International Equities

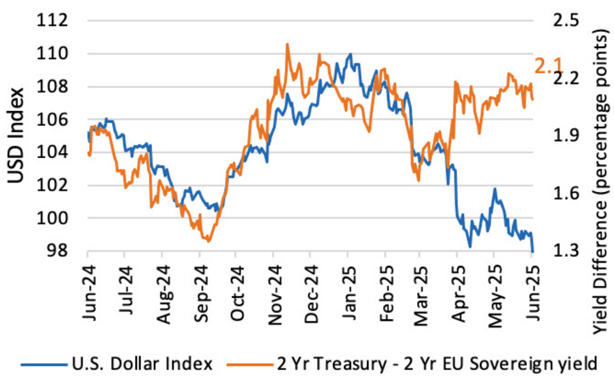
Currency Backdrop

Authors: Crit Thomas, CFA, CAIA / Erik M. Aarts, CIMA / Tim Paulin, CFA

June 16, 2025

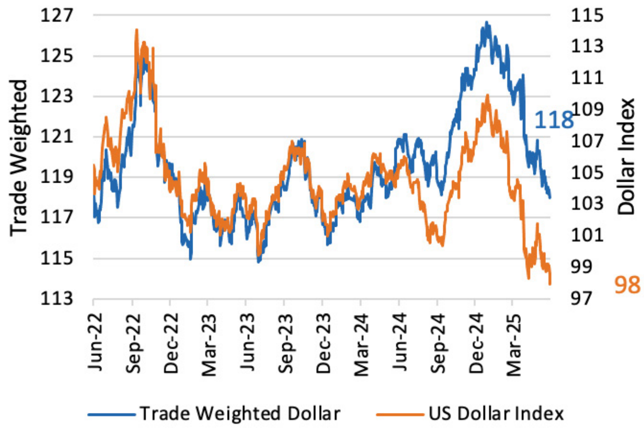
- The U.S. dollar has weakened notably in recent months, even as conventional supports, like widening interest rate differentials and newly imposed tariffs, would normally push it higher. This break from historical patterns suggests a deeper shift in investor sentiment and macro fundamentals.
- Part of the story is growth. Expectations for the U.S. economy are softening amid tighter credit conditions, a peaking labor market, and signs of consumer fatigue, which are contributing to U.S. growth concerns.
- Investors may also be responding to growing political uncertainty. The Trump administration's confrontational stance, particularly its willingness to use economic leverage unilaterally, has eroded trust in U.S. policy stability, diminishing the dollar's traditional safe-haven status.
- From a valuation perspective, the dollar looks vulnerable longer term. On a purchasing power parity (PPP) basis, it remains overvalued relative to many major currencies. The real trade-weighted dollar has also begun to turn lower, signaling a potential shift toward a secular decline.
- Twin deficits present additional pressure. The U.S. continues to run sizable current account and fiscal deficits, requiring steady foreign capital to sustain. If overseas demand weakens, the dollar could come under further strain.
- Foreign appetite for U.S. assets appears to be cooling, especially among large asset holders such as sovereign wealth funds and global central banks. While total foreign holdings remain high, recent growth has been driven more by the private sector.
- In short, while the dollar's recent decline runs counter to some traditional macro drivers, shifting fundamentals and perceptions may be ushering in a new chapter for the greenback, supporting a strategic weight to international equities for U.S.-based investors.

U.S. Dollar Index and Relative Interest Rates



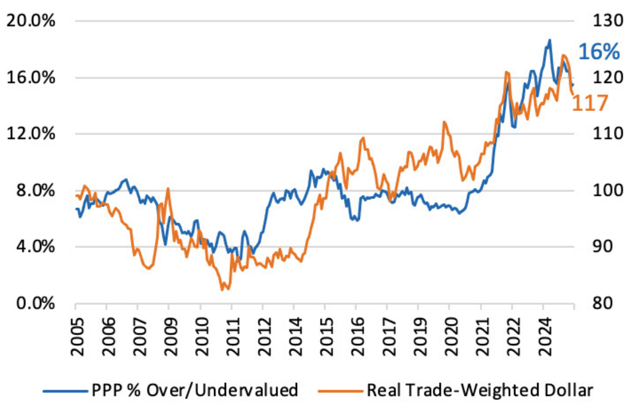
Source: Bloomberg. 1 year of daily data through Jun 11 2025

