Time to Rebalance International Equities?

May 2017

Executive Summary

Diversified investors may be frustrated by the underperformance of their international equity returns relative to their domestic equity returns over the last 7 years. This frustration may have caused some diversified investors to minimize their rebalancing efforts, resulting in a significant U.S. overweight, and an equally significant international equity underweight. Prudent investors likely know that they need to address this weighting imbalance but they may be asking themselves: Is now the time to rebalance?

U.S. vs. International Equity Returns

Growth of $10,000 Since Market Bottom in March 2009

As of March 31, 2017. **Past performance is no guarantee of future results.**
Source: FactSet, MSCI, Dow Jones.

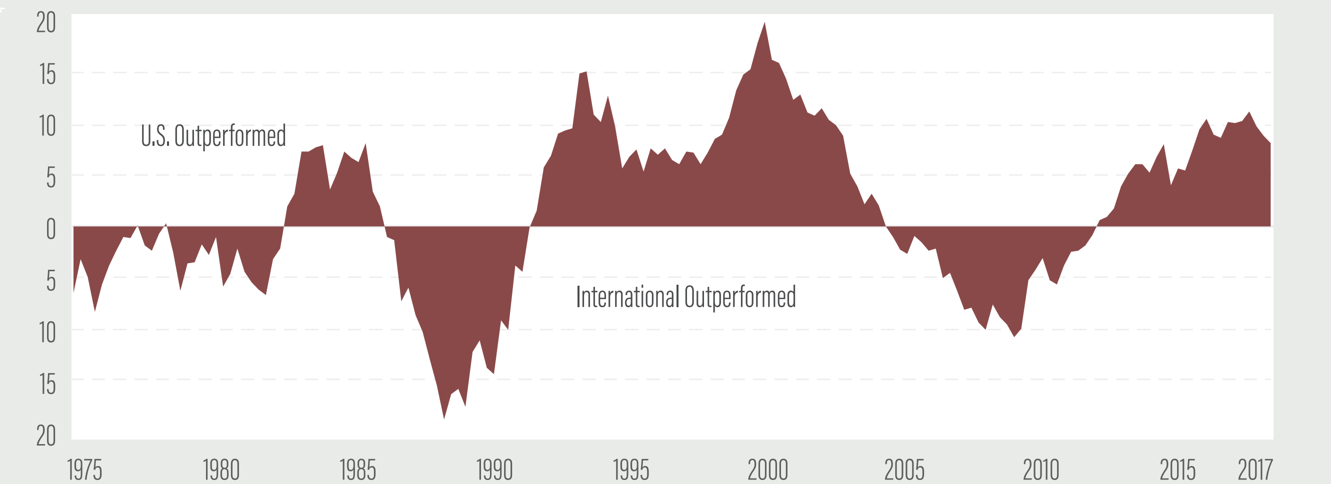
Is Now the Time to Increase Your International Equity Allocation?

History Supports Cyclicality of Performance between U.S. and International Equities

- 2009 was the last year that international equities outperformed U.S. equities; however, since 1975, the average cycle of U.S. and international equity out-or underperformance is 6.8 years.
- In the current cycle, U.S. equities have outperformed for over 7 years.
- It is difficult to predict when the current trend will reverse leading to international equity outperformance, but history suggests that we are closer to a reversal than another 7+ years of U.S. dominance.

6.8 Years: The Average Cycle of U.S. and International Equity Out- or Underperformance.

A 30-year look at U.S. and International Return Cycles[1]



Source: MSCI, Standard and Poor's Corporation, FactSet as of March 31, 2017. S&P 500 and MSCI ACWI ex USA Indices shown.
[1] Rolling 5-year annualized performance.
Past performance is no guarantee of future results.

In the Current Environment, Valuations for International and Emerging Markets Equities Are More Attractive than U.S. Equities

