REGIONAL & COUNTRY ALLOCATION

October 19, 2023

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Shifting from Europe to UK, still overweight US and Japan

After reducing Europe to neutral last month, we take another step and cut Europe to underweight and move UK to a mild overweight. Relative revisions have weakened further for Europe but have improved for the UK, alongside relative returns.

We remain significantly overweight the US and Japan, and maintain our underweights in Emerging Markets, Canada, and Asia ex Japan. We discuss Japan's local-currency strength in earnings and returns and its weak currency, which may be trying to stabilize.

Regional Pair	Favored
Emerging vs Developed	Developed
N. America vs EAFE	N. America
Europe vs Asia	Asia
US vs Canada	US
Eurozone vs UK	UK
Japan vs Asia ex Japan	Japan

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Regional allocation recommendations

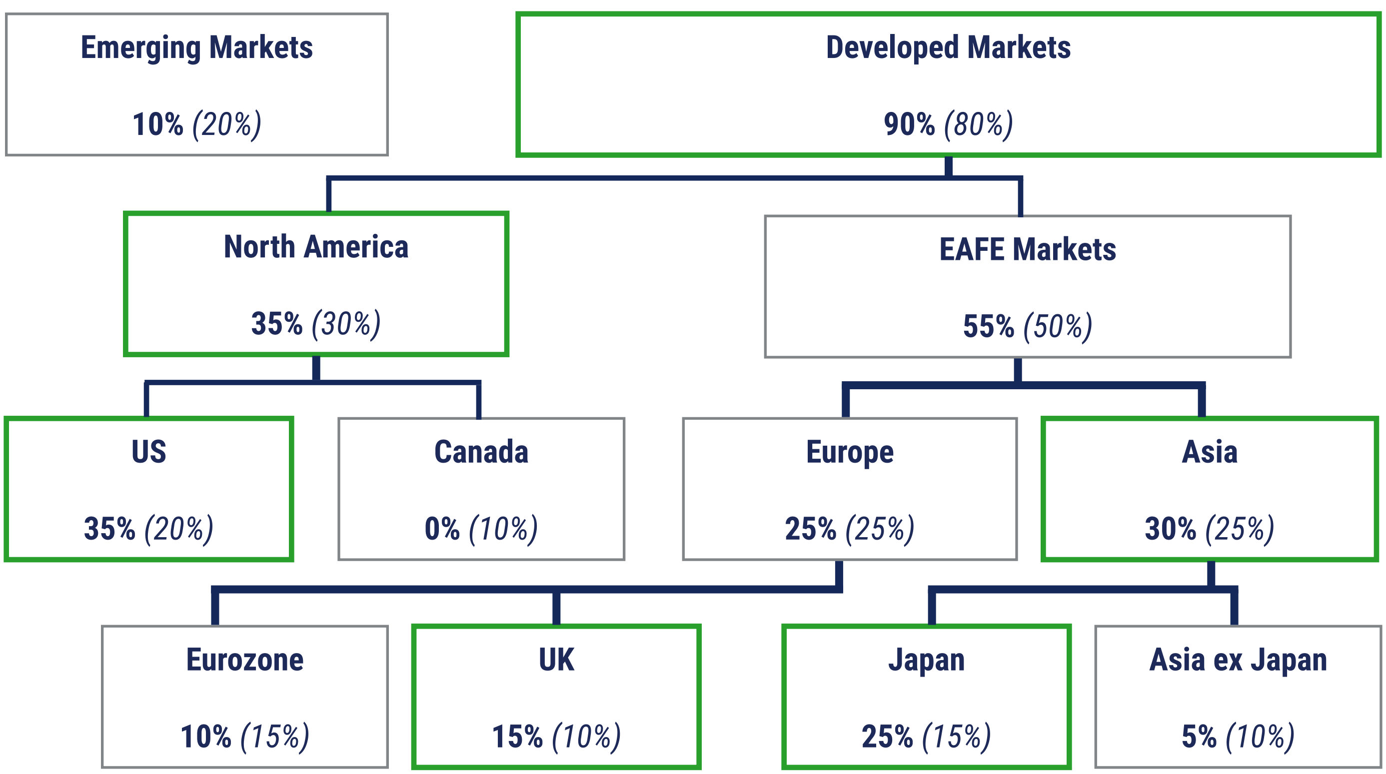
Exhibit 1 below and at right shows our **updated regional allocation framework and our current recommendations.** Our hierarchical framework highlights a set of pair-wise regional allocation decisions that capture most of the key decisions that clients are making. It allows for flexibility by providing both simple independent binary (i.e., in or out, over- or underweight) decisions at several levels, as well as a complete set of recommended allocation weights for those looking to see how all of the recommendations combined can fit together.

