Why International:

THE CASE FOR INTERNATIONAL INVESTING

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Introduction

Historically, globally diversified portfolios have earned superior risk-adjusted returns over the long run compared to portfolios composed of only domestic (U.S.) equities and bonds.

However, despite international markets outperforming domestic in 2017, they have significantly underperformed since the financial crisis of 2008, making investors wary of international investing. It is important for those investors to realize that the inherent benefits of international diversification have not changed.

In this paper, we review the reasons investors should continue to invest internationally. Overall, we believe that investing globally should result in a better investor experience over time.

Global Market Share

Over the years, international equities have grown to account for about half of the global equity market, as seen in Chart 2. Within the international asset class segment, emerging markets (EM) such as China, Brazil, and India have a strong representation at 12% (see Chart 1). Despite the size of international markets, U.S. mutual fund investors hold an average of only 27% of their total equity allocation in non-U.S. funds, according to Morningstar. Consequently, investors may be missing out on significant opportunity.

In a traditional view of financial markets, it would make sense to invest proportionally based on mar-ket capitalization. This is how most market indices are weighted, including the S&P 500 Index. In doing so, this would mean that about half of one's investments would be international, as previously shown. So, why don't investors typically hold this much?

- First, when putting together their asset allocation, investors tend to focus on set allocation levels, such as 60% equities and 40% bonds, as opposed to allowing their portfolio to fluctuate with market capitalization.
- Second, many international markets are not as developed as the U.S. market.
- Lastly, investors tend to have a home bias toward their country of residence. This is not just a U.S. phenomenon. More information is readily available about domestic markets within home borders, which lowers investor uncertainty. Also, depending on investment account structure, there may be regulatory constraints when investing abroad.

Whatever the reasons for home biases, they have resulted in imperfect global markets that do not sync up with market capitalizations.

CHART 1: WEIGHTS IN MSCI ALL COUNTRY WORLD INDEX

% global market capitalization, float adjusted

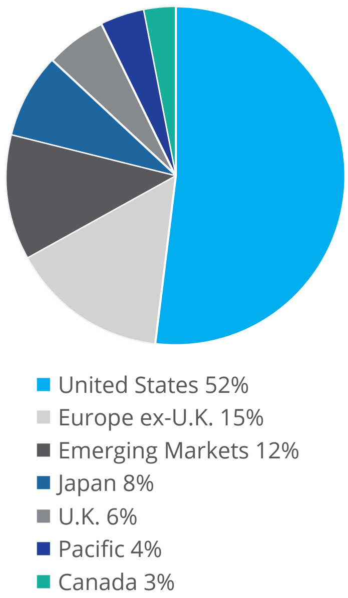
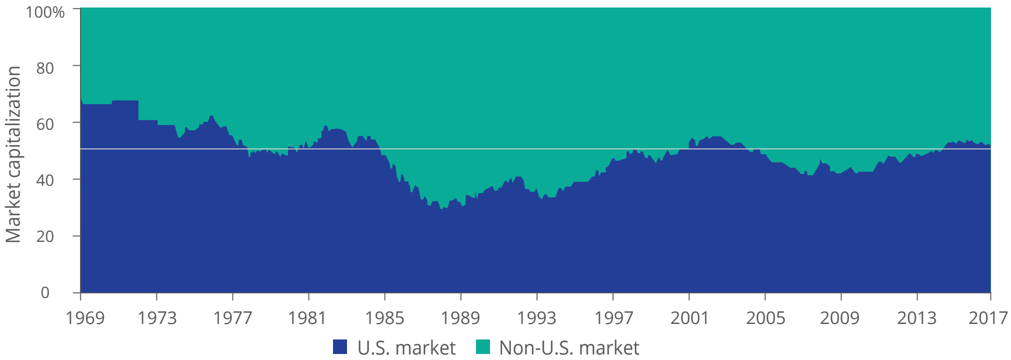


CHART 2: HISTORICAL MIX OF GLOBAL EQUITY MARKET CAPITALIZATION

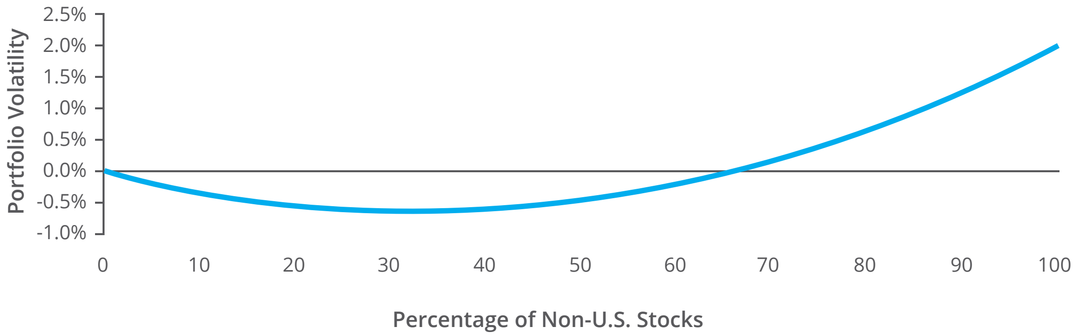


Source: Vanguard: "Global Equities: Balancing Home Bias and Diversification," data from 1969 through 2013 and Morningstar Direct data thereafter.
Notes: U.S. market represented by MSCI USA Index; non-U.S. market represented by MSCI World Index ex USA from 1969 through 1987 and MSCI All Country World Index ex USA thereafter. Data as of 12/31/2017.

Reduced Portfolio Volatility

Market cap weighting is not the only way to allocate portfolios. Since one of the main reasons to invest internationally is to increase diversification, it may make sense to focus on an allocation that minimizes volatility. Chart 3 below shows portfolio volatility, from 1970 to 2016, for various stock-to-bond portfolios using allocations of U.S. and non-U.S. equities. As shown, diversification benefits get stronger as more international is added, until the 30-40% range is reached. Furthermore, a portfolio with up to nearly 70% international still has lower volatility than a domestic-only portfolio.

CHART 3: AVERAGE ANNUALIZED CHANGE IN PORTFOLIO VOLATILITY WHEN ADDING NON-U.S. STOCKS TO A 100% U.S. PORTFOLIO, 1970-2016



Notes: Non-U.S. equities are represented by the MSCI World Index ex U.S.A. from 1970 through 1987 and the MSCI All Country World Index ex U.S.A. thereafter. U.S. stocks are represented by the MSCI U.S.A. Index.

Past performance is no guarantee of future results. The performance of an index is not an exact representation of any particular investment, since you cannot invest directly in an index.

Sources: Derived from data provided by Thomson Reuters Datastream and MSCI

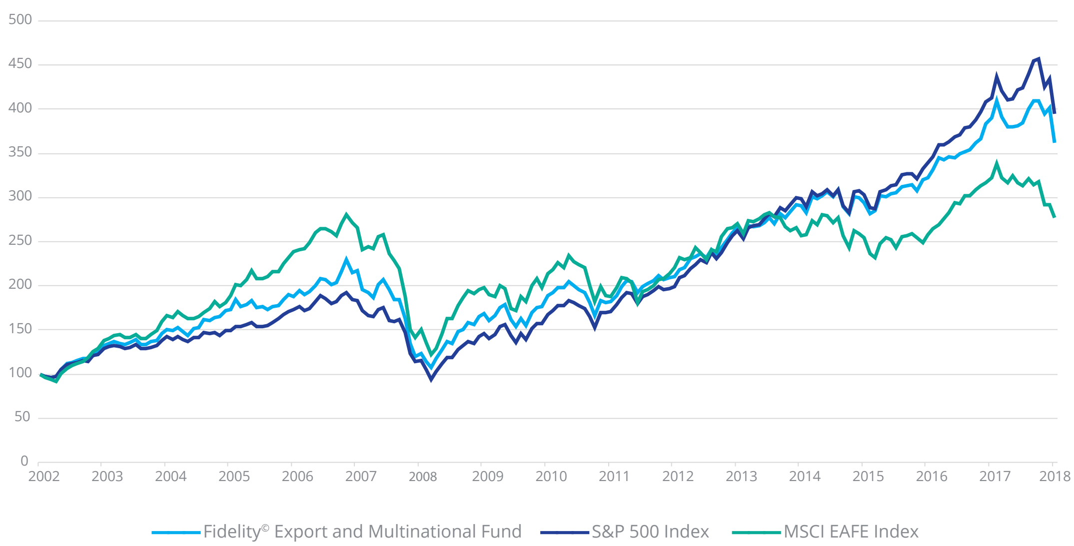
Reduced Portfolio Volatility

Some investors believe they can gain international exposure simply by investing in U.S.-based multinational corporations. While it is true that many large U.S. companies do business overseas, investors may miss many potential benefits by not investing in international companies.

