U.S. stocks continue to rise inexorably relative to their global counterparts, with American market capitalization now capturing over 60% of the broad equity benchmark.

This report will evaluate the durability of U.S. outperformance and identify signposts for its eventual exhaustion. It will also draw lessons from the late 1990s, an era that strongly echoes that of today. The key message for asset allocators is that it is premature to reduce overweight U.S. exposure in anticipation of cyclical shifts in relative equity performance.

ALPINEMACRO
A Unique Mind On The Markets
GLOBAL ASSET ALLOCATION
July 18, 2024

# Time To Hedge Against U.S. Equity Hegemony?

- U.S. equity outperformance has been broad-based, with sectors beyond tech and its adjacent industries showing significant profit growth and robust stock returns.

- The widening productivity gap between the U.S. and the rest of the world shows no signs of peaking, reducing the odds of an impending downturn in relative earnings growth.

- U.S. relative equity valuation, while significantly elevated, will become concerning once profit metrics start to deteriorate, which is not currently the case.

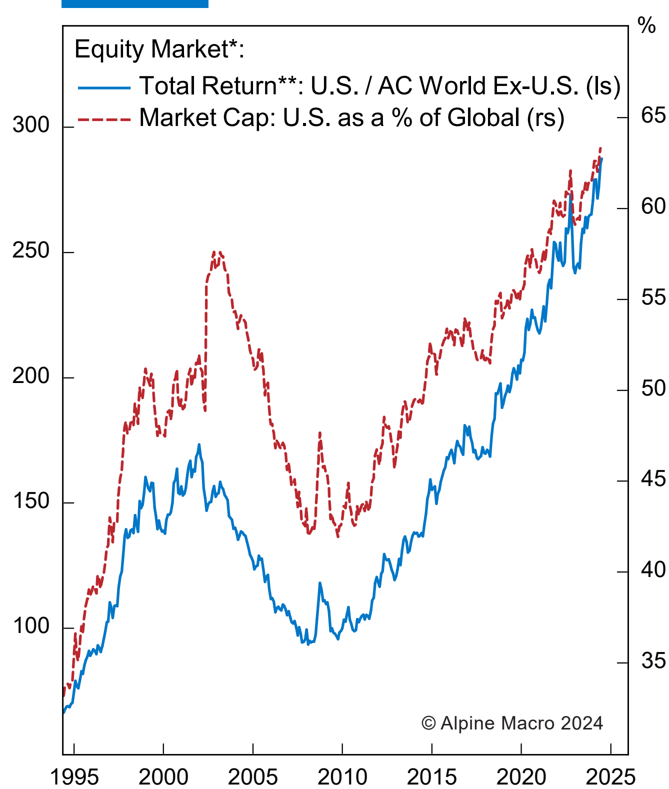
imo this has peaked or will peak soon

- Forthcoming tech sector capex and falling yields should further reinforce U.S. outperformance.

- The next recession will likely prolong U.S. dominance given the defensive nature of its market and the dollar.



**Chart 1** An Inexorable Rise




*Based on large/mid/small-cap indexes expressed in USD terms; source: MSCI
**Rebased to Jan 2010=100

U.S. equities continue to trounce their global counterparts, boasting nearly 200% of total return outperformance in dollar terms since 2010 (**Chart 1**). As a result, U.S. market capitalization has now captured over 60% of the global benchmark, surpassing even the peak levels seen in the early 2000s.

This report will peel back the layers sustaining the American equity freight train and assess their

# ALPINEMACRO 2024 INVESTMENT CONFERENCE

NEW YORK | MONDAY, SEPTEMBER 16th **USD $1,995 - REGISTER NOW**

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# Tipping Point In Financial Markets: A Melt-up or Meltdown?

## Agenda

08:10 - 08:30 **Opening Remarks : The Shifting Macro Landscape: Opportunities & Risks**
**Chen Zhao,** Chief Global Strategist

08:30 - 9:30 **Emerging Mega Trends: How Should Investors Be Prepared?**
**Ruchir Sharma,** Chairman of Rockefeller International and Founder and Chief Investment Officer of Breakout Capital

09:30 - 10:30 **Inflation, Disinflation and Fed Policy: Are We on the Right Path?**
**Mike Dooley,** Professor Emeritus at University of California, Santa Cruz and Chief Economist at Figure Technologies

10:30 - 10:45 Coffee Break

10:45 - 11:45 **Fireside Chat: Bull Bear Debate**
**Francois Trahan,** Founding Partner of The Macro Institute Versus
**Jim Paulsen,** Author of the Paulsen Perspectives research newsletter on Substack

11:45 - 12:30 **The Long and Shorts of U.S. Equities**
**Gina Martin Adams,** Bloomberg Intelligence Global Director of Portfolio Strategy, Chief Equity Strategist

12:30 - 14:15 **Luncheon Speaker: Biden Vs Trump: How The World Will Be Changed**
**Greg Valliere,** Chief U.S. Policy Strategist AGF Investments

14:15 - 15:00 **How Is AI Reshaping the Money Management Business?**
**Gareth Shepherd,** Co-Head of Voya Machine Intelligence (VMI) & Portfolio Manager, Voya Investment Management

