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The Case for and Against US Stock Market Exceptionalism

Despite high valuations, the US stock market remains attractive due to strong economic growth and productivity. But diversifying globally can help manage risks and uncover undervalued opportunities.

Insight from sub-adviser Schroders Investment Management

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US stocks finished 2024 comfortably on top of the world for the sixth year of the past seven, with the MSCI USA Index returning another 20%-plus year.[1] In contrast, the MSCI Europe ex UK Index languished with only a 1% return.[2]

Haters Gonna Hate

It's popular to hate on the US stock market and predict an end to its extended dominance, even as inflows continue. But bull markets don't die of old age. There has to be a reason.

In this article, I set out five reasons why now might be the time to downgrade exposure to US stocks (specifically, large caps). However, it would be unbalanced to not also consider valid arguments in the other direction, of which I highlight six. Whichever side of the debate you sit on, you should challenge yourself by considering the other, rather than blithely discounting it.

Key Points

- Naysayers for US stocks have fair points: They're very expensive and concentration is at record highs. In some aspects, non-US stocks look comparably attractive.
- However, there are still many underlying strengths that could continue to boost US performance vs. international peers.
- Investors may want to consider active approaches that can diversify against US risk vs. forgoing it altogether.

Part 1: The Arguments Against Investing in US Stocks

1. **Valuations**

FIGURE 1: US Valuations Are Uncomfortably High
US Cyclically Adjusted Price-Earnings Multiple (CAPE)

As of 1/1871-2/2025. **Past performance does not guarantee future results**. CAPE = price divided by 10-year average earnings, in inflation-adjusted terms. For illustrative purposes only. Data Sources: Robert Shiller and Schroders.

[1] Source: MSCI USA Index

[2] Source: LSEG Datastream, MSCI, Schroders

Outside the peak of the dot-com bubble, US valuations are close to their most expensive in the past 143 years. **FIGURE 1** shows the cyclically adjusted price-earnings multiple (which compares prices with average earnings over the previous 10 years), but we could have equally made the same argument using other valuation measures and over shorter time horizons.

Although not a new argument, 2024's rally has propelled valuations to uncomfortably high levels.

> US valuations are close to their most expensive in the past 143 years.

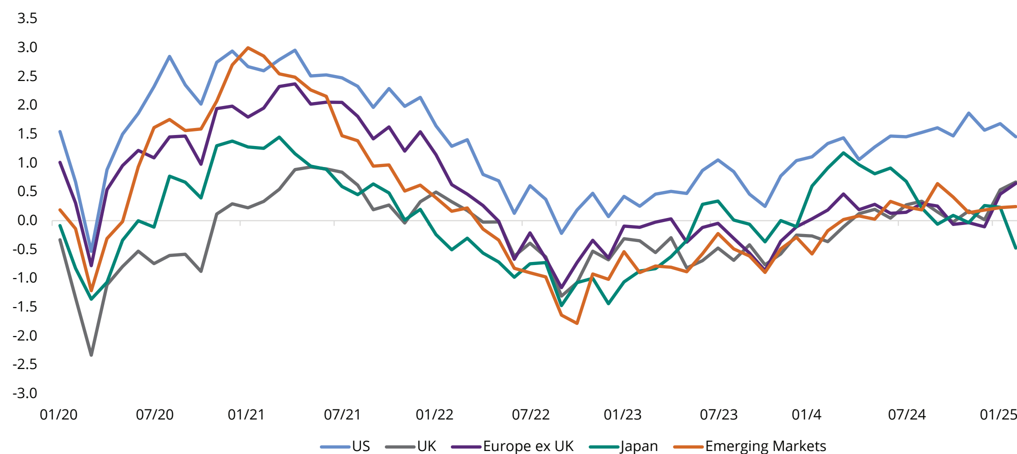
2. US Valuations Are Stretched to the Extreme vs. Other Stock Markets

While the US is at levels that historically would've been bubble territory, valuations elsewhere are still reasonable—and very cheap vs. the US. **FIGURE 2** shows a composite valuation indicator for five major stock markets, with degrees of expensiveness/cheapness averaged across five individual measures: CAPE, trailing price/earnings (P/E),[3] forward P/E, price/book,[4] and dividend yield.[5] These are calculated on a "z-score"[6] basis, which adjusts for differing variability of the individual measures to make them more comparable.