The benchmark (neutral) weights are based partly on relative capitalization weightings, but simplified and adapted for our purposes. In particular, no region has a benchmark weight less than 10% regardless of the actual cap weighting. Our recommended weights, however, can vary more and will generally be kept in increments of 5%, including zero weights potentially.

At right is a summary list of the views shown below.

Regional Pair	Favored
Emerging vs Developed	Developed
N. America vs EAFE	N. America
Europe vs Asia	Asia
US vs Canada	US
Eurozone vs UK	UK
Japan vs Asia ex Japan	Japan

Exhibit 1: We reduce Europe ex UK further to underweight and raise UK to overweight. We remain overweight the US and Japan, and underweight in Canada, EM, and Asia ex Japan.



Recommended allocations are shown in **bold** in each box, neutral (benchmark) weightings shown in *italics* in parentheses. Favored regions within each pair are highlighted in **green**.

Source: Mill Street Research, Factset, Bloomberg

Global revisions slip slightly, Japan leads while Europe weakens, China still lags

Global analyst estimate activity has been edging lower lately, with more activity likely as Q3 earnings reports are now coming out.

Japan maintains its spot as the strongest region on our equal-weighted revisions breadth readings (lower chart, right). It continues to do well domestically but faces persistent weakness in the yen, complicating matters for non-Japanese investors (p. 8).

The US has weakened recently, now showing slightly negative revisions but still somewhat above the global average. The results of Q3 earnings reports will likely be important for the near-term direction of analyst revisions activity, particularly with bond yields jumping higher recently.

Canada has held up, helped by higher crude oil and a bounce in precious metals prices. This leaves it now second among our regions on an equal-weighted basis, but Canada is still well below average on a cap-weighted basis.

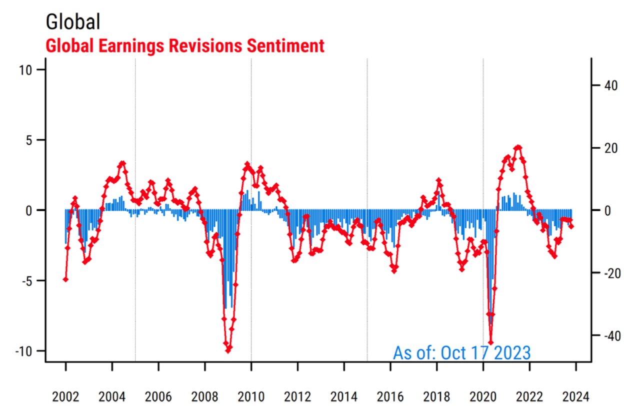
The UK has also improved substantially recently on revisions metrics, and the cap-weighted readings are likely also helped by higher oil prices. (p. 7).

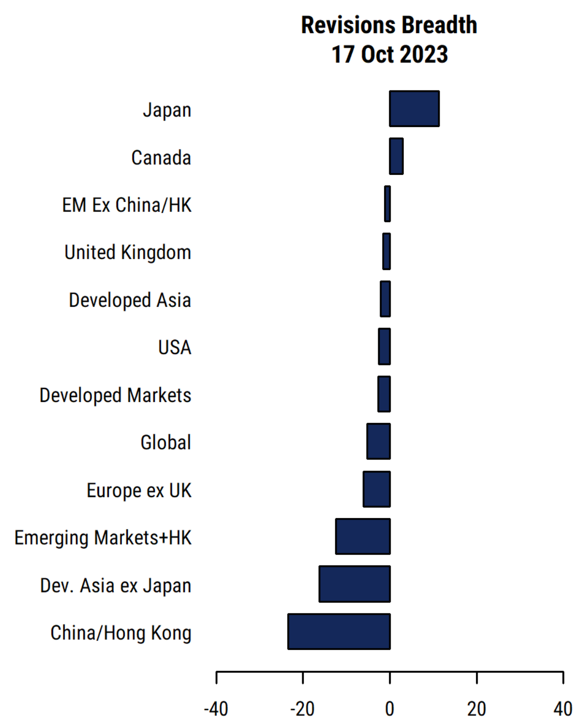
Europe has continued to see its revisions metrics deteriorate, as we have noted in recent reports. So after downgrading Europe to neutral last month, we move to a mild underweight this month (p. 6).

