HSBC Asset Management

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# Broadening-out story – where are we?

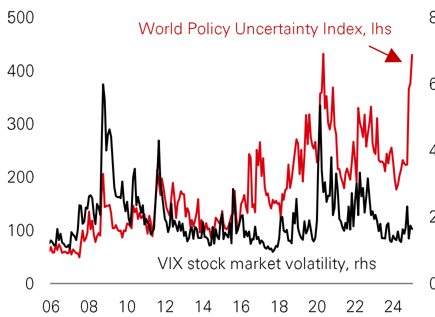
**Macro Insight** | 28 February 2025

### Revisiting US exceptionalism after a rise in uncertainty and big market moves

Forecasting the direction of financial markets has recently become more challenging with trade/policy uncertainty at pandemic levels (Figure 1) and with concerns about US Tech dominance given new entrants and rising capex. The US has delivered some phenomenal gains: ***Nvidia's market cap is up 10-fold since 2022***. While cycles can vary, we've seen this before in the 2000 Tech boom (Figure 2). Investors question if the recent US wobbles are more '*buy the dip*' *opportunities or something different this time*. Although it may not be the end of US exceptionalism, the last decade is unlikely to be repeated. Since 2020, there were USD$1.2 trillion of inflows to US equity funds versus a meagre USD$0.2 trillion to Rest-of-World funds (*BoA Flow Show, 23/01/25*). If the world ex-US sees even marginal improvements relative to the US we could see some meaningful reversals. Even after the recent bout of broadening out (Figure 29) many valuation gaps remain extreme.

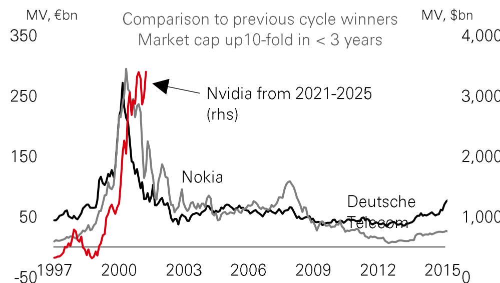
In this Macro Insight, we revisit US exceptionalism and broadening in a sea of change. European and Chinese equities are up 12% to 17%, outperforming the US (MSCI), but will it last? **We look to answer three key questions:** 1) What does US exceptionalism look like? 2) Are the risks rising? and 3) What's left in the broadening-out trade?

**Figure 1: Uncertainty back at pandemic levels**




Source: HSBC Asset Management, Macro bond, February 2025

**Figure 2: We've seen it before, 10-fold jump in MV**



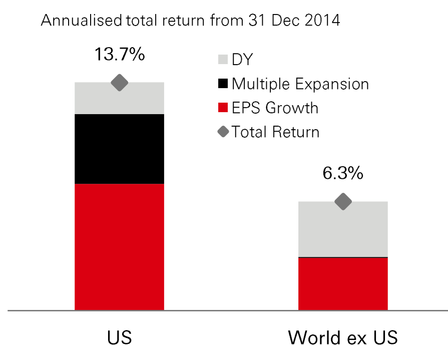

Source: HSBC Asset Management. Refinitiv, February 2025

## 1. What does US exceptionalism look like

### US equity returns were more than double the world

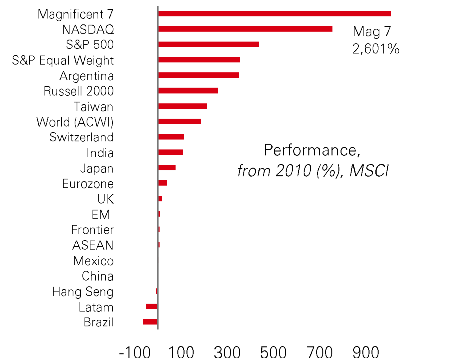
Over the past decade, the *annualised total return* for the US was 13.7% versus 6.3% for the World ex-US. US earnings and multiple expansion (Figure 3) were helped by the AI miracle. Index performance post the Great Financial Crisis tells a similar story. Nasdaq and the S&P 500 are up 750% and 430% respectively (even Russell beat the world). On the contrary, the winners of the previous globalisation boom (from 2003-2008) struggled the most. Europe and Asia were largely flat and even worse, *Latin America and Brazil fell backwards*.