- First, the global leading multinationals not domiciled in the U.S., such as Samsung and Toyota, have market leadership within their industries.
- Second, U.S. multinationals often hedge the currency risk of their foreign operations. Foreign currency plays a role as an additional portfolio diversifier (as discussed later).
- Lastly, U.S. industries are more developed technologically, as compared to the rest of the world. By not investing internationally, investors may lose the opportunities and diversification benefits of some of the "old world" industries, such as electrical equipment and durable household goods, that are prevalent in less developed economies.

Further, in general, the stocks of U.S. multinational companies also tend to move in line with other U.S. stocks, thereby losing international diversification benefits. Chart 4 below compares the Fidelity© Export and Multinational Fund to the U.S. market and international developed markets. The relationship between multinationals and the U.S. market is much closer than the relationship between multinationals and international markets.

CHART 4: U.S. MULTINATIONALS VS. DOMESTIC AND INTERNATIONAL MARKETS



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Performance

It is impossible to predict which market will perform best in a given year. In addition, it is rare to find a single market that consistently outperforms for multiple years, as observed in Chart 5. Given this, it makes sense to hold a portfolio that is diversified across a number of regions and asset classes.

When looking at five-year period returns by broad region (see Chart 6 below), outperformance is variable. Having exposure to the "all world" index would have provided the most stable returns over time.

CHART 5: A DIVERSIFIED PORTFOLIO MAY REDUCE VOLATILITY

Ranked Annual Total Returns of Key Indices (200-2018)

FPO-MISSING LINK

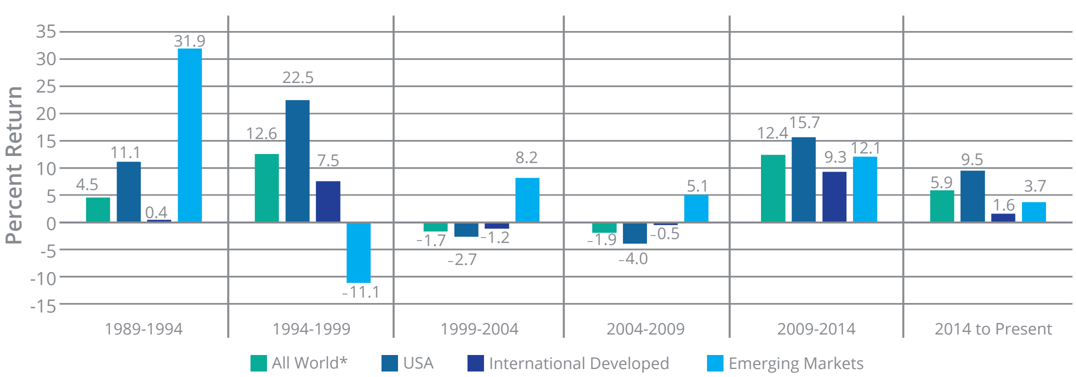
2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Cumul.	Annual	Std. Dev
55.8%	25.6%	34.0%	32.1%			78.5%	26.9%						21.3%	37.3%			32.5%
47.3%	20.2%	21.4%	26.3%	39.4%		31.8%	18.9%		18.2%				12.0%	25.0%	470.7%	12.3%	20.5%
38.6%	18.3%	13.5%	18.4%	16.2%		27.2%	16.8%		17.3%				11.8%	21.8%	389.3%	11.2%	19.8%
28.7%	11.1%	7.3%	15.8%	11.2%		26.5%	15.1%		16.3%	38.8%	13.7%		11.2%	15.6%	313.3%	9.9%	18.1%
23.9%	10.9%	4.9%	13.7%	8.9%		22.8%	12.1%	7.8%	16.0%	32.4%	6.0%		8.2%	14.6%	222.1%	8.1%	16.3%
22.1%	9.1%	4.6%	4.3%	7.0%		18.9%	7.8%	2.1%	11.8%	22.8%	6.0%	1.4%	2.6%	3.5%	212.8%	7.9%	12.1%
4.1%	4.3%	2.4%	2.1%	5.5%	5.2%	5.9%	6.5%	0.5%	4.2%	14.2%	4.9%	0.5%	1.0%	1.7%	83.9%	4.1%	2.6%
				-1.6%	-23.9%			-4.2%	-1.1%	-2.0%	-2.2%	-0.7%			-4.0%	-0.3%	
					-33.8%			-12.1%		-2.6%	-4.9%	-0.8%					
					-35.6%			-13.3%		-9.5%	-17.0%	-4.4%					
					-37.0%			-18.4%				-14.9%					
					-43.4%							-24.7%					
					-53.3%												

COMMODITIES BONDS EMERGING MARKETS GLOBAL BALANCED INTL. STOCKS SM.-CAP STOCKS LG.-CAP

Global Balanced is represented by 60% stock and 40% bond with the stock portion being 60% domestic and 40% international. Domestic equities are represented by Russell 3000 Index, international equities represented by MSCI ACWI ex U.S. Index, and bonds represented by the Barclays Aggregate Index. Source: Morningstar Direct as of 12/31/2018.

Source: Morningstar Direct as of 12/31/2018. Global Balanced is represented by 60% stock and 40% bond with the stock portion being 60% domestic and 40% international. Domestic equities are represented by Russell 3000 Index, international equities represented by MSCI ACWI ex U.S. Index, and bonds represented by the Barclays Aggregate Index.

CHART 6: REGIONAL PERIOD RETURN (5 YEAR)



The all world index is currently comprised of 52% U.S. investments and 48% international investments. Source: Morningstar Direct, as of 12/31/2018

Diversification

Diversification typically results in reduced volatility at the total portfolio level over the long term. Historically, considerable diversification benefits can be attributed to the independent movement of various international markets in reaction to factors, such as their specific domestic business, monetary, and fiscal policy cycles. In general, foreign countries offer exposure to a wider array of economic and market forces than those in the U.S.

Chart 7 below displays various asset classes and their correlations with each other, as well as their volatilities. By combining multiple asset classes with differing correlations into their portfolio, investors increase diversification and may reduce volatility, making for a smoother investment ride.

CHART 7: ASSET CLASS CORRELATIONS

	U.S. Large Cap	EAFE	EME	Bonds	Corp. HY	Munis	Currcy.	EMD	Cmdty.	REITs	Hedge funds	Private equity	Ann. Volatility
U.S. Large Cap	1.00	0.89	0.82	-0.28	0.74	-0.10	-0.48	0.61	0.56	0.79	0.84	0.85	16%
EAFE		1.00	0.92	-0.13	0.79	0.02	-0.66	0.72	0.61	0.68	0.86	0.83	20%
EME			1.00	-0.06	0.90	0.10	-0.67	0.86	0.67	0.61	0.87	0.79	24%
Bonds				1.00	-0.04	0.81	-0.19	0.26	-0.15	0.03	-0.21	-0.27	3%
Corp. HY					1.00	0.12	-0.54	0.88	0.67	0.67	0.83	0.73	12%
Munis						1.00	-0.20	0.45	-0.11	0.08	0.00	-0.12	4%
Currencies							1.00	-0.63	-0.60	-0.43	-0.47	-0.57	8%
EMD								1.00	0.58	0.61	0.71	0.62	8%
Commodities									1.00	0.43	0.73	0.70	20%
REITs										1.00	0.59	0.67	25%
Hedge funds											1.00	0.85	7%
Private Equity												1.00	10%

Source: J.P. Morgan Asset Management

Notes: Indexes Used - Large Cap: S&P 500 Index; Currencies: Federal Reserve Trade Weighted Dollar; EAFE: MSCI; EME: MSCI Emerging Markets; Bonds: Barclays Capital Aggregate; Corp HY: Barclays Capital Corporate High Yield; EMD: Barclays Capital Emerging Market; Cmdty.: DJ UBS Commodity Index; Real Estate: NAREIT Equity REIT Index; Hedge Funds: CS/Tremont Multi-Strategy Index; Equity Market Neutral: CS/Tremont Equity Market Neutral Index. All correlation coefficients and annualized volatility calculated based on quarterly total return data for period 09/28/2007 to 09/29/2017.