China remains the weakest region once again alongside Developed Asia ex Japan. There have been few signs of improvement in China itself on our metrics, and some weakening of the cap-weighted readings (p. 5). It is only the slipping of other regions' revisions that has allowed relative readings for China and Asia ex Japan to hold up.

Tighter monetary policy in many areas, China's weakness, and increased unrest in the Middle East have been headwinds, partly offset by the US economy's persistent strength and higher oil prices for some regions.

Exhibit 2: Global estimate revisions have slipped a bit as Q3 earnings reports get underway. Japan is still the leader, while the US has slipped. Canada has improved along with the UK, while Europe has weakened further.





Source: Mill Street Research, Factset, Bloomberg

MILL STREET RESEARCH

Regional ETF Ranking and Top-Ranked Global Large-Caps

Exhibit 3 at right shows the **cap-weighted aggregate MAER ranking for the constituents of the seven ETFs that track the major regions that we follow**. While there can be a tendency for the aggregate rankings to cluster near the neutral 50% level at times due to the broad, heterogeneous composition of these indices, we can get a feel for where there are areas of bottom-up strength and weakness based on our six-factor composite MAER ranking model.

The regional ETF ranking shows **Japan still leading the list, now followed by the UK and US.** Europe is now only mid-table. Pacific ex Japan is once again weakest though its aggregate rank has improved lately.

Exhibit 4 below is a list of the top 25 largest global stocks that rank within the ***top decile*** of the combined universe of all constituents of the seven ETFs shown here. Thus these stocks are some of the **most attractive names in our work globally that are also heavy weights in the cap-weighted indices** (ETFs). The US again still has heavy representation, along with a few Japanese listings. Cyclical sectors and Financials dominate the list this month.

Exhibit 3: Cap-weighted aggregate MAER ranking of constituents of key regional index ETFs.

Regional ETF Aggregate MAER Rankings
17 Oct 2023

Region (ETF)	Aggregate MAER Rank	1 Month Ago	2 Months Ago
Japan (EWJ)	64.1	57.5	59.1
UK (EWU)	56.0	46.4	42.9
USA (SPY)	53.8	55.2	59.1
Eurozone (EZU)	49.9	49.6	52.5
Emerging Markets (EEM)	49.4	49.8	46.0
Canada (EWC)	45.3	41.6	41.0
Pacific ex Japan (EPP)	41.5	38.8	35.4

Exhibit 4: Top-ranked large-cap stocks globally based on our multi-factor MAER ranking model

Top Ranked Global Large-Cap Stocks
17 Oct 2023

Ticker	Name	Country	Sector	Market Cap (USD, $Mil)
PETR4-BR	Petroleo Brasileiro SA Pfd	Brazil	Energy	102,177
857-HK	PetroChina Company Limited	Hong Kong	Energy	190,911
STLAM-IT	Stellantis N.V.	Italy	Cons. Discretionary	62,834
7203-JP	Toyota Motor Corp.	Japan	Cons. Discretionary	292,168
7267-JP	Honda Motor Co., Ltd.	Japan	Cons. Discretionary	61,091
8058-JP	Mitsubishi Corporation	Japan	Industrials	68,567
PRX-NL	Prosus N.V. Class N	Netherlands	Cons. Discretionary	118,625
ITX-ES	Industria de Diseno Textil,	Spain	Cons. Discretionary	115,306
CMCSA-US	Comcast Corporation Class A	United States	Comm. Services	182,572
PDD-US	PDD Holdings Inc. Sponsored	United States	Cons. Discretionary	139,302
BKNG-US	Booking Holdings Inc.	United States	Cons. Discretionary	106,306
PEP-US	PepsiCo, Inc.	United States	Cons. Staples	220,487
EOG-US	EOG Resources, Inc.	United States	Energy	78,198
BRK.B-US	Berkshire Hathaway Inc. Cla	United States	Financials	755,420
JPM-US	JPMorgan Chase & Co.	United States	Financials	428,735
WFC-US	Wells Fargo & Company	United States	Financials	153,596
CB-US	Chubb Limited	United States	Financials	88,772
AMGN-US	Amgen Inc.	United States	Health Care	152,137
MDT-US	Medtronic Plc	United States	Health Care	96,876
CAT-US	Caterpillar Inc.	United States	Industrials	139,091
GE-US	General Electric Company	United States	Industrials	119,743
ETN-US	Eaton Corp. Plc	United States	Industrials	84,496
FDX-US	FedEx Corporation	United States	Industrials	62,360
SHW-US	Sherwin-Williams Company	United States	Materials	65,017
NVDA-US	NVIDIA Corporation	United States	Technology	1,085,269