**Figure 3: US returns were double the world**




Source: HSBC Asset Management, MSCI USD Refinitiv, February 2025

**Figure 4: Winners since the Great Financial Crisis**




Source: HSBC Asset Management, MSCI USD, US Indices, Refinitiv

**Is change afoot? US equities lagged when uncertainty hit pandemic levels**

**We review US exceptionalism and the case for broadening out**

**Our view:**

Risks to US exceptionalism potentially rising

Valuation gaps to rest of world are still extreme

Our base-case of modest tariffs and a narrowing of growth differentials between the *US vs RoW* supports a change in leadership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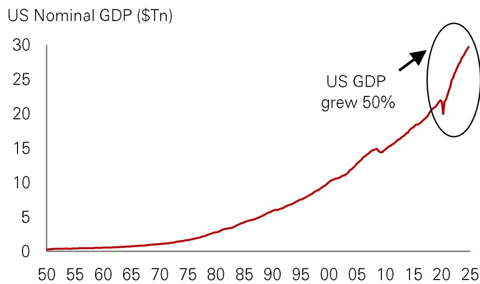
**Index returns assume reinvestment of all distributions and do not reflect fees or expenses. You cannot invest directly in an index. Any forecast, projection or target where provided is indicative only and not guaranteed in any way.**

## US GDP growth is up 50% in five years

US nominal GDP growth rose 50% in five years (Figure 5) from USD 19.9 trillion in April 2020 to c. USD 30 trillion today, *double last cycle's pace*. Helped by US budget deficits of often 8-9%, tax cuts and fiscal support (like the IRA/Chips act). **If you plough this much into the economy, it can't help but drive profits higher.** Capital flows and growth/yield differentials have also propped up the *Fed's trade-weighted USD*, which is still not far from its highs.

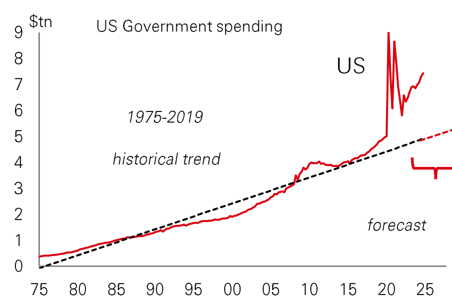
**US GDP growth was exceptional, but so was *post pandemic* government spending; both sit above trend**

**Figure 5: GDP growth up 50% in 5 years**




Source: HSBC Asset Management Macrobond, February 2025

**Figure 6: Spending way above trend**




Source: Macrobond, US Fed Gov't Expenditures SA/AR in USD, February 25

## US Tech driven. Profits grew 240% - 6x more than world ex-US profits

The S&P Tech sector net profits grew by 240% (160% for Nasdaq) over 10 years. US market profits rose by a modest 105% over the same period, **suggesting room for catch up in non-Tech areas or the smaller caps/S&P equal-weighted index.** The World ex-US and Europe up were up only 40% with Emerging Markets (EM) up 4%. The Tech rise was more than matched by sector market performance *evidencing multiple expansion* (Figure 8). Profits tend to mean revert in the long run (as in 2000) challenging a repeat performance.

**US Tech profits are up 240% in a decade; Tech sector performance was double**

**Emerging markets profits were up only 4%**

**Figure 7: S&P Tech dominate profits**

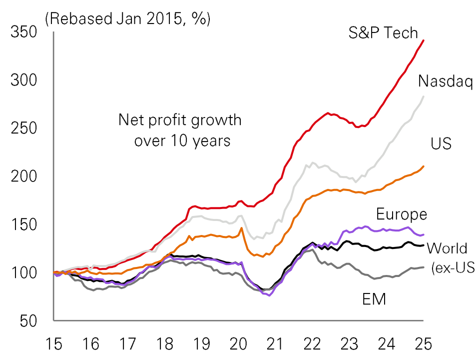
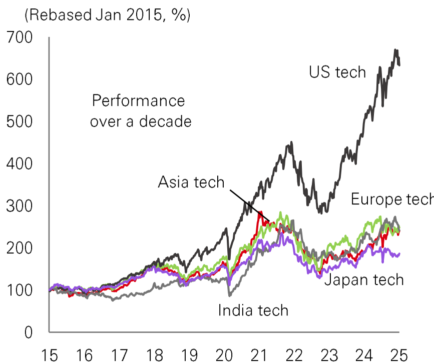



**Figure 8: US Tech and the Rest**




Source: HSBC Asset management, US S&P Tech/Nasdaq Comp, DataStream, World scope, Refinitiv, February 2025

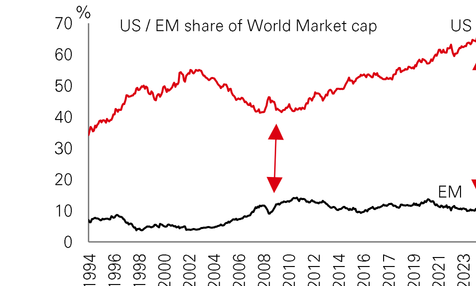
## US makes up 70% of global equities – a 30 year high!