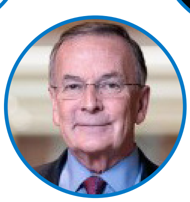
15:00 - 15:15 Coffee Break

15:15 - 16:30 **Commodity Panel: Secular Trend, Energy and Prospect of ESG**
**Tavi Costa,** Partner/Macro Strategist at Crescat Capital
**Lenka Martinek,** Managing Partner, Sustainable Market Strategies, Nordis Capital
**Adam Rozencwajg,** Managing Partner, Goehring & Rozencwajg

16:30 - 17:30 **Cocktails & Networking**

## Guest Speakers + Alpine Macro Strategists


Ruchir Sharma


Greg Valliere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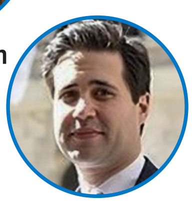
Gina Martin Adams


Adam Rozencwajg

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persistence. It will also draw lessons from the late 1990s, an era that strongly echoes that of today. The key message for asset allocators is that it is premature to reduce overweight U.S. exposure in preparation for cyclical shifts in relative equity performance.

## Unpacking The Torrid Run

There is no secret as to why U.S. stocks have done vastly better than their global peers. **Chart 2** deconstructs relative common currency total returns into four broad components:

- Superior earnings growth explains roughly half of U.S. outperformance.

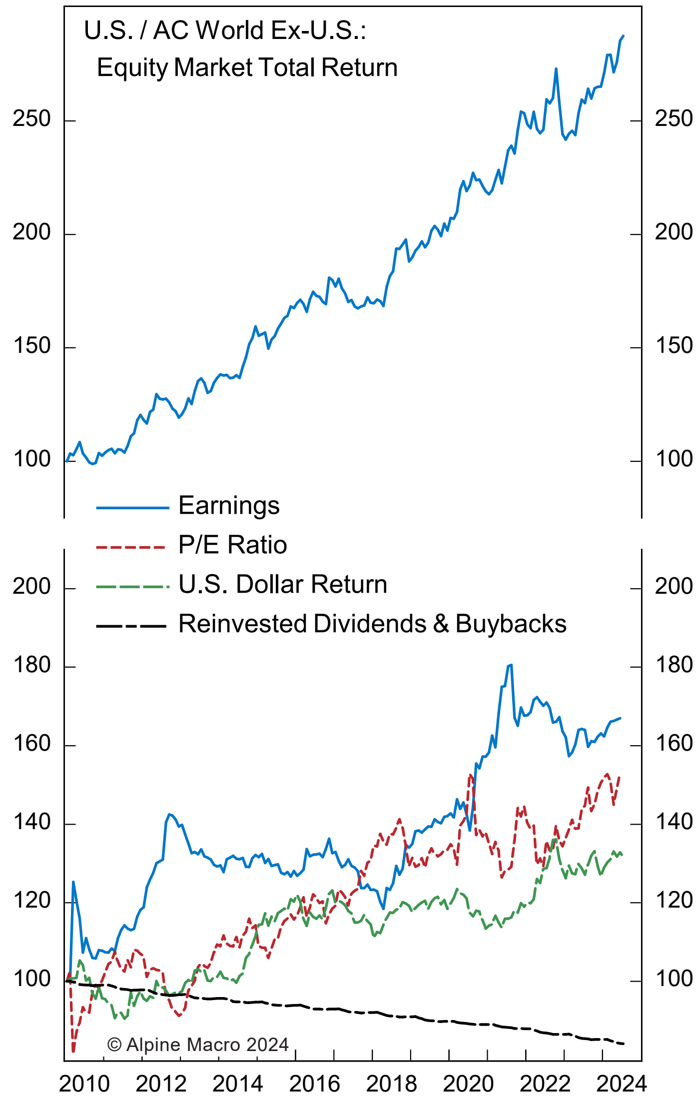
- The ability of U.S. firms to consistently churn out faster profits have subsequently led investors to assign higher earnings multiples to the American market, making this the second most important contributor to relative returns.

- An appreciating dollar delivers another third of outperformance.

- Income returns from dividends and share buybacks act as balancing items, *detracting* from the relative performance of U.S. stocks. This is due to higher dividend yields from international equities and the diminishing impact of buybacks on increasingly expensive U.S. stocks.

While the widely acknowledged primary driver of the U.S. market's outperformance is the rapid rise in earnings, investors often attribute both stellar profits and returns mainly to tech-related industries. However, this perspective may be overly simplistic.