Outside the US, valuations are close to fair value when compared with history. It's only the US that's above average. Market moves in early 2025 have narrowed this valuation gap, but it remains wide.

FIGURE 2: Non-US Valuations Remain Reasonable, But the US Is Expensive in Absolute and Relative Terms

Composite Valuation Metric = Average Z-Score Across Five Valuation Metrics



As of 2/28/25. Our assessment of expensive/cheap is relative to a 10-year rolling average of each market across five valuation metrics: CAPE, forward price-to-earnings, trailing P/E, P/B, and dividend yield. For illustrative purposes only. Data Sources: LSEG Datastream, MSCI, and Schroders.

The consequence is that, on a relative value basis, other stock markets are valued at historically cheap levels compared with the US. The MSCI World ex USA Index trades at more than a 40% discount to the US in terms of trailing price/earnings. Within the US, small caps have also fallen to a sizeable discount to large caps. Historically, they've traded at a premium, reflecting their typically stronger expected growth rates (**FIGURE 3**).

This isn't simply a result of US large caps having a larger allocation to the highly rated technology sector. Almost every industry group among international stocks trades at a significant discount to the US. The median discount on both a forward and trailing price/earnings basis is about 20%.

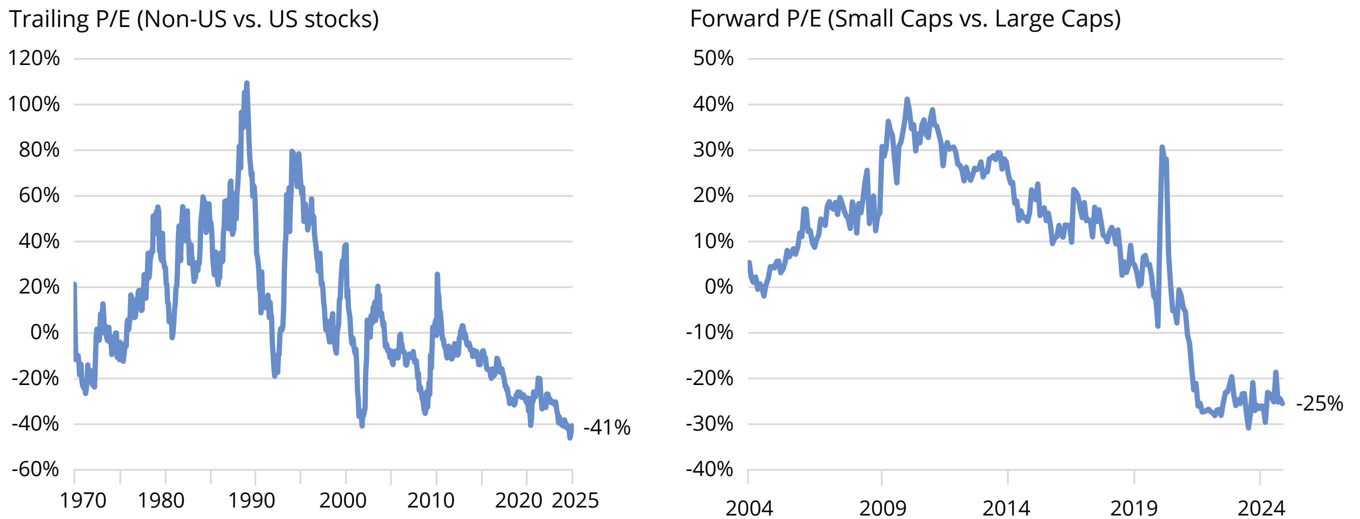
[3] Price-to-earnings ratio measures a company's share price relative to its earnings-per-share and helps assess the relative value of a company's stock.

[4] Price/Book is the ratio of a stock's price to its book value per share.

[5] Dividend yield is a stock's dividend per share divided by the price per share.

[6] Z-score measures the number of standard deviations (standard deviation measures the portfolio's total-return volatility; a higher standard deviation indicates greater historical volatility) above or below the average.