US equities are near 70% of world equities, a 30-year high (Figure 9). Critically Artificial Intelligence (AI) and Tech were the main drivers. Global Tech more than tripled from 6.8% in 2013 to over 25% today, sitting above its 2000 high. US Tech is now 80% of global Tech. If global Tech's market weight triples again from here, it rises to 75% of global equities**.**

**Gap between US and EM market weight is also a 30-year high**

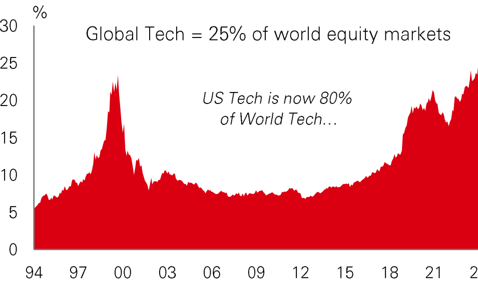
**Tech's share has tripled in a decade; *we don't think that can be repeated***

**Figure 9: US share of global equities – 30-year high**




Source: HSBC Asset Management, MSCI, Refinitiv, February 2025

**Figure 10: Tech share world equities > 2000 peak**




Source: HSBC Asset Management, MSCI, Refinitiv, February 2025



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## 2. Key risks to US exceptionalism

Investors question if these historic gains can be repeated. In this section we investigate extreme profit margins/EPS growth, valuations, and risks. While these risks are real, in our own risk-off scenario, where US tariffs are fully implemented, global growth topples over, and the USD/US Equities are the 'go to' safe-havens - these risks might matter less.

Risks are rising

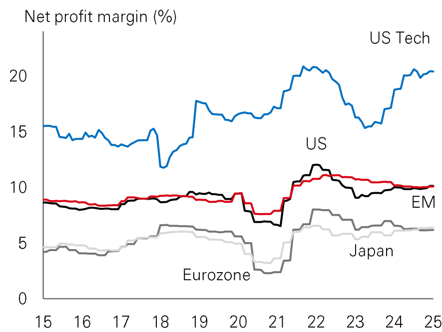
**US Tech's net profit margin is at lifetime highs. Can it carry on?**

US Tech's net profit margin is 21%. This is 1) a record, 2) double the 2018 level and 3) twice the margin earned by the wider US (Figure 11). It matters because: US Tech is over 40% of the US market and in **2023 and 2024 over 50% of S&P 500 profit growth came from Tech and Commercial Services.** We are not convinced this trajectory will continue. Consensus EPS growth is also undergoing a big shift. In 2024 Nasdaq's profit growth was an impressive 44%, four-times world profit growth (Figure 12). This year that multiple falls by half to twice world profit growth, a sign that EPS growth is broadening out. *The latest IBES consensus profit growth estimates have been moved higher for Europe and lower for the US for full year 2025e with China too seeing positive revisions relative to the US.*

US Tech has grown to 40% of US market, but with margins at life-time highs – upside is limited

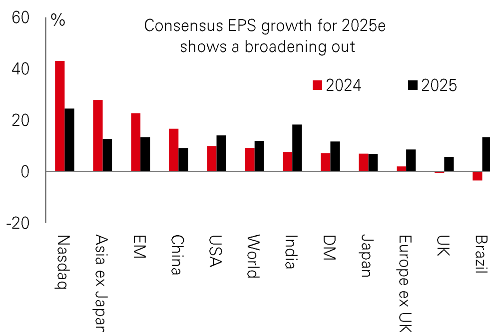
Market wide US margins are still modest, Japan and Eurozone offer catch-up

**Figure 11: Trailing Tech net profit margin at peak**




Source: HSBC Asset Management, DataStream/World-scope, February 2025

**Figure 12: Nasdaq EPS growth premium narrowing**




Source: HSBC Asset Management, IBES consensus EPS, February 2025

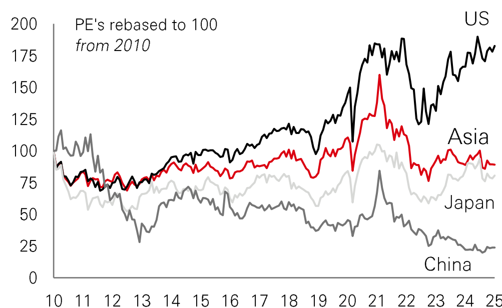
### US Tech valuations are not adjusting to profit outlook