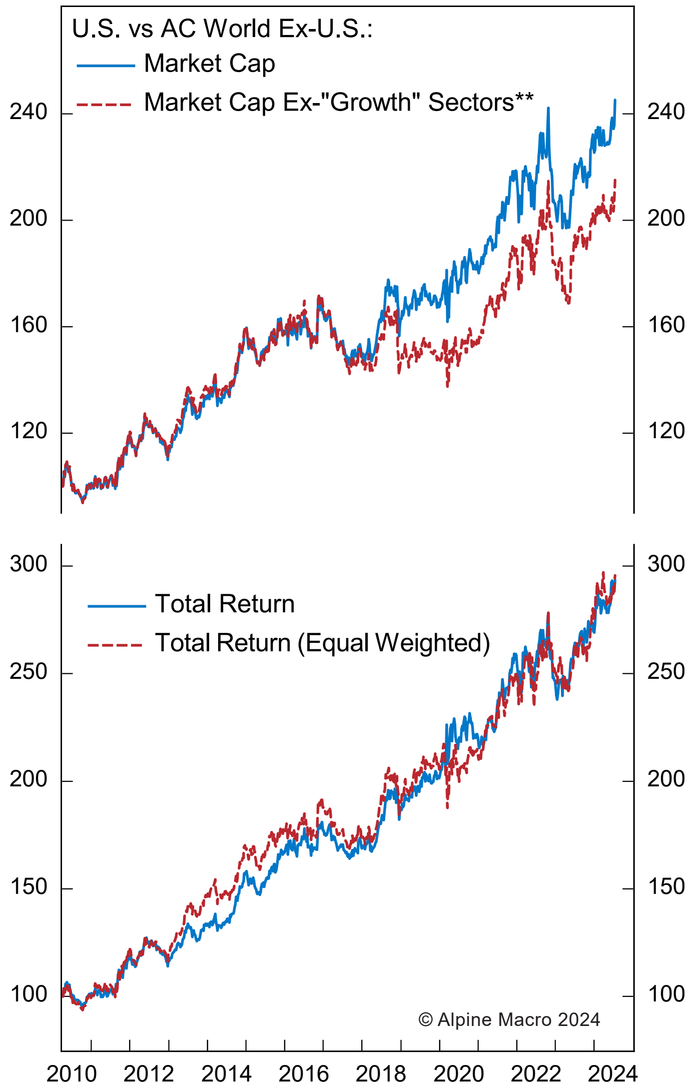
**Chart 2** Earnings Have Led The Way




Note: All series are rebased to Jan 2010=100; based on large/mid/small-cap indexes; source: MSCI

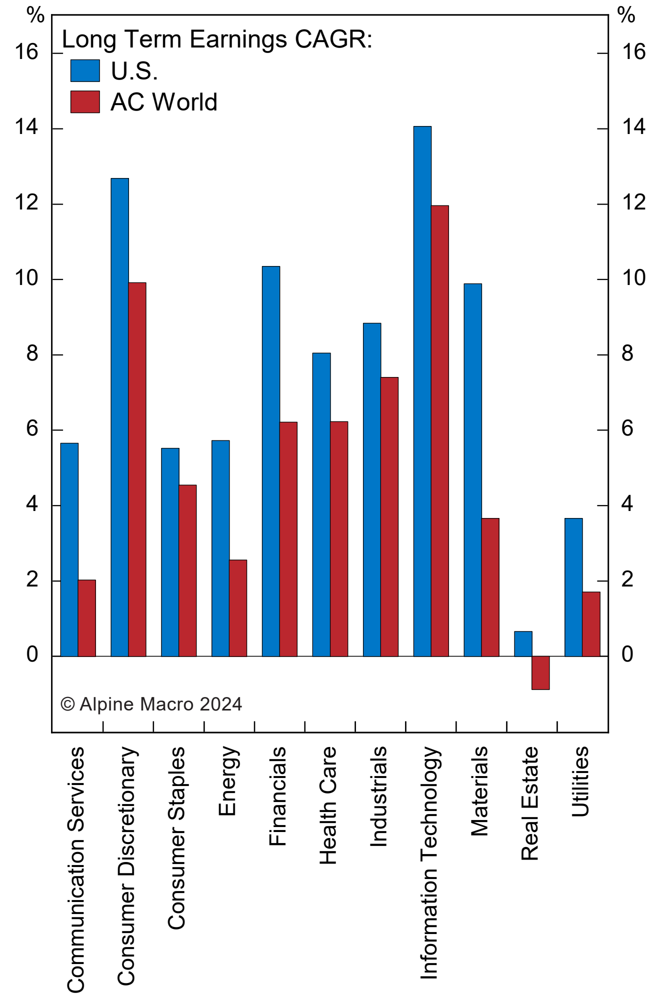
As shown in the top panel of **Chart 3**, U.S. stocks continue to perform exceptionally well even after excluding the growth-oriented sectors that have raced ahead since 2018. In fact, the difference in relative returns is negligible when comparing equal-weighted indexes (**Chart 3**, bottom panel). This is consistent with U.S. earnings outpacing global earnings in *every* sector during this bull cycle (**Chart 4**).

