What percentage of a portfolio should be international equities?

Federated Hermes

Portfolio Construction Solutions

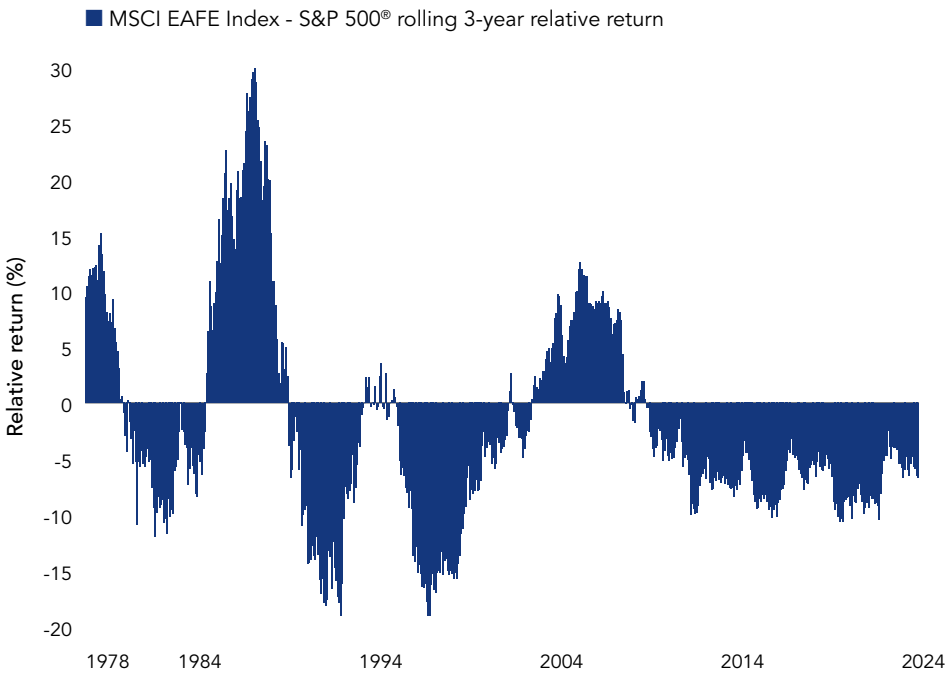
Key takeaways

- **Several cycles of international equities outperforming US equities have occurred over the past 50 years [Exhibit 1]**
- **Our minimum variance analysis showed that having around 20% international equities—roughly one-third of the equity allocation—in a traditional 60/40 stocks/bonds portfolio produced the highest long-term returns with the lowest risk [Exhibit 2]**
- **Tactical shifts around the neutral 20% international equities allocation may benefit the performance of a portfolio**

Why is 20% the "neutral" allocation to international equities?

Several cycles of international equities outperforming US equities have occurred over the last 50 years. Despite recent relative performance, maintaining exposure to both has remained a sound approach. The key question is, what's the right allocation?

Exhibit 1: International equity outperformance has come in cycles since 1976



- The most recent cycle of international outperformance occurred in the early 2000s, during a period that encompassed the US-led dot-com bust and a weakening dollar.
- Led by mega-cap growth, US stocks dominated global returns after the Global Financial Crisis. Earnings growth, along with a strong dollar propelled the S&P 500® to outperform the rest of the world.
- International equity markets rebounded in 2025, outperforming US equities amid tariff uncertainty, renewed growth in international markets, a weaker dollar and monetary and fiscal stimulus.

Rolling 3-year relative returns (annualized, shifting monthly) as of 12/31/24. Sources: Monthly returns 1/1/76 through 12/31/24 of the MSCI EAFE Index and the S&P 500®, Morningstar, Inc., Federated Hermes analysis. This information is for illustrative purposes only and is not indicative of any specific investment. Past performance is not indicative of future results.