The US Tech Sector's Price to Earnings multiple rose 82% since 2010. Other regional Tech sector PEs were flat to down over this period. The PEs in Figure 14 suggest that Chinese Tech might be under-valued *even after the Deep-Seek driven rally.* Although the region's Tech differs to the US (Meta is asset light), it is evolving. Europe looks high, but Tech's share of the region's market cap is less than one-quarter of what it is in the US so there could be some over-crowding in pockets like German Software.

Tech was largely a US story

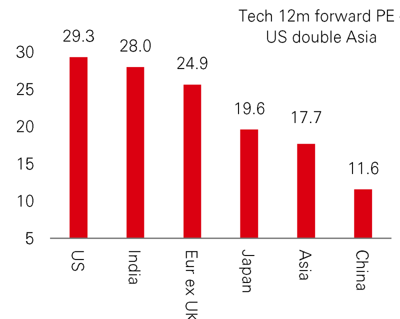
Even after the recent rally China's Tech PE looks relatively modest at 11.6x

**Figure 13: Rebasing Tech Sector PE's to 2010**




Source: HSBC Asset Management, MSCI, Refinitiv, February 2025

**Figure 14: Tech Sector PE Globally – big gaps**




Source: HSBC Asset Management. Datastream, Refinitiv, February 2025

### US Tech valuation versus its own history also looks high

US Tech is highly valued and, importantly, it's highly valued on *record earnings*. The Price to Book (P/B) of 12x exceeds the peak of the 2000 Tech bubble. If investors bought Nvidia in 2022 they would have seen a 10-fold jump in its market cap two years on from USD$350 billion to USD$3.5 trillion. This cycle might be different: balance sheets are healthier, plus it looks more like a potential profit bubble (if new entrants have their way) than the valuation-

Tech valuations on a life-time high P/B multiple too (Figure 15)



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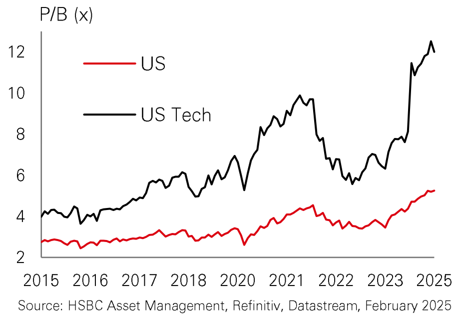
driven bubble in 2000. But it is still eye catching to see that Nvidia's market cap move was almost identical in speed and magnitude to that of Nokia and Deutsche Telecom's two years into the 2000 peak. New entrants like Deep-Seek (and others) are coming. Profits are at risk if new entrant offerings are similar but cost a lot less.

**Nvidia's market cap rose *10-fold* in 2 years**

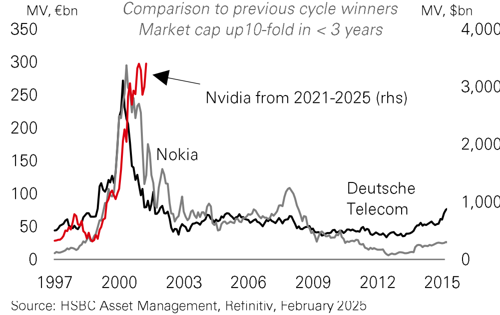
**We've seen it before: Nokia and DT followed a similar path, but it didn't end well**

**Figure 15: US Tech Price/Book at life-time highs**




Source: HSBC Asset Management, Refinitiv, Datastream, February 2025

**Figure 16: A look at history: 2000 bubble vs today**




Source: HSBC Asset Management, Refinitiv, February 2025

## Other risks: New entrants and excessive capital expenditure

**Risks are rising**

There are **two key and often under-estimated risks** in tech-driven transformations

- Under-estimating the threat of *new entrants*
- Over-estimating the Return on Invested Capital (ROIC) as *capex intensifies*

