

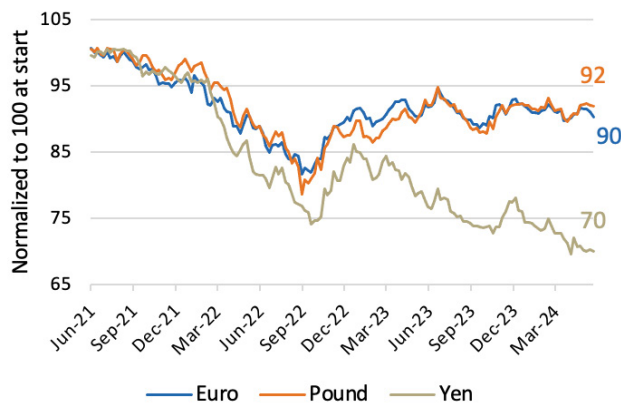


Authors: Crit Thomas, CFA, CAIA / Erik M. Aarts, CIMA / Brian Cheyne, CFA, CIMA

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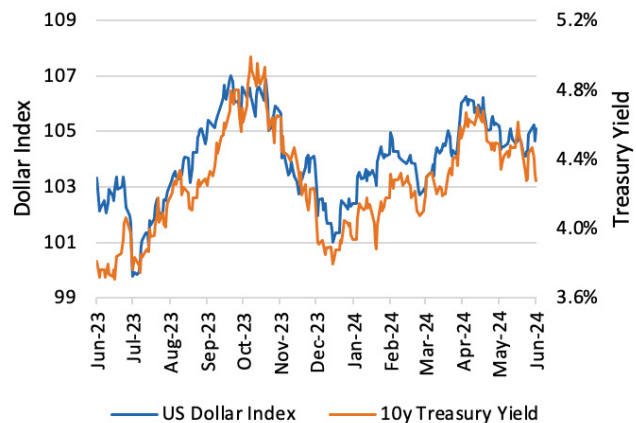
- ▶ The U.S. dollar has weakened slightly versus developed currencies since the end of April, through mid June. The dollar has been following the path of 10-year Treasury rates which are largely tied to expectations for Fed policy.
- ▶ Last month we asked if that was it for the dollar as it did not strengthen following a string of inflation reports that pushed out the expected timing of a Fed pivot. Since then, the ECB cut rates for the first time, and now the dollar is a little lower. For U.S. investors, this is encouraging as it suggests that the currency headwind is dying. We continue to believe that going forward, the dollar will be less of a drag versus developed currencies and could turn into a tailwind.
- ▶ Even versus the yen, the dollar has weakened slightly, despite a modest pullback in Japanese yields. On a purchasing power parity basis, the yen looks very cheap versus the dollar. For example in Japan, a Big Mac is 50% cheaper in dollars than it is here in the U.S.
- ▶ The U.S. dollar also weakened slightly versus emerging markets from the end of April, through mid June. This is despite elections in Mexico and India that were seen as disappointing from an investment perspective. The Mexican peso sold off nearly 12% after the ruling Morena party won the presidency and a super majority in both houses of Congress. This significant majority has raised concerns over the ease of passing legislation that may be less market friendly.
- ▶ China's yuan is the largest weight in the MSCI EM Currency Index and China effectively manages their currency. The yuan looks overvalued versus the dollar given the wide interest rate differential. Yet China has been reluctant to let the yuan fall as it would harm trade optics.

## Developed Currencies versus the Dollar



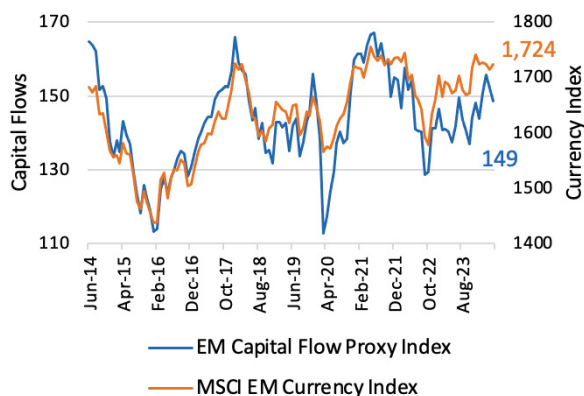
Source: Bloomberg. 3 years of weekly data through June 2024.

## US Dollar and Treasury Yields



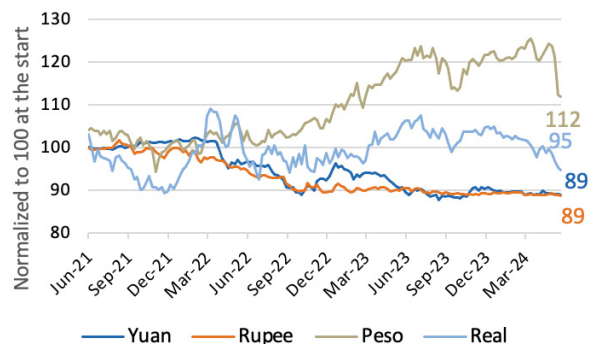
Source: Bloomberg. 1 year of daily data through Jun 17 2024.