**Chart 3** Not Just A "Growth" Story...




*IT, Communication Services, and Health Care
Note: All series are rebased to Apr 2010=100; large/mid-cap indexes in USD terms, except for U.S. market cap calculations which use large/mid/small-cap indexes; source: MSCI

**Chart 4** ...As All Sectors Have Outshone On Profits



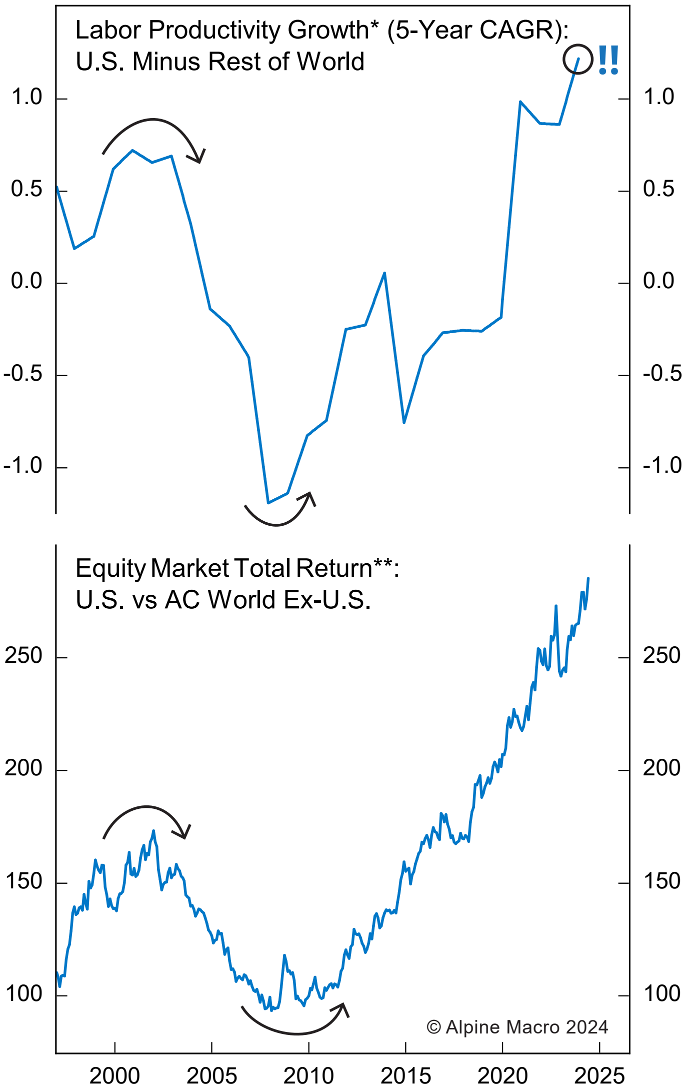

Note: For all sectors except Real Estate, the CAGR period is from Jan 2010 to Jul 2024. For Real Estate, the CAGR period is from Sep 2016 to Jul 2024; source: MSCI

**Bottom Line:** Superior earnings growth is the primary reason for U.S. equity outperformance, though multiple expansion and a stronger dollar have also been significant contributors. Notably, this outperformance is broad-based, with U.S. sectors beyond tech and tech-adjacent industries also achieving robust profit expansion and impressive stock returns.

## It Boils Down To Earnings

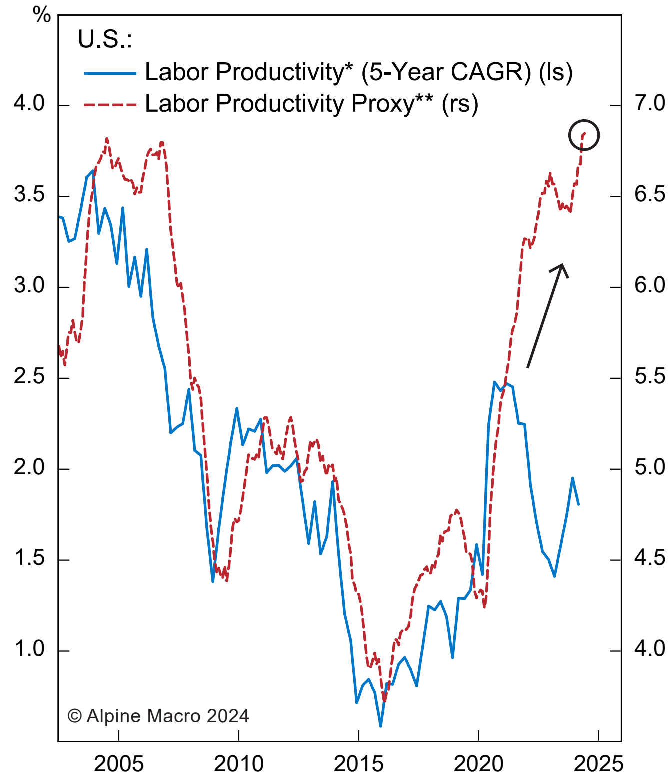
"American exceptionalism" is increasingly cited *ex-post* to explain the outsized rewards for shareholders of U.S. stocks. The reasoning is that the U.S. economy closely adheres to free market capitalism, with minimal regulatory distortions, a stable and competitive business environment, a strong rule of law, a deep pool of immigrant talent, and an elite higher education system. While these points are valid, they could also have been made at any point in the last half-century.

