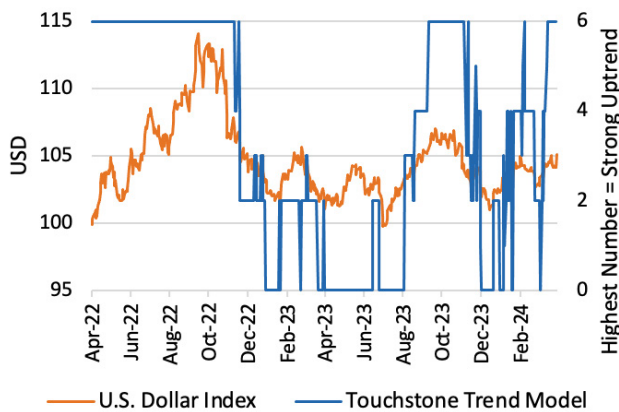




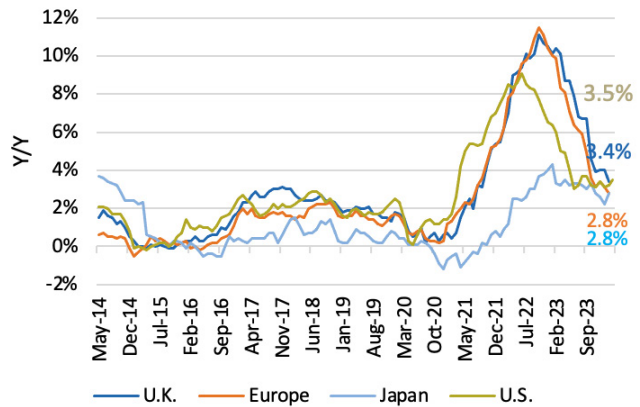
- ▶ Recently the dollar moved back into a strong uptrend versus developed market currencies. U.S. economic conditions remain healthy and sticky inflation has pushed out the timing of the anticipated Fed pivot.
- ▶ Dollar strength versus developed currencies since the pandemic has led many to believe that it will give back those gains once the Fed begins its easing cycle. We believe relative economic strength may deter a dollar swoon.
- ▶ Relative shorter-term interest rates have been an important currency driver since the pandemic, though it was less important before that. Currencies have many drivers and it is important to monitor changes in the relative importance among the drivers. Currently, rates remain in the driver's seat.
- ▶ Emerging market currencies have recently performed much better versus the USD than developed markets.
- ▶ Interest rates have been a part of the EM story as many EM central banks raised rates before the Fed, supporting their currencies. China, on the other hand, has been lowering rates but has taken measures to keep their currency from falling.
- ▶ Capital flows have been an important EM currency driver. Capital flows represent the money moving into or out of a country due to trade and/or investment. Capital inflows indicate a trade surplus and/or increased foreign direct investment. Rising capital inflows generally spur economic growth and put upward pressure on a country's currency.

U.S. Dollar Index Trend



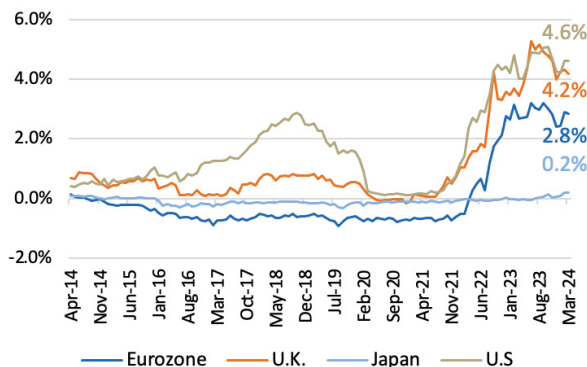
Source: Bloomberg. 2 years of daily data through Apr 10 2024. Model based on moving averages and price trends.

Headline Inflation (CPI by Region)



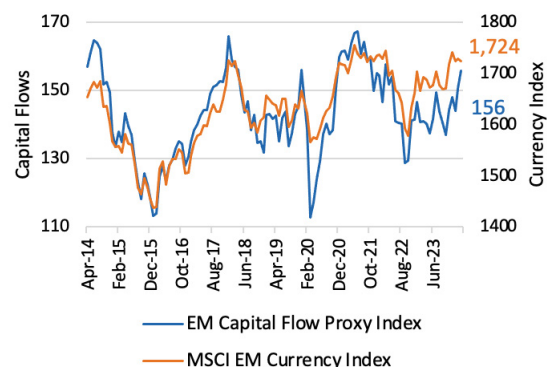
Source: Bloomberg. 10 years of monthly data through U.K. through Feb 2024, Europe through Feb 2024, Japan through Feb 2024, U.S. through Mar 2024.