To determine the appropriate "neutral" strategic domestic and international equities investment mix, we used a method backed by modern portfolio theory, minimum variance analysis, which involves using diversification to reduce volatility. A minimum variance portfolio seeks to reduce risk (measured by standard deviation) while maximizing return potential. The analysis tests the results of different allocation mixes until it finds the minimum variance portfolio: the blend with the highest return and lowest risk potential.

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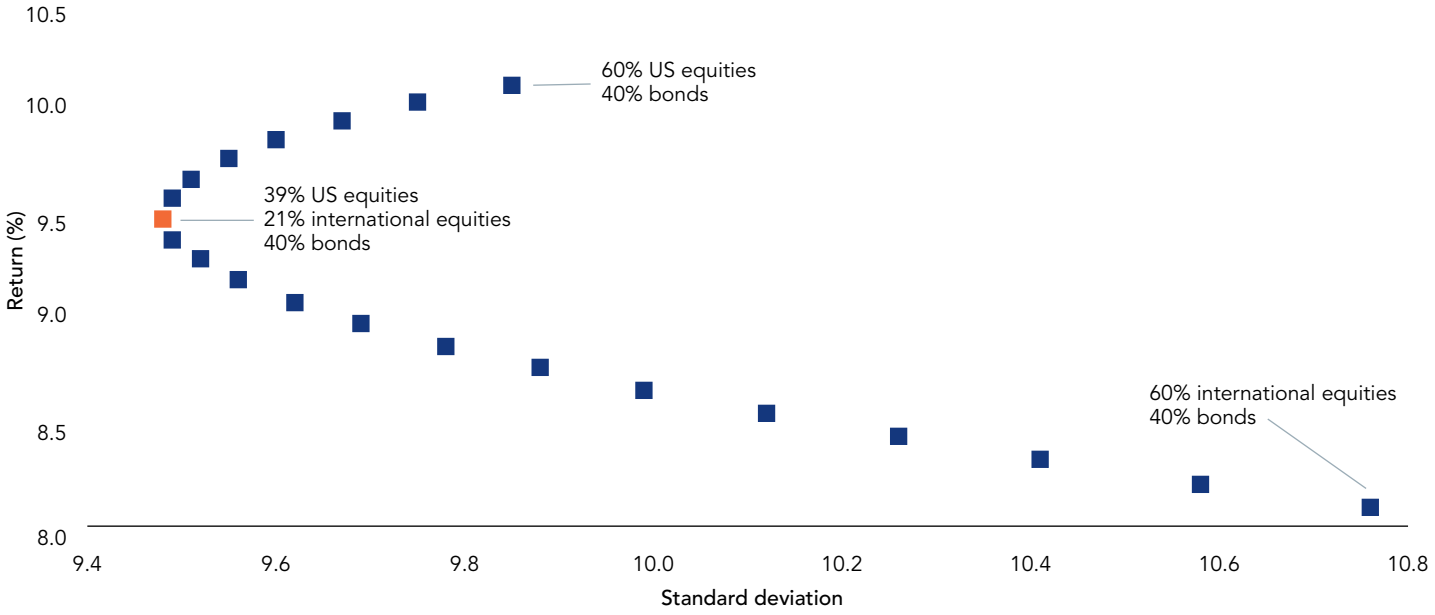
Minimum variance portfolio

For this analysis, our base portfolio is a 60/40 equities/bonds portfolio, rebalanced monthly from 1/1/76 to 12/31/24. Focusing only on the 60% equity sleeve, we formed 21 different equity allocation mixes increasing/decreasing the international/US equity mix by 3% increments, while maintaining a constant 40% allocation to bonds. The indexes used in this analysis are the S&P 500® for US equities, the MSCI EAFE Index[1] for international equities and the Bloomberg US Aggregate Bond Index for bonds.

The resulting minimum variance portfolio selects an equity sleeve of 39% domestic equities and 21% international equities (35% of the total equity allocation) to go along with the 40% bonds in a diversified 60/40 portfolio. **Exhibit 2** shows the return and risk efficient frontier as the equity portfolio moves from all domestic to all international stocks.