US Dollar Indexes



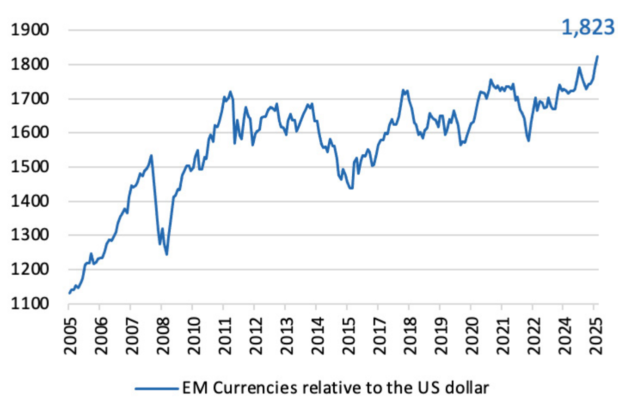
Source: Bloomberg. 3 years of daily data through Jun 12 2025

U.S. Dollar Valuation Measures



Source: Bloomberg. 20 years of monthly data through May 31 2025

MSCI EM Currency Index



Source: Bloomberg. 20 years of monthly data through May 30 2025

International Equities

Developed Ex-U.S.

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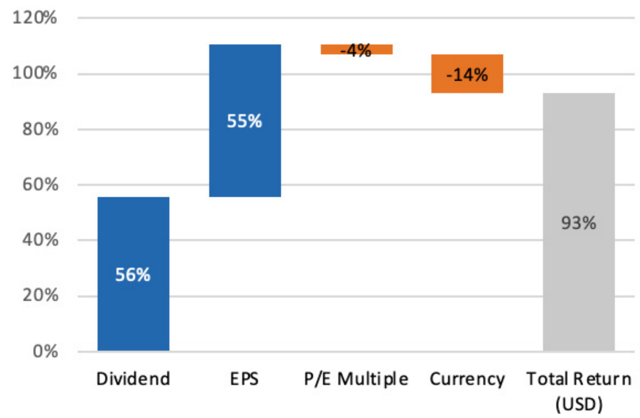
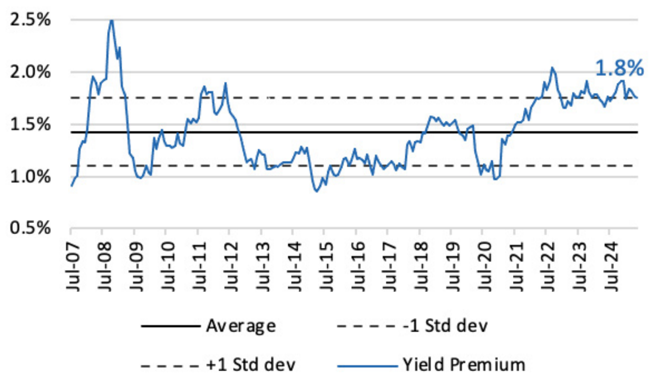
- We have increased our exposure to developed international equities to a strategic weight, reflecting a more balanced risk/reward profile relative to U.S. equities.
- We believe that traditional headwinds, such as currency volatility and valuation discounts, are unlikely to be significant performance drags and may even turn into tailwinds. When these factors are neutralized, international developed equities stand on more equal footing with their U.S. counterparts, with earnings and dividends driving returns.
- Meanwhile, U.S. equities face pressure from high valuations and the prospect of slower economic growth, suggesting more muted returns ahead.
- By contrast, the international landscape shows signs of improvement. Germany's suspension of its debt brake opens the door to fiscal stimulus which could bolster growth, and Japan continues to push for more shareholder-friendly corporate behavior. In Europe, moderating inflation has allowed the ECB to ease policy more aggressively than the Fed.
- That said, risks remain. Global trade tensions, especially tariffs, remain a concern, as does tepid growth in key end markets like the U.S. and China. The U.S. is the EU's largest export partner, accounting for about 5% of the EU's GDP.
- Additionally, a stronger euro, spurred by a weaker U.S. dollar, could hurt the competitiveness of European firms in global markets. European companies have begun warning about the impact of a stronger euro on competitiveness in the U.S. and Chinese markets.
- Looking ahead, we could become more constructive on developed international equities if Europe were to pursue structural reforms, especially deregulation and capital markets integration.