2 Year Government Bond Yields



Source: Bloomberg. 10 years of monthly data through Mar 2024.

Capital Flows and Currency Movement

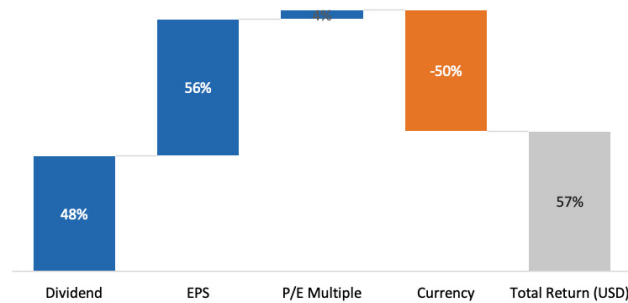


Source: Bloomberg. 10 years of monthly data through Mar 2024.



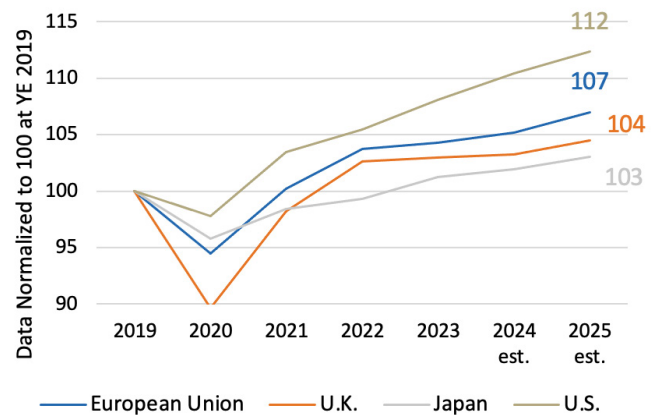
- ▶ Foreign index returns can be decomposed to four main drivers: dividend income, earnings growth, changes in the multiple on earnings, and currency. The below chart provides those components. The total return in USD is the sum of the components.
- ▶ As can be seen currency was a significant performance detractor for U.S. investors.
- ▶ Another cause of MSCI EAFE Index relative underperformance was slower earnings growth. Over the last 10 years earnings growth for the MSCI EAFE Index was 56% (in local currency terms), while S&P 500 Index earnings increased 103%.
- ▶ Several factors have contributed to the earnings underperformance, both cyclical and secular.
- ▶ Cyclical factors include slower relative economic growth, monetary policy differences, and geopolitical factors such as Brexit and the Russian invasion of Ukraine.
- ▶ Secular factors include index composition with a value style bias and differences in sector weights. Additionally, foreign companies also tend to face greater regulatory requirements that raise compliance costs. Europe has much more stringent environmental and labor regulations, and a higher tax burden.
- ▶ Next month we will turn our focus to the future and begin to provide our views on each of the return drivers and how they may stack up relative to domestic equities and emerging markets.

MSCI EAFE Index Return Composition



Source: Bloomberg. Cumulative total returns over the last 10 years through Mar 2024.

Real GDP Growth Since 2019



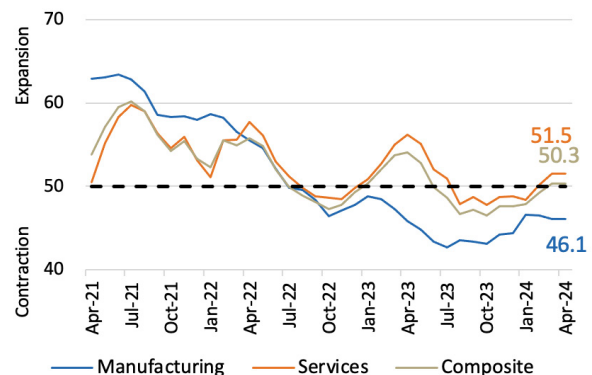
Source: Bloomberg. Normalized real GDP growth since 2019, with consensus forecasts for 2024 and 2025.

Eurozone Earnings Cycles



Source: Bloomberg. 20 years of monthly data through Mar 2024. Order book data advanced 6 months.

Eurozone: IHS Markit Diffusion Indexes



Source: Bloomberg. 20 years of monthly data through Apr 2024.