Correlations

All else equal, it tends to be preferable to add asset classes to a portfolio that have lower correlations, as this may lower portfolio volatility. Correlations between domestic and international markets tend to be somewhat consistent, although they become more closely correlated in significant market downturns. As shown below (Chart 8a), an investor should realize a diversification benefit from investing on a global scale due to low correlations between the U.S. and various international markets.

Comparing the volatility of returns also illustrates the benefit of diversification (Chart 8b). Although each country experiences higher volatility individually, when combined, diversification lowers volatility to about the same level as the U.S. alone.

CHART 8A: CORRELATIONS OF RETURNS IN FOREIGN EQUITY MARKETS WITH U.S. EQUITY MARKET

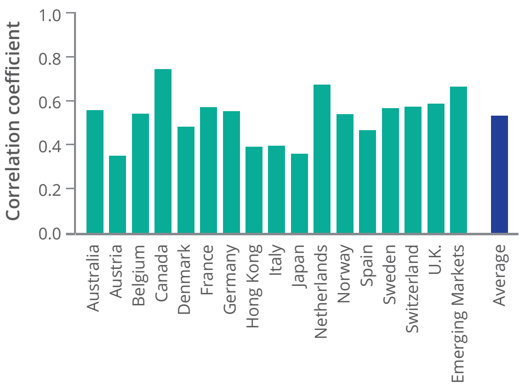
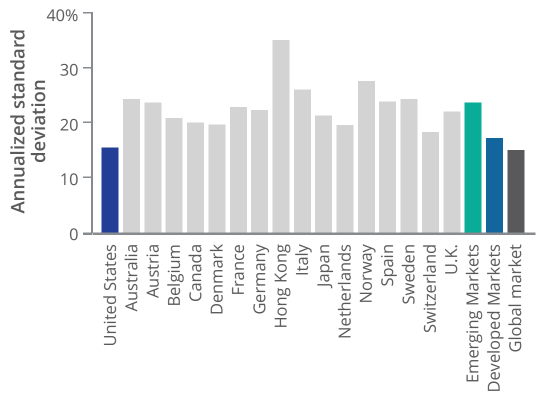


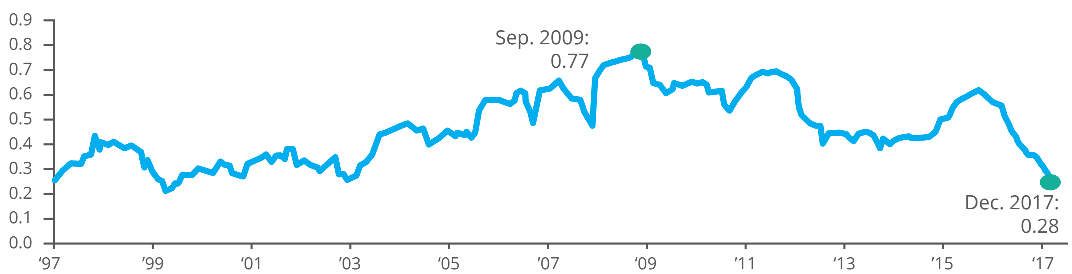
CHART 8B: VOLATILITY OF RETURNS FOR COUNTRY AND REGIONAL INDEXES



Source: Morningstar Direct as of 12/31/2017

Notes: Country returns represented by MSCI country indexes; emerging markets represented by MSCI Emerging Markets Index; developed markets represented by MSCI World Index ex USA; global market, including both developed and emerging marktes, represented by MSCI All Country World Index. All data from 01/01/1988 to 12/31/2017.

CHART 9: GLOBAL EQUITY MARKET CORRELATIONS ROLLING 1-YEAR CORRELATIONS, 30 COUNTRIES

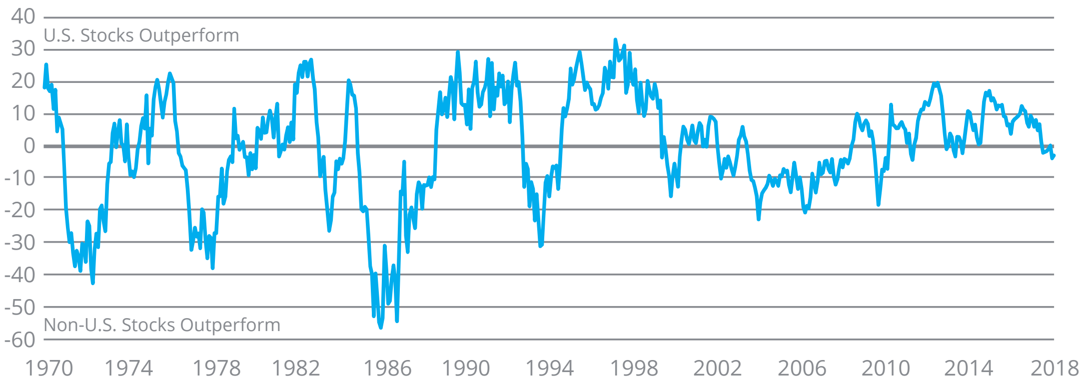


Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management, as of 12/31/2017

Return Dispersion

As long as there is a gap among returns of different asset classes, significant diversification benefits exist. Historically, as Chart 10 shows, there has been a wide dispersion of returns between domestic and international investments.

CHART 10: TRAILING 12-MONTH RETURN DIFFERENTIAL BETWEEN U.S. AND NON-U.S. STOCKS (%)



Morningstar Direct as of 12/31/2017

Notes: U.S. equities represented by MSCI USA Index; international equities represented by MSCI World ex USA Index from 1970 through 2017

Although international investments are best known for reducing volatility in the long run, they can also offer significant short-term benefits by giving investors access to opportunities in various regional markets. Chart 11 below shows performance dispersion between various categories of investments. The country category happens to have the widest range of performance variability.

CHART 11: PERFORMANCE DISPERSION AMONG CATEGORIES OF INVESTMENTS

Category	Return Dispersion	Correlation
Style	1.17%	0.99
Size	1.81%	0.99
Factor	3.58%	0.95
Sector	9.93%	0.87
Country	43.98%	0.82

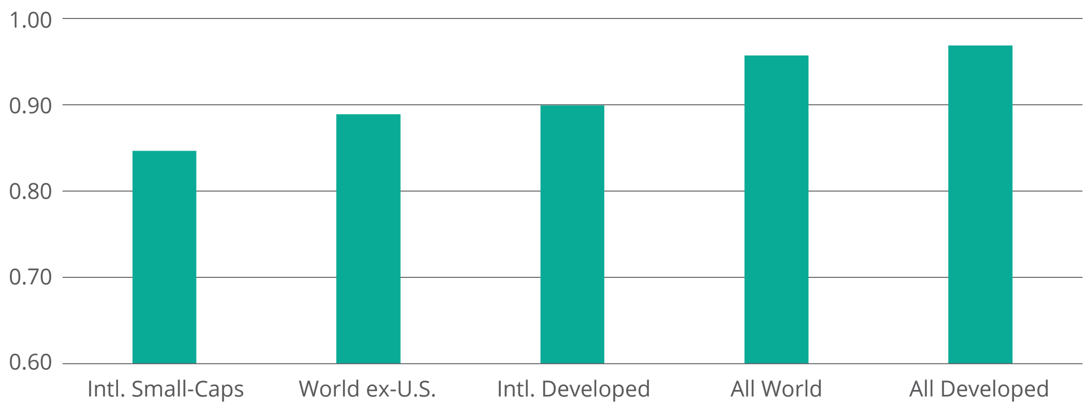
Souce: Morningstar Direct, as of 12/31/2017.

Notes: Return dispersion is highest 10-year annualized return minus the lowest. Correlation is average 10-year correlation versus the ACWI ex U.S. Index.