Source: Mill Street Research, Factset, Bloomberg

Cap-weighted revisions for regions and global sectors

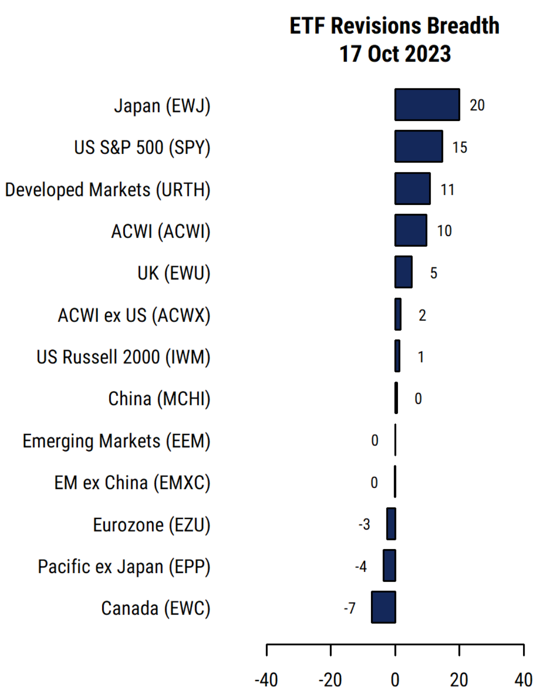
Below are updates of our cap-weighted regional revisions breadth aggregates based on the benchmark regional index ETF constituents, and our own global cap-weighted sector revisions breadth aggregates. While the broad patterns are typically similar to those seen in the equal-weighted data, there can be notable differences. **Cap-weighted revisions in aggregate edged slightly lower for the ACWI index, with developed markets remaining stronger than Emerging Markets.**

Japan and the US are still the leaders, though the US has eased somewhat while Japan held steady since last month, allowing Japan to take the top spot. The Eurozone dipped notably while the UK improved, reversing the earlier relative strength of Europe over the UK. Pacific ex Japan got less negative, now roughly tied with Canada at the bottom of the list. China weakened since last month but EM ex China improved somewhat.

Communication Services is still at the top of the global cap-weighted sector revisions, but has dipped since last month in absolute terms. Consumer Discretionary is again second but also lower than last month, while Energy has jumped up to third thanks to higher oil prices. Technology and Industrials remain positive but somewhat less so.

Materials is again the weakest in the global sector table, along with Real Estate. Real Estate deteriorated since last month while Materials was little changed. Health Care was a bit better but remains below average, while Financials saw its cap-weighted revisions dip notably since last month, as did Utilities.

Exhibit 4: Based on cap-weighted benchmark regional ETFs, Japan and the US are leaders again. UK improved while Europe weakened. Communication Services and Consumer Discretionary lead among sectors, but less so, while Energy saw improvement. Materials and Real Estate remain the weakest sectors.



Global CW Sector Avg. Revisions Breadth
17 Oct 2023

Sector	Current	1m Ago	3m Ago	6m Ago
Comm. Services	25.7	37.3	22.9	-5.0
Cons. Discretionary	16.3	28.7	18.5	0.3
Energy	14.3	-2.9	-6.1	-35.3
Technology	9.3	11.7	16.2	-15.2
Industrials	7.0	11.4	13.0	2.9
Cons. Staples	2.9	6.4	5.6	-7.7
Financials	1.6	8.4	-1.3	-1.8
Utilities	1.3	5.3	6.0	-9.8
Health Care	-4.1	-5.4	-0.2	-11.0
Real Estate	-12.4	-6.9	-4.0	-18.2
Materials	-14.4	-14.1	-18.2	-12.6

Source: Mill Street Research, Factset

Moving Europe to underweight as revisions activity weakens

After downgrading Europe to neutral last month, we take another step and move Europe to a mild underweight.

