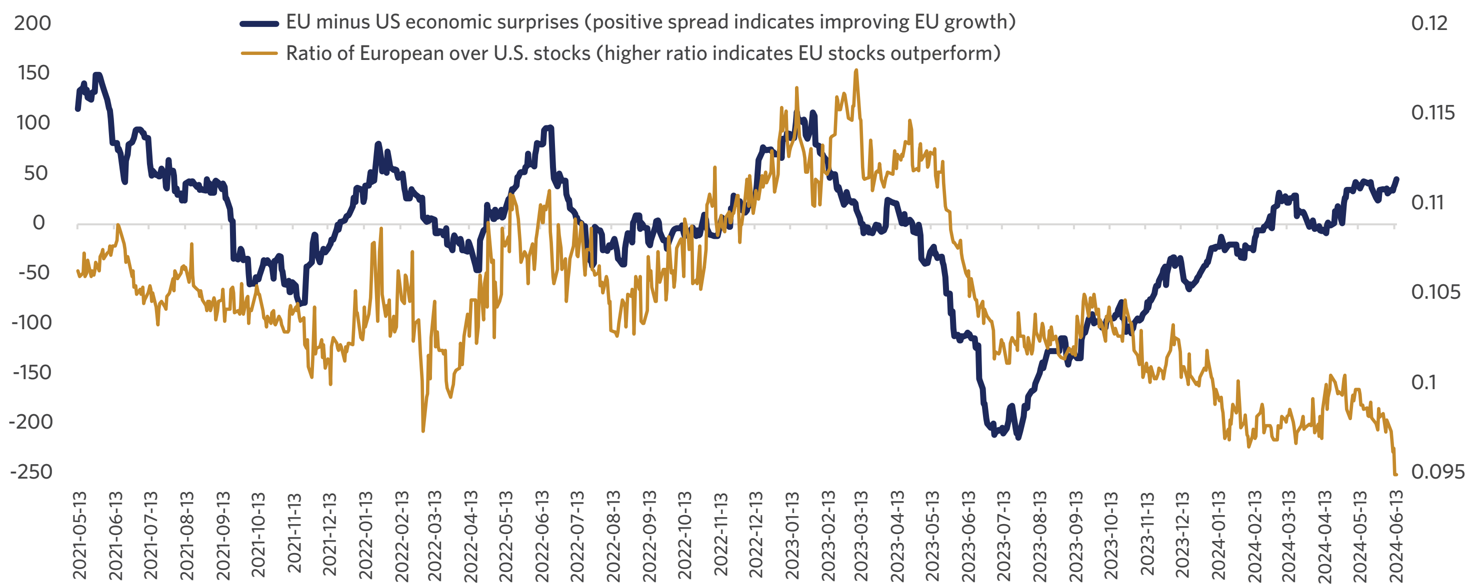
Narrowing growth gap could help overseas developed stocks



Source: Bloomberg, Edward Jones. U.S. stocks represented by the S&P 500; EU stocks represented by the Stoxx 600.

International outlook

Global growth has stayed resilient this year despite high borrowing costs, bolstered by U.S. strength. As major central banks start cutting rates to normalize policy, early signs of recovery outside the U.S. are starting to emerge.

European economy sees a gradual rebound - After the euro area economy stagnated for more than a year, a modest recovery appears to be under way. Growth picked up more than expected in Q1, and timely survey indicators have moved higher since then, suggesting the region's cyclical outlook is improving. Despite unemployment falling to historic lows, inflation pressures have receded, and the European Central Bank (ECB) has started to gradually ease policy. Political uncertainty in France at the end of Q2 weighed on stocks in the region. A proxy for European large-cap stocks (Stoxx 50), has been keeping pace with the S&P 500 over the past two years and continues to trade at large discount to U.S. stocks, while outperforming the TSX. With eurozone activity rebounding from a lull and U.S. economic activity normalizing after a period of exceptional strength, we believe overseas developed-market stocks offer catch-up potential and diversification benefits.

China stocks rally, but concerns remain - In response to an uncertain economic environment and an ongoing real estate crisis, Chinese policymakers have lowered interest rates, allowed banks to keep smaller reserves, and announced measures to absorb some of the excess housing inventory. The policy support has helped improve investor sentiment and sparked a Q2 rebound in stocks. But we remain cautious on the sustainability of the rally as earnings estimates have not turned higher and are hovering around 2017 levels. Also, housing activity remains depressed, and there is a looming threat of another trade war ahead of the U.S. elections. Regardless of the election outcome, the fracturing in the U.S.–China relationship could continue.

Global rate-cutting cycle begins - More central banks began easing policy in Q2, with the ECB and BoC (Bank of Canada) lowering interest rates in June. With inflation not yet returned to target, central banks will likely take a cautious approach to rate cuts. But we think a multiyear easing cycle will continue to gain steam next year. Lower rates can help drive a recovery in manufacturing activity and benefit cyclical sectors, which carry a higher weight in overseas indexes relative to the U.S.

Investing in equities involves risks. The value of your shares will fluctuate, and you may lose principal. Special risks are inherent to international investing, including those related to currency fluctuations and foreign political and economic events.

▶ Action for investors

We recommend underweighting emerging-market and Canadian equities, staying neutral with overseas developed equities, and overweighing U.S. stocks.

