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International Developed Market Stocks: Diversification Beyond U.S. Borders

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Introduction

While U.S. stocks have provided dominant returns in recent years, international developed markets—think Europe, Japan, Australia, and Canada—remain an essential part of a globally diversified portfolio. These markets offer different economic cycles, sector exposures, and currency dynamics, helping investors smooth out the bumps in their long-term returns.

What Are International Developed Markets?

International developed markets are advanced economies outside the U.S., typically characterized by stable political systems, mature financial markets, and well-established regulatory frameworks. The MSCI EAFE Index (Europe, Australasia, and the Far East) is the primary benchmark for this segment, covering over 800 large- and mid-cap companies across 21 countries.

Historical Returns and Risk

Over the past 50 years, international developed markets have delivered long-term returns similar to U.S. stocks, though with different cycles and sometimes higher volatility. In 2024, the MSCI EAFE Index returned about 12%, trailing the S&P 500's 25% but still delivering solid performance[1]. Over the last five years, leading international ETFs have posted annualized returns of roughly 11%—again, a step behind the U.S., but with valuable diversification benefits[1].

Why International Developed Markets Matter Now

International stocks are currently trading at lower valuations than their U.S. counterparts. As of 2024, the price-to-book ratio for developed markets is about 3.2, compared to 4.7 for the U.S. S&P 500[2]. This valuation gap, combined with the potential for a weaker U.S. dollar and economic recovery in Europe and Japan, could provide a tailwind for international stocks in the coming years.

International markets also offer sector diversification. For example, European markets are heavier in financials and industrials, while Japan has a strong presence in automation and robotics. This helps reduce reliance on the U.S. tech sector, which now dominates U.S. index returns.

The Role of International Developed Markets in a Portfolio

Adding international developed markets to your portfolio can reduce overall risk and enhance returns, especially during periods when U.S. stocks lag. Many experts recommend allocating 20–30% of your equity portfolio to international stocks, with roughly two-thirds of that in developed markets.

Why Funds and ETFs Are the Smart Way to Own International Developed Markets

Investing directly in foreign stocks can be complicated due to currency risks, unfamiliar regulations, and tax issues. International mutual funds and ETFs—such as Vanguard FTSE Developed Markets ETF (VEA) and iShares Core MSCI EAFE ETF (IEFA)—offer broad, low-cost exposure to hundreds of companies across dozens of countries. These funds handle currency conversion, tax compliance, and rebalancing for you.

Risks and Considerations

International developed markets face their own challenges, including slower economic growth, political uncertainty, and currency fluctuations. Investors should be prepared for periods of underperformance relative to the U.S., but history shows that leadership rotates over time. Maintaining a consistent allocation is key to capturing the benefits of global diversification.

Points to Remember

- International developed markets provide valuable diversification, lower valuations, and different sector exposures compared to the U.S.
- Recent returns have lagged U.S. stocks, but valuation gaps and changing economic cycles could set the stage for future outperformance.
- The best way to invest is through diversified mutual funds or ETFs, which simplify currency, tax, and regulatory issues.
- A strategic allocation to international developed markets (15–20% of total equity exposure) can enhance long-term returns and reduce risk.

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