**Chart 5** **Productivity Gap Explains Relative Performance**




*Using per person employed data expressed in 2022 PPP U.S. dollars; rest of world figure is calculated as the median reading among 132 countries; source: The Conference Board
**Rebased to Jan 2010=100; large/mid/small-cap indexes expressed in USD terms; source: MSCI

**Chart 6** **Is U.S. Productivity Understated?**




*Non-farm output per hour; source: BLS
**Based on the difference between the "output" and "employment" component of the ISM survey; proxy is economy-weighted (80% services / 20% manufacturing) and shown as a 5-year average; source: ISM

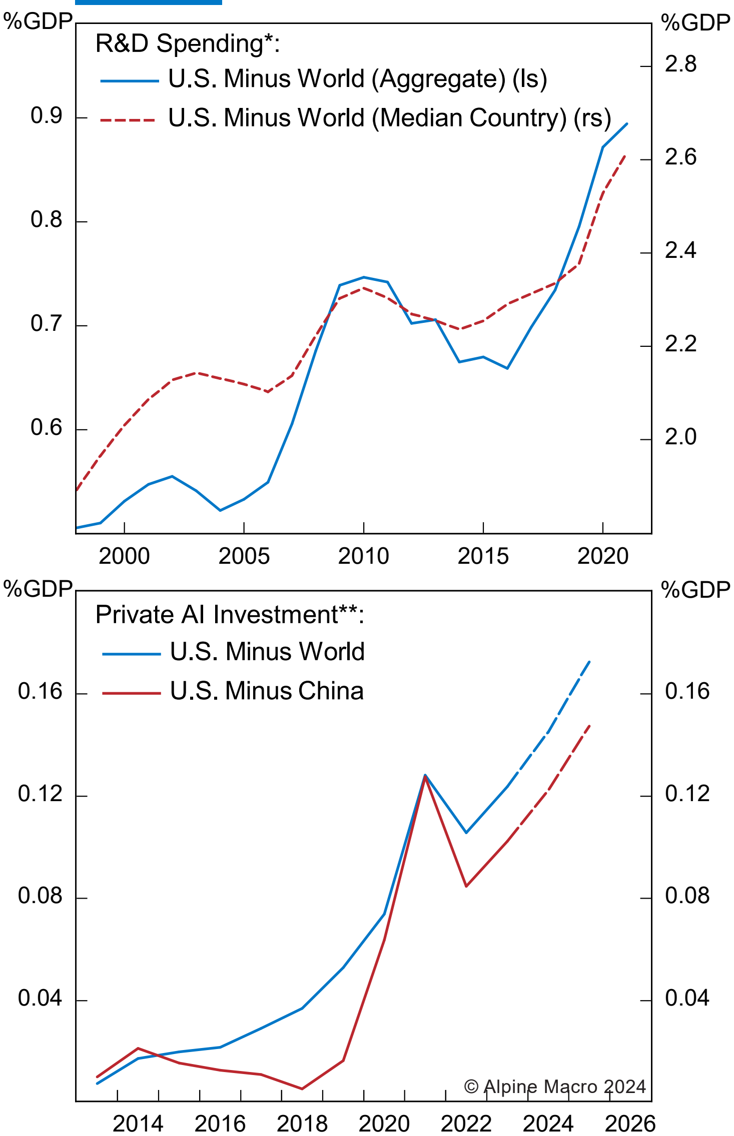
Ultimately, it is the trends in earnings which dictate the multi-year swings in relative equity performance. Since profits are largely derived from productivity, the latter generally tracks the fortunes of the U.S. equity market compared to the rest of the world (**Chart 5**).

While the U.S. productivity advantage is currently at its highest point in decades, predicting its next inflection point is fraught with difficulty. Nevertheless, examining related proxies provides no indication that the gap will peak imminently:

- An ISM-based measure of U.S. productivity, based on the differential between the "output" and "employment" components of the survey, continues to surge (**Chart 6**). Unlike the quarterly and revision-prone official statistics, this gauge offers more real-time insight into the underlying productivity trend.

- U.S. spending on research and development remains in a structural uptrend compared to the rest of the world (**Chart 7**, top panel). Despite the