MSCI EAFE Index Return Composition



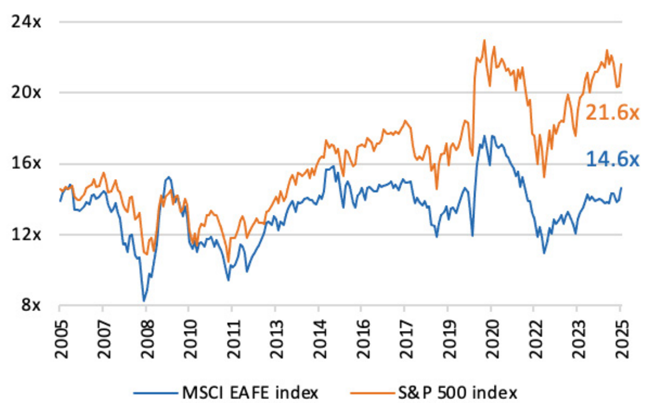
Source: Bloomberg. Cumulative total returns over the last 10 years through May 2025

Difference in Dividend Yield: MSCI EAFE Index - S&P 500 Index



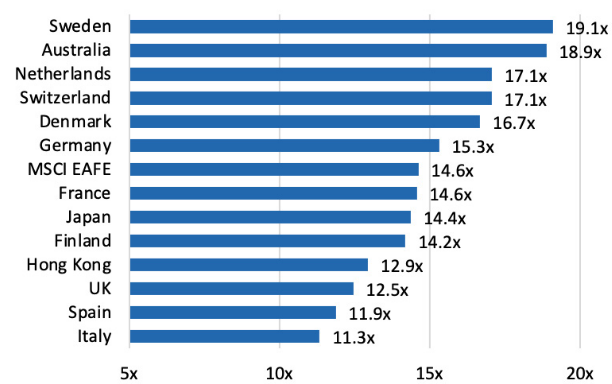
Source: Bloomberg. 1 year of daily observations through May 07 2025

