Chart of the Week

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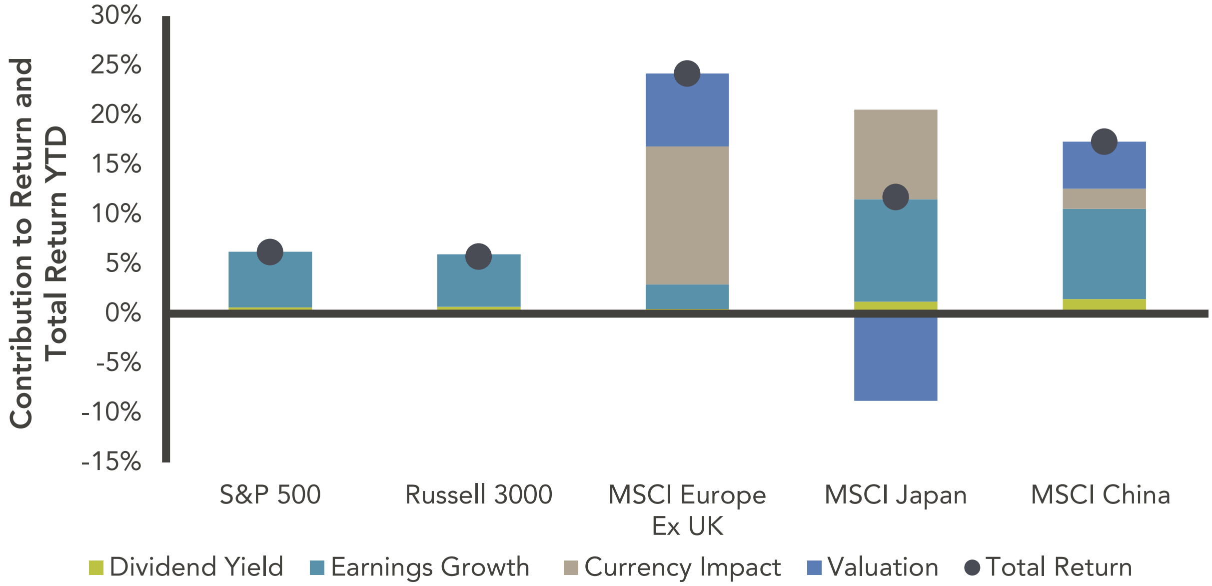
Non-U.S. Stocks: Currency Leads, Earnings Lag

JULIA SHEEHAN, ASSOCIATE RESEARCH ANALYST

Currency tailwinds and valuation gains have boosted international equities this year, but lower earnings growth has tempered investor enthusiasm



Source: Bloomberg as of June 30, 2025

There was a striking reversal in equity performance trends during the first half of 2025, with non-U.S. stocks outperforming their U.S. peers by a significant margin. Specifically, the MSCI ACWI ex-U.S. and Russell 3000 indices returned 17.9% and 5.8%, respectively, on a year-to-date basis through June 30. While it is unclear whether this shift is a temporary phenomenon or the unraveling of a multidecade pattern, a deeper exploration of year-to-date returns for various equity benchmarks may provide some answers. Notably, currency movements, particularly the weakening of the U.S. dollar, have played an outsized role in the returns of non-U.S. stocks this year, adding 14% and 9% to the total year-to-date returns of the MSCI Europe ex-UK and MSCI Japan indices, respectively. Multiple factors have contributed to this bout of dollar weakness, including uncertainty regarding tariffs, concerns about the U.S. fiscal deficit, and a growing global interest in diversifying into non-U.S. assets. European and Asian equities have benefitted from these dynamics, with both regions experiencing strong capital flows in the first half of the year. This helps explain the second-largest return driver for international equities in 2025: multiple expansion. Indeed, improving investor sentiment and capital inflows have recently propelled international equity valuations above their long-term averages. Pledges for increased defense spending and infrastructure development in Europe (as described in a recent Chart of the Week) are especially

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stoking enthusiasm among investors, with fiscal stimulus measures and rate cuts serving as additional sentiment tailwinds.

While the factors detailed above warrant excitement about non-U.S. equities, it is prudent to address the risks facing the asset class as well. To that point, a third takeaway from the return decomposition detailed above is what is nearly absent from the total return of Europe and Japan: meaningful earnings growth. While certain sectors of the non-U.S. market, such as Financials and Information Technology, have strong growth projections, broad earnings expectations are mixed, with European companies expected to report a 0.3% drop in earnings for the second quarter. In conclusion, there is certainly a case for optimism related to the prospects of non-U.S. stocks going forward, but it is important to underscore the importance of earnings growth as the key driver of long-term returns.

PREPARED BY MARQUETTE ASSOCIATES

180 North LaSalle St, Ste 3500, Chicago, Illinois 60601
CHICAGO BALTIMORE MILWAUKEE PHILADELPHIA ST. LOUIS

PHONE 312-527-5500
WEB marquetteassociates.com

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