**Chart 7** Staying On The Bleeding Edge

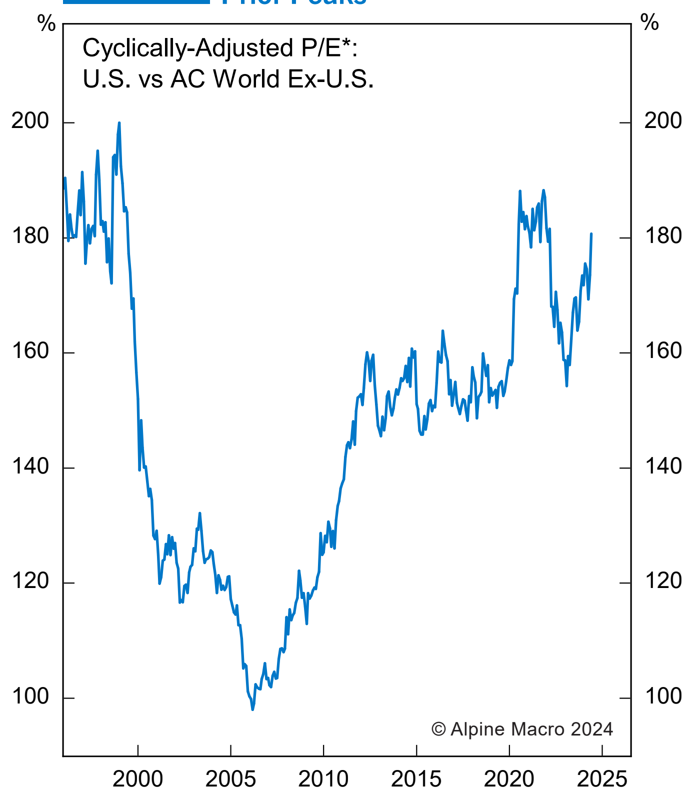



*Source: World Bank
**Dashed lines denote projections; source: Goldman Sachs

time lag in the availability of the standardized cross-sectional data, it suggests that the accrual of technological benefits in favor of the U.S. should persist.

- The U.S. lead in private AI investment continues to widen, with field advancements likely to drive a further acceleration in productivity growth (**Chart 7**, bottom panel). Crucially, the U.S. government actively encourages such investment, unlike China, which is more skeptical of large, successful private tech companies.

**Chart 8** Expensive, But Still Below Prior Peaks




*Equity market price divided by the 10-year moving average of real earnings; U.S. shown as a percentage of AC World Ex-U.S.; source: MSCI, BLS, Dallas Fed, Alpine Macro

**Bottom Line:** The widening productivity chasm between the U.S. and the rest of the world shows no signs of topping out, thereby reducing the likelihood of a looming downturn in the U.S. corporate sector's relative earnings growth.

## Paying Over The Odds?

Of course, bull runs often end when investors pay too high a premium on extrapolated profit growth. This overenthusiasm eventually leads to disappointment,

looks like this might change for the better now as spoken about in the 3rd Plenum of 2024 as reality fails to meet inflated expectations. Consequently, returns fall as investors begin to correct their overextended positions.

What can be said about where the relative U.S. bull market stands when drawing parallels to the late 1990s?

First, while relative U.S. valuations are undoubtedly high by historical standards, they have yet to surpass the heights seen during the Dot Com bubble, or even the immediate post-pandemic period (Chart 8). Mere precedent suggests that U.S. stocks have room to get even more expensive.[1]

Second, the rising overvaluation of the U.S. market in the late 1990s occurred in the context of a steady deterioration in American firms' relative return on equity (Chart 9, top panel). Enthralled with the prospect of mania-like returns, investors' attention to the fundamentals fell by the wayside.

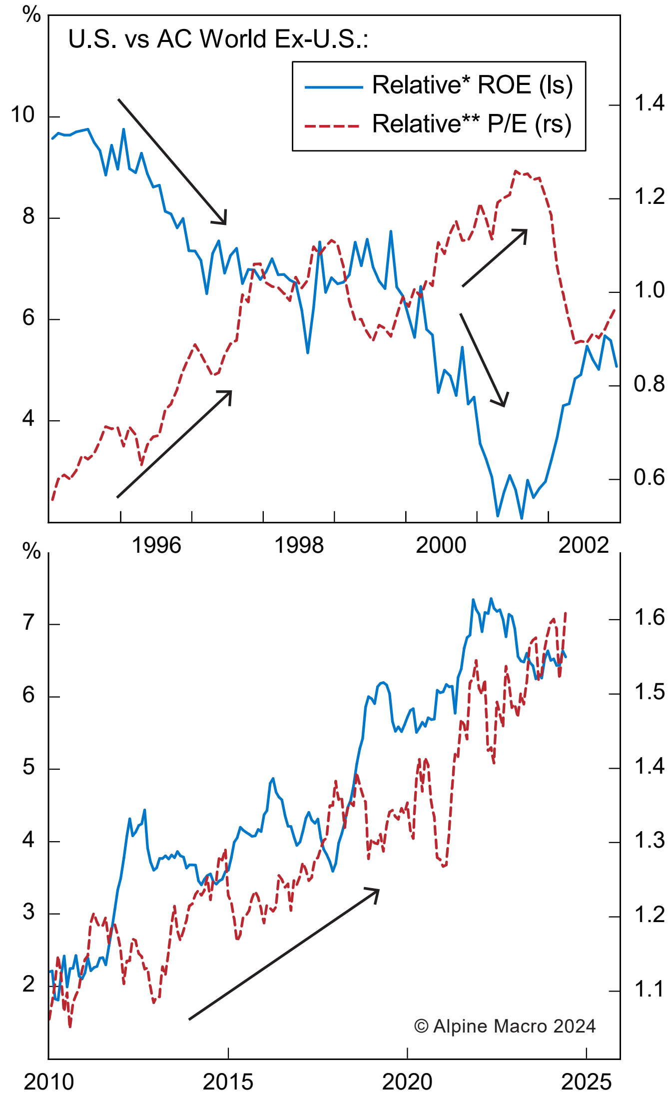
This pattern has not been repeated in the last 15 years. Instead, markets have consistently shown discipline, bidding up U.S. stocks in keeping with their improving return on capital (Chart 9, bottom panel).

