ECF Endowment Management

Fourth Quarter 2022

Why International Markets Are Very Relevant

During the last decade (2011-2021), the U.S. equity market dramatically outperformed the international market, with the S&P 500 Index returning 11.7% annually and the MSCI EAFE Index (a proxy for the International Developed Equity Markets) returning only 4.3% annually. So far this year (through October 31), international stocks continued to struggle, with the MSCI EAFE Index down about 25% and the S&P 500 index down just 19%.

With the ongoing war in Ukraine, a looming recession in Europe, the zero-COVID policy in China, and lingering effects from supply chain disruptions, it's not surprising that international assets are struggling right now. And the argument to steer away from international markets and invest solely in the U.S. may seem to be reinforced by these lagging performance numbers. However, despite recent lackluster performance, international markets offer longer term opportunities for investors to benefit from economic growth, secular trends, and diversification, suggesting that international exposure remains a necessary part of a portfolio.

Chart 1: Annualized performance through different economic cycles

	US: S&P 500	Int'l: MSCI EAFE
Jun 1981 - July 1990	11.6%	17.8%
Jun 1990 - March 2000	11.6%	4.6%
Feb 2001 - Dec 2007	2.5%	6.4%
Nov 2007 - Nov 2021	8.4%	-0.3%

Source: Refintiv, 2022

Here are five reasons international investments can add value:

#1: Leadership in Market Performance Runs in Cycles

In recent years, U.S. markets have led the way, outpacing international markets. While leadership in a region may persist for some time, it can also reverse. This change often occurs when an economy shifts from growth to recession. When this occurs, one region may face economic headwinds while another region can continue to perform well. For example, International stocks outperformed in the 1980s, but during the 1990 recession, a shift to U.S. outperformance occurred. During the 2001 recession, there was another switch back to international outperformance. And during the 2008 recession, the leadership flipped again to the U.S. The U.S. markets do not always dominate (see Chart 1).

One reason regional leadership rotates is because company valuations (based on both price and earnings) become expensive after a period

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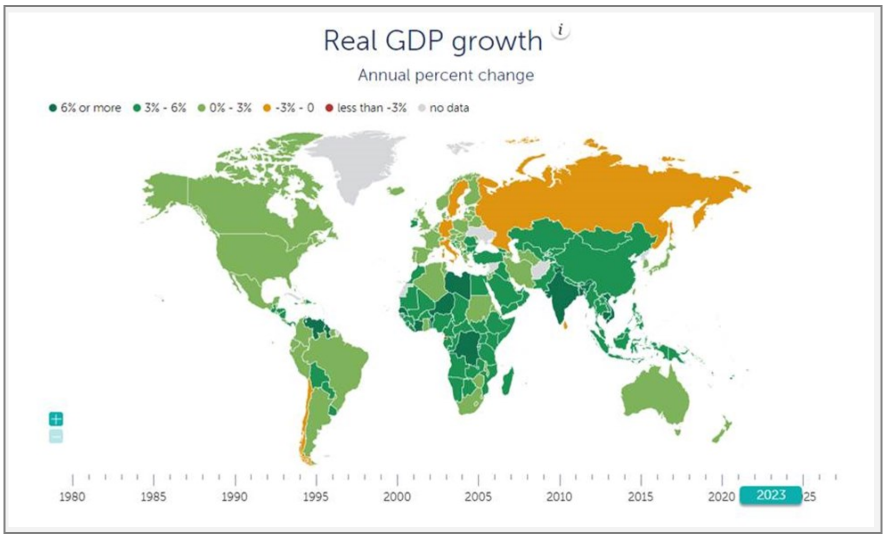
of strong performance but remain more attractive in another region.

