December Commentary

Investing in the Good Ole USA and a Heartfelt "Gesundheit"

My first professional employer, Barnett Bank, was a bank holding company based in Jacksonville, Florida. In the early to mid-1990s, Barnett was known as the "blue collar" bank and trust company in the state. We managed several billion dollars in client assets at a time when the S&P 500 was in the 400s, General Electric and IBM were dominant U.S. corporations, and a billion dollars still meant something. Early at Barnett, I worked in the department responsible for managing their common trust funds and proprietary mutual funds. Being the proverbial low man on the totem pole, I had the grave misfortune of assisting with the proofing, writing, and rewriting of prospectuses and annual reports when necessary. Talk about tedious work.

During my tenure at Barnett, senior management made the decision to add an "International Equity Fund" to the lineup. Since we didn't have real expertise in foreign equities, we hired a sub-advisor specializing in the international markets. "We" is a strong word choice because I didn't have any part in the decision-making process. Regardless, our new International Equity Fund was incredibly popular with portfolio managers, trust administrators, and advisors. If memory serves, our new international offering was all anyone wanted to discuss for quite a while. After all, and believe it or not, international investing was not as mainstream back then for investors as it is now. It was nowhere close, and having the fund made us unique compared to much of our competition. Then, when the investment returns for our new fund offering didn't match the sizzle, inflows and the hype largely stagnated. It wasn't necessarily the sub-advisor's fault - the U.S. was simply a better bet in the mid-1990s.

The U.S. market has offered significantly better total returns than international markets over the last three decades.

I share that little story because I have been somewhat dispassionate about international investments for an extended period – almost three decades. In my way of thinking, they are akin to the congealed salad your favorite aunt brings to every holiday get-together. It isn't any good, but, by golly, you better put some on your plate. To help support my unsavory analogy, from 1989 through November 2024, the S&P 500 had a total rate of return of nearly 3,200%. By comparison, the international equivalent, MSCI EAFE, has returned less than 430%. That approximates annualized returns of 10.5% and 4.9%, respectively. Truthfully, you would have done better investing in the Lehman/Bloomberg U.S. Aggregate Bond Index with a 454% total return and 5.0% annualized versus the international equity market. I'm convinced that comparing the U.S. equity markets to international ones is like pitting the technology sector against utilities. Will tech stocks always beat utilities over every trailing period from now until eternity? Of course not. However, would you prefer to own tech stocks or utilities over the next decade? If you had to bet all your money on one sector, which would you choose, technology or utilities? I imagine most people reading this newsletter would probably opt for tech stocks. It's not that utilities don't play a role in portfolio diversification because they certainly do. However, which would you rather own over the long haul?

Without question, an obvious counter to my argument for U.S. stocks over their international counterparts would be "developed international markets are so much cheaper than the U.S." By nearly every traditional valuation measure, this is an entirely accurate statement. The U.S. market, as defined by the S&P 500, has higher price/earnings (P/E), price/book (P/B), and price/sales (P/S) ratios than the MSCI EAFE Index. Frankly, they are not even close. So, international stocks will indeed outperform domestic at some point, right? If traditional valuation tools were the only reasons stocks perform the way they do, it would be a probability and not just a possibility. However, they aren't. And perhaps more relevant, it depends on your time horizon. Are you talking about three months, three years, or a decade? If history is any indicator, I would rather own domestic stocks over any 10-year market cycle in the future. Like most investors, I, too, like to put my money where the growth is likely. Consider this example: according to FactSet, the P/E, P/B, and P/S ratios for Alphabet Inc. (GOOGL) Class-A shares are all significantly higher than Ford Motor Company (F). So, according to every widely accepted fundamental investment metric, GOOGL is currently much more expensive than Ford. Yet, guess which one has a 12-month price target of roughly +25% from its recent price and which has a +4% target? I will give you one guess: it isn't Ford despite being so much "cheaper" than GOOGL. Hey, I am not trying to knock Ford. Truth be told, I like several of their pickup trucks!