**New-entrants: Deep-Seek raises the risk of *new non-US entrants***

US Tech companies have reached peak net margins because they were seen to have near monopoly status. Their large cash balances also enable massive capex programs aimed at keeping the barriers to entry high. Deep-Seek validates the risk of new entrants. If it can piggyback off early-stage spending and the huge sunk costs of other model builders, it opens the door to AI products at a fraction of the price. *This throws the near monopoly status of US Mega cap tech into question.*

**Deep-Seek and other new entrants increase the risks which demands more risk premium**

**Capex rising faster than sales – Telecoms in 2000**. While cycles vary, it helps to revisit them. The Telecoms capex binge into and out of the 2000 bubble was driven by a belief that they were the winners of a move to on-line retail. After all that spending, the cost of bandwidth collapsed by 80-90% post 2000 and many companies went under. *In the end, it was the internet companies that reaped the benefits of the world wide web.* Today many Tech/Social network companies have more cash than debt, but investors still need to make a competitive return on the cash as many await for the yet to be proven AI benefits. Capex has risen: US Tech's ***Capex/Sales ratio* is at a 30 year high of 9.3%** - this is both above its 2000 level and well above its long-term average of c. 6%. Something to keep an eye on.

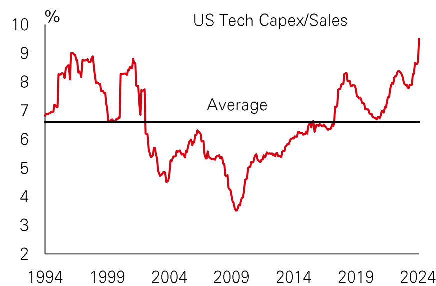
**Capex is rising faster than sales and at a record high**

**Trade tension – the US is not immune**

Although the full scope of tariffs remains uncertain and the rest of the world remains exposed, US Tech is also vulnerable. This is not just because it is expensive or could lose monopoly status but because it is one of the most globally interconnected sectors. In the US almost 60% of Tech sales leave the US (Figure 18). *The superior exceptional returns of the US of the past 20 years are partly down to the US being a world leader in global trade. Building walls and promoting protectionism could threaten that.*

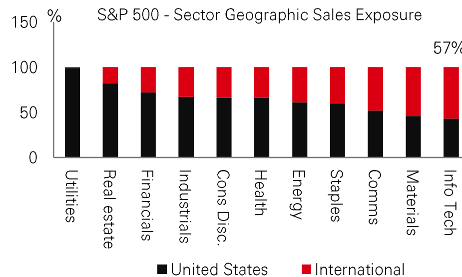
**US Tech is not immune to tariff risk, c.60% of its sales leave the US**

**Figure 17: Capex to Sales is hitting new highs**




Source: HSBC Asset Management, DataStream/World-scope, February 2025

**Figure 18: Tariffs - US Tech exposed to overseas**




Source: HSBC Asset Management, Refinitiv Fact-Set, February 2025



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## 3. Broadening out – revisiting the opportunity and valuation gaps

Our 2025 Investment Outlook (Nov 24) base-case sees modest US tariffs, moderating growth/inflation, a gradual easing, and stability in China as domestic policy offsets US tariffs. This supports a change in market leadership. It also highlights our preference for EM/Frontier over DM. Within DM we prefer Japan and more selectively Europe. We also tilt towards value and smaller caps (including the S&P equal-weighted index). With world policy uncertainty at pandemic levels, recent bouts of outperformance might cause a pause for breath or profit-taking in some high performing markets (Figure 29). However, our longer run models still show extreme valuation gaps between the US and much of the rest.

**Our base-case scenario supports broadening out**

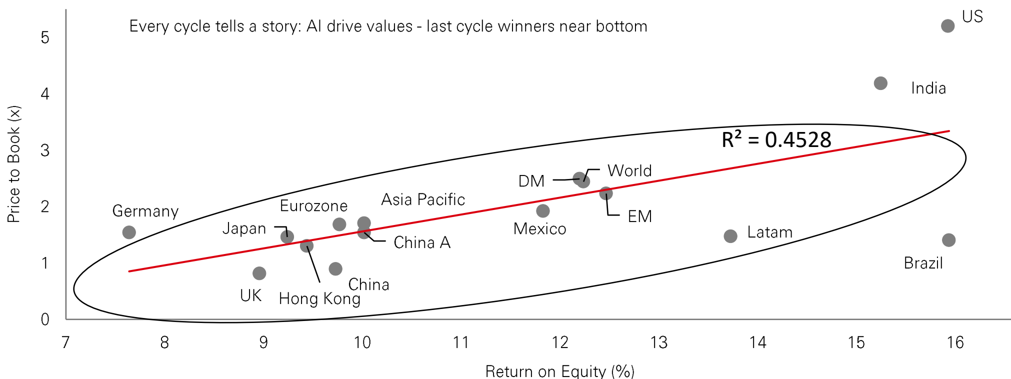
**Our models still show large valuation gaps**