While Europe still looks cheap on its relative forward earnings yield, our equal-weighted relative revisions metrics have gone from well above average a few months ago to slightly below average now (second section, top chart at right).

And the same can be said for cap-weighted revisions too. The lower chart at right shows the revisions indicators for the cap-weighted MSCI Eurozone index on an absolute basis, and the downturn is clearly visible. While global (MSCI ACWI) revisions have dipped somewhat, Europe's readings have weakened faster lately.

At the same time, relative return momentum has weakened, also reversing earlier relative strength. This is true not only for our broad, equal-weighted relative return data (top section and third section of chart at right), but also for the cap-weighted MSCI Eurozone index.

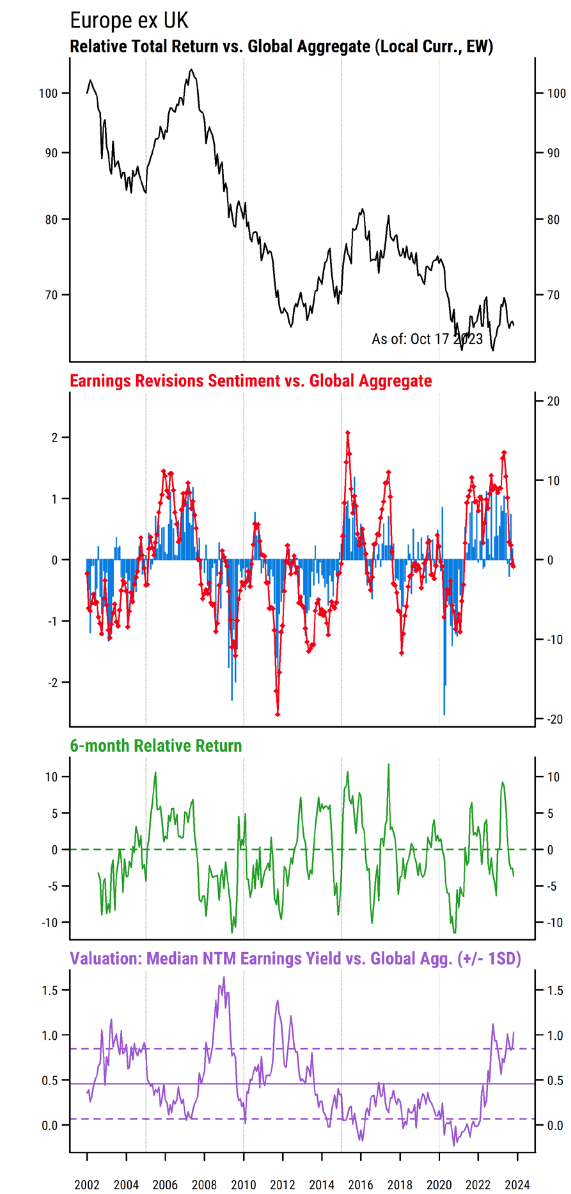
The decline in European fundamental momentum has been led by deterioration in the large Industrials and Consumer Discretionary sectors, along with the smaller Technology sector. Improvement in Energy and Communication Services have been partial offsets recently.

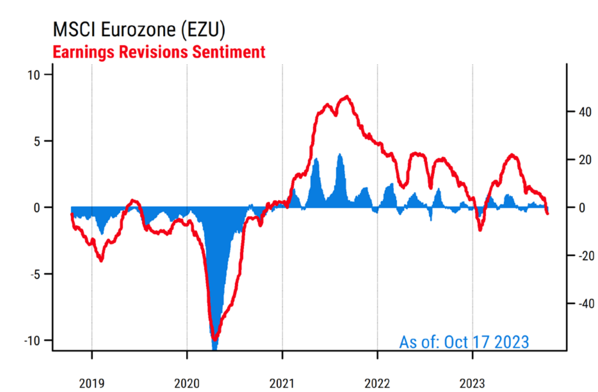
Macroeconomic reports have also been weaker recently, with the Citigroup Economic Surprise index for the Eurozone having been in solidly negative territory (meaning data coming in below consensus expectations) since May. While it is well off its July lows, it remains negative and below the corresponding readings for the US, UK, and Japan.

The euro has also reflected the concerns about Europe, particularly relative to the strong US dollar. So while the MSCI Eurozone index has been relatively steady in recent months versus the global MSCI ACWI index in local currency terms, it has been lagging when viewed in US dollar terms due to the weakness of the euro.

