Global Matters Weekly

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New Year. New me. New you. New US?

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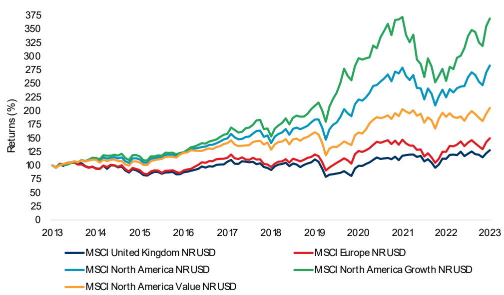
As we enter 2024, various market outlook pieces are being published, with the intention to forecast and anticipate what this year's markets will bring. We can look at historical data and analyse trends but, as an industry, we often don't get it right and this is certainly true of US equities. For years – and in the case of US equity bears, up to ten years – many have highlighted that the US market is overvalued and that investors should switch into more attractively priced regions like the UK and Europe. All logic tells us that this is true and yet the US equity market continues to defy the laws of gravity and portfolios that have been underweight the region have suffered on a relative basis.

If we take a look at regional market performance over the past ten years (Chart 1) we can see that US equities benefitted from phenomenal returns until the end of 2021 and again in 2023, far surpassing the gains in other developed market regions. However, if we dig a little deeper, we can see that US growth stocks have been the key driver of overall US equities returns and if we strip out the FAANGMs/Magnificent 7 stocks then performance of US growth stocks is far less extreme. If we also consider US value stock performance, again this is much less extreme, albeit still ahead of other developed regions.

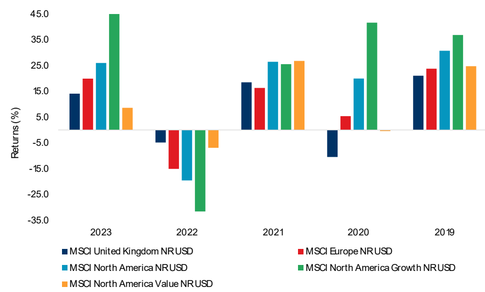
Chart 1 – Annual regional performance over the past ten years



Source: Morningstar, MGIM. as at 31 December 2023.

Zooming in on annual returns over the past five years (Chart 2) we can see a similar story, however interestingly in 2021 when we saw a downturn in markets globally, US value stocks actually fell by less than other developed regions. US growth stocks on the other hand fell most significantly which is unsurprising given the impact of the rising interest rate environment, and that valuations had much further to fall from peak levels in 2021.

Chart 2 – Annual regional performance over the past five years



Source: Morningstar, MGIM. as at 31 December 2023.

Many will look at these returns and draw parallels with the 2000 dot-com bubble however, a standout difference between then and now is that the technology companies investors were buying were very small, with no history or profits. The technology companies investors are buying today are giants with valuations in the trillions and profits in the billions. These companies are 'priced for perfection' as the hype surrounding them continues to skyrocket – Nvidia had a price to earnings ratio of 144x in April 2023, 40x as of today, and to put this in context, Barclays Bank is trading on a 5x P/E ratio. The risk with valuations this rich is that any hint of negative news is likely to have a disproportionate impact on their valuation and you risk significant losses, particularly if you invested at the peak. So, we have to consider if this could be a different kind of tech bubble.

Putting the technology sector aside, it's worth thinking about North America more broadly: compared with other regions, consumers are in good shape with high savings levels and decade-long mortgages, the job market is strong with low unemployment levels, corporates have surprised on the upside and maybe, just maybe, the FED has managed to engineer a soft landing in the push and pull between inflation and interest rates. This must be caveated because mortgages are coming up for renewal, we're starting to see cracks in corporate earnings and we're far from a conclusion on the soft-landing debate, but overall, one can conclude that the US is better positioned than other regions.

As we have entered new year's prior, many have contemplated whether it was the year the US market would take a downward turn, but new themes have led to a bounce for a segment of US companies, such as lockdown beneficiaries, artificial intelligence and electric vehicles. 2022 is a

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a blip in this story but then arguably that sell-off has led to valuations becoming more compelling in certain areas. The only 2024 event we are certain of is the presidential election, but history has shown that market impact is short-lived when it comes to elections so probably not worth paying this too much attention.

Is this the year where US equities fall behind? Well, who knows! But our stance is that an underweight to the region does makes sense and it's not wise to chase the returns of momentum growth-stocks like the magnificent 7, but there are pockets of value in the US equities universe and it's important to maintain exposure, especially if you can select the right fund managers to navigate the course.

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