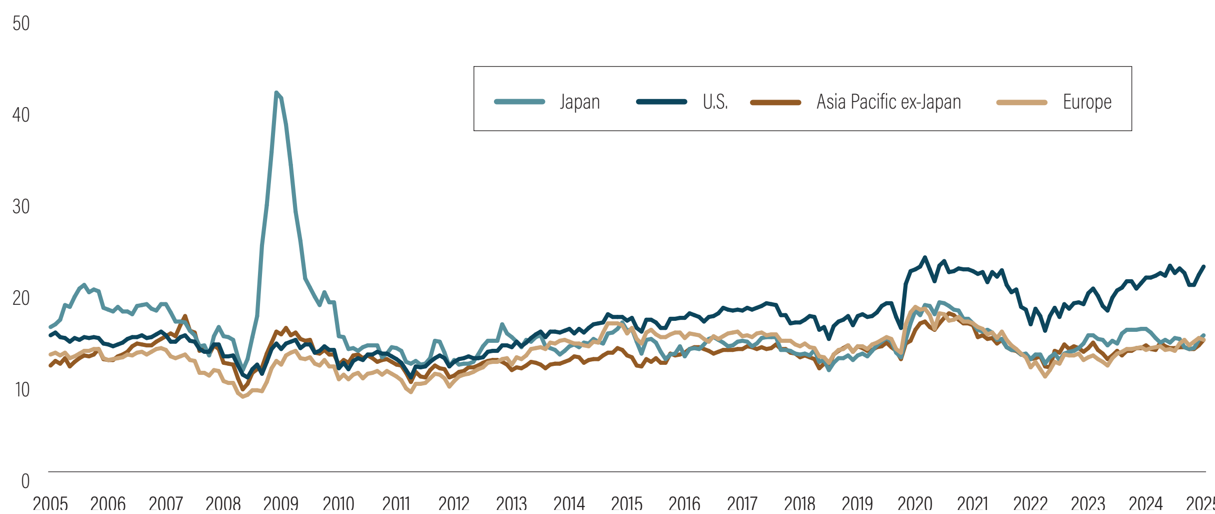
In our view, this fiscal sea change supports equities in two ways. First, higher government spending raises GDP, which filters into higher corporate earnings. Some analysts estimate that recent defense and infrastructure expansions could lift European earnings-per-share growth by about 3% annually over the next five years, in turn justifying higher equity valuations. Second, pro-growth budgets may improve investor sentiment and attract capital. Europe is changing from a region associated with budget cuts to one undertaking bold investments. This narrative shift could prompt global investors to rethink underweight positions in Europe, especially given currently low valuations.

3. International Is Cheap vs. the U.S.

International equities generally trade at a discount to the U.S. given the latter's significant exposure to faster-growing technology companies and the former's great exposure to "real" economy sectors such as Financials, Materials and Industrials. As of June 2025, the MSCI EAFE traded at a one-year forward price/earnings (P/E) ratio of 13.5, compared to about 21 for the S&P 500. Historically, the S&P 500's forward P/E has averaged a premium of about 25 – 30% over the MSCI EAFE, making the current gap far wider than usual and close to its largest in several decades. Even when neutralizing sector differences between the indices, we believe international looks inexpensive on a relative basis.

A HISTORIC VALUATION GAP

12-Month Forward P/E Ratios



Source: Bloomberg, data through June 30, 2025. Regions/countries represented by the MSCI Japan, U.S., Asia (ex-Japan) and Europe indices.

4. Europe Chooses Growth Over Regulation

Europe is beginning to loosen its historically tight regulations and bureaucracy in order to prioritize growth and strategic industries. For years, a common critique of Europe was that "overregulation"—from rigid labor laws and heavy red tape to stringent rules on businesses—contributed to slower growth. Now, facing new economic and geopolitical realities, European policymakers are increasingly willing to cut red tape and adopt an industrial policy mindset in consultation with business leaders. We think this represents an important potential tailwind, with renewed emphasis on competitiveness, innovation and regulatory efficiency.

How we got here is worth considering. The U.S. Inflation Reduction Act of 2022 (which poured $369 billion into clean energy subsidies) served as a wake-up call for European leaders, who feared that capital and companies would be lured to the U.S. The EU quickly drafted a "Green Deal Industrial Plan" that eases state aid rules (so governments can subsidize key green technologies), streamlines permitting for renewable energy projects, and provides incentives for nascent industries like battery manufacturing, hydrogen and carbon capture.

Another example of positive reform is the "Europe First" Sovereignty Agenda. Rising geopolitical tensions and supply chain disruptions have led to an EU-wide emphasis on "strategic autonomy," ensuring that Europe isn't overly dependent on foreign powers. This has prompted new policies to develop European capabilities in defense, semiconductors, batteries and critical materials.

In sum, Europe's policy mindset is shifting from one of stringent oversight to one of competitive pragmatism: not abandoning regulations, but recalibrating them to encourage domestic growth, innovation and security.

5. Japan Is Winning on Inflation and Corporate Reform

After the "lost decades" of deflation and weak growth, global investors have been warming up to Japanese equities in recent years. The Bank of Japan's (BoJ) preferred measure of inflation has remained above its 2% target for nearly three years, which could mean that Japan is finally leaving deflationary stagnation behind it. In January, the BoJ raised interest rates for the first time in 17 years to 0.5%, a further sign of confidence that better times await. Many Japanese companies have been raising prices, which has been a tailwind for their revenues and earnings.

Perhaps more important for longer-term investors, rules published last year by the Tokyo Stock Exchange (with the support of the Japanese government) seek to force companies to improve capital efficiency, profitability and engagement with shareholders—or face delisting by 2026. This follows other measures such as unwinding "cross-shareholding" networks to reverse corporate Japan's track record of complacency, low returns on equity, poor capital allocation policies and weak governance. Stock buybacks in Japan in 2024 set a record and were almost double the prior year.

There is still plenty of room for improvement, and we think the next few years could be rewarding for stock-pickers who stay the course.

Conclusion: A Shift in Leadership?

Investors waiting for a rotation into international stocks have been disappointed over the last 15 years as much-anticipated "catalysts" such as economic catch-up potential, a weakening U.S. dollar and the narrowing of valuation discounts failed to materialize. In our view, the transition to a new geopolitical and economic regime, characterized by higher capital investment to ensure self-sufficiency in key national strategic interests, including infrastructure, energy, defense and broader economic resilience, could provide better results. To capitalize, however, we believe investors need to look beyond the past "exceptionalism" of the U.S., where, after outsized returns in recent years and given high current valuations, returns moving forward may be more subdued. Generally, return potential is viewed as more favorable where expectations are low rather than high. U.S. expectations are at generational highs, while the opposite is true for international equity markets.

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