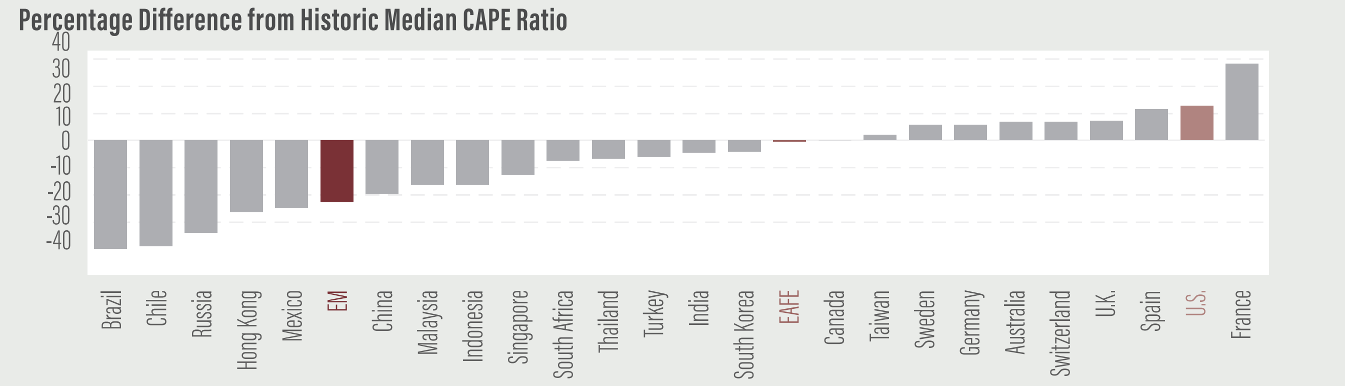
- Many investors believe that lower valuations are a contributor to equity outperformance.
- As the table below illustrates, Emerging Markets and Foreign Developed equities are trading at lower valuations relative to U.S. stocks, which may provide more of an opportunity for foreign equities.
- Not only are current U.S. valuations greater than foreign equities, but the U.S. CAPE and P/B valuations are expensive relative to U.S. history, as represented by the 100th percentile (CAPE) and 93rd percentile (P/B) historical ranking.
- Foreign Developed and Emerging Markets equity valuations are also attractive relative to their own history as represented by the 48th (CAPE) and 43rd (P/B) historical percentile ranking for the MSCI EAFE Index, and the 16th (CAPE) and 49th (P/B) historical percentile ranking for the MSCI Emerging Markets Index.

Valuation	U.S.	EAFE	Emerging Markets
Shiller Price to Earnings (P/E)[1]	24.8x	16.9x	10.9x
Historical CAPE Percentile[1]	100th	48th	16th
Price/Book (P/B)[2]	2.9x	1.6x	1.5x
Historical P/B Percentile[2]	93rd	43rd	49th

Source: FactSet, MSCI.
Cyclically adjusted price-to-earnings ratio (CAPE) is a valuation measure that is defined as price divided by the average of ten years or earnings, adjusted for inflation.

[1] Data for MSCI US, MSCI EAFE & MSCI EM from 12/04–03/17.
[2] Data for MSCI US from 02/2001, EAFE from 09/97, EM from 06/00–03/17.

- When comparing countries' current CAPE P/E ratio relative to their historic median, only a few stand out as relatively over-valued.



Source: Bloomberg, Robert Shiller, MSCI.
Data Time Periods: EAFE, Chile, Spain, EM, Brazil, Sweden, Australia, India, Mexico, Taiwan, Canada, Switzerland, US: 12/2004–03/2017. Singapore: 12/2004–10/2016. Turkey, Malaysia: 11/2005–03/2017. China: 10/2005–03/2017. Indonesia: 8/2006–03/2017. South Korea: 11/2006–03/2017. France: 1/2006–03/2017. Russia: 12/2005–03/2017. Thailand: 02/2007–03/2017. UK, Germany, Hong Kong: 05/2005–03/2017. South Africa: 07/2006–03/2017. Date and time periods vary based on the lack of historical data available for each country. In each country's case the earliest date that data was available was used.

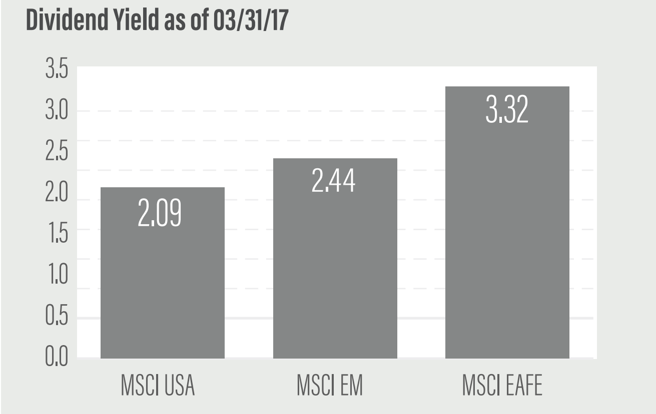
Higher Dividend Yields for Foreign Equities May Attract Capital

- With global interest rates near historic lows, investors may continue to search for income in a variety of asset classes that may include global equities.
- The dividend yields for the MSCI EAFE Index (3.32%) and the MSCI EM Index (2.44%) are significantly higher than the yield of the MSCI USA Index (2.09%), which may attract more capital to foreign equities in the current low interest rate environment.