FIGURE 3: Non-US and Small-Cap Stocks Are Historically Cheap vs. the US

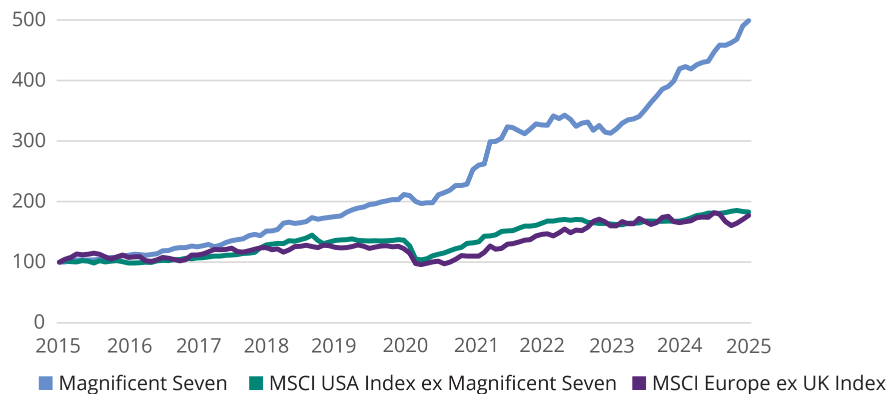


As of 2/28/25. **Past performance does not guarantee future results.** Investors cannot directly invest in indices. Left hand chart: Non-US stocks are represented by the MSCI World ex-US Index, US by the MSCI USA Index. Right hand chart: Small caps are represented by the S&P Smallcap 600 Index, large caps are represented by the S&P 500 Index. Different indices and time horizons are used in the two charts for reasons of data availability. For illustrative purposes only. Please see representative index definitions on page 10. Data Sources: LSEG Datastream, MSCI, S&P, and Schroders.

3. The Magnificent Seven Are Skewing the Data

FIGURE 4: Minus the Magnificent Seven, European Companies Have Been Almost as Good at Growing Earnings as US Companies

Next 12-Month Earnings (US in dollars, Europe Ex UK in Euros) Indexed To 100



As of 2/28/25. **Past performance does not guarantee future results.** Investors cannot directly invest in indices. The Magnificent Seven is the name given to Amazon, Alphabet, Apple, Meta Platforms, Microsoft, Nvidia, and Tesla. For illustrative purposes only. Data Sources: LSEG Datastream and Schroders.

European companies garner a lot of criticism compared with their US peers but, over the past decade, they've competed favorably with most US companies in generating earnings growth. The shortfall has been against the Magnificent Seven (Amazon, Alphabet, Apple, Meta Platforms, Microsoft, Nvidia, and Tesla). They've significantly outperformed European companies, but the rest of the US market hasn't.

Sentiment toward non-US stocks is so downbeat that you'd think the US is the only market in which companies are expected to perform well. That limited view risks leading to missed opportunities. Around half of European, UK, and Japanese companies are forecast to deliver double-digit earnings growth in the next 12 months, a slightly higher figure than in the US.

4. US Consumers Own Record Amounts of Stocks

While sentiment toward non-US stocks is pretty downbeat compared with the US, some measures of sentiment toward US stocks have been exuberant. US households have also never had so much of their assets invested in stocks (**FIGURE 5**). Excessively positive sentiment is often a contrarian indicator (pride goeth before the fall).

A counter argument could be made that, with so much wealth tied up in the stock market, US policymakers may have a bias toward rescuing markets from a worst-case scenario because of the economic knock-on effects. But this would only apply in a severe downside scenario.

FIGURE 5: US Households' Allocations to Equities Are at Record Highs
Directly and Indirectly Held Equities as a Share of Financial Assets for Households and Non-Profit Organizations

As of 9/30/24. Data Sources: Federal Reserve, LSEG Datastream, and Schroders.

5. Even International Benchmarks Are Highly Concentrated in the US

Even if you're optimistic about the case for US equities, there comes a point when you have to question how much you're comfortable investing to back that view. At the end of February, the weight of the US in the MSCI World Index of developed-market stocks had risen to 73%. In the MSCI ACWI Index, which tracks developed- and emerging-market stocks, it stood at 66% (**FIGURE 6**).