Third, U.S. firms are still becoming increasingly efficient not only in utilizing shareholders' equity but also in converting revenue into earnings (Chart 10). In contrast, economy-wide profit margins were already declining by 1998, underscoring how corporate health at the time was increasingly concentrated within the tech sector.

While the lofty margins of today are more susceptible to mean reversion, the ratio of unit selling costs

1 Alpine Macro *U.S. Themes & Strategy* "Mania Roadmap: AI and Macro Drivers" (April 17, 2024).

**Chart 9** Not Like The Late 90s In Terms Of Relative ROE...

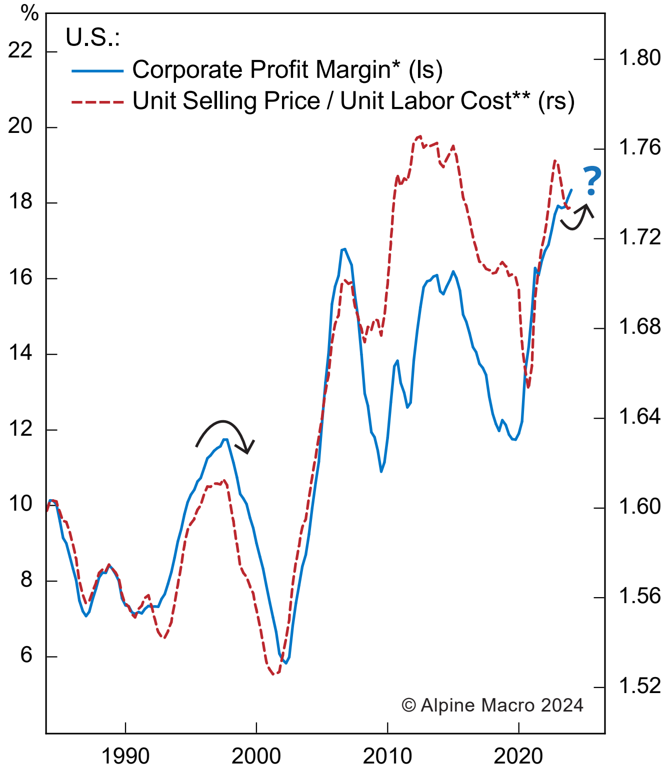



*Calculated as a difference
**Calculated as a division
Note: All series are calculated based on large/mid/small cap indexes; source: MSCI

to unit labor costs have yet to flash a warning. The measure could remain elevated for a while longer as a gradually loosening labor market, along with a likely acceleration in productivity, further suppress wage growth and flatter profit margins.

**Bottom Line:** U.S. relative equity valuation, though substantially elevated, has further scope to rise

**Chart 10** ...Or Profit Margin Trends




*Corporate profits of domestic non-financial industries, with an inventory valuation adjustment, as a proportion of gross domestic non-financial income; shown as a 4-quarter moving average
**For domestic non-financial corporate sector; shown as a 4-quarter moving average

compared to the late 1990s. Valuation will become concerning once profit metrics start to deteriorate, which is not currently the case.

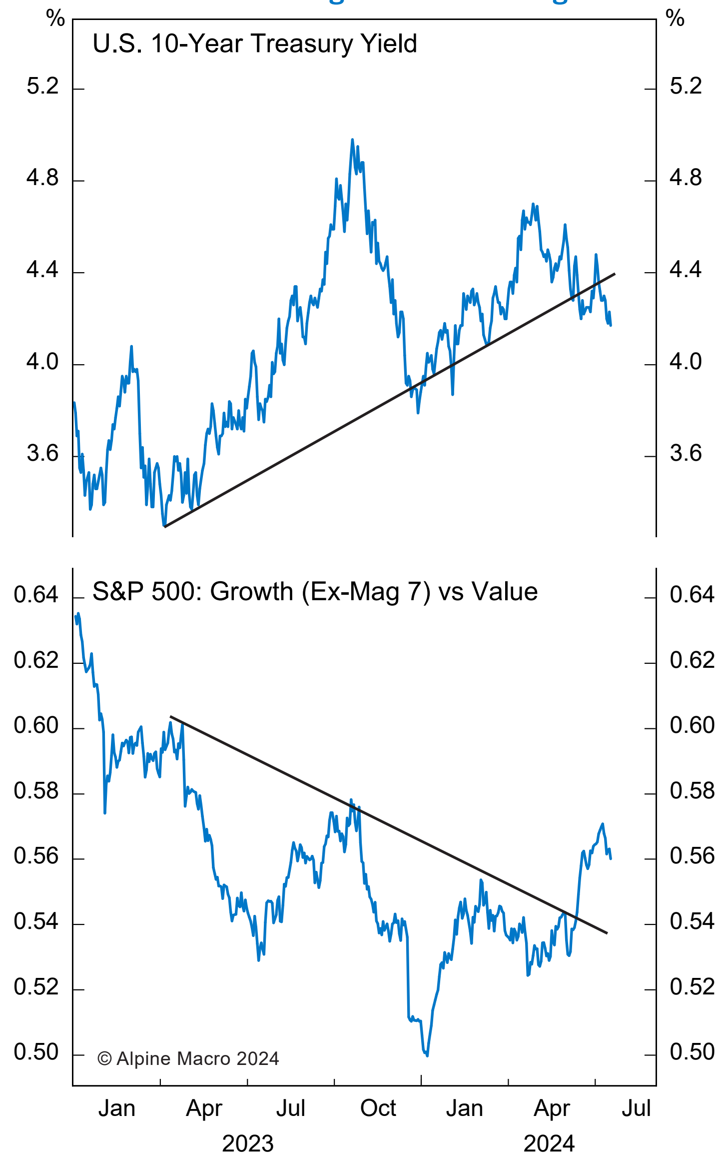
## Final Considerations For Asset Allocators