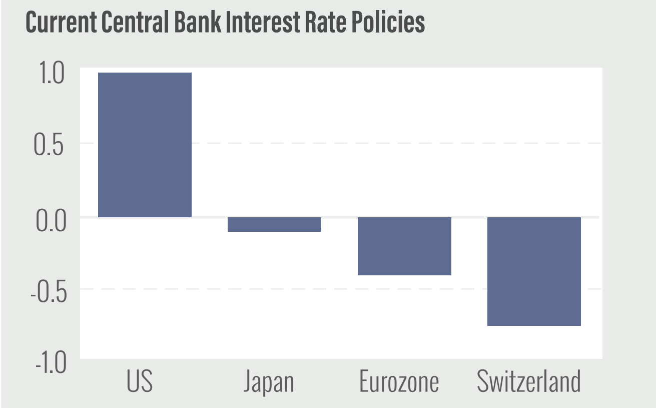
Foreign Central Bank Policy Has the Potential to Remain Accommodative

- Many foreign central banks, such as the European Central Bank (ECB), the Bank of Japan and the Swiss National Bank, have signaled for ongoing accommodative monetary policies and negative target short-term interest rates. The U.S. Federal Reserve (the "Fed"), on the other hand, raised the target short-term interest rate in December 2015 and 2016.
- If the foreign central banks maintain their extremely accommodative monetary policies, while the Fed continues to raise the target short-term rate, investors may have an opportunity to benefit from this discrepancy.[1]

Diversified investors understand the potential benefits of allocating equity assets outside of the United States to seek to enhance the risk/return profile of their investment portfolios. One thing we know for certain is that the cyclicality, valuations and economic fundamentals of the equity markets will continue to change.



Source: FactSet, MSCI. **Past performance is no guarantee of future results.**



Source: Federal Reserve, Bank of Japan, ECB, Swiss National Bank, as of March 31, 2017.

We believe the key is to consistently rebalance to the portfolio's original desired asset allocation.

[1] Foreign equities may be more desirable, relative to U.S. equities, given the foreign central banks' encouragement for investors to invest in risk assets relative to extremely low interest bearing securities.

About AMG Funds

AMG Funds provides access to premier asset managers through a **unique partnership** where the investment managers are truly independent.

AMG Funds is not beholden to a single investment approach or a single manager in delivering quality investment solutions. This **innovative approach** leverages each manager's specific expertise to deliver products that cover the complete asset class spectrum.

Delivering the talents of all of these portfolio managers under a consolidated platform allows AMG Funds to offer **unmatched access** to specialized investment expertise.

Diversification does not guarantee a profit or protect against a loss in declining markets.
Investments in international securities are subject to certain risks of overseas investing including currency fluctuations and changes in political and economic conditions, which could result in significant market fluctuations. These risks are magnified in emerging markets.
Price/book (or P/B) ratio is calculated by dividing the market price of a company's outstanding stock by its book value (total assets of a company less liabilities) and then adjusting for the number of shares outstanding. Stocks with negative book values are usually excluded from this calculation.
Price/earnings (or P/E) ratio is a comparison of the company's closing stock price and its trailing 12-month earnings per share.
MSCI All Country World Index (ACWI) ex USA is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI ACWI ex USA consists of 45 country indices comprising 22 developed and 23 emerging market country indices. The developed market country indices included are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the United Kingdom. The emerging market country indices included are: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Turkey and United Arab Emirates.
The MSCI USA Index is designed to measure the performance of the large and mid cap segments of the U.S. market. With 617 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in the U.S. MSCI All Country World Index.
The MSCI Emerging Markets (EM) Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.
The MSCI Emerging Markets Index consisted of the following 22 emerging market country indices: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand and Turkey.
The MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. & Canada. The MSCI EAFE Index consists of the following 21 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the United Kingdom.
The S&P 500 Index is a capitalization-weighted index of 500 stocks. The S&P 500 Index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.
The S&P 500 Index is proprietary data of Standard & Poor's, a division of McGraw-Hill Companies, Inc. All rights reserved.
The indices are unmanaged, are not available for investment and do not incur expenses.
AMG Distributors, Inc., a member of FINRA / SIPC.

AMG Funds

www.amgfunds.com

linkedin.com/company/amg-funds