Let's face it: the global economy runs through the United States, either directly or indirectly. For instance, the second largest holding in the $54 billion iShares MSCI EAFE ETF (EFA), an international index fund, is Danish pharmaceutical giant Novo Nordisk (NOVOB). Denmark's six million citizens aren't enough to make NOVOB a household name here in the States, as their entire population is about the same size as Colorado, Wisconsin, or Maryland. So, should it surprise anyone that NOVOB gets about 60% of its revenue from North America (primarily the U.S.)? Interestingly, despite being headquartered in a European country, the company receives just over 20% of its revenue from Europe, the Middle East, and Africa. Without question, many of our large international firms generate more money "overseas" than they do in the United States. However, you will be hard-pressed to find one where the U.S. isn't one of the prominent individual markets, if not the dominant one.

That said, the U.S. consumer is vast, for the most part, "fat and happy," and our U.S.-based corporations span the globe like no other. Consider this recent list of Forbes's most influential brands from around the world in order from 1 through 20: Apple, Google, Microsoft, Amazon, Facebook, Coca-Cola, Disney, Samsung, Louis Vuitton, McDonald's, Toyota, Intel, NIKE, AT&T, Cisco, Oracle, Verizon, Visa, Walmart, and General Electric. If my counting is correct, that makes 17 U.S. corporations in the top 20. While the rest of the world slightly catches up from 21-100, it isn't by much, as American firms dominate the rollcall of companies. If this list is correct, it is a fairly feeble showing by the rest of the world. When taken together, instead of asking why more American investors don't embrace more opportunities worldwide, a better question might be: why should they? While that may border on sounding xenophobic and arrogant, it doesn't mean it is not a great question. Then, there is the issue of where corporate profits are generated. Let me give you a hint: it is not close. Suppose you consider this data set from tradingeconomics.com. After making currency adjustments, the corporate profitability for the eleven countries on this list does not total 60% of the profits of the United States, once again proving our country's corporate dominance is hard to deny.

In other words, revenue and profits within the global economy are concentrated in the United States.

This doesn't mean the rest of the world isn't essential; far from it. However, current and historical data make a perfectly logical argument as to why so many American investors are seemingly indifferent to investing in foreign businesses; too many dollars and dominant companies reside in the world's most excellent economy. Please hear me when I say I don't harbor any ill will toward the international equity markets. Having them in a portfolio provides diversification, can reduce volatility, and potentially enhance returns on the equity side of most allocations - not unlike a molded gelatin salad full of fruit, adding culinary variety to an otherwise splendid holiday meal. Ok, maybe that comparison is a little snarky. Don't get me wrong; a few fantastic foreign companies have proven highly competitive against our domestic counterparts. However, until the Eurozone collectively shows signs of long-term, systemic vibrancy, it may be a while until investors change their tune and begin investing more enthusiastically there. And quite honestly, the same could be said of Japan or the United Kingdom. Let's face it: Investors don't care what language you speak, the food you eat, or the clothes you wear. Seriously, they do not. They care about generating the highest possible level of return they can for the amount of risk they are willing to take. However, given market history, breadth, liquidity, economic innovation, entrepreneurialism, continued growth prospects, and overall risk tolerance, all things still point to the United States as the best long-term country to place the most significant position of your equity exposure. No questions asked. Maybe, just maybe, it makes sense to include one small serving of lime green molded Jello mixed with fruit; it will make your favorite aunt smile and may eventually satiate your palate. Deliberately, our investment team made the decision to limit international exposure on behalf of our clients to a much lesser extent than many of our competitors. While many of them, and so-called international market pundits, recommend up to a 25% allocation, we have been and continue to be in the mid-single digits for non-domestic exposure. Our decision has enhanced overall portfolio returns and we are convinced it will as we move forward.

So, why this topic to start the new year? The U.S. dollar has reasserted its dominance and threatens to make other global currencies less significant. Further, despite the Federal Reserve cutting the overnight rate, which should make U.S. deposits less attractive, foreign investors poured money into our financial system last year. Lastly, it can be argued the U.S. economy and financial system may be more sheltered from the world's economic woes than the rest of the world is from ours. Or another way of putting it: "When the U.S. economy gets a runny nose, the rest of the world comes down with the flu." However, when the rest of the world catches a cold, the U.S. offers up a "gesundheit." There *might* be some irony in there somewhere.

Until next month—

by David Lackmann
Florida Director of Investment Management

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