#2: Economic Growth Occurs Globally

Economic growth is global, not just domestic. This year, the U.S. economy has been challenged by higher inflation and interest rates and dampening growth, and this struggle may very well continue into 2023. Forecasts are currently calling for the real growth rates in the U.S. next year to be a muted 1.0%. However, growth rates in other regions are still expected to be robust next year. According to the IMF forecasts (see Chart 2), Asia is poised to lead the way with Indian and Chinese economies expected to grow 6.1% and 4.4%, respectively. The Middle East is expected to grow at 3.6% and Latin America at 1.7%. These and other countries or regions are expected to outpace the U.S. in 2023. And although European

Chart 2: Real GDP Growth estimates for 2023



Source: IMF, Nov 2022

forecasts are mixed, with some countries expected fall into recessionary territory, growth in others are expected to outperform that of the U.S.

#3: Secular Trends Can Drive Long Term Growth

Growth can also be driven by fundamental changes in an economy, such as demographic changes, evolving consumer behavior, or the development of new technologies. These "secular trends" are long-term changes not tied to any industry business cycle (as recently seen in travel, restaurants, and manufacturing). Secular trends can drive long-term growth when spending flows into industries benefiting from the change. And much like economic growth, this can be found in each region globally.

U.S. Equities: The emergence of the mobile phone, cloud computing, and social media are all considered secular trends. Growth in this segment, broadly categorized as technology, has outpaced growth in other sectors and has left the U.S. equity markets highly concentrated in a small number of mega cap stocks. At the end of 2021, the top four companies in the S&P 500 made up approximately 20% of the index. Three of the four names fall within the technology sector, helping to boost it to 25% of the S&P 500 versus just 10% at the end of 2002. An investment in the U.S. market will inevitability bring more exposure to technology stocks and the growth segment (companies expected to grow earnings at a faster rate than average).

European Equities: European markets, in contrast, are more heavily weighted in other sectors and include more conventional value (companies which seem to be undervalued by the market) companies. These often shine during times of economic recovery. In 2021, the MSCI Europe index was composed of 16.3% Health Care, 16.0% Financials, 14.6% Industrials, and 13.5% Consumer Staples. And Technology was just 7.0% of the index. Beneath the surface are additional differences. Important secular trends such as decarbonization are a growing segment, particularly as climate becomes more relevant. Europe is a leader in the long-term shift to sustainability. The European Green Deal, approved in 2020, cleared the path for Europe to reach targeted greenhouse gas emission reductions by 2030 and to be net-zero by 2050. The EU has committed to spending 1.38% of GDP to reach this goal. These include initiatives for electric cars, clean water and soil, and protection of seas and forests. In comparison, the U.S. had committed to spend just 0.6% of GDP and only with a recent increase (through the Inflation Reduction Act of 2022) did this figure increase to 1.2% of GDP.

Asia: Leading the charge in Asia is China. The Chinese economy has grown 47-fold from 2000 (GDP of $360.9B) to 2021 (GDP of $17.7Tr). In comparison, the U.S. economy merely doubled, from $10.25Tr in 2000 to $23Tr in 2021. China's economic growth during the last two decades has brought the size of its economy in line with the U.S. economy and catapulted it into the second largest economy of the world, just behind the U.S. Further, China's GDP is on pace to overtake U.S. GDP by 2050. Not only is China the largest exporter and second largest importer of goods, but the secular shift from an industrial nation to a consumer nation could lead to doubling of private consumption by 2030. There's no denying

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Chart 3: Projected Returns

	With International Asset Classes	Without International Asset Classes (Estimated)
Active Passive 70/30	7.84%	7.10%
Active Passive 60/40	7.60%	6.87%
All Passive 70/30	7.14%	6.40%
All Passive 60/40	6.97%	6.24%

Source: State Street Global Advisors, ECF, 9/30/22

that China is not just a relevant economy; it's a massive economy and often thought of as one of the two growth engines of the world.

#4: International Exposure Increases Projected Portfolio Return

State Street Global Advisors & ECF portfolios are positioned for long-term investing and capture a diversified set of asset classes, including International Developed Equities, International Emerging Market Equities, and Emerging Market Fixed Income. State Street's set of projections suggest that exposure to these international asset classes may bring additional value over investments limited to the U.S. markets. More specifically, projections suggest portfolios with international asset classes could add approximately 0.73% annually on average over the long-term. Chart 3 shows projected returns for the Active/Passive and the All-Passive strategies in both 70/30 and 60/40 allocations.