That's a lot of money in one country. What makes it more problematic is that the US itself is a very top-heavy market at present. While investors might think that passively tracking the global market gives them diversified exposure to global companies, the reality is that these seven stocks make up a similar weight in the MSCI ACWI Index (19.8%) as the next seven biggest *countries* in the Index combined (20.5%).[7] These seven stocks also make up the same weight as the 2,128 smallest companies in the MSCI ACWI Index combined (out of 2,647 total constituents).

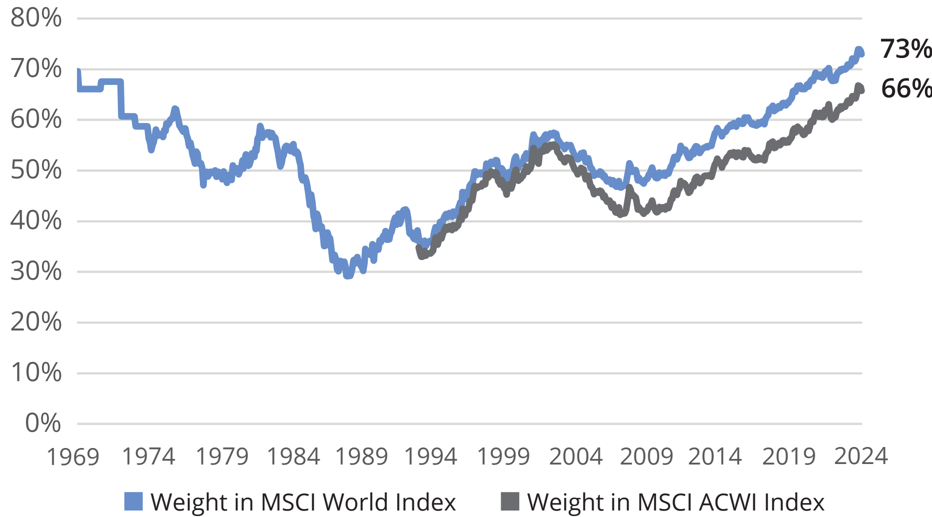
This much weight in so few stocks is worrying from a risk-management perspective. It also means the wealth of investing opportunities offered around the world amount to barely a rounding error in the performance of the global market. In other words, I think active approaches could prosper.

> "The Magnificent Seven make up the same weight as the next seven biggest countries in the MSCI ACWI Index.

[7] Source: LSEG Datastream and Schroders.

FIGURE 6: US Concentration in the International Benchmarks Has Reached a Record High

US Weight in Major Global Benchmarks



As of 2/28/25. Data Sources: LSEG Datastream, MSCI, and Schroders.

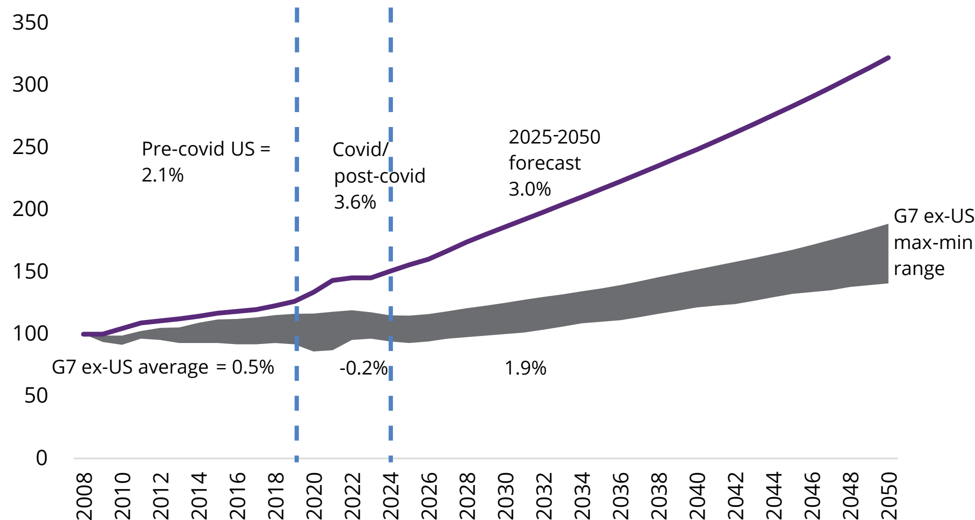
Part 2: Arguments in Favor of Investing in US Stocks