## Capital Flows and Currency Movement



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

## Emerging Market Currencies versus the Dollar



Source: Bloomberg. 3 years of weekly data through Jun 14 2024.



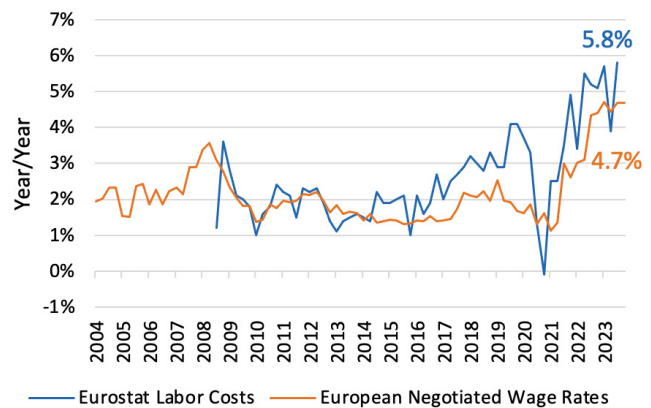
- ▶ We slightly reduced our underweight to developed international equities in April. Last month we outlined our view that there is the potential for European outperformance in the second half of the year based on reduced currency risk and an upturn in the European economy just as the U.S. economy may be slowing.
- ▶ We are still underweight; what are we waiting for?
- ▶ The ECB did make a policy pivot as expected in June, lowering the bank lending rate by 25 basis points. What we are looking for is some visibility to where they go from here. The unemployment rate in the E.U. is the lowest seen since its inception in 1991 and wage growth remains high, indicating very tight labor conditions. Additionally, while headline inflation data has been encouraging, services inflation remains stuck at a high level. It will be hard for the ECB to justify more cuts until we see less labor and pricing pressure. And now the potential for a French populist win in a snap election may also introduce concerns about extended fiscal largess in that country.
- ▶ Another factor holding us back is that Europe and the MSCI EAFE index have a Value style tilt. The index has historically tended to outperform when Value stocks are in favor. We are seeing signs of economic bottoming, but believe more aggressive monetary easing will be needed to meaningfully push Value stocks ahead of Growth.
- ▶ Japan is much more of a corporate transformation narrative. Large, unwieldy conglomerates are getting shaken up to restructure and spin off underperforming businesses. Additionally, the stock exchange is taking steps to require companies with low book values to take steps to increase their value or risk delisting. Currently, 58% of the stocks in the MSCI Japan Index have a price-to-book value of less than 1.5x. For comparison only 16% of the S&P 500 fall below 1.5x. That suggests a lot of opportunity for value creation. One risk is the potential strengthening of the yen, as that could hurt profitability as many corporations moved production out of Japan.

## Eurozone Unemployment Rate



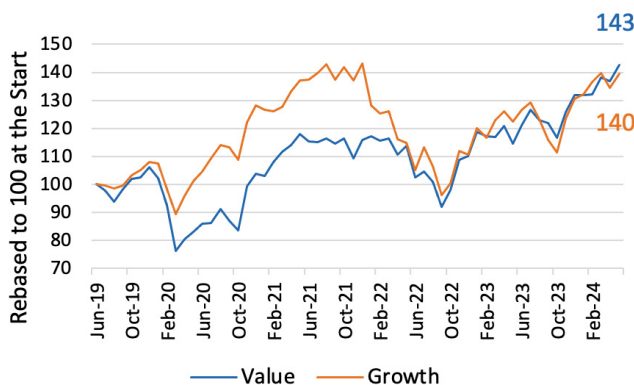
Source: Bloomberg. 10 years of monthly data through Apr 2024

## European Wage Growth



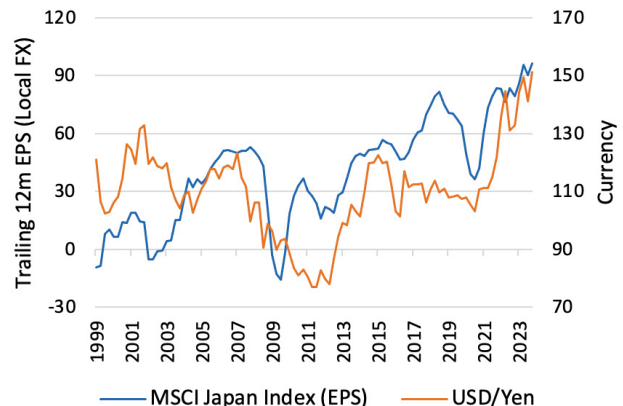
Source: Bloomberg. 20 years of quarterly data: Labor Costs through Jun 2024, Negotiated Wage Rates through Mar 2024