International Small-Caps

The benefits of international diversification are greater when investing in international small-cap stocks (as shown in Chart 12), and the reason for that is fairly simple. Many large international companies are global giants, selling their products and services all over the world. Thus, they tend to perform mostly like domestic companies with broad market conditions heavily impacting their earnings. On the other hand, many smaller companies are more dependent on the conditions within their local economies. Thus, their returns are driven more by local, idiosyncratic factors, therefore making them an effective diversifier.

CHART 12: INTERNATIONAL SMALL-CAPS – CORRELATION WITH U.S.



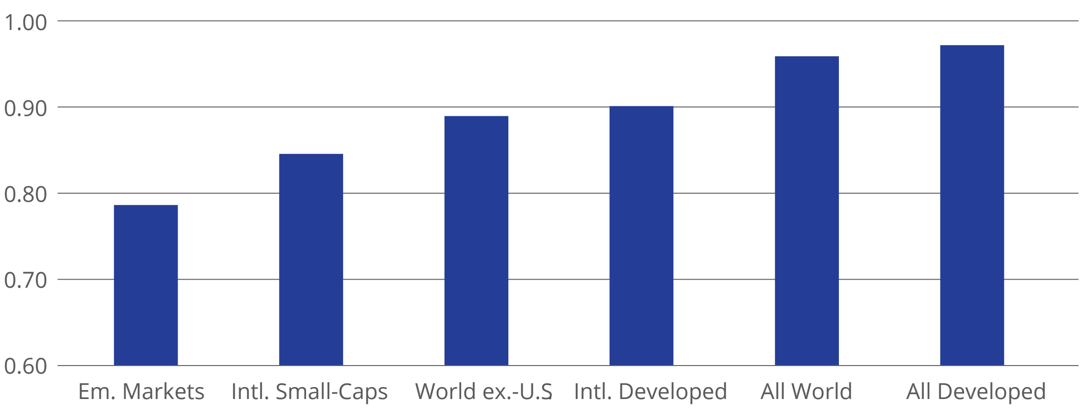
Source: Morningstar Direct data from 01/01/2007 to 12/31/2017

Emerging Markets

Similar to international small-caps, emerging markets (EM) also have lower correlations, and thus, higher diversification benefits, compared to developed markets (see Chart 13).

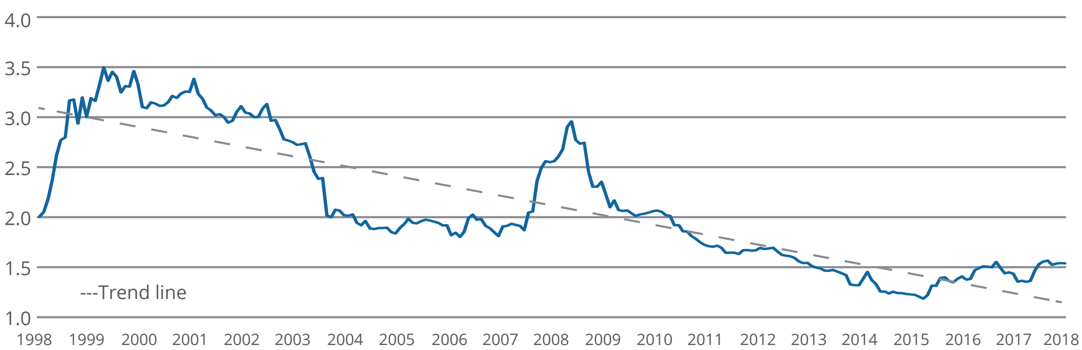
The higher risk of Emerging Markets versus some other asset classes is the primary fear a "risk-averse investor" may have about investing in this asset class segment. While it is true that individual EM countries have unique political, financial, and economic risks, they are also highly uncorrelated with each other. Portfolios invested broadly in EM generally have significantly less overall risk. Historically, EM have been less correlated with the U.S. and international developed markets, but have offered higher returns and more volatility. But, as shown in Chart 14 below, volatility levels have been declining. EM are simply not as scary as they used to be.

CHART 13: EMERGING MARKETS – CORRELATION WITH U.S.



Source: Morningstar Direct data from 01/01/2007 to 12/31/2017

CHART 14: RATIO OF EMERGING TO DEVELOPED MARKET VOLATILITY, 1998-2018



Source: Morningstar Direct data from 01/01/2007 to 12/31/2017

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Frontier Markets

Frontier markets (FM) – the market classification that precedes emerging markets – are an even more granular subset of the international universe. The same themes hold as in EM, but to a greater degree. For example, as seen in Chart 15, correlations of FM with developed markets are even less than those of EM. Also, as shown in Chart 16, smaller markets tend to exhibit lower correlations. Furthermore, although FM countries exhibit the greatest volatility individually, they have actually exhibited lower volatility than both developed and emerging markets when combined, as seen in Chart 17. Overall, FM exposure can boost diversification benefits and lower portfolio volatility.

Beyond risk reduction, FM investments may offer growth opportunities. These markets are at the earliest stage of development, which means they have high potential for improvement. FM countries typically exhibit growing economic and demographic factors, such as population, labor force, wages, and infrastructure. Thus, GDP growth for these countries has historically been expected to be much faster than in developed ones.

CHART 15: FRONTIER MARKETS – CORRELATION WITH U.S.

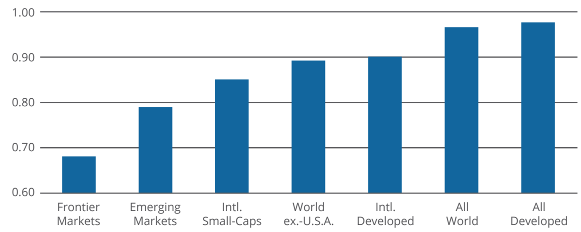


CHART 16: FRONTIER MARKETS – CORRELATIONS WITH GLOBAL MARKET

Correlation on Left Axis/Market Cap ($B) on Right Axis

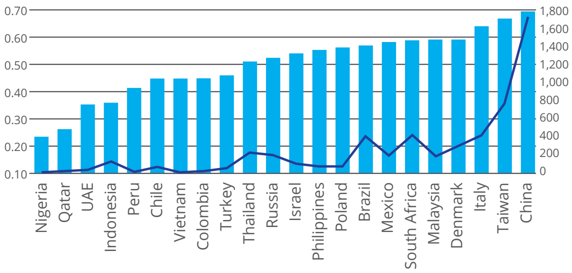


CHART 17: FRONTIER MARKETS – VOLATILITY OF RETURNS (%)

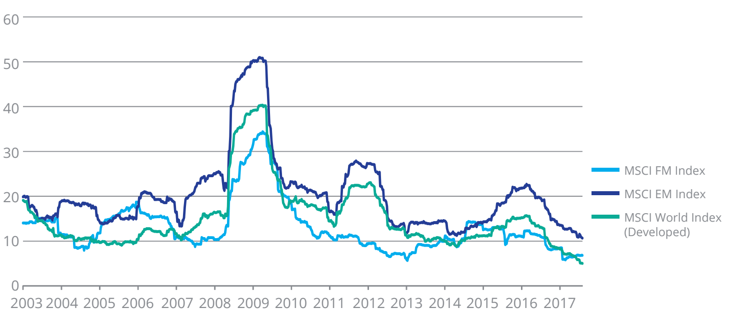


Chart 15: Source: Morningstar Direct data from 01/01/2007 to 12/31/2017

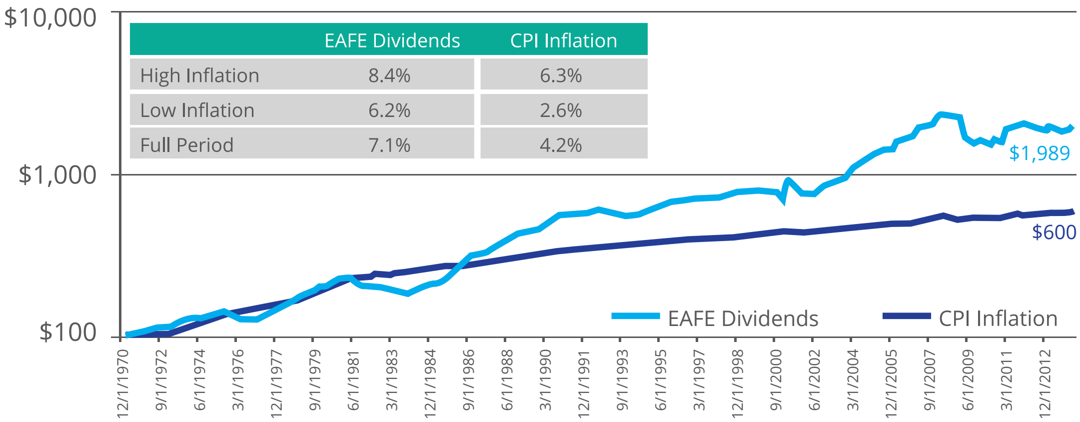
Chart 16: Source: Morningstar data as of 12/31/17 using 5-year monthly correlations

