MARKETS

Investors are ignoring a crucial risk that has Charles Schwab's global strategy chief up at night — and they'll be caught off guard as US stocks lag international equities for years

James Faris Jun 10, 2024, 9:34 AM CDT

Share Save

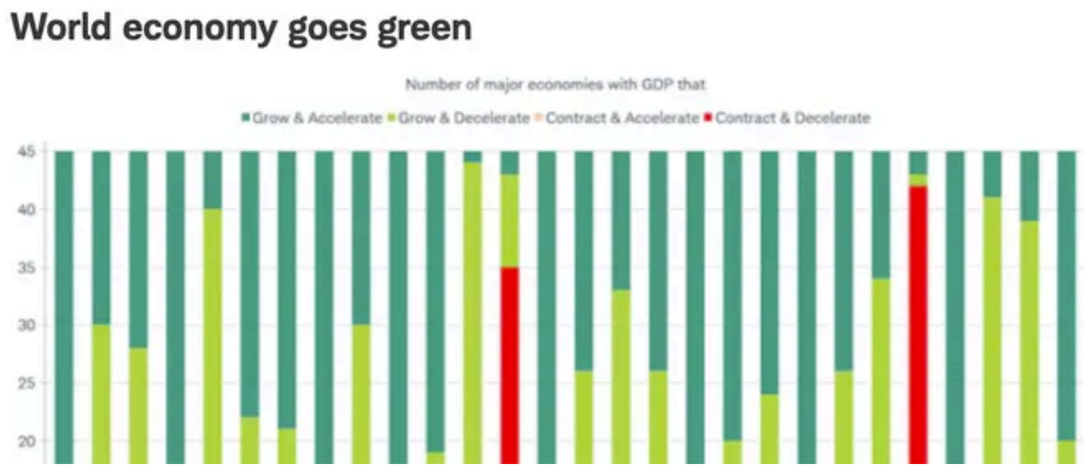
AP Photo/Henny Ray Abrams

After calling the global economic rebound, Jeffrey Kleintop shares the risks he sees.

- **Charles Schwab's global strategy chief explained the hidden danger that elections carry.**
- **The market veteran also outlined a compelling bull case for international stocks.**

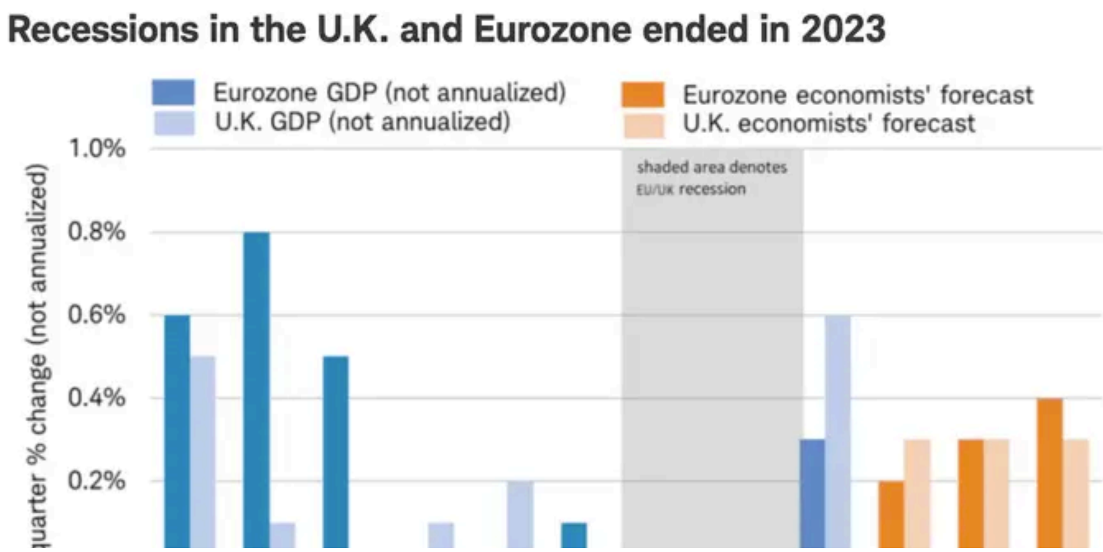
A pivotal year for the global economy is off to a promising start, but investors still have plenty to bite their nails about.

