Three Pillars of International Investing

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Today's investors may be handicapping their return potential by not considering international stocks, which remain an important part of a diversified equity portfolio. An active approach to international investing unlocks a broad opportunity set, allowing investors to search for the best investment ideas around the world. And we believe portfolios constructed with this in mind have the potential to deliver superior risk-adjusted returns.

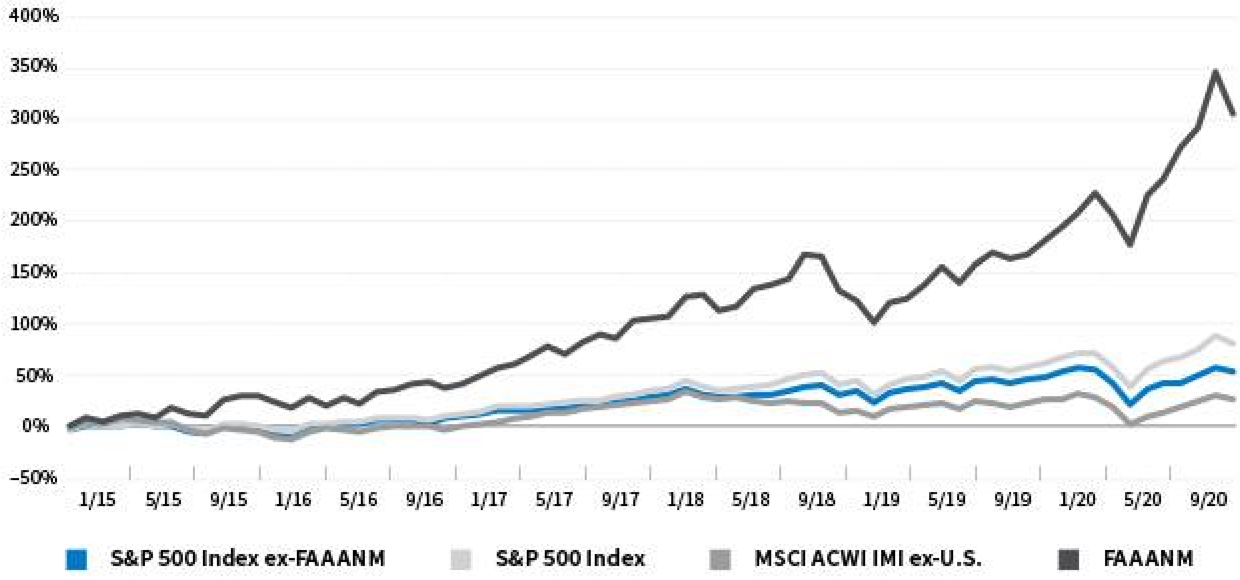
U.S. Equity Outperformance: Highly Concentrated

U.S. equity markets have significantly outperformed international equity markets since the Global Financial Crisis (GFC), leaving some investors hesitant to diversify outside the United States. But the outperformance of U.S. equities has not been broad. Investors should consider the elements of this outperformance—namely, the fact that it has been highly concentrated.

While the S&P 500 Index has outperformed the MSCI All Country World Index (ACWI) ex-U.S., much of that outperformance can be explained by a few key stocks, mainly in the information technology (IT) sector, as the chart below illustrates.

S&P 500 Index Performance Driven by FAAANM Stocks (Cumulative Returns)

The performance of the S&P 500 Index has been driven by a few key stocks, including those referred to as "FAAANM"—Facebook, Apple, Alphabet, Amazon, Netflix, and Microsoft.



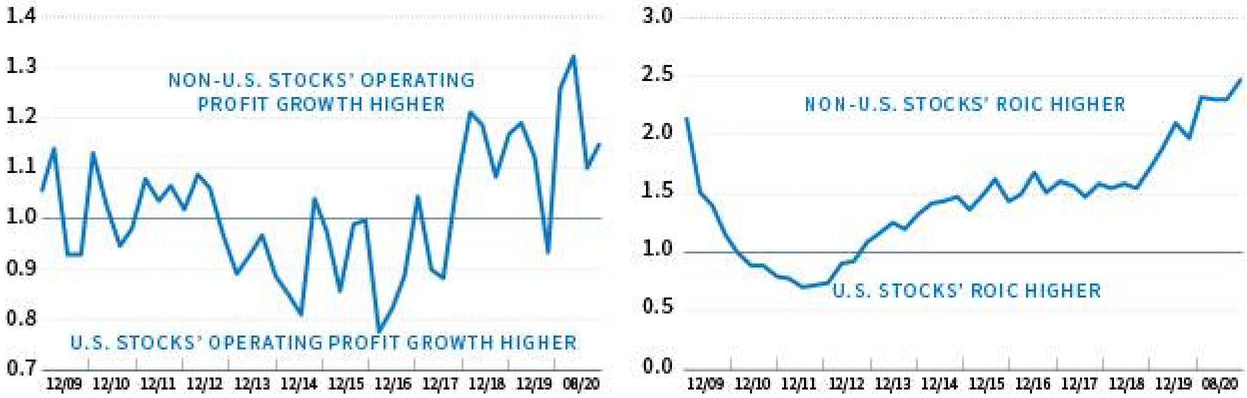
Sources: IDC and William Blair, as of 9/30/20. **Past performance is not indicative of future returns.** Indices are unmanaged and do not incur fees or expenses. A direct investment in an unmanaged index is not possible.