#5: Diversification Offers Risk Management Benefits

Finally, and possibly the most important, is the benefit of diversification. Portfolios are not just seeking the highest possible return but are also seeking to minimize variability in returns over time. Asset classes that respond differently in different economic climates do just this, allowing investors to better plan for the future. Top performing asset classes will rarely remain in that position year after year. And a well-diversified portfolio, invested with geographic and asset class diversity, acts as a risk management tool to manage the variability of returns.

To illustrate diversification in action, we turn to our quilt showing performances of asset classes from best to worst from 2015 to 2021 (see Chart 4). And we rank ECF's Active/Passive strategy performance against these asset classes. In these years, the best performing asset classes ranged from 0% to +37%. However, the worst performing asset classes ranged from -23% to +6%. This portfolio consistently avoided losses compared to the worst performing asset classes during the last 6 years.

Chart 4: Annual Performances by Asset Class (2015-2021)

2015	2016	2017	2018	2019	2020	2021
S&P 500 1.4%	R2000 21.3%	MSCI EM 37.3%	US AGG 0.0%	S&P 500 31.5%	R2000 20.0%	Global REITs 31.3%
EM Debt 1.2%	S&P 400 20.7%	MSCI EAFE 25.0%	US TIPs -1.3%	S&P 400 26.2%	S&P 500 18.4%	S&P 500 28.7%
US AGG 0.6%	US HY 17.5%	S&P 500 21.8%	US Int Credit -2.2%	R2000 25.5%	MSCI EM 18.3%	Commodity 27.9%
ECF Active/ Passive	Commodity 14.6%	ECF Active/ Passive	US HY -2.3%	MSCI EAFE 22.0%	S&P 400 13.7%	S&P 400 24.8%
US Int Credit -0.6%	S&P 500 12.0%	S&P 400 16.2%	EM Debt -4.3%	Global REITs 21.9%	US TIPs 11.0%	ECF Active/ Passive
Global REITs -0.8%	MSCI EM 11.2%	R2000 14.7%	S&P 500 -4.4%	ECF Active/ Passive	ECF Active/ Passive	R2000 14.8%
MSCI EAFE -0.8%	EM Debt 10.2%	Global REITs 10.4%	Global REITs -5.6%	MSCI EM 18.4%	US Int Credit 9.8%	MSCI EAFE 11.3%
US TIPs -1.4%	ECF Active/ Passive	EM Debt 10.3%	ECF Active/ Passive	EM Debt 15.0%	MSCI EAFE 7.8%	US TIPs 6.0%
S&P 400 -2.2%	US Int Credit 6.0%	US HY 7.5%	R2000 -11.0%	US HY 14.4%	US AGG 7.5%	US HY 5.4%
R2000 -4.4%	US TIPs 4.7%	US Int Credit 6.5%	S&P 400 -11.1%	US Int Credit 14.2%	US HY 6.2%	US Int Credit -1.0%
US HY -4.6%	Global REITs 4.1%	Commodity 3.6%	Commodity -11.7%	US AGG 8.7%	EM Debt 5.3%	US AGG -1.5%
MSCI EM -14.9%	US AGG 2.7%	US AGG 3.5%	MSCI EAFE -13.8%	US TIPs 8.4%	Commodity 1.4%	EM Debt -2.1%
Commodity -23.5%	MSCI EAFE 1.0%	US TIPs 3.0%	MSCI EM -14.6%	Commodity 6.1%	Global REITs -9.0%	MSCI EM -2.5%

Source: ECF, 2022, ECF's Active/Passive 70/30 Strategy

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Webinar, Part 2 :

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Join the Episcopal Church Foundation for a free webinar, "Marketing Your Endowment: Creating a Communications Strategy" on

Wednesday, December 7, 2 - 2:30 pm, Eastern

Focus will be on creating a promotion strategy that encourages long-term support for your organization's endowment.

(Register here: https://bit.ly/marketingendowment)