Many of the same arguments could have been made, to varying degrees, at any point in the past few years. I've made some of them myself! It's not new that the US is expensive, nor is the relatively high weight of the US in global markets. The extent of these is new, yes, but we should be humble about using them to predict its downfall. "Markets can remain irrational for longer than you can remain solvent" isn't a popular saying among investors for nothing. The next section addresses reasons why investors could justifiably feel optimistic about the prospects for US stocks compared to international peers.

1. **US Productivity Is Soaring; Elsewhere, It's Languishing**

FIGURE 7: US Productivity Growth Has Been, and Is Expected to Continue to, Outperform

Output Per Worker, Rebased To 100 In 2008



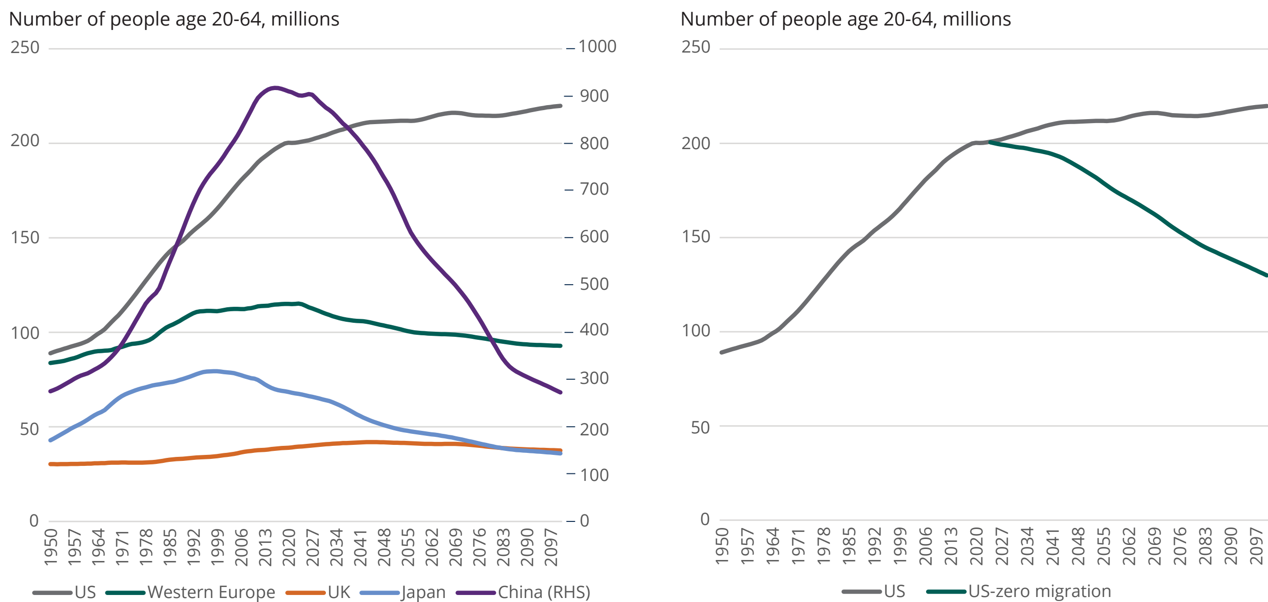
As of 2/28/25. Data from 2024-2050 are forecasts. Forecasts included are not guaranteed and should not be relied upon. G7 covers Canada, France, Germany, Italy, Japan, the UK, and the US. For illustrative purposes only. Data Sources: LSEG Datastream, Oxford Economics, and Schroders.

The level of productivity is a key driver of economic growth. US productivity growth soared ahead of the rest in the years following the Great Financial Crisis and then, when COVID-19 hit, rather than falling back to the pack, it accelerated further ahead. This gap is forecast to continue. If these forecasts come true, US economic exceptionalism could endure.