### Regions

We compare the current Return on Equity (ROE) to the price you pay for it, or the Price to Book multiple. The US has the highest ROE *at 15.9%,* but your paying up for it (Figure 19). If the increase in the pace of capex isn't followed by exceptional returns, ROE could suffer. *The capex/sales ratio for US Tech is at a 30 year high of 9.3% as shown in Figure 17.* China and Latam are the biggest laggards.

**Investors are paying up for US growth - the less expensive areas include Latam and China**

**Figure 19: Global comparison: Return on Equity (ROE) vs Price/Book, the US stands out**




Source: HSBC Asset Management, Refinitiv, DataStream, World scope, February 2025

### Valuation gaps to the US are still largely double the long run average.

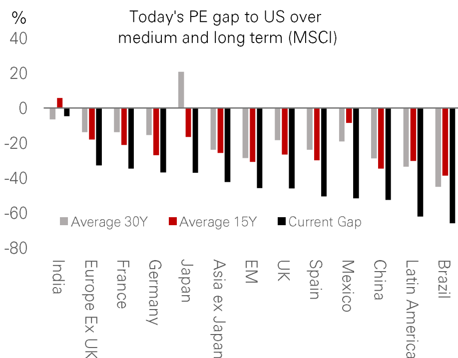
Regional equities normally trade at a discount to US equities (the higher quality growth market globally). But, below we show the gaps today are unusually large. Latin American's PE multiple is today 63% cheaper than the US – double both the 15 year and 30 year gap. Dividend yields and Price to Book metrics tell a similar story.

**The discounts to the US remain unusually high**

**We like income: RoW dividend yields are abnormally high (vs US)**

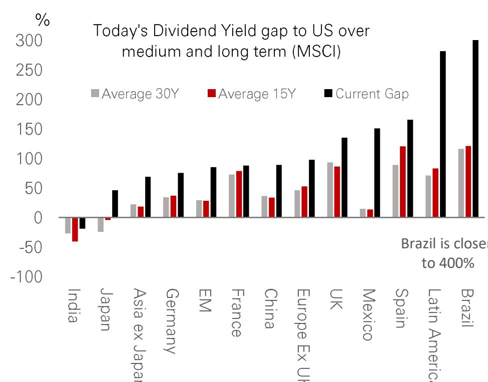
**Brazil stands out, but big gaps exist in Europe/Asia**

**Figure 20: PE premium/(discount) to US vs history**




Source: HSBC Asset Management, MSCI, Refinitiv, February 2025

**Figure 21: DY premium/(discount) to US vs history**




Source: HSBC Asset Management, MSCI, Refinitiv, February 2025

### Emerging markets versus developed markets

Recently, EM growth has started to pick up relative to DM (Figure 22). If US growth moderates a little (policy uncertainty/tariff disruption for domestics and delayed impact of past tightening) this would support broadening out. However, Asia, and therefore China, have a big weight in EM so stabilisation in China is key. More demand-side (fiscal) stimulus, property stabilisation efforts, and structural reform to rebalance the economy/revive consumer confidence would help reflate the economy. India too could offer GDP growth of

**Recently EM growth has started to improve relative to US**



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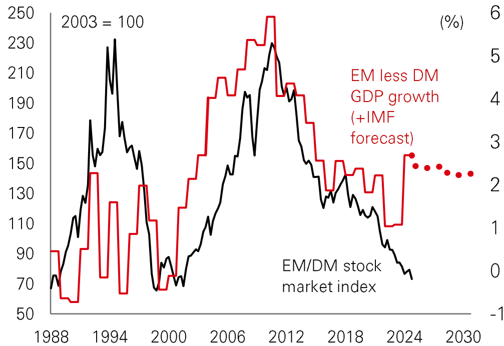
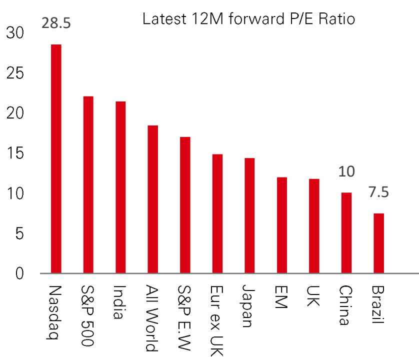
close to 6.5%.  We think much of the growth risk between US and non-US regions is still largely in the price (Figure 23) with Japan on a 14x PE along with **China and Brazil on 10x and 7.5x respectively versus S&P and Nasdaq on 22x and 28x.**