Forward P/E Ratios



Source: Bloomberg. 20 years of monthly observations through May 2025

Forward P/E by Country



Source: Bloomberg. Data as of Jun 11 2025

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Emerging Markets

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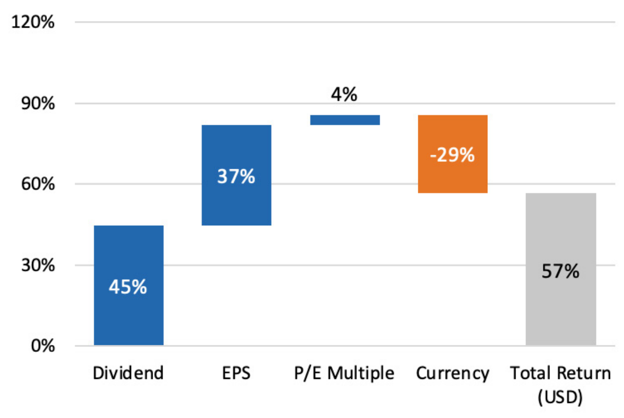
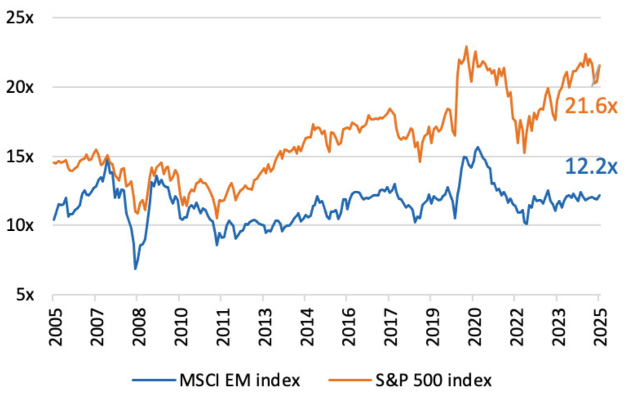
- We also increased exposure to emerging market (EM) equities to a strategic weight, reflecting a more balanced outlook compared to U.S. equities.
- Similar to developed markets, we believe that currency risks and valuation discounts are now less likely to be drags on returns and may even enhance returns. When these factors are neutralized, EM equities look more attractive versus their U.S. counterparts, with dividends and earnings as primary return drivers.
- Historical EM earnings growth over the last 10 years has been distorted by structural changes to the MSCI EM index. These changes include the removal of Russia and greater inclusion of Chinese equities, particularly A shares.
- Looking forward, we believe EM earnings are likely to rival or exceed those of U.S. equities over the next decade, supported by favorable demographics and a more growth-orientated index composition. Near term EM earnings are projected to outperform U.S. stocks this year and next.
- Valuation remains a relative strength. EM equities continue to trade at meaningful discounts to the S&P 500 on both earnings and book value (with India the one exception). With less margin pressure from elevated wage costs and less saturation in tech and services, there is room for operating leverage to play out in future earnings cycles.
- While China remains an important component, its declining weight has lessened the drag from its underperforming tech sector and efforts to bring the private sector more firmly under state control. This shift may allow faster-growing markets with healthier corporate earnings trends to exert greater influence on the index-level growth trajectory.
- U.S. trade policy remains a significant risk (or opportunity) for EM. We need more clarity on this before considering whether to become more constructive on EM. For now, we believe a strategic allocation is appropriate.

MSCI EM Index Return Composition



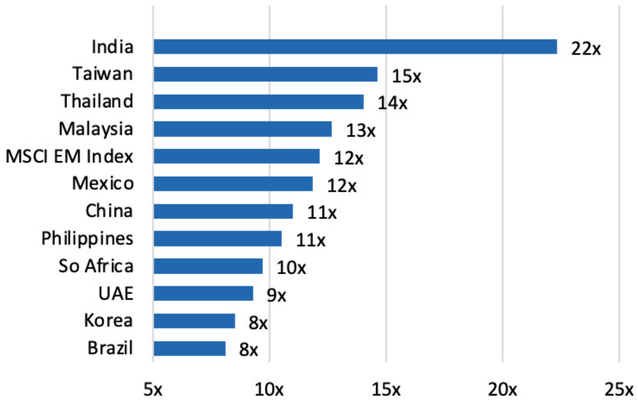
Source: Bloomberg. Cumulative total returns over the last 10 years through May 2025

Forward P/E Ratios



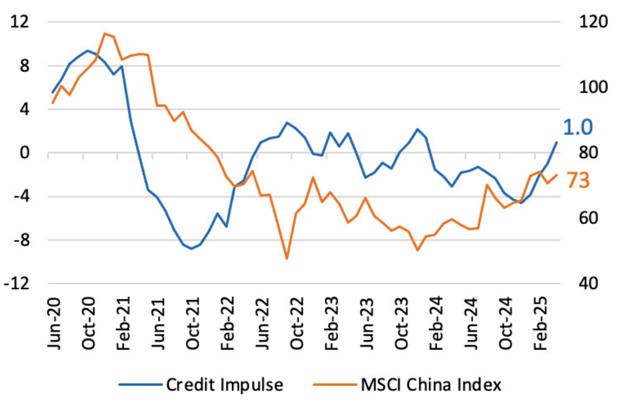
Source: Bloomberg. 20 years of monthly observations through May 2025

Forward P/E by Country



Source: Bloomberg. 10 years of monthly data through Apr 2025

China Credit Impulse



Source: Bloomberg. 5 years of monthly data through Apr 2025. The credit impulse measures the change in new credit issues as a % of GDP.

