

Global diversification is regaining value

State Street · Ginger Perry;Dane Smith · 2026-09-07 · English original

Declining correlations, rising tracking error, and greater country-level dispersion suggest international markets are delivering increasingly distinct outcomes from US equities.

While global equity markets still share a common equity beta, their return paths have become less synchronized. That makes international exposure increasingly useful as a source of differentiated outcomes, an improvement from previous years.

Weekly Highlights

Source: FactSet, using monthly total returns data in USD 8/31/2011 – 8/31/2026.

Source: FactSet, MSCI as of 8/31/2026. 36-month rolling correlations calculated using monthly returns data in LC for MSCI Japan and MSCI USA.

Source: FactSet, MSCI as of 8/31/2026. 36-month rolling correlations calculated using monthly returns data in LC for MSCI Europe and MSCI USA.

The international diversification opportunity set is changing

International markets have not escaped the global forces shaping equities, such as AI (which we've previously written about in [AI leaders reshape the EM investment story | State Street](#)), inflation and monetary policy. Yet, these common themes have not produced uniform market behavior globally. Since 2020, rolling correlations between US equities and several major international markets have steadily declined. China is the clearest outlier, reflecting a return path increasingly shaped by domestic policy, property stress and its own economic cycle. While correlations remain broadly positive, the decline over time is meaningful. At the same time, the US has become an increasingly dominant share of global equity benchmarks, rising from 53% of the MSCI ACWI Index a decade ago to 63% today (FactSet, as of 9/1/2026). As a result, many investors have become more concentrated in US equities.

While correlations measure co-movement, tracking error measures the variability of return differences relative to the US market. In this context, higher tracking error indicates larger variability in performance from US returns, illustrating distinct return experiences over time.

Compared to 10 years ago, relative-return dispersion as demonstrated by the trajectory of tracking error has increased for several regions, notably Europe and EM. China remains the highest-tracking-error market, but the wider pattern suggests that international allocations are varying in performance more than they did earlier in the sample.

So... why are regional outcomes diverging?

Country-level dispersion helps explain why regional markets are following increasingly distinct paths.

As shown by the chart above, country-level dispersion is rising, showing a noticeable uptick over the past couple of years. This trend suggests that regional allocations are increasingly shaped by local dynamics, even when responding to the same global themes. AI remains one example of regional

differentiation, with the US benefiting from hyperscalers and software platforms while Taiwan has benefited through semiconductor manufacturing. Regional equity markets have differing drivers as well. Europe has been influenced by defense spending and industrial policy, Japan by corporate governance reforms and a weaker yen, and several emerging markets by commodity and energy dynamics. For example, Brazil has grown as a major oil producer, meanwhile South Africa is a top supplier of platinum, highlighting the spectrum of economic and market drivers across the EM complex.

Macroeconomic policy can also be a source of cross-country differentiation. As inflation, growth, and fiscal conditions have evolved differently across economies since the pandemic, central banks have increasingly pursued distinct policy paths, contributing to a wider range of market outcomes. As of the time writing, the US Federal Reserve and the ECB are on temporary pause (although showing increasingly hawkish signals), while the Bank of Japan continues to normalize policy, the RBA remains on the path of rate increases, and select EM central banks, including Brazil's, have pursued targeted cuts to support domestic demand. Diverging inflation paths help explain why policy responses have become less synchronized. Using FactSet data for 6 developed markets (US, UK, France, Germany, Japan, Switzerland) going back to 2016, inflation outcomes today remain more dispersed than they were prior to the pandemic, reflecting differences in fiscal responses, labor markets, energy exposure and supply-chain disruptions, thereby affecting central bank policy.

Bond markets are also pricing local risks differently. For example, taking 12 developed economies, the current 10-year rate differential between the highest and lowest rate is 2.11%, while 10 years ago, the differential was 1.81% (FactSet, using data 9/30/2026-8/31/2026 for Canada, US, UK, Germany, France, Japan, Spain, Denmark, Finland, Italy, Norway, and Sweden). Hence, this dispersion in long-term government yields reflect inflation expectations, fiscal trajectories, and geopolitical risks.

Diversification: A balance of risk and return

However, greater diversification potential does not mean that international equities will necessarily outperform the US. Over the past 15 years, US equities have delivered the strongest cumulative return, returning roughly 724% cumulatively vs ACWI ex-US at 217% (FactSet, total cumulative returns as of 8/31/26 in USD). While an internationally diversified portfolio could have reduced concentration, it would have lagged a US-only allocation.

The bottom line

While global markets continue to be influenced by many of the same themes, they are producing increasingly divergent outcomes across countries and regions. Correlations between the US and major international markets have declined, relative-return dispersion has increased, and country-level outcomes have become more varied. Macroeconomic drivers such as inflation and monetary policy, as well as local experiences of global phenomena (supply shocks, tech growth) can create dispersed outcomes across countries. The combination is expanding the opportunity set outside the US. While regional performance is becoming more differentiated, AI remains a shared catalyst across many markets, allowing investors to broaden their geographic exposures without losing access to a defining structural growth trend.

Source: FactSet, MSCI, State Street Investment Management. Data as of 8/31/2026 unless otherwise stated. The performance data quoted represents past performance. Past performance does not guarantee future results. Investing involves risk, including the risk of loss of principal.

Go beyond the headlines...

Skimmed the summary? Dive deeper with the full PDF—your go-to for weekly market insights and analysis.

State Street Global Advisors Worldwide Entities

State Street Global Advisors (SSGA) is now State Street Investment Management. Please go to statestreet.com/investment-management for more information.

The whole or any part of this work may not be reproduced, copied or transmitted or any of its contents disclosed to third parties without SSGA's express written consent.

The trademarks and service marks referenced herein are the property of their respective owners. Third party data providers make no warranties or representations of any kind relating to the accuracy, completeness or timeliness of the data and have no liability for damages of any kind relating to the use of such data.

Source: <https://www.ssga.com/hk/en/institutional/insights/mind-on-the-market-07-september-2026>