Figure 22: EM versus DM growth gap




Source: HSBC Asset Management, Macrobond, February 2025

Figure 23: EM valuations < half Nasdaq




Source: HSBC Asset Management, MSCI, February 2025

**If GDP and profit gaps narrow – we think valuations should too**

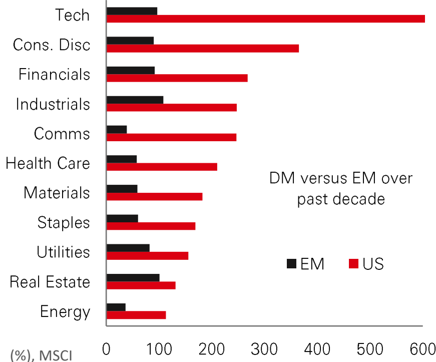
## Sectors – DM leaves EM in dust

The charts below look at the winners and laggards over the past decade. Tech was up 632% in the US but only 97% in Emerging markets. The more bond-like equity sectors like consumer staples, health care and even real-estate (valid on rate concerns) have been neglected in both regions.

**EM sectors lags more including Tech, Comms, Consumer Discretion and Financials**

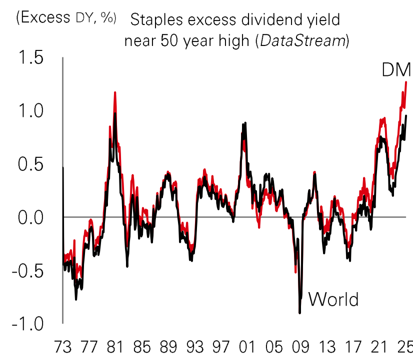
**Global Staples offer above-average yield today**

Figure 24: Decade of US Sector performance




Source: HSBC Asset Management, MSCI, Refinitiv, February 2025

Figure 25: World/DM Staples excess DY




Source: Note: Datastream index excludes Wal-Mart and Costco, Feb 2025

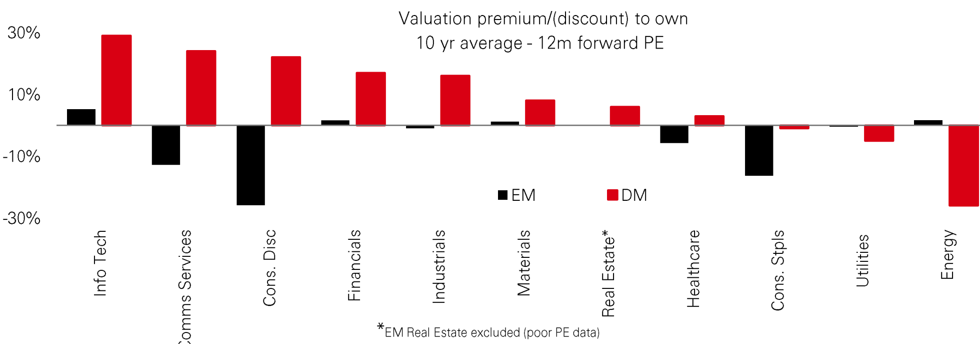
## Sector valuations – more appealing in EM versus DM

Staples lag in both EM and DM. Global Staples offer a relative dividend yield that is near its 50-year high which might be why they participated in the broadening out year to date. Energy, Tech/Commercial Services, Discretion and Financials also show big gaps.

**Valuation gaps between DM & EM sectors are still extreme**

**China Tech on PE of 11.6x (< half US Tech)**

Figure 26: EM vs DM – each sector's valuation versus its own 10-year history




Source: HSBC Asset Management, Refinitiv, MSCI, February 2025

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## Style Factors

### Small cap discounts still extreme – bigger outside of US

**Valuation supports smaller caps**

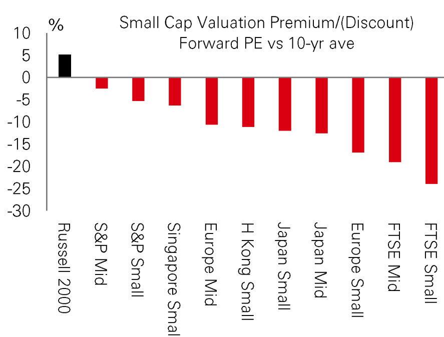
The Russell 2000 is no longer cheap (Figure: 27). That may be due to a re-rating that has not yet backed up yet by improving profits. Making America great again through more local investment should help. Non-US valuations look even better. Investors ask if small caps are more immune from trade tariffs. Perhaps given a greater domestic exposure, but it is hard to find their *costs of goods sold* data. We think overall business conditions matter more.