Europe still faces energy and inflation worries and exposure to China's weakness, as well as the ongoing lack of coordinated fiscal policy. So with bottom-up fundamental indicators weakening alongside price, the weight of the evidence argues for underweighting Europe now.

Exhibit 5: Deterioration in relative revisions and returns argues for underweighting Europe now





Source: Mill Street Research, Factset, Bloomberg

Raising UK to mild overweight

Alongside our downgrade of Europe ex UK, we move the UK to a mild overweight as relative fundamentals and return trends favor the UK over continental Europe now.

While Europe's relative revisions metrics have been deteriorating lately, those of the UK have been improving from earlier weak readings. Our equal-weighted UK universe shows revisions breadth now notably above the global average (top chart, right), marking a reasonably sharp reversal in the last two months.

At the same time, relative returns for the UK have improved as well. The middle chart at right shows the MSCI UK index relative to the MSCI ACWI ex-USA index (to remove the dominant effect of the heavily weighted US market). We see that relative returns have turned up after earlier underperformance in both local currency and US dollar terms (more so in local terms).

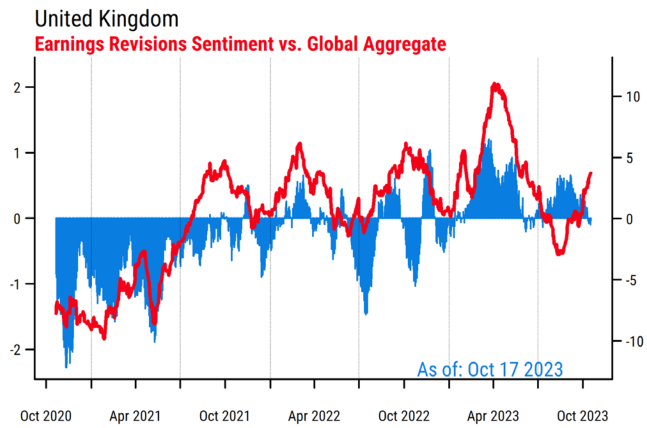
We have noted previously that the MSCI UK index has some relatively heavy sector weighting differences compared to other regions (table, right). The two biggest sectors are Financials and Consumer Staples (each 18-19%), followed by Energy with nearly 15% of the weight.

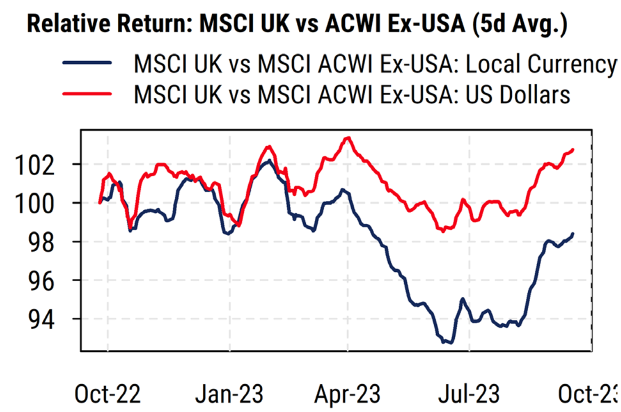
So one result of the recent rise in crude oil prices has been to support the overweighted Energy sector in the UK index. Note, though, that only three of the 82 index constituents (and only nine of the 221 UK stocks in our MAER universe) are Energy stocks, but two of them (Shell and BP) are extremely large and thus have heavy market-cap weights.

At the other end of the table, we see that the UK index has almost no Technology exposure (only two stocks with less than 1% weight combined), and little Communication Services weight. These sectors have been much weaker on revisions and returns in Europe and UK than in the US recently, so their low weight has been a net benefit lately.

For now at least, the relative fundamental and price trends favor the UK over Europe, so we shift our allocation preferences accordingly.

Exhibit 6: UK revisions have improved, helping relative returns do likewise. Sector weightings help explain some of the shift. We now favor UK over Europe.





MSCI UK Sector Weights

Sector	Weight (%)
Financials	18.96
Consumer Staples	18.44
Energy	14.86
Health Care	13.39
Industrials	10.78
Materials	8.86
Consumer Discretionary	5.71
Utilities	4.08
Communication Services	2.71
Information Technology	0.95
Real Estate	0.86

Source: Mill Street Research, Factset, Bloomberg

Japan still doing well locally but facing persistent yen weakness

We maintain our overweight in Japan, with the focus still on local-currency holdings given the persistent weakness in the yen relative to the US dollar.