Chart 17: Source: Morningstar Direct data as of 12/31/17. Showing 52-week standard deviation

Dividends

Dividends offer enhanced total return, particularly in uncertain market environments, where they also offer potential reduced volatility. Dividends provide income similar to bonds, but with greater inflation protection due to the ability for the dividends to grow. Historically, dividends from developed international assets (as defined by the MSCI EAFE Index) have grown by over 7% per year – significantly ahead of U.S. inflation (see Chart 18).

CHART 18: EAFE DIVIDEND GROWTH AND CPI INFLATION



	EAFE Dividends	CPI Inflation
High Inflation	8.4%	6.3%
Low Inflation	6.2%	2.6%
Full Period	7.1%	4.2%

Data from December 31, 1970 - June 30, 2014. EAFE Dividends refers to MSCI EAFE Index Dividends. High Inflation period: 12/31/70-12/31/89. Low Inflation Period: 12/31/89-06/30/14. Source: MSCI, Professor Robert Shiller.

In Credit Suisse's Global Investment Returns Yearbook, the authors examined contributions to market returns from capital gains and dividends back to 1900. They discovered that capital appreciation was the driver behind year-over-year performance, but long-term returns were largely attributable to reinvested dividends.

More recently, interest income available on 10-year bonds declined significantly from 1999 to 2017. Income on U.S. Treasury Bills was quite volatile over the same time frame (see Charts 19a and 19b). Conversely, MSCI EAFE Index dividends exhibited healthy stable growth despite the contraction in 2008 (see Chart 20 on next page).

CHART 19A: U.S. TREASURY BIILLS (3 MO) INTEREST INCOME FROM HYPOTHETICAL $1M INVESTMENT

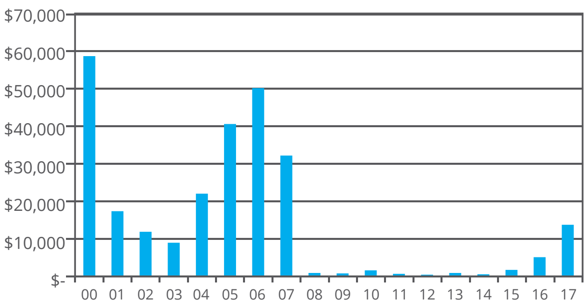
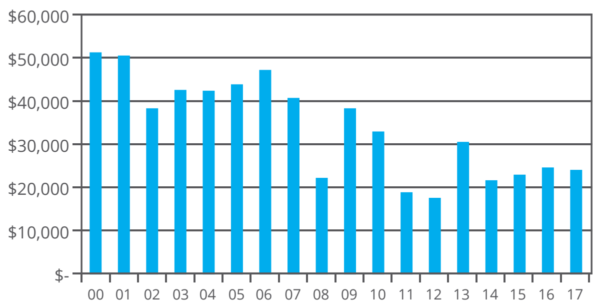


CHART 19B: 10-YR U.S. TREASURY NOTE INTEREST INCOME FROM HYPOTHETICAL$1M INVESTMENT

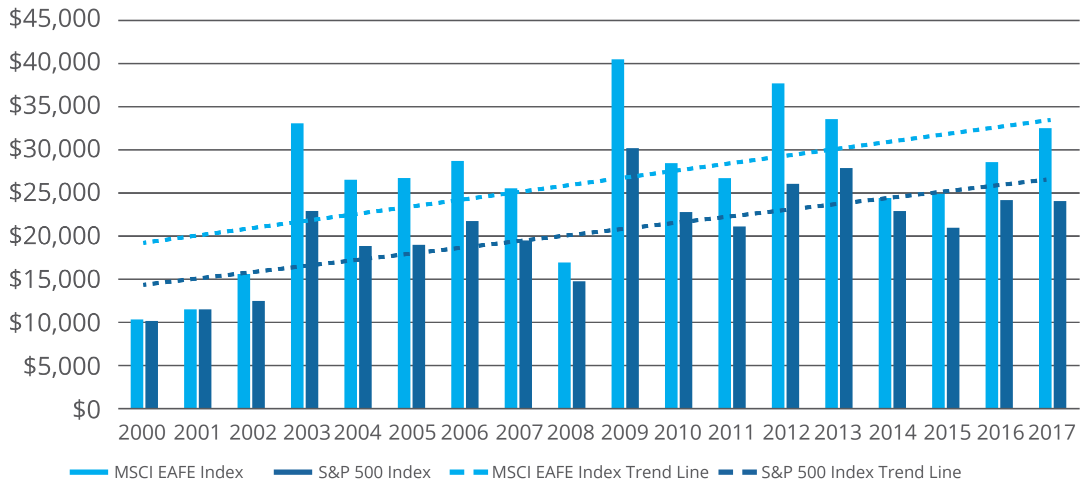


Source: Bloomberg data as of 12/31/2017

Historically, dividend yields on international securities have been higher, and have offered higher growth compared to domestic yields. International dividends also offer income diversification. This means differences between domestic and international dividends help diversify income streams:

- Frequency: U.S. stocks typically pay dividends quarterly, while international stocks' dividends may pay quarterly, semi-annually, or annually.
- Variability: U.S. dividends do not vary as much with changing market conditions as international dividends.
- Declines: U.S. companies are known to have downward sticky dividend policies (they are reluctant to lower their dividend for the fear of losing shareholders). International companies do not typically share this fear.
- Currency: Currency is a factor with international investments.
- Taxes: Countries have different tax policies when it comes to dividends.

CHART 20: HYPOTHETICAL DIVIDENDS OF THE S&P 500 & MSCI EAFE INDEXES, $1M INVESTED (12/31/1999 - 12/31/2017)