2. The US Also Has More Favorable Demographic Projections

The US working-age population is expected to continue growing, supporting *long-term* US economic growth ... but this hinges on immigration. A shift to a less accommodative stance on immigration could easily remove this advantage.

FIGURE 8: The US Workforce Is Still Growing While Others Shrink



1950-2023 are estimates. 2024-2100 are forecasts, medium-variant and zero migration-variant. Forecasts included are not guaranteed and should not be relied upon. For illustrative purposes only. Data Sources: UN World Population Prospects 2024 and Schroders.

3. Economic Momentum Is With the US

It's not just long-term economic momentum that the US has in its favor, it's also performing better on a more cyclical level. Economic surprises have been more positive than in other regions, and the Schroders Economics team recently upgraded US growth expectations for 2025 and 2026. We now expect 2.5% growth next year, compared with 2.1% previously. This compares with 1.1% for the eurozone and 0.9% for the UK. Even stronger growth of 2.7% is forecast for 2027, comfortably ahead of other developed markets.

This does come a cost, however, with higher US inflation also forecast. This is likely to have consequences for interest rates and borrowing costs, ultimately posing a risk to growth. Although our central case is for strong US economic performance, in a downside scenario, higher inflation and rates could push the US in a stagflationary (i.e., slow economic growth coupled with high unemployment and rising inflation) direction.

4. A Buoyant US Economy Could Benefit US Stocks More Than Overseas Stocks

US large-cap stocks generate approximately 60% of revenues from the US; other markets are less than half that. If the US economy does power ahead, US companies stand to be the main beneficiaries.

But US small caps and value stocks are even more highly geared to domestic growth than large caps. If that's your main reason for backing US stocks, there may be better ways to do so.

FIGURE 9: Geographic Revenue Exposure of Major Global Stock Markets

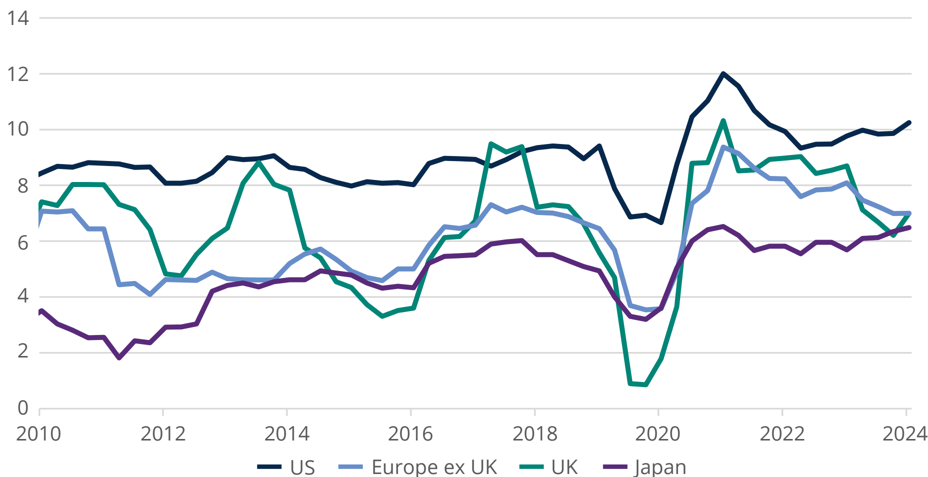
Equity Index	Geographic Source of Revenues (%)					
	US	Europe ex UK	UK	Japan	Emerging Markets and Frontier	Other/ unallocated
US	59	9	5	5	24	4
Europe ex UK	23	35	4	2	31	4
UK	27	14	22	3	29	5
Japan	17	7	2	46	24	4
Emerging Markets	13	4	1	2	78	3
US Small cap	77	4	1	1	10	6
US Value	69	7	2	2	16	3
US Growth	50	10	2	3	31	4

As of 11/19/24. Other/unallocated includes Canada, Australia, New Zealand, and Singapore. Analysis based on the most recently available data. Representative indices are: US = MSCI USA Index; Europe ex UK = MSCI Europe ex UK Index; UK= MSCI UK Index; Japan = MSCI Japan Index; Emerging Markets = MSCI Emerging Markets Index; US Small Cap = Russell 2000 Index; US Value = MSCI USA Value Index; US Growth = MSCI USA Growth Index. For illustrative purposes only. Data Sources: Factset and Schroders.