As shown in the four-panel chart at right, relative revisions for Japan are quite strong, completely reversing the drop earlier this year. Relative returns for our equal-weighted, local currency indices have improved alongside the earnings picture, with strong six-month relative returns. The picture is similar when viewing Japanese revisions and returns on a cap-weighted basis in local currency terms.

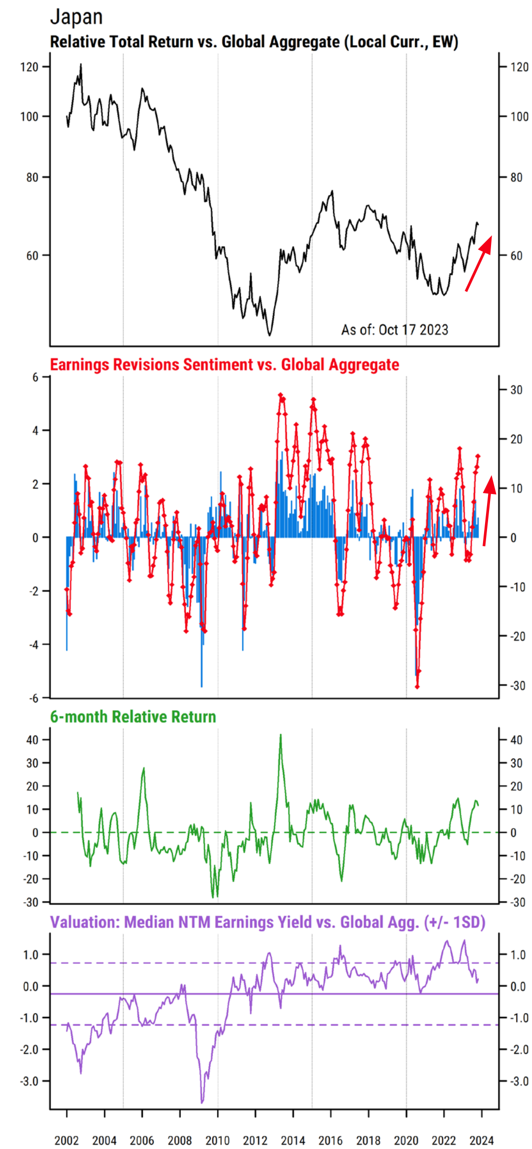
And while relative valuations (purple line) have deteriorated, they are still well within their range over the last decade, and cheaper than the full 20+ year average.

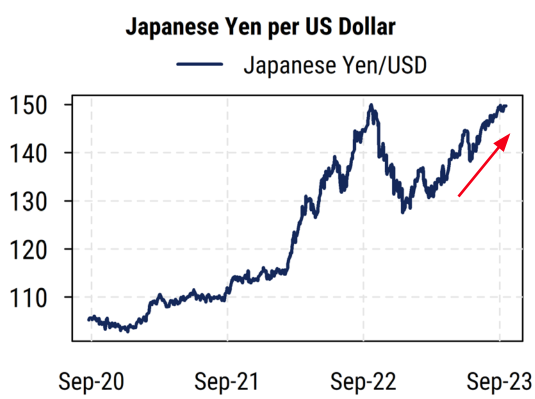
The bigger concern for non-Japanese investors for some time now has been the weakness in the yen. The yen's weakness has been most dramatic relative to the US dollar, which has strengthened versus most currencies this year (left chart below), but has been visible relative to the euro as well (right chart below).

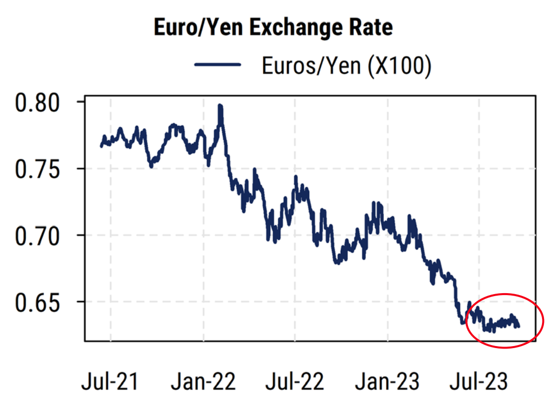
Most recently, though, there are some signs that the yen's weakness versus the euro has at least paused, and may be slowing down versus the dollar after talk of currency intervention by the Bank of Japan. Interest rate differentials remain extremely wide in favor of the US versus Japan, but may be near their peak if the Fed is done tightening and could cut later next year.