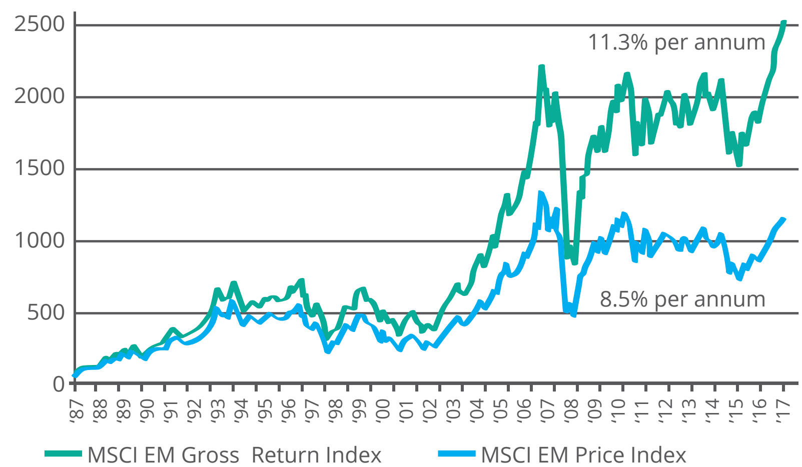


Source: Morningstar Direct data as of 12/31/2017

Emerging Market Dividends

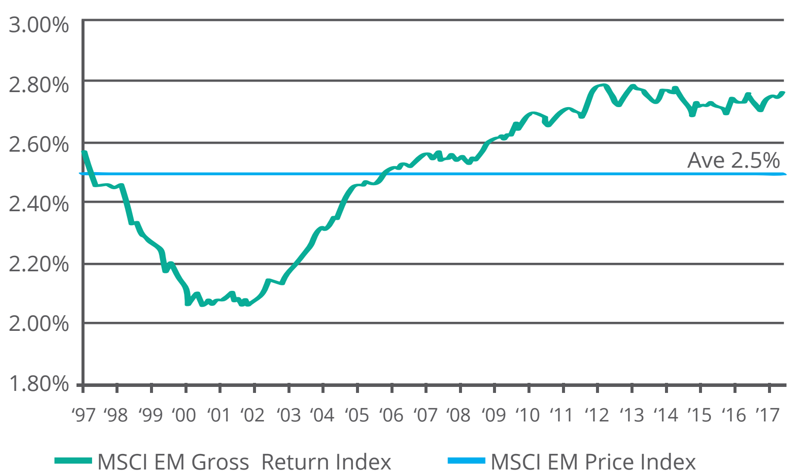
Dividends in emerging markets are another compelling story. Dividends have accounted for 33.5% of the cumulative total return of EM since the inception of the MSCI EM Index in 1987 (as shown in Chart 21a). This equates to about a 2.5% per year increase in performance (as shown in Chart 21b). EM have exhibited relatively strong dividend growth, which is partly attributable to high earnings growth, prevalent in developing countries with growing economies. But, dividend growth has actually outpaced earnings growth by 1.5% per year since 1995. This difference comes from an increase in the dividend payout, which has historically been above that of the broad global market (MSCI World Index).

CHART 21A: MSCI EM PRICE INDEX VS. MSCI EM GROSS RETURN INDEX (INCL. DIVIDEND) (12/31/1987 – 12/31/2017)



Source: Data from MSCI.com as of 12/31/2017. Index = 100 on 12/31/1987.

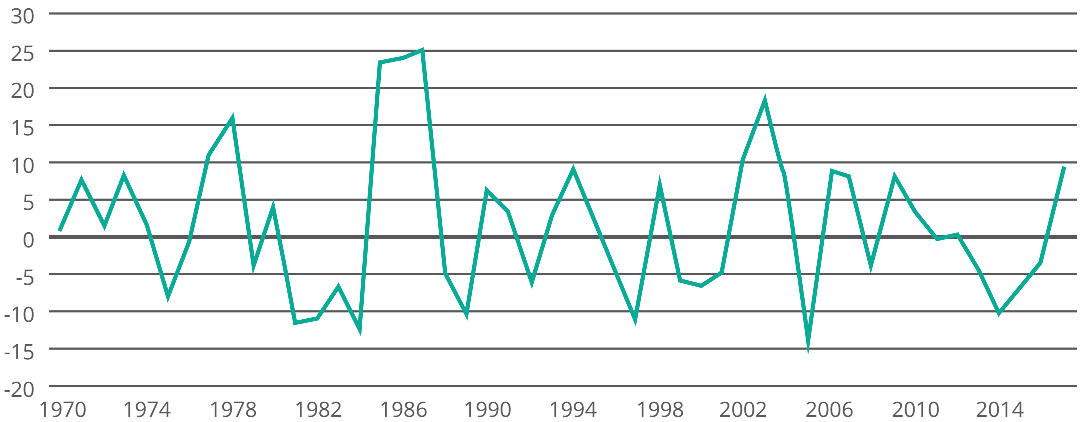
CHART 21B: PORTION OF MSCI EM INDEX'S 10-YEAR TOTAL RETURN FROM DIVIDENDS (12/31/1997 – 12/31/2017)



Currency

Currencies are often overlooked when discussing investment strategies, but they do serve a role when investing internationally. Currency can be considered an additional alternative asset class that has a low correlation with equities. Fluctuations in currencies are unpredictable in some foreign markets, but over time, this translates into further diversification benefits. Chart 22 below shows how currencies have impacted the returns of international equities for U.S. investors over various periods. What may be surprising is the degree of performance currencies can have, ranging from about -15% to an upside of just over 25%.

CHART 22: ANNUAL CONTRIBUTION OF U.S. DOLLAR TO NON-U.S. EQUITY RETURNS (%)



Source: Morningstar Direct data from 1970-2017 using MSCI World Index ex-U.S. USD return minus local return.

Economics

Economic activity and investment returns are typically related. It makes sense that companies within a country experiencing economic growth benefit more than those in a country with poor growth. Chart 23a compares the positive correlation between aggregate GDP growth and the total equity market returns in specific counties. Many components make up GDP, but population growth has historically been a great contributor to growth, which can be seen in Chart 23b. A country's workforce productivity should benefit as its workforce increases. Economic and population growth vary by country so it is important to diversify investments globally to take advantage of that growth.

CHART 23A: REAL EQUITY RETURNS AND AGGREGATE GDP 1900-2013

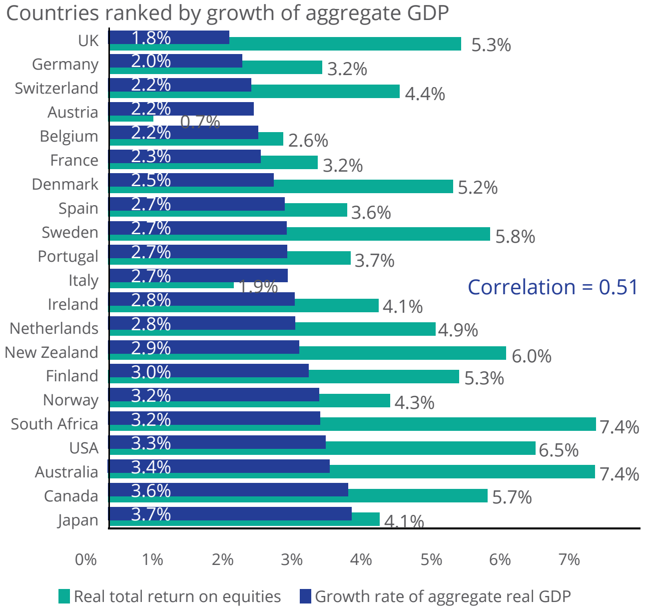
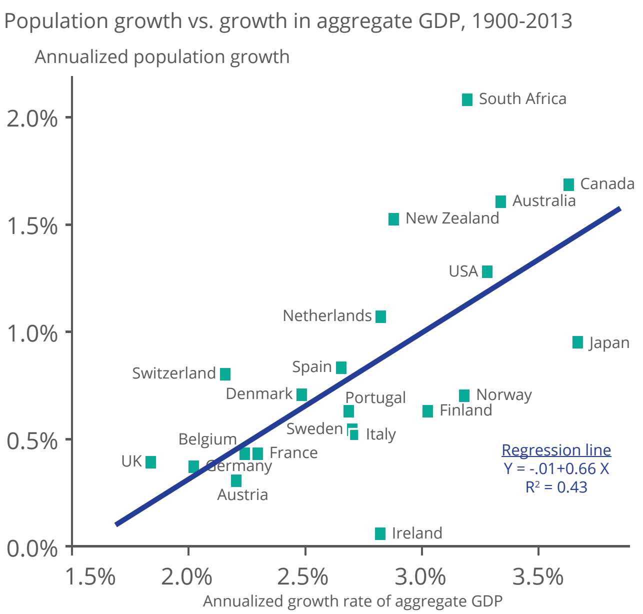


