We establish a link between two recent trends: (i) the rise in cross-country stock market correlations over the past three decades, and (ii) the increase in foreign direct investment (FDI) positions over the same period. We document the presence of these phenomena, both for the US versus developed economies, as well as for bilateral pairs of developed economies, and show that the relation between FDI and stock market correlations survives controlling for other relevant factors. We then develop a two-country asset pricing model with multinational firms in order to inspect and quantify the mechanism underlying the increases in stock market correlations and FDI. We find that the increase in FDI positions in the calibrated model can account for approximately one third of the rise in the observed stock market correlations. We also extend the model to account for increases in trade and portfolio diversification and find that, in contrast to FDI, these two factors do not generate an increase in stock market correlations in this context.