## Total Returns: MSCI EAFE Style Indexes



Source: Bloomberg. Total returns over the last 5 years through May 2024

## Japan Earnings and Currency

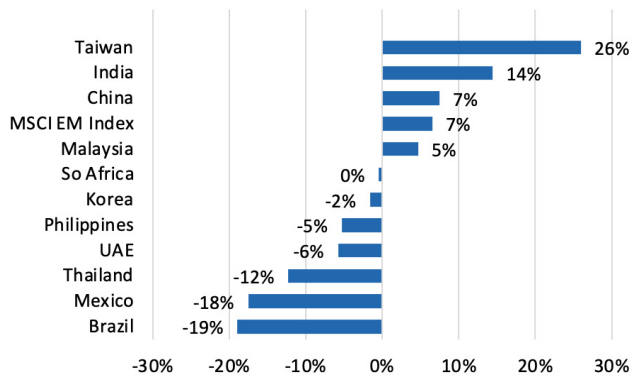


Source: Bloomberg. 25 years of quarterly data through Mar 2024



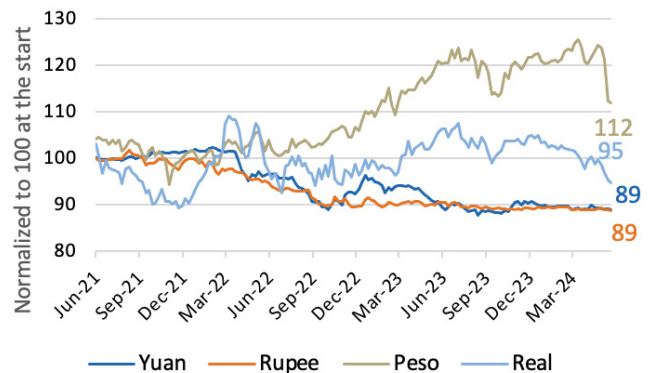
- ▶ We remain neutrally weighted in emerging market equities. But we do have moderate concerns surrounding the potential for a prolonged Fed pause, as it could deter EM central banks from easing.
- ▶ Year-to-date Brazil and Mexico have been the worst performers. Both are suffering from political woes. The Mexican election raised concerns about fiscal stability and a potential leftward shift in policies. A drop in stock prices was exacerbated by a fall in the peso. In Brazil, investors are questioning how much further their central bank can go with the easing cycle that started last year. Very tight labor conditions coupled with political backsliding on fiscal discipline have put monetary policy on pause. Much like Mexico, stock declines were exacerbated by a fall in the Brazilian real.
- ▶ The top performing country year-to-date has nothing to do with politics or central bank actions and everything to do with AI. Taiwan Semiconductor, at 48%, is the largest weight in the MSCI Taiwan Index, delivered a year-to-date return of 68% (through June 13). Taiwan Semi is the largest semiconductor foundry in the world and makes chips for Nvidia.
- ▶ The performance of Indian stocks remains strong. India is now the second largest weight in the MSCI EM Index representing 18% of the index. Returns have been broad based and economically driven. The economy is expected to grow 7.8% this year and estimates have been rising since the start of the year. The drawback for this market is extended valuations. The Indian index is very expensive relative to its own history and the MSCI EM Index.
- ▶ China has modestly outperformed the index to date. This was mostly a function of having a very low expectations bar coming into the year. While economic growth estimates have increased, real estate and geopolitical risks remain.

## YTD Total Returns (in USD) by Country



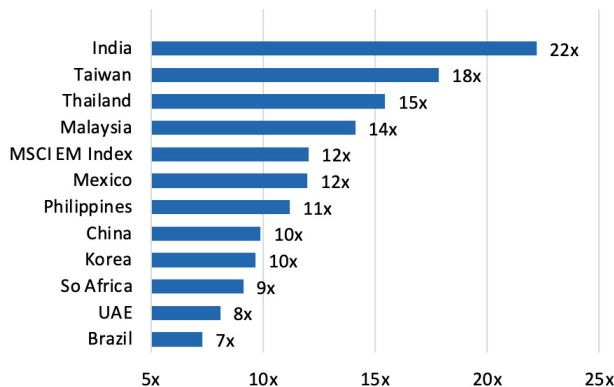
Source: Bloomberg. Data as of Jun 14 2024