### Growth still elevated – near end 2022 levels

**Growth index still powers over Value**

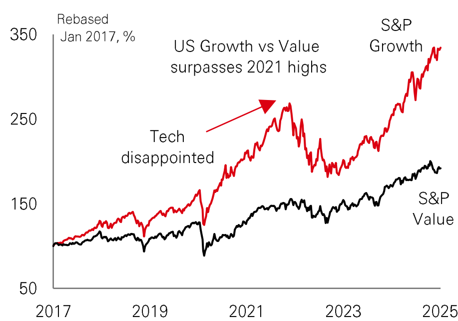
The S&P 500 growth versus value index still looks stretched. We have not yet seen the reversal we saw end 2022 when investors realised that US mega cap Tech was cyclical. Both Amazon and Nvidia disappointed early 2023 and Tech sold off for six to seven months, it lasted until a new round of enthusiasm for Chap GPT re-invigorated the growth/tech trade.

**Figure 27: Small caps offer better value ex US**




Source: HSBC Asset Management, Refinitiv, MSCI, February 2025

**Figure 28: S&P US - Growth versus Value**




Source: HSBC Asset Management, Refinitiv, S&P, February 2025

**Conditions are supportive for broadening out**

### Conclusion

After some big market moves (Figure 29), we re-visit the case for broadening out. Our Investment Outlook *base-case scenario* supports it: modest US tariffs, moderating US growth/inflation with gradual easing and US bond yields/USD that have peaked. It also helps if GDP and profit growth gaps between US and non-US regions start to narrow. The US had to hit many extremes to reach its 70% weight in global equities, we think these would be difficult to repeat. In 2012, the Nasdaq was on a 14x PE (12m forward). Today it is double that on 28x. We also think US Tech might be masking some left behind laggards/ upside in non-Tech US given where the overall modest US profit margin (Figure 11).

**We like left behind value in EM/China and for DM it's Japan and *selectively* Europe**

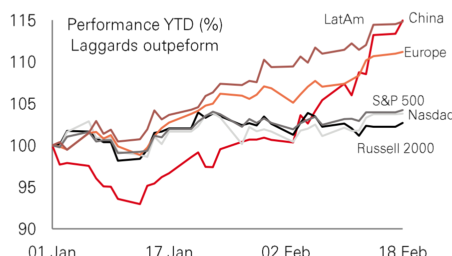
**We like the S&P equal-weighted index**

**Lagged sectors include Utilities and Health Care plus many EM Consumer sectors**

**Is change afoot?** We found it intriguing that when the World Policy Uncertainty Index recently hit pandemic levels (Figure 1), the *rest of the world outperformed rather than the more typical US safe-haven*. We wonder if enthusiasm for US exceptionalism is waning. Figure 30 suggests we are in the early stages of any reversal – albeit the reversal won't go up in a straight line. Our note illustrates significant value in many left-behind pockets. If in the next few years, we find the US is *a little less perfect* (technology loses monopoly status, trade policy hurts at home and fiscal pressures mount) and non-US regions are a little bit better (looser fiscal backdrop, more investment and better relative growth), then today's valuation gaps should continue to narrow.

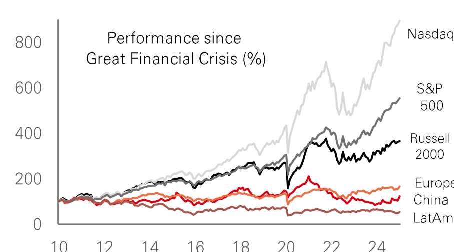
**We see many selective opportunities**

**Figure 29: Broadening-out YTD – is trade over?**




Source: HSBC Asset Management, Refintiv, MSCI, 21 February 2025

**Figure 30: No, long run gaps are still extreme**




Source: HSBC Asset Management, Refintiv, MSCI, 21 February 2025

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Content ID D041442_v1.0 ; Expiry Date: 27.02.2026