5. US Companies Have Been Consistently More Profitable

FIGURE 10: US Companies Are More Profitable and Are Forecast to Grow Faster

Net profit margin (%)



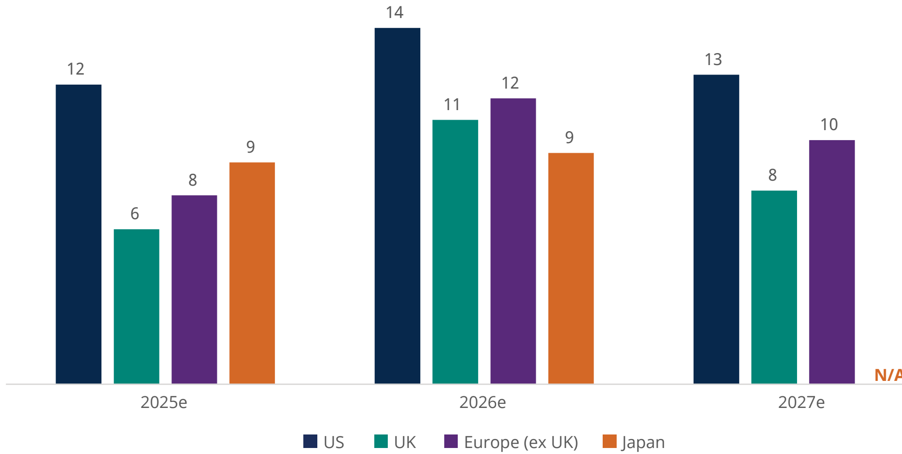
Quarterly data as of 12/31/24. **Past performance does not guarantee future results.** Based on Datastream total market equity indices, which represent all the stocks that trade in a particular country or region. For illustrative purposes only. Data Sources: LSEG Datastream and Schroders.

Although one of the earlier arguments was that European stocks hadn't undershot US earnings growth by much outside of the Magnificent Seven, the reality is that, in aggregate, US companies have been consistently more profitable. The source of the growth matters less than the level of earnings growth itself, since that's what investors benefit from when investing in the US market.

Furthermore, US earnings growth is forecast to stay high through 2025 -2027, comfortably ahead of other major developed markets.

FIGURE 11: US Earnings Are Projected to Keep Growing

Corporate Earnings: Consensus Year-Over-Year Earnings Per Share Growth Forecasts (%)



As of 2/28/25. Earnings per share measures how much profit a company makes per share of common stock. Forecasts included are not guaranteed and should not be relied upon. Note: Japan EPS is four-quarter sum until 6/30 of next calendar year, e.g. 2025 = 3/31/25 – 3/31/26. Japan forecast for 2027 is not currently available. For illustrative purposes only. Data Sources: LSEG Datastream and Schroders.

In 2024, for the first time, a higher proportion of UK large companies bought back at least 1% of their shares than US companies.

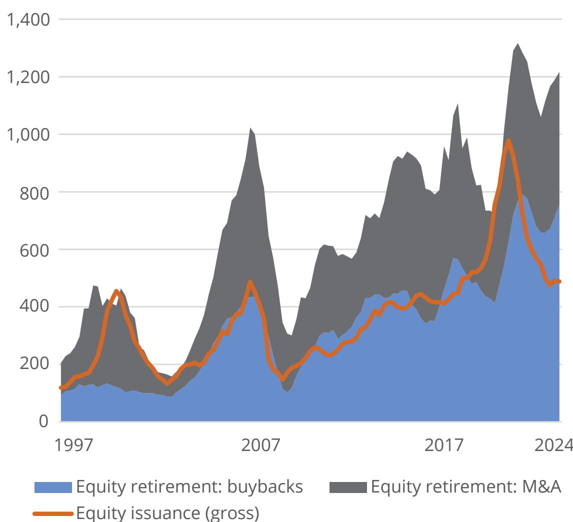
6. Demand Is Outpacing Supply

Corporate buying, through share buybacks and mergers & acquisitions (M&A), provides a persistent source of demand for US stocks. This demand has exceeded the new supply of equities each year for the past 20 years, apart from 2021.