## Emerging Market Currencies versus the Dollar



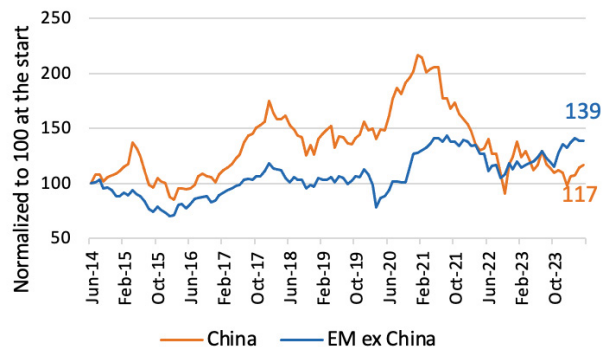
Source: Bloomberg. 3 years of weekly data through Jun 14 2024

## Forward P/E by Country



Source: Bloomberg. Data as of Jun 14 2024

## Total Returns in USD using MSCI Indexes



Source: Bloomberg. 10 years of monthly data through May 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	
	May 2024	YTD	2023	2022	2021	Index Weight	2024	2025
<b>MSCI EAFE</b>	<b>4.0%</b>	<b>7.5%</b>	<b>18.4%</b>	<b>14.0%</b>	<b>11.8%</b>	<b>100%</b>	<b>-1%</b>	<b>8%</b>
MSCI United Kingdom	3.6%	8.8%	13.0%	-4.8%	18.5%	14%	-8%	4%
MSCI Japan	1.4%	7.2%	21.5%	-16.3%	2.0%	23%	14%	8%
MSCI Europe	5.5%	8.8%	21.6%	-17.3%	16.5%	48%	-4%	9%
<b>MSCI EM</b>	<b>0.6%</b>	<b>3.4%</b>	<b>10.1%</b>	<b>-19.7%</b>	<b>-2.2%</b>	<b>100%</b>	<b>17%</b>	<b>15%</b>
MSCI China	2.4%	6.8%	-11.3%	-21.8%	-21.6%	25%	15%	13%
MSCI India	0.8%	9.4%	21.3%	-7.5%	26.7%	18%	34%	15%
MSCI Taiwan	5.3%	15.8%	31.3%	-29.1%	26.8%	18%	24%	18%
MSCI Korea	-3.6%	-7.5%	23.6%	-28.9%	-7.9%	12%	20%	27%

Valuations								
	P/E (TTM)	Percent Rank	P/E (FTM)	Percent Rank	P/CF	Percent Rank	P/S	Percent Rank
<b>MSCI EAFE</b>	<b>15.5x</b>	<b>27%</b>	<b>14.6x</b>	<b>60%</b>	<b>9.9x</b>	<b>70%</b>	<b>1.5x</b>	<b>97%</b>
MSCI United Kingdom	12.6x	21%	11.7x	33%	8.1x	24%	1.4x	74%
MSCI Japan	16.5x	42%	16.6x	68%	9.6x	69%	1.2x	99%
MSCI Europe	15.8x	30%	15.1x	70%	10.5x	80%	1.6x	94%
<b>MSCI EM</b>	<b>15.5x</b>	<b>69%</b>	<b>13.1x</b>	<b>69%</b>	<b>10.4x</b>	<b>89%</b>	<b>1.4x</b>	<b>65%</b>
MSCI China	12.8x	36%	10.2x	26%	10.7x	67%	1.2x	29%
MSCI India	25.4x	88%	25.0x	95%	19.2x	95%	2.7x	91%
MSCI Taiwan	22.8x	73%	20.5x	93%	13.5x	79%	2.0x	79%
MSCI Korea	17.1x	82%	11.1x	52%	7.4x	73%	0.9x	90%

Fundamentals								
	Dividend Yield	Percent Rank	Profit Margin	Percent Rank	ROE	Percent Rank	Net Debt / EBITDA	Percent Rank
<b>MSCI EAFE</b>	<b>3.0%</b>	<b>54%</b>	<b>8.3%</b>	<b>89%</b>	<b>10.8%</b>	<b>68%</b>	<b>1.6</b>	<b>8%</b>
MSCI United Kingdom	3.9%	63%	7.7%	63%	11.4%	43%	0.6	10%
MSCI Japan	2.0%	68%	6.8%	94%	9.0%	79%	-1.6	6%
MSCI Europe	3.0%	53%	8.8%	93%	12.4%	73%	3.2	5%
<b>MSCI EM</b>	<b>2.8%</b>	<b>75%</b>	<b>8.5%</b>	<b>46%</b>	<b>10.7%</b>	<b>26%</b>	<b>2.0</b>	<b>87%</b>
MSCI China	2.6%	63%	8.3%	12%	9.9%	19%	2.9	97%
MSCI India	1.1%	14%	9.8%	59%	16.2%	54%	2.3	41%
MSCI Taiwan	2.4%	34%	8.9%	67%	12.7%	60%	0.3	15%
MSCI Korea	2.2%	82%	4.6%	41%	5.4%	24%	3.1	70%

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 May; 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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