Global stocks, as measured by the MSCI World Index, are up nearly 10% year-to-date. That surge follows a shaky 2023 in which GDP growth in a fourth of the world's 45 biggest economies decelerated and contracted, which was the highest rate since 2012 — other than 2020. Notably, the US wasn't one of them, despite countless predictions to the contrary.



Charles Schwab

Fortunately, most of those contractions were shallow and short-lived. Several key economies, including Europe and the United Kingdom, have enjoyed recoveries as growth resumed early in the year and accelerated this quarter, thanks to improvements in manufacturing and trade.



Charles Schwab

This rebound came as no surprise to Jeffrey Kleintop, Charles Schwab's chief global investment strategist. Kleintop called the gradual growth uptick in December and thinks it will continue in the second half of the year, as he wrote in his mid-year outlook published in early June.

However, the veteran strategy chief is also bracing for heightened volatility since there are risks that investors either aren't appreciating or noticing at all.

Elections are a key risk — but not for the reason you think

Kleintop believes the most underrated risk in markets during the second half of 2024 is also the biggest storyline: the outcome of elections.

"The biggest risks are often hiding in plain sight," he said in an interview. "I see election risks as one of — if not the biggest — risks to markets in the second half of the year."

While the world will be glued to the US presidential election, Kleintop said that's not the only race that's keeping him up at night. There will be dozens of key elections around the world this year, including in the United Kingdom in early July.

The European Union's parliament election results came out over the weekend, and the key takeaway was that far-right political parties made major inroads. That solidified one of Kleintop's chief concerns: that the global shift away from globalism is afoot.

The EU's results were remarkably similar to India and Mexico, which had been a surprise. Kleintop spoke with Business Insider on June 5, before the EU's election took place, though he had already diagnosed this trend.

"In both cases, markets are concerned about a shift to more populist policies," Kleintop said of India and Mexico.

Populism is a political philosophy centered around anti-establishment sentiment that, fittingly, has grown more popular in recent years. Many political pundits pinpoint the worldwide revival of populism to the rise of Donald Trump in the mid-2010s, though it's not restricted to the political right. In fact, Kleintop noted that Democrats have many populist policies, like taxing the rich.

Examples of populist policies include trade restrictions like tariffs, which make imports more expensive. While policies restricting trade can produce targeted benefits by boosting a country's domestic industries, Kleintop said they can also fuel inflation and hurt global growth.

"Markets could respond negatively to an outlook of rising tariffs and trade frictions that might potentially boost inflation and weigh on exports," Kleintop wrote in his mid-year outlook.

Export-reliant countries, like industrial-heavy European nations or goods-makers in Asia, could be crippled by populist policies implemented around the globe, Kleintop said. The global strategist isn't sure how much further the populist pendulum will swing, but he's worried to find out.

"It is a risk, and one I think markets are very much undercounting as they're looking at potential threats in the second half of this year," Kleintop said.