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Market Characteristics

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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

	May 2025	YTD	2024	2023	2022	Index Weight	EPS Growth Estimate 2024	EPS Growth Estimate 2025
MSCI EAFE	**4.7%**	**17.3%**	**4.3%**	**18.9%**	**-13.9%**	**100%**	**NA***	**NA***
MSCI United Kingdom	4.4%	17.6%	7.5%	14.1%	-4.2%	14%	-4%	9%
MSCI Japan	4.1%	10.1%	8.7%	20.8%	-15.7%	22%	-7%	13%
MSCI Europe	4.9%	22.2%	1.0%	22.7%	-16.7%	54%	1%	11%
MSCI EM	**4.3%**	**8.9%**	**8.1%**	**10.3%**	**-19.2%**	**100%**	**NA***	**NA***
MSCI China	2.8%	13.2%	19.7%	-11.0%	-21.8%	27%	6%	12%
MSCI India	1.2%	3.0%	12.4%	21.3%	-6.2%	19%	8%	14%
MSCI Taiwan	12.5%	0.8%	35.1%	31.3%	-29.5%	18%	13%	14%
MSCI Korea	7.8%	18.7%	-23.1%	23.6%	-28.9%	10%	19%	14%

Valuations

	P/E (TTM)	Percent Rank	P/E (FTM)	Percent Rank	P/CF	Percent Rank	P/S	Percent Rank
MSCI EAFE	**16.3x**	**41%**	**15.9x**	**72%**	**10.3x**	**80%**	**1.7x**	**100%**
MSCI United Kingdom	13.4x	32%	13.4x	55%	8.3x	34%	1.4x	80%
MSCI Japan	16.0x	37%	16.5x	51%	9.5x	66%	1.2x	98%
MSCI Europe	17.1x	45%	16.3x	85%	11.1x	87%	1.7x	96%
MSCI EM	**14.4x**	**51%**	**13.5x**	**74%**	**10.0x**	**81%**	**1.6x**	**82%**
MSCI China	12.9x	38%	12.0x	49%	11.0x	70%	1.4x	47%
MSCI India	26.5x	92%	24.3x	94%	19.8x	95%	2.8x	92%
MSCI Taiwan	16.9x	45%	16.8x	72%	11.3x	65%	1.9x	72%
MSCI Korea	10.0x	20%	9.7x	23%	5.3x	26%	0.8x	87%

Fundamentals

	Dividend Yield	Percent Rank	Profit Margin	Percent Rank	ROE	Percent Rank	Net Debt / EBITDA	Percent Rank
MSCI EAFE	**3.1%**	**56%**	**10.2%**	**97%**	**10.8%**	**67%**	**1.7**	**11%**
MSCI United Kingdom	3.6%	47%	11.0%	88%	10.5%	35%	1.0	15%
MSCI Japan	2.3%	83%	7.7%	99%	9.6%	91%	-1.5	6%
MSCI Europe	3.1%	55%	10.5%	99%	11.7%	64%	3.3	11%
MSCI EM	**2.7%**	**62%**	**11.3%**	**93%**	**12.6%**	**61%**	**2.1**	**81%**
MSCI China	2.5%	58%	11.5%	65%	11.7%	37%	3.4	99%
MSCI India	1.2%	19%	11.0%	63%	14.6%	31%	2.3	41%
MSCI Taiwan	2.5%	36%	11.1%	92%	16.3%	93%	0.2	11%
MSCI Korea	2.3%	85%	8.6%	95%	9.0%	50%	2.7	46%

For Index Definitions see: TouchstoneInvestments.com/insights/investment-terms-and-index-definitions

*Local currency earnings estimates are not available for broad indexes with a mix of currencies.

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

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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 Tim Paulin, CFA – Senior Vice President, Investment Research and Product Management, 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.

A Word About Risk

Investing in equities is subject to market volatility and loss. Investing in foreign and emerging markets securities carry the associated risks of economic and political instability, market liquidity, currency volatility and accounting standards that differ from those of U.S. markets and may offer less protection to investors. The risks associated with investing in foreign markets are magnified in emerging markets due to their smaller economies. Events in the U.S. and global financial markets, including actions taken to stimulate or stabilize economic growth may at times result in unusually high market volatility, which could negatively impact asset class performance. Banks and financial services companies could suffer losses if interest rates rise or economic conditions deteriorate.