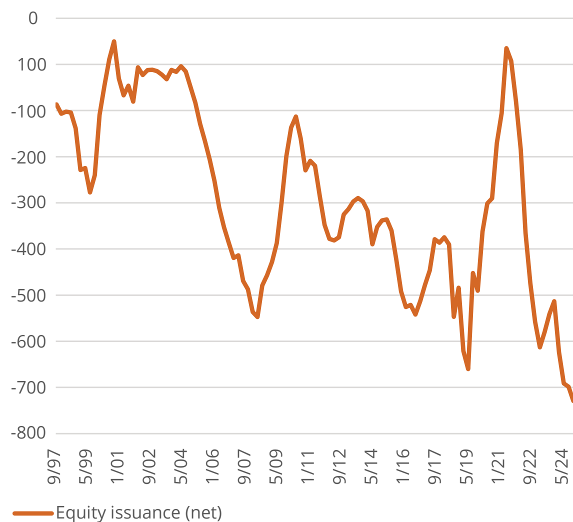
One change on this front is that buyback activity has been increasing in non-US markets. In 2024, for the first time, a higher proportion of UK large companies bought back at least 1% of their shares than US companies. However, this proportion has also been rising steeply in Japan, France, and Germany, so the advantage that US stocks had on this front is fading.

FIGURE 12: Prices Are Supported by High Levels of Corporate Buying

Buybacks + M&A > Equity Issuance ($ billions)



Net Equity Issuance Has Been Deeply Negative ($ billions)



Data as of 9/30/24. Data covers US-domiciled public and private non-financial companies. Equity issuance covers initial public offerings as well as equity issuance by existing companies. Net equity issuance = gross equity issuance (the total value of funds raised by companies through the sale of equity, both publicly and privately, without accounting for repurchases or share buybacks) - equity retirements (through buybacks and mergers & acquisitions (M&A)). For illustrative purposes only. Data Sources: Federal Reserve and Schroders.

In Summary

US stocks are very expensive, you likely already own a *lot* of them, and some sentiment measures are bullish in the extreme. This is problematic, and the inflationary risks of President Donald Trump's policies shouldn't be discounted.

However, US stocks also have a lot going for them, and other global markets have their own issues (looking at you, France, Germany, UK, and China).

In my view, investors may want to consider diversifying to manage US risk rather than take a strongly negative view on the US:

- Small caps, mid caps, and value stocks are cheaper and geared to US domestic strength
- International stocks are even cheaper, and many individual companies outside the US are performing well
- Active approaches within large caps can enhance exposure to (relatively cheaper) smaller companies within the large-cap market

To learn more about balancing domestic vs. international exposure in your portfolio, please talk to your financial professional.

MSCI ACWI Index is a free float-adjusted market capitalization index that measures equity market performance in the global developed and emerging markets, consisting of developed and emerging market country indices. MSCI index performance is shown net of dividend withholding tax.

MSCI Emerging Markets Index is a free float-adjusted market capitalization-weighted index that is designed to measure equity market performance in the global emerging markets.

MSCI Europe ex UK Index is a free-float adjusted market-capitalization-weighted index designed to measure the equity market performance of the developed markets in Europe excluding the United Kingdom.

MSCI UK Index is designed to measure the performance of the large and mid cap segments of the UK market.

MSCI Japan Index is designed to measure the performance of the large and mid cap segments of the Japanese market.

MSCI USA Index is a free float-adjusted market capitalization index that is designed to measure the performance of the large and mid cap segments of the US market.

MSCI USA Growth Index captures large and mid cap securities exhibiting overall growth style characteristics in the US.

MSCI USA Value Index captures large and mid cap US securities exhibiting overall value style characteristics.

MSCI World ex USA Index is a free float-adjusted market capitalization index that captures large and mid cap representation across developed markets countries excluding the United States.

Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe.

S&P 500 Index is a market capitalization-weighted price index composed of 500 widely held common stocks.

S&P SmallCap 600 Index consists of 600 small-cap stocks. A small-cap company is generally defined as a stock with a market capitalization between $300 million and $2 billion.

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