While growth and returns in the U.S. IT sector relative to the non-U.S. IT sector might have at one time foreshadowed the strong outperformance we have seen, that dynamic has shifted. U.S. IT sector growth and return expectations have declined on an absolute and relative basis when measured against the non-U.S. universe, as the chart below illustrates.

In fact, as we will discuss later, we believe the outlook for growth and returns in aggregate across all sectors is more favorable for international equities.

IT Sector Growth and Returns Have Shifted in Favor of the Non-U.S. Universe

The U.S. IT sector's growth and return on invested capital (ROIC) have declined on an absolute basis as well as relative to the non-U.S. universe. The charts below show the spread between U.S. and non-U.S. stocks.



■ **MSCI ACWI IMI ex-U.S. IT Sector vs. Russell 3000 Index IT Sector: NTM Operating Profit Growth**

■ **MSCI ACWI IMI ex-U.S. IT Sector vs. Russell 3000 Index IT Sector: ROIC**

Sources: Worldscope, IBES, and William Blair, as of 9/30/20. **Past performance is not indicative of future returns.** NTM is next 12 months.

International Investing: Three Pillars

This narrowing of growth in the United States may be a signal for concern given the lack of diversity across sectors, market capitalizations, and corporate lifecycle. Investors may be handicapping their return-generation potential by not investing internationally. We base this thesis on three pillars.

First, company-specific factors, including what we call "sustainable value creation," are increasingly more important than country-specific factors, and companies that deliver strong sustainable value creation are increasingly found outside the United States.

Second, expectations for earnings growth and return on invested capital (ROIC) have become favorable outside the United States—and our outlook for growth in key industries suggests accelerating demand and emerging business models abroad.

Lastly, the regulatory environment outside the United States is more conducive to the proliferation of disruptive business models.

In addition, while investors are understandably hesitant to consider non-U.S. investing given geopolitical tensions that imply a movement toward deglobalization or "slowbalization," this dislocation is not without upside.

In fact, there has been an acceleration of the repatriation of intellectual capital, investment in local supply chains, and the emergence of domestic champions offshore. This has created, for international investors, a growing opportunity set for portfolios.

An Active International Approach Can Add Value

An active approach to identifying high-quality growth investments outside the United States has the potential to unlock a broad opportunity set, allowing investors to search for the best investment ideas around the world.

The use of a wide aperture in identifying high-quality growth investments, regardless of region or country of domicile, may lead to portfolios with heightened conviction, lower turnover, and higher risk-adjusted returns than constraining the focus to a narrower mandate.

In our white paper and following blog posts, we discuss these three key pillars and how they inform our thesis—that investors interested in growth should consider investing internationally. Leveraging these ideas to gain insight into where global profit pools are growing and constructing portfolios from those ideas could result in strategies that deliver superior risk-adjusted returns.

Three Pillars of International Investing Series
Part 2: Fishing in Bigger Ponds
Part 3: A Changing Tide Favors Non-U.S. Stocks
Part 4: Disruptive Business Models Drive Growth Abroad

The Standard & Poor's (S&P) 500 Index is a market-capitalization-weighted index of the 500 largest U.S. publicly traded companies. The MSCI All Country World Index (ACWI) Investable Market Index (IMI) captures large-, mid-, and small-cap representation across developed and emerging markets. The ex-U.S. variation of the index excludes the United States. The Russell 3000 Index measures the performance of the 3000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market. Index performance is provided for illustrative purposes only.

Alaina Anderson, CFA, partner, is a portfolio manager and research analyst on William Blair's Global Equity team.

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