

Non-US Equity Markets Shine in Q3

Sep 2024

International markets performed strongly in Q3, with the MSCI ACWI ex-US Index up 8.06%, outpacing many broad-based US indices. Most regional indices worldwide were positive for the quarter, with Asian regional indices leading the way. China was a standout performer in Asia as a late-quarter rally boosted stocks in that country. After a brief mid-quarter sell-off, Japanese equities also ended the quarter in positive territory. European equities, including stocks in the United Kingdom, were also broadly positive.

The long-awaited shift of the interest-rate cycle is here, with the Federal Reserve cutting US rates 50 basis points (bps) in September and signaling several more rate cuts are on the table. In the Fed's wake, several other major global central banks cut rates, too, including the European Central Bank, Swiss National Bank, and, notably, the People's Bank of China, which not only lowered rates but banks' reserve requirements, too (more on China momentarily). The Bank of Japan, which has only recently lifted the country out of its long-standing negative rates regime, increased rates from 0.1% to 0.25% in late July as it attempts to balance nascent inflation after years of deflation, a markedly weaker yen and lackluster economic growth.

The apparent end of the higher interest-rate cycle helped spur markets higher in September, as did some noteworthy policy shifts in China, which has been struggling to lift its economy out of relative malaise since roughly the pandemic. Late in September, the government announced not only a raft of monetary policy shifts (including the aforementioned rate and reserve requirement cuts), but also a forthcoming fiscal policy package aimed at spurring domestic demand – which surprised investors and seemingly boosted sentiment significantly, as China's market made a meaningful jump thereafter. However, details of the fiscal stimulus are yet to be announced, so whether this proves a true game-changer, which finally lifts the country out of its property sector-induced swoon or not, remains to be seen.

Global monetary policy has been and will likely continue to be supportive after years of tightening, which could bode well for international equities. However, the pace of recovery remains uncertain in many regions, and there are risks that inflation may spike again, potentially undermining efforts to boost growth.

Many European economies are grappling with a tough combination of growth challenges, competitive threats, high energy costs, conflicting policy initiatives, and debt burdens. The United Kingdom, France and Germany all have yet to return to the economic growth experienced before the COVID-19 pandemic, and with COVID-era stimulus having ended, a new economic direction is needed to maintain competitiveness with the US and China.

French President Macron has pushed for a more unified, efficient single-energy market, including low-carbon initiatives, and has criticized the fragmented state of industries such as telecommunications, chemicals, and energy. Macron has advocated for higher R&D investment and more unified regulatory frameworks across sectors such as AI, steel and chemicals.

Germany, in particular, has been negatively impacted by high energy costs and international competition in industries like automobiles, where Chinese electric vehicles are taking market share from German auto companies. How France and Germany deal with competitive threats remains to be seen as Macron has begun to advocate for tariffs to protect industries. Germany is against tariffs as their auto companies are heavily reliant on foreign sales, which retaliatory tariffs could hurt. As some European countries begin to talk about how to reduce their debt levels, new tax proposals in the United Kingdom, France and Italy are risks that may be underappreciated, and we are monitoring how they could affect the profitability of companies operating in those countries.

China's outlook remains challenging despite policy initiatives that caused local equity markets to rally to finish the quarter. The Chinese economy has gone through a period of high savings rate and is still reliant on investments and exports. Rate cuts, housing support and a lending program for equities were all announced together in an effort to boost confidence. While this is all positive, it doesn't seem enough in our view. Consumer spending is still weak, and while Chinese equities remain cheap, it's difficult to foresee a significant turnaround without addressing deeper economic and consumer sentiment issues.

In Japan, we remain encouraged by corporate governance reform. While a new Prime Minister and an increase in interest rates made headlines in the quarter, corporate governance reform will be a more powerful driver of long-term returns. Companies embracing better capital allocation and enhanced shareholder value creation could unlock value for shareholders that hasn't been experienced for decades. We remain focused on companies that not only talk about change but also show action, and we can see evidence of their willingness to change.

Globally, geopolitical risks remain elevated. The conflict in Ukraine shows little sign of resolution, and tensions in the Middle East remain high, particularly with Israel's continued operations in neighboring territories and the potential for escalation with Iran. While these risks pose ongoing challenges, any surprise de-escalation in these conflict zones could boost market sentiment.

Despite these challenges, we remain committed to identifying attractive opportunities that have the potential to produce above-average returns over the next five years. Our primary focus is on achieving value-added results for our clients through active portfolio management, with a belief that we can outperform the market by maintaining our disciplined approach.

MSCI ACWI ex USA Index measures the performance of large- and mid-cap stocks in developed (excluding the US) and emerging markets. The index is unmanaged, market capitalization weighted, includes net reinvested dividends, does not reflect fees or expenses (which would lower the return) and is not available for direct investment. Index data source: MSCI, Inc. See diamond-hill.com/disclosures for a full copy of the disclaimer.

The views expressed are those of Diamond Hill as of October 2024 and are subject to change without notice. These opinions are not intended to be a forecast of future events, a guarantee of future results or investment advice. Investing involves risk, including the possible loss of principal. Past performance is not a guarantee of future results.