If the yen can at least stabilize, non-yen-based investors would find it easier to participate in the local currency strength of Japanese equities.

Exhibit 6: Japan's earnings trends are strong, as are returns in local currency. The yen remains a concern, but could be trying to stabilize soon.







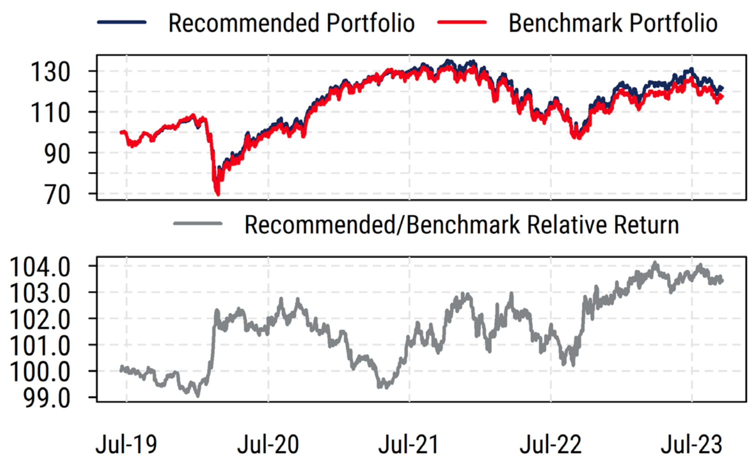
Source: Mill Street Research, Factset, Bloomberg

Hypothetical Performance Tracking

Below we show hypothetical performance tracking results for the regional allocation recommendations as published in this report (page 2). See important disclosures below and on the following page.

The allocation weightings were first published July 16th, 2019. Results after March 18th, 2020 will reflect the revised regional framework used in this report.

Regional Allocation Recommendation Performance, US Dollars

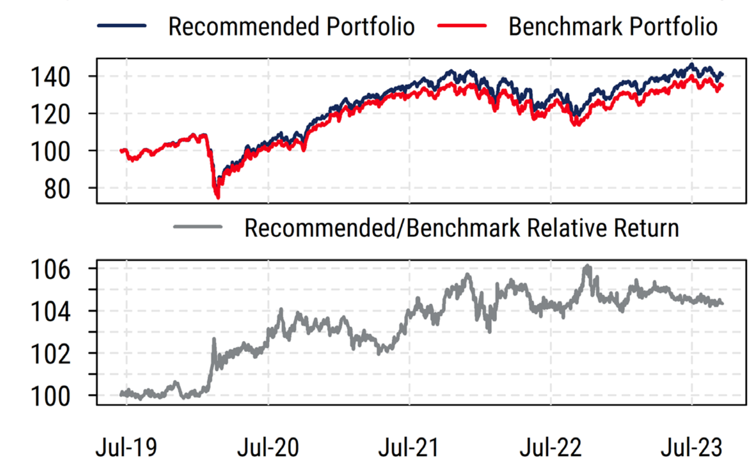


Regional Allocation Recommendation Summary Statistics, US Dollars

16 July 2019 - 17 October 2023	Recommended Portfolio	Benchmark Portfolio
Ann. Return (%)	4.56	3.76
Ann. Volatility (%)	20.44	20.48
Sharpe Ratio	0.15	0.11

Returns based on ETFs corresponding to each region using total returns in US dollars.

Regional Allocation Recommendation Performance, Local Currency



Regional Allocation Recommendation Summary Statistics, Local Currency

16 July 2019 - 17 October 2023	Recommended Portfolio	Benchmark Portfolio
Ann. Return (%)	8.12	7.08
Ann. Volatility (%)	14.20	14.05
Sharpe Ratio	0.47	0.40

Returns based on MSCI indices corresponding to each region using total returns in local currency terms.

Note: Results shown here do not reflect any actual trading and are for informational purposes only. They do not include important considerations such as transactions costs, taxes, fees or other expenses. Past performance is no guarantee of future results.

Source: Mill Street Research, Factset, Bloomberg

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