CHART 23A: REAL EQUITY RETURNS AND AGGREGATE GDP 1900-2013

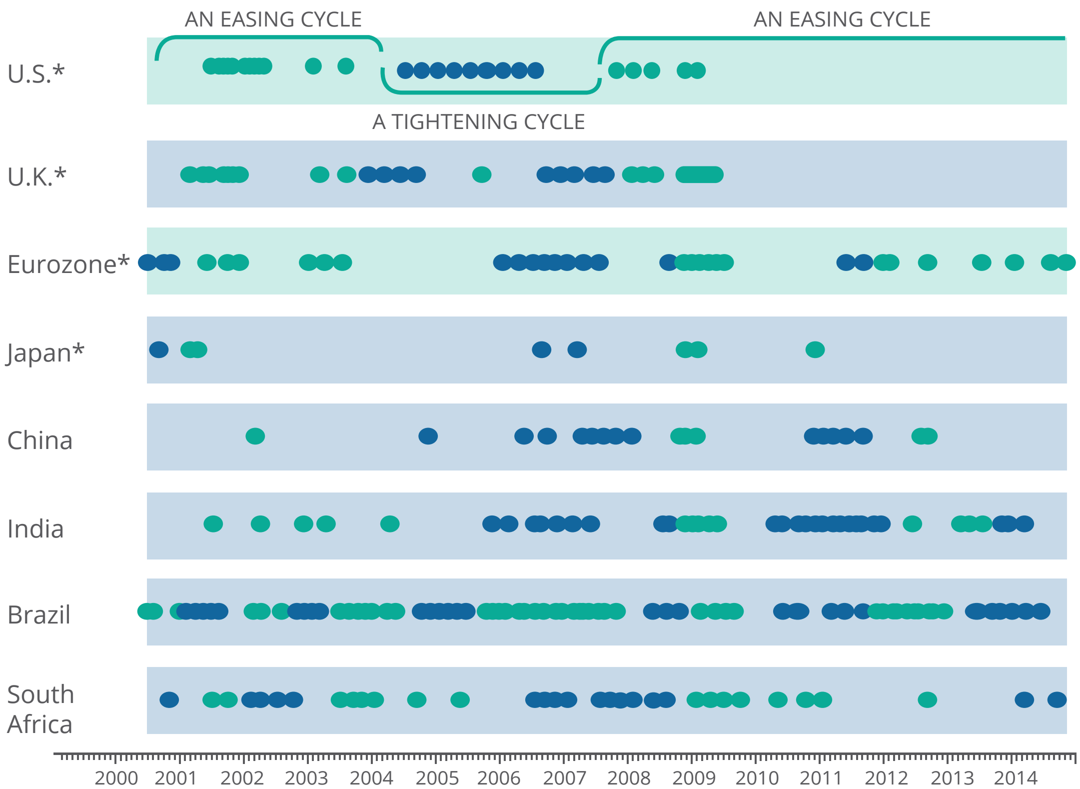


Source: Credit Suisse Global Investment Returns Yearbook 2014; Source: Elroy Dimson, Paul Marsh, and Mike Staunton, using data from Barro and Maddison

When economic performance starts to deteriorate within a country, many times its central bank will begin reducing interest rates in an effort to increase liquidity and boost economic activity and growth in financial markets. Alternatively, a booming economy is often accompanied by high inflation rates; therefore, the central bank may increase interest rates to keep inflationary pressures in check. A rise in rates takes liquidity out of the markets, which may be unfavorable for equity markets. As illustrated in Chart 24, countries initiate central bank actions over different time frames, depending on their economic situations. Again, it is important to diversify among countries to take advantage of easing cycles (decreasing interest rates) and dampen possible losses from tightening cycles (increasing interest rates).

CHART 24: CENTRAL BANK INTEREST RATE ACTIONS (6-30-2000 TO 9-30-2014)

Green: interest rate cuts; Red: interest rate hikes.



**U.S., U.K., and Japan have introduced quantitative easing, a method more than just impacting the short-term interest rates*

International Fixed Income

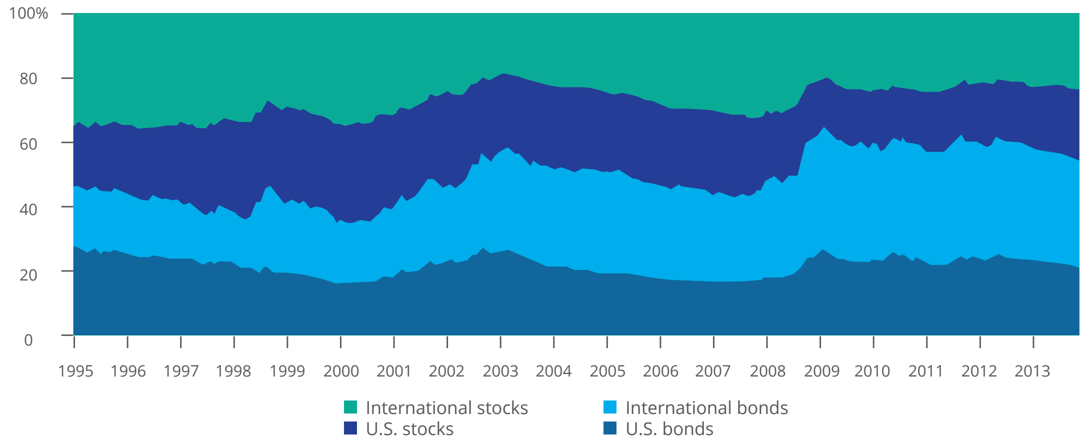
Similar to international equity markets, international fixed income markets have gained significant market share over the last couple decades. As seen in Chart 25, they now make up the largest chunk of the global investable market. This increase can be attributed to growth of international economies, advances in information sharing, and increased acceptance of government foreign debt issuance. Investing in international bonds may have been daunting in the past, but nowadays these assets can be efficient and cost-effective additions to portfolios.

International bonds add some of the same benefits to diversified portfolios as international equities. Their lower correlations with U.S. bonds means they may provide diversification benefits when the U.S. bond market is struggling. As previously mentioned, countries have differing interest rates and inflation levels (two main drivers of bond returns). This allows for diversification of bonds across individual countries. Additionally, a combination of various foreign country bonds results in less volatility when compared to standalone U.S. bonds.

A more granular option within international fixed income is emerging market bonds. Just like emerging market stocks, these bonds offer unique opportunities for diversification through uncorrelated returns and risks. They typically have higher yields to compensate for increased risks, including political uncertainty. But again, the risks are not correlated from country to country in both developed and emerging markets; thus, in the aggregate, much of the risk is diversified away.

Lastly, access to international bonds has been greatly simplified through innovations in financial products, including exchanged traded funds (ETFs), which are discussed in the next section. Some of these products offer currency hedging, which dilutes the impact of foreign currency exposure on international holdings.

CHART 25: GLOBAL INVESTABLE MARKET COMPONENTS, 1995-2013



Source: Vanguard "Global fixed income: Considerations for U.S. Investors"

Notes: International bonds represented by Barclays Global Aggregate ex-USD Bond Index; U.S. bonds represented by Barclays U.S. Aggregate Bond Index; U.S. stocks represented by MSCI USA Index; international stocks represented by MSCI All Country World Index ex USA. All data through December 31, 2013.

Down Market Performance

A common misconception is that when the U.S. market has negative returns, international markets perform even worse: when U.S. market sneezes, international markets catch a cold. The international markets downside underperformance myth is busted in Chart 26 below which shows the following findings:

- U.S. and International markets are both positive about 60% of the time
- When the U.S. market is negative, international markets are positive about 30% of the time
- Additionally, when the U.S. market is negative, international markets outperform the U.S. market more than half the time (about 57%)

Thus, international markets can serve as diversifiers for U.S. down market periods.

CHART 26: DOWN MARKET PERFORMANCE SCENARIOS (1970-2017)

Scenario	% of Time
U.S. Negative	38.2%
Intl Negative	40.6%
Intl Positive if U.S. is Negative	30.9%
Intl Outperforms when U.S. is Negative	56.8%

Source: Morningstar Direct monthly return data from 01/31/1970 to 12/31/2017.
U.S. market represented by MSCI USA Index and international markets represented by MSCI World ex USA Index.