Therefore, given the widespread use of modern portfolio theory to manage assets, it should come as no surprise that throughout the industry, many money managers recommend strategic long-term allocations of about 20% to international equities.

Exhibit 2: The 21% allocation to international equities produced the highest long-term return with the lowest risk versus the other allocation mixes in the graph below from 1976 to 2024



Returns from 1/1/76 through 12/31/24 of the S&P 500®, MSCI EAFE Index and Bloomberg US Aggregate Bond Index. Sources: Morningstar, Inc., Federated Hermes analysis. This information is for illustrative purposes only and is not indicative of any specific investment. **Past performance is not indicative of future results.**

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Considerations for a tactical overweight or underweight

In addition to quantitative portfolio analysis, current market trends and expectations can be important inputs to the allocation decision, along with risk appetite and investor comfort with international equities. The minimum variance analysis considered nearly 50 years of data. As shown in **Exhibit 1,** there were periods where a tactical overweight or underweight would have benefited returns. For the past 10 years, for example, diversifying US equities with most other major asset classes would have reduced total returns.

We believe the need for alternative sources of return has grown. As a result, diversifying strategies are likely to command a higher premium, benefiting non-US asset ownership. US equity valuations are near record highs, with many forecasts of lower US growth. On the other hand, international valuations suggest there is more room for expansion, and a weakening US dollar supports non-dollar-denominated assets. We expect international equities across capitalizations and emerging markets may play a bigger role in generating total return in an overall portfolio.

Conclusion

An allocation to international equities can be an important source of risk-adjusted portfolio returns. International equities offer diversification from mega-cap growth stock concentration and US bias common in equity portfolios and country-specific risks such as political events.

Based on Federated Hermes' observations, clients may want to assess their allocations to international equities. Federated Hermes' Portfolio Construction Solutions Team (PCS), which reviews hundreds of client portfolios annually, has found that moderate client portfolios remain, on average, underweight international equities. PCS found that in 2024, clients had almost 20% of the equity portion of their portfolios allocated to international equities versus the 35% recommended in the frontier analysis.

Now may be an appropriate time to get back to neutral and eventually go overweight international equities.

Federated Hermes offers international equities strategies designed to seek diversification, growth or income generation for strategic or tactical needs. Financial advisors: PCS offers individual consultations to assess the appropriate amount of international exposure for client portfolios.
Call 1-888-400-7838 to learn more.

[1] We've chosen the MSCI EAFE Index instead of the MSCI All Country World Index (ACWI) ex-USA to extract a longer data history. The MSCI ACWI ex-USA has an inception date of 2001, which didn't give a good sample size. When tested, the results using the MSCI ACWI ex-USA performance when it began populating showed results/trends that were similar to the MSCI EAFE Index.

The information and data contained herein are provided solely for informational purposes. Accordingly, this communication does not represent specific investment advice and should not be construed as an investment recommendation.

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Diversification and asset allocation do not assure a profit nor protect against loss.

International investing involves special risks including currency risk, increased volatility, political risks, and differences in auditing and other financial standards.

Prices of emerging markets securities can be significantly more volatile than the prices of securities in developed countries, and currency risk and political risks are accentuated in emerging markets.

Bond prices are sensitive to changes in interest rates, and a rise in interest rates can cause a decline in their prices.

Standard deviation is a measure of the dispersion of a set of data from its mean. In finance, standard deviation is applied to the annual rate of return of an investment to measure the investment's volatility. Standard deviation is also known as historical volatility and is used by investors as a gauge for the amount of expected volatility or risk.

MSCI EAFE Index (Europe, Australasia and Far East) is an equity index which captures large- and mid-cap representation across Developed Markets countries around the world, excluding the US and Canada. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

S&P 500® is an unmanaged capitalization-weighted index of 500 stocks designated to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

Bloomberg US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market.

Indexes are unmanaged and cannot be invested in directly.

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