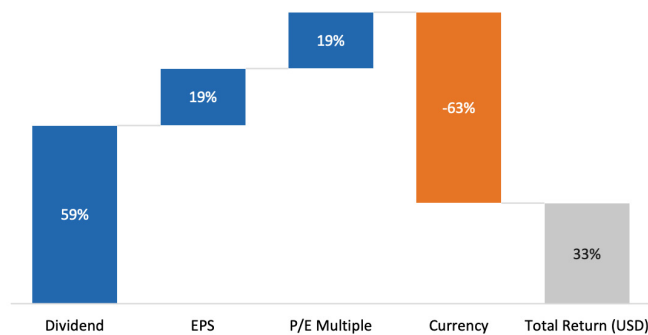


Authors: Crit Thomas, CFA, CAIA / Erik M. Aarts, CIMA / Brian Cheyne, CFA, CIMA

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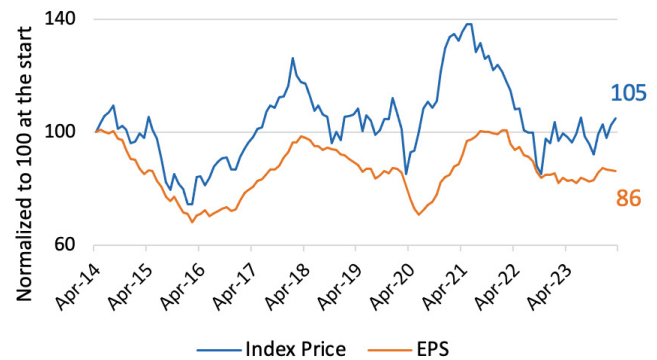
- ▶ Last month we noted that investing in Emerging Markets has not been very fruitful for MSCI EM Index investors versus the S&P 500 Index over the last 10 years.
- ▶ Through March the MSCI EM Index had a total return of just 33% over the last 10 years versus 236% for the S&P 500 Index.
- ▶ Currency was an important detractor from performance, but lack of earnings growth was important as well.
- ▶ MSCI EM Index earnings grew just 19% over the last 10 years (in local currency terms). Isn't EM supposed to be a growth story? S&P 500 Index earnings were up 103% over the same time.
- ▶ As we peel back the onion, we find that the EM earnings present a very complicated story. And it starts with large index changes that have made comparability to the past difficult. Russia had a 5% weight in 2014 and was removed in 2022. China's weight increased from 14% to 23% due mainly to the addition of A-shares. This is despite the fact that the MSCI China index underperformed the MSCI EM Index. How do we reconcile EPS given the magnitude of these changes?
- ▶ Significant state owned enterprise (SOE) exposure has been shown to be a significant drag on earnings, though that exposure has come down with the removal of Russia.
- ▶ Another factor is EPS dilution from share issuance. This has been a constant drag for EM investors. Sector mix has also been an issue with historically greater exposure to Energy, Materials (which saw price declines), and SOE exposed Financials.

MSCI EM Index Return Composition



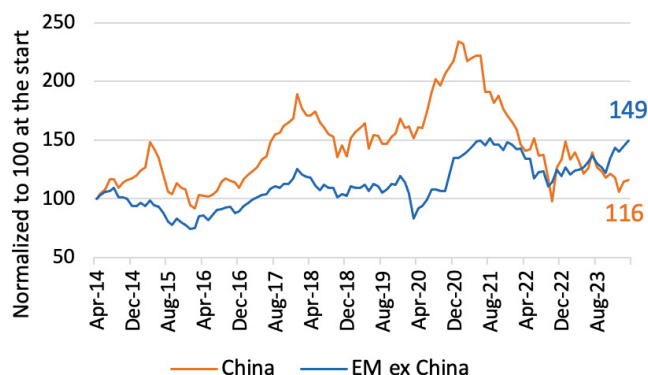
Source: Bloomberg. Cumulative total returns over the last 10 years through Mar 2024.

MSCI EM Index Price and Forward EPS (In USD)



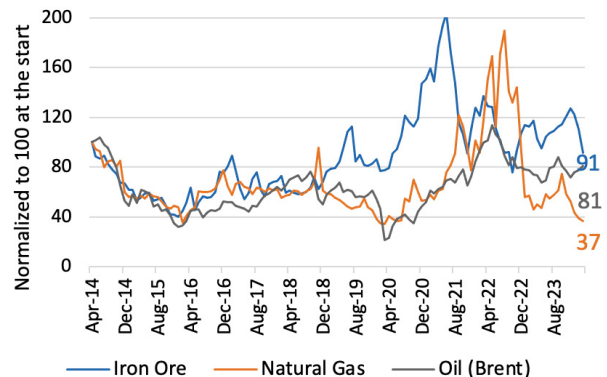
Source: Bloomberg. Normalized real GDP growth since 2019, with consensus forecasts for 2024 and 2025.

Total Returns in USD using MSCI Indexes



Source: Bloomberg. 10 years of monthly data through Mar 2024.