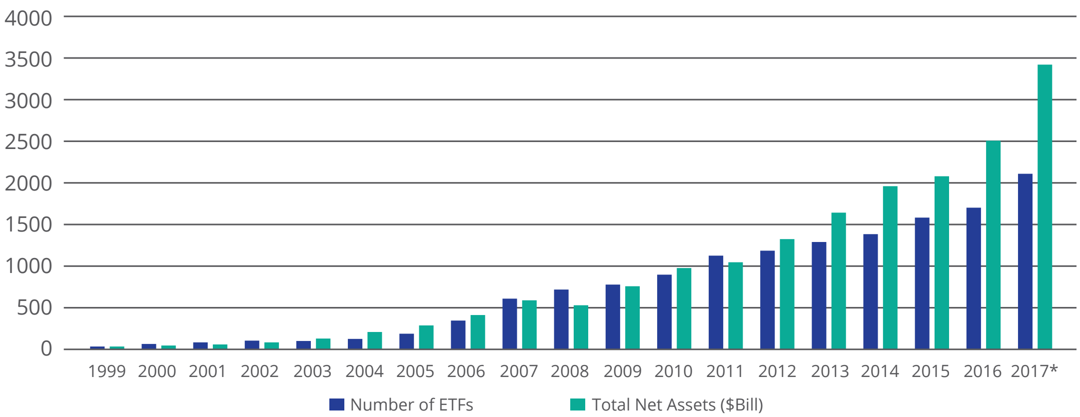
Accessing International Investments Through ETFs

It is difficult, and sometimes impossible, to invest in individual securities in international markets. These securities trade on exchanges of their respective domicile, which are regulated by the local government. To purchase these stocks, foreign investors need access to those exchanges, which may not be possible due to regulatory constraints.Another issue is liquidity, since individual securities may not trade often. This means there may not be a buyer when an investor wants to get out of a security quickly. Liquidity issues also increase costs, as the foreign investor has to pay a premium to acquire securities. With transaction costs, it can become expensive to trade the many securities needed to build a globally diversified portfolio. Often, it is difficult to find information on foreign companies and may take a considerable amount of time and resources to research individual stocks. Lastly, various foreign tax considerations can be added to the mix of costs. So what can be done to alleviate some of these problems?

The answer is to use a fund structure for international investments. Using investment vehicles, such as mutual funds and exchange traded funds (ETFs) is a simple way to access a broadly diversified international portfolio at a lower cost and with minimal effort. These funds can hold thousands of securities from various regions all in one neat wrapper. Mutual funds typically have higher costs due to their structure and minimum investment requirements, as well as trading only at the close of a market day. Many mutual funds are actively managed, which also increases costs. Due to their creation/redemption mechanism and typical lack of minimums, ETFs tend to be a lower cost option. ETF investors can trade any time throughout the market day as they would with a stock, which allows them to take advantage of intraday market opportunities. Most ETFs follow an index, which not only reduces costs, but also allows for an unbiased exposure to the region of choice.

A recent surge in available ETF options (see Chart 27) has opened up markets not previously accessible to the average investor, such as investments from around the world, including focused regions like frontier markets. Another innovation has been the introduction of "smart beta" or "factor based" indexing, which is index weighting using a methodology other than market capitalization. Factors include such things as value, quality, momentum, size, and low volatility. Investors now have the opportunity to access almost any global region in a cost-effective and efficient way, while tilting toward factors deemed most favorable.

CHART 27: TOTAL NET ASSETS ($B) AND NUMBER OF ETFS



*Source: Data 1999-2016 from www.ici.org; *2017 is data from Morningstar Direct*

Conclusion

International securities serve an important role in a fully diversified portfolio. Foreign securities make up a large portion of the aggregate global financial market. In fact, the international share has been growing over time.

Diversification is the main benefit of adding international assets to a portfolio. Compared to the U.S. market, international securities have larger return dispersions and lower correlations. When combined, they tend to have lower volatilities. When measuring optimal volatility levels, it appears that a 30-40% allocation to international equities can yield the best results. Much of the diversification is attributable to the differing economic conditions in various countries.

It is important to broaden into international markets in order to take advantage of favorable global conditions, especially when the domestic outlook is unfavorable. Now, through ETFs, it is easier than ever to access even the hardest to reach markets in a cost-effective manner.

The reasons for staying within home borders are simply dissipating. In today's ever-changing technological environment, the importance of global investing cannot be overlooked.

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The graphs and charts contained in this work are for informational purposes only. No graph or chart should be regarded as a guide to investing.

An ETF is a type of investment company whose investment objective is to achieve the same return as a particular index, sector, or basket. To achieve this, an ETF will primarily invest in all of the securities, or a representative sample of the securities, that are included in the selected index, sector, or basket. ETFs are subject to the same risks as an individual stock, as well as additional risks based on the sector the ETF invests in. Market capitalization, or market cap, refers to the total dollar value of all of an issuer's outstanding shares of stocks. Generally, large cap firms consist of companies whose market cap is between $10 Billion and $100 Billion; mid cap securities generally consist of companies whose market cap is between $2 Billion and $10 Billion; small cap securities generally consist of companies whose market cap is between $300 Million and $2 Billion. Additional diversifiable risks for mid cap companies include, but are not limited to, liquidity risk and business risk. These two risks are present to an even greater degree for small cap firms. International investing is an investment strategy where investors chose global investment instruments.

International investing can be accomplished utilizing a variety of investment vehicles including, but not limited to, ETFs, American Depository Receipts, or a direct investment in a foreign stock exchange. Diversifiable risks include, but are not limited to, political risk and currency risk. Emerging market investing refers to the practice of investing in a developing market of a foreign nation. The pre-requisites of this practice include a market within the foreign nation along with some form of regulatory body. Emerging markets involve greater risk and potential reward than investing in more established markets. Diversifiable risks for emerging markets include, but are not limited to, political risk, currency risk, and liquidity risk. Frontier markets refer to markets within developing countries that are considered pre-emerging. Diversifiable risks for frontier markets are similar to the risks of emerging markets, but to a higher degree. These risks include, but are not limited to, political risk, currency risk, and liquidity risk.

The MSCI USA Index is a free float adjusted market capitalization index that is designed to measure large and mid cap US equity market performance. It is member of the MSCI Global Equity Indices and represents the US equity portion of the global benchmark MSCI ACWI Index. The MSCI ACWI captures large and mid cap stocks across developed markets and emerging markets countries. The index covers approximately 85% of the global investable equity opportunity set. The MSCI ACWI ex U.S. Index (MSCI All-Countries World Index, excluding U.S.) is an index considered representative of stock markets of developed and emerging markets, excluding those of the U.S. The MSCI EAFE Index is an index which tracks performance of international equity securities in developed countries in Europe, Australia, Asia, and the Far East, excluding the U.S. and Canada. The MSCI Emerging Markets Index is an index which tracks performance of large and mid-cap firms across countries classified as emerging market countries. The Russell 3000 Index is an unmanaged index considered representative of the U.S. stock market. The index is composed of the 3,000 largest U.S. stocks. The S&P 500 Index is an unmanaged index of 500-large capitalization companies. This index is widely used by professional investors as a performance benchmark for large-cap stocks. The Bloomberg Barclays Capital U.S. Aggregate Bond Index measures performance of the U.S. investment-grade bond market. The Barclays Capital High Yield Index includes publicly issued U.S. dollar denominated, non-investment grade, fixed-rate, taxable corporate bonds that have a remaining maturity of at least one year, regardless of optionality, are rated high-yield (Ba1/BB+/BB+ or below) using the middle rating of Moody's, S&P, and Fitch, respectively (before July 1, 2005, the lower of Moody's and S&P was used), and have $600 million or more of outstanding face value. The Barclay's Capital Emerging Market Index measures the performance of the sovereign, local currency bond markets of emerging market countries. The Barclays Global Aggregate Corporate Ex USD Bond Index (USD Hedged) measures the performance of Investment Grade securities and is selected by a Market Value process. The Dow Jones Commodity Index Series measures the commodity futures market, emphasizing diversification and liquidity using a simple, transparent, equal-weighted approach. The DJ Commodity Index is now known as the Bloomberg Commodity Index. The FTSE NAREIT All Equity REITs Index is a free-float adjusted, market capitalization-weighted index of U.S. Equity REITs. Constituents of the Index include all tax-qualified REITs with more than 50 percent of total assets in qualifying real estate assets other than mortgages secured by real property. The Credit Suisse Hedge Fund Index is an asset-weighted hedge fund index and includes only funds, as opposed to separate accounts. The Credit Suisse Equity Market Neutral Hedge Fund Index is a subset of the Credit Suisse Hedge Fund Index that measures the aggregate performance of dedicated short bias funds. The FTSE Multinationals Index Series is a family of indices that separates and measures the performance of multinational and local companies outside/inside the domestic region in which they are incorporated. An index is an unmanaged group of stocks considered to be representative of different segments of the stock market in general. You cannot invest directly in an index.

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