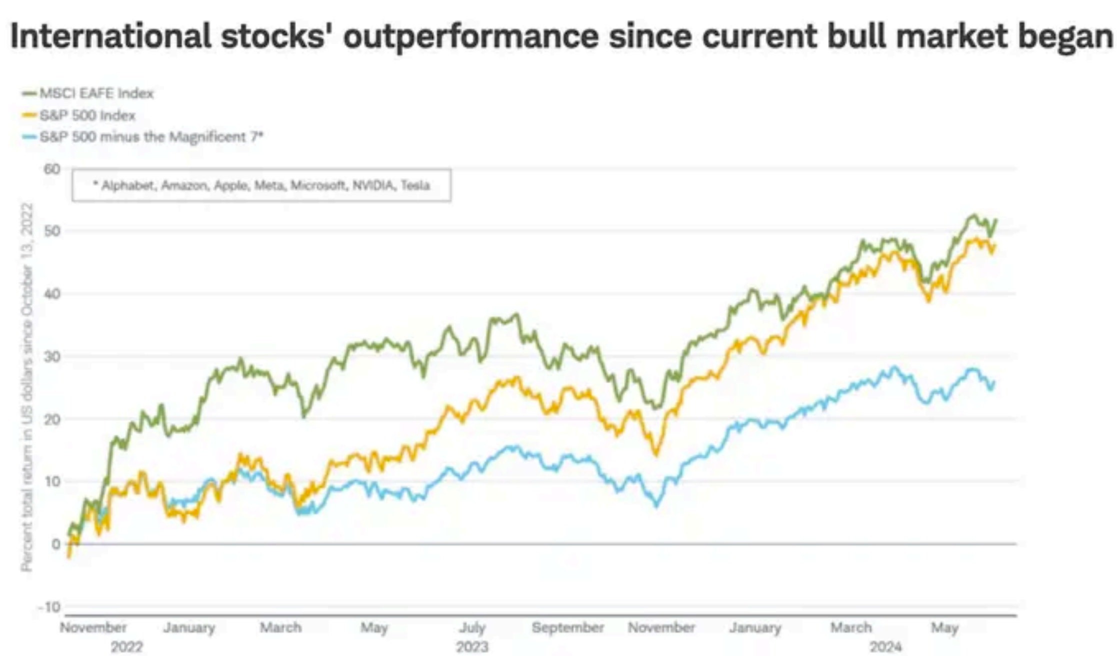
Kleintop noted that tariffs would be a huge help to certain companies, as would other populist policies like research and development grants, subsidies, and tax breaks. These benefits could, in some cases, more than outweigh higher import costs and be a net positive.

And while Kleintop isn't a proponent of populist policies, he doesn't expect extreme trade restrictions that may derail the global economic expansion. The same goes for geopolitical risks in the Middle East and between Russia and Ukraine, though a shock is always possible.

Why international stocks will best the US

Investors should hedge against the potential downsides of populism and geopolitical conflicts by owning a diverse basket of international stocks, Kleintop said.

The global strategy chief noted that non-US stocks have topped the S&P 500 since the start of this bull market in October 2022. That discrepancy would be even wider if not for the so-called Magnificent 7 growth stocks: Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla.



Charles Schwab

That outperformance streak will continue, Kleintop predicted. International equities trade at much cheaper valuations than their US peers on a forward price-to-earnings basis, even after their rally, he noted. Plus, the group will post better earnings and benefit from a falling US dollar and an improving economy, while US companies contend with positive but slowing growth.

History also supports Kleintop's call. In the last half-century, US stocks and their international peers have been on alternating streaks of outperformance. If that pattern holds, foreign firms will take the baton from US equities, which have mostly led global markets since the financial crisis.

"It's not a surprise to me — after a full cycle of outperformance, whatever has led is just overextended in terms of earnings expectations, in terms of valuations, so many factors," Kleintop said. "The sectors and the environment that helped those stocks lead generally changes. And in fact, we are in a different environment — interest rates are higher, the market's rewarding different factors in the market. So it's not surprising at all to me, as we start a new global economic and market cycle, we've got new leadership."

International stocks should lead as long as the economic expansion goes, Kleintop said. That means US companies may lag for years, though that doesn't mean investors should ditch them.

"I wouldn't say that you would want to abandon US equities, or even abandon some of those high-flying tech or AI-related stocks," Kleintop said. "I think it's time to consider some diversification. Diversification has been a dirty word for a long time."

The best way to invest in international companies is to take a broad-based approach, Kleintop said. He'd rather own a diverse set of developed-market firms through an index fund instead of trying to pick winners in certain markets, countries, or sectors.

"You don't necessarily want to take on that risk — you don't need to," Kleintop said. "You can have a broader, more diversified global portfolio to hold over many years and not have to worry about the ups and downs of one sector or country, and yet still benefit from the outperformance of the whole international spectrum."