Commodity Prices



Source: Bloomberg. 10 years of monthly data through Mar 2024.



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The Indexes mentioned are unmanaged statistical composites of stock market or bond market performance. Investing in an index is not possible.

Total Net Returns in USD							EPS Growth Estimate	
	March 2024	YTD	2023	2022	2021	Index Weight	2024	2025
MSCI EAFE	3.3%	5.8%	18.2%	-14.5%	11.3%	100%	-2%	8%
MSCI United Kingdom	4.6%	4.0%	7.7%	7.2%	19.6%	13%	-10%	5%
MSCI Japan	3.0%	11.0%	20.3%	-16.7%	1.7%	24%	10%	9%
MSCI Europe	3.5%	5.9%	19.9%	-15.1%	16.3%	47%	-5%	10%
MSCI EM	2.5%	2.4%	9.8%	-20.1%	-2.5%	100%	17%	15%
MSCI China	0.9%	-2.2%	-11.2%	-21.9%	-21.7%	23%	14%	14%
MSCI India	0.8%	6.1%	20.8%	-8.0%	26.2%	18%	34%	15%
MSCI Taiwan	7.9%	12.4%	30.4%	-29.8%	26.1%	18%	20%	20%
MSCI Korea	5.2%	1.6%	23.2%	-29.4%	-8.4%	13%	14%	26%

Valuations								
	P/E (TTM)	Percent Rank	P/E (FTM)	Percent Rank	P/CF	Percent Rank	P/S	Percent Rank
MSCI EAFE	15.7x	31%	14.8x	64%	10.1x	76%	1.5x	96%
MSCI United Kingdom	12.2x	17%	11.8x	29%	7.8x	18%	1.3x	65%
MSCI Japan	16.9x	45%	17.1x	69%	9.9x	74%	1.3x	100%
MSCI Europe	16.2x	35%	15.2x	76%	10.7x	83%	1.6x	94%
MSCI EM	15.6x	69%	12.6x	73%	10.5x	90%	1.4x	60%
MSCI China	11.7x	25%	9.4x	14%	10.1x	61%	1.0x	13%
MSCI India	26.2x	93%	23.5x	95%	19.5x	96%	2.8x	91%
MSCI Taiwan	23.3x	74%	18.7x	93%	13.6x	80%	2.0x	78%
MSCI Korea	21.9x	88%	11.6x	84%	8.7x	88%	1.0x	94%

Fundamentals								
	Dividend Yield	Percent Rank	Profit Margin	Percent Rank	ROE	Percent Rank	Net Debt / EBITDA	Percent Rank
MSCI EAFE	2.9%	49%	8.1%	87%	11.1%	74%	1.2	4%
MSCI United Kingdom	3.9%	63%	7.7%	61%	11.4%	42%	0.6	9%
MSCI Japan	1.9%	56%	6.9%	95%	9.4%	87%	-1.3	7%
MSCI Europe	2.8%	49%	8.6%	91%	12.7%	74%	2.4	1%
MSCI EM	2.6%	64%	8.3%	42%	10.5%	23%	1.9	78%
MSCI China	2.7%	67%	8.4%	13%	9.9%	19%	2.5	91%
MSCI India	1.1%	16%	9.2%	45%	15.2%	38%	2.9	83%
MSCI Taiwan	2.5%	36%	8.3%	63%	12.2%	52%	0.3	11%
MSCI Korea	1.8%	56%	4.0%	31%	4.6%	12%	3.2	78%

For Index Definitions see: [TouchstoneInvestments.com/insights/investment-terms-and-index-definitions](https://www.touchstoneinvestments.com/insights/investment-terms-and-index-definitions)

Source: Bloomberg. Percent ranks are based on 30 years of monthly data as of the end of March; EPS growth estimates based on consensus bottom-up analyst estimates.



The Touchstone Asset Allocation Committee (TAAC) consisting of Crit Thomas, CFA, CAIA – Global Market Strategist, Erik M. Aarts, CIMA – Vice President and Senior Fixed Income Strategist, and Brian Cheyne, CFA, CIMA – Senior Investment Strategy Specialist, develops in-depth asset allocation guidance using established and evolving methodologies, inputs and analysis and communicates its methods, findings and guidance to stakeholders. TAAC uses different approaches in its development of Strategic Allocation and Tactical Allocation that are designed to add value for financial professionals and their clients. TAAC meets regularly to assess market conditions and conducts deep dive analyses on specific asset classes which are delivered via the Asset Allocation Summary document. Please contact your Touchstone representative or call 800.638.8194 for more information.

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