The key investment takeaway is that, barring an evaporation in earnings expectations or a loss in investor confidence, the risk of an abrupt reversal in U.S. equity outperformance remains low.

Still, there are a few additional factors that are likely to prolong U.S. dominance.

The first is that U.S. tech stocks have only recently experienced a recession by their own standards

**Chart 11** U.S. Growth Stocks Ex-Mag 7 Breaking Out On Declining Yields




based on capex, wages and employment. With the consolidation now over, capital outlays are poised for a rebound given the strong incentives to adopt labor-replacing and productivity-enhancing technologies. This should reinforce the sector's pricing power, wide profit margins and market leadership.

Also, the anticipated decline in yields could further extend U.S. outperformance due to the market's substantial weighting in "high duration" growth sectors. Excluding the Magnificent 7, U.S. growth stocks have *underperformed* value, consistent with the climb in rates (Chart 11). Not surprisingly, this residual index is breaking out just as technical downside to yields loom. With the weighting of growth-oriented sectors[2] comprising over 50% of the U.S. market, compared to just 30% in the rest of the world, American relative performance stands to benefit.

Finally, a decisive cyclical rotation away from the U.S. may only occur *after* the next recession. That is because U.S. equities generally outperform during recessions given their more defensive nature compared to international stocks (Chart 12). U.S. common currency returns would be further bolstered by the counter-cyclical dollar, which tends to strengthen during growth downturns.

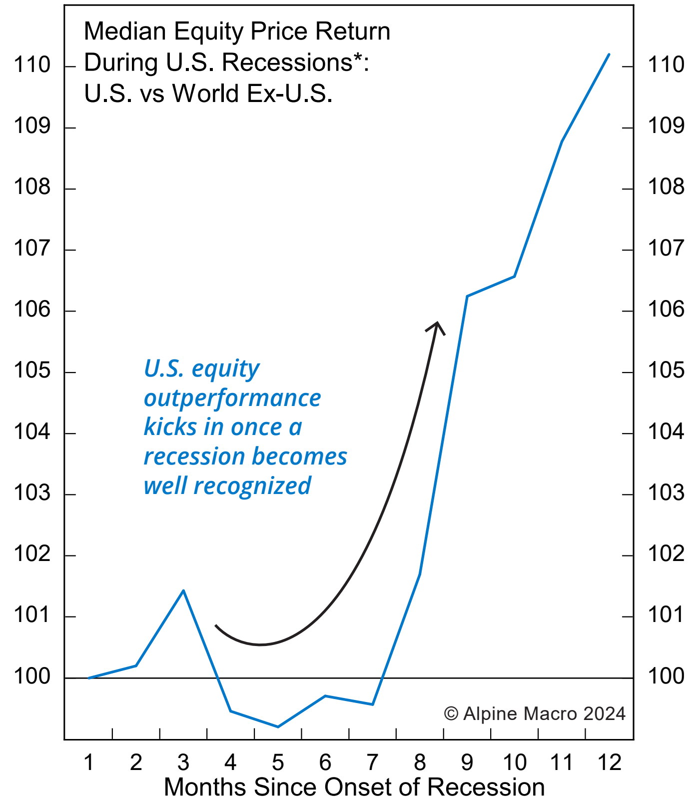
In brief, the strategy playbook might mirror that of the Dot Com era. Though the bubble burst in early 2000, U.S. stock outperformance did not peak until 2002. This suggests that asset allocators today should have ample warning to reduce their U.S. exposure heading into the next cycle.

**Bottom Line:** Forthcoming capital outlays in the tech sector and falling yields, which benefit lagging growth stocks, should reinforce U.S. market leadership. Moreover, U.S. outperformance should be prolonged until after the next recession.

**Bassam Nawfal**

*Chief Asset Allocation Strategist*

**Chart 12** **Recession Can Prolong U.S. Equity Dominance**




*Sample includes 7 NBER-defined recessions since 1969, excluding the 2020 pandemic; expressed in U.S. dollar terms and rebased to 100 at start of recessions; source: MSCI

but it is usually these foolish Americans that start the recessions no

2 "Growth" sectors are defined as IT, Communication Services, and Health Care.

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