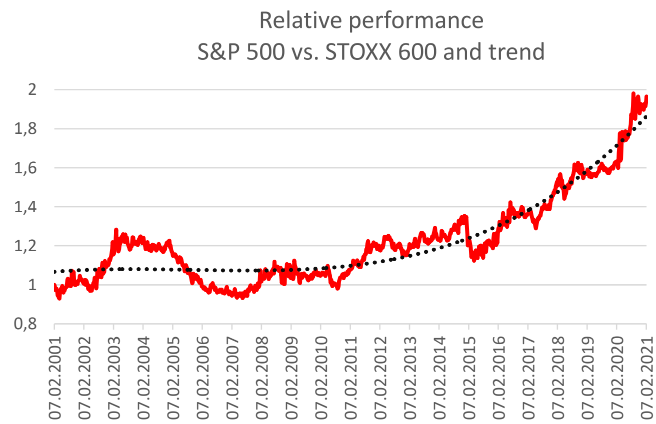
M.M.WARBURG & CO
BANK

ECONOMIC SITUATION AND STRATEGY February 12, 2021

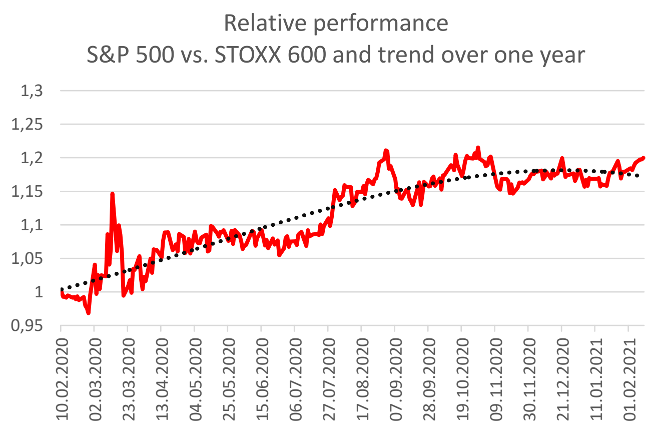
United States or Europe? – Why (again) everything speaks for US equities

European investors usually put emphasis on European stocks. There are several reasons for that. They tend to shy away from currency risk and frequently exhibit a home bias in selecting stocks. Nevertheless, they would have been well-advised to dismiss exchange rate risks and minimize home bias in recent years, since US stocks have long outperformed their European counterparts significantly. That is particularly true of the last ten years, when the S&P 500 index managed performance double that of the STOXX 600, as the chart below shows.



In the last ten years, stocks of the S&P 500 have actually outperformed those of the STOXX 600 more than 55% of the time on a weekly basis. If we look at rolling monthly periods, the number rises to almost 60%. It comes to 65% on rolling quarterly periods, and the probability of outperformance is no less than 80% on rolling annual periods. Several conclusions may be drawn from this. One could only take advantage of this by means of tactical changes in the weighting of stocks from the United States and Europe, if one repeatedly overweighted European stocks versus US stocks over short investment periods of a few weeks and achieved a comparatively high hit rate in the tactical decisions. Ultimately, though, one would have been well-advised simply to maintain a structural overweighting of US stocks and wait out short-term phases of underperformance.

It is seldom a coincidence when one region systematically outperforms another to such an extent. Directly comparing the United States with Europe also makes it relatively clear why US stocks have performed so well. Earnings have grown at a higher rate, and continual stock buybacks by US companies have tended to drive up price-earnings ratios. But should one now simply rely on the structural outperformance by US stocks for the next ten years and refrain from any tactical changes? After all, the years from 2001 to 2011 show that structural outperformance does not hold good for every random period. In those ten years, US stocks were unable to decouple sustainably from European stocks. At least a few months ago, we briefly had the feeling that a point might have been reached when we should count more on European stocks, at least temporarily. The reason for that optimism was the foreseeable approval of the first covid-19 vaccines. At the time, we thought that if vaccine availability were increasingly to restore economic normalcy, the business cycle should benefit greatly. And since many cyclical stocks are found in Europe, that would argue in favor of temporary outperformance by European stocks.



Indeed, European stocks did fare better than US stocks for a few weeks in late summer and again in autumn, but a systematic trend reversal is not discernible, as the chart above shows. So, are the fireworks already over? We think that might be the case. For, there is another point that must be considered going forward. In late summer and autumn of last year, there was vague hope of vaccines, but it now appears that there are huge differences in vaccination progress among countries and regions. While almost 14% of the US population has been vaccinated, the rate in Germany is still below 5%. Other major European countries like France are even further behind. This trend will not change in the months ahead, so we may expect that large parts of the US population will exhibit vaccination protection this summer, while Europe will probably not achieve that before the beginning of 2022.

The United States thus has a dramatic advantage over Europe. For, while the risk that another lockdown might become necessary in autumn 2021 at least theoretically still exists for Europe, that is presumably no longer an issue for the United States. Moreover, there is yet another point that speaks in favor of the United States. There are several indications that the UK variant of the coronavirus might become dominant in Europe, while the "classic" variant still appears to be dominant in the United States thanks to travel limitations. We showed a few weeks ago based on mobility data and associated infection incidence that the UK variant is undoubtedly more contagious. Now, that variant is striking the continent whose vaccination project is lagging – not a good combination.

Besides covid-related arguments, however, there are other reasons why active investors should rely more on US stocks again, while naturally not dispensing with international diversification. The United States has demonstrated repeatedly in recent decades that it rebounds from crises more quickly and dynamically than Europe. In the past, though, the Federal Reserve has put the brakes on this dynamism by raising its key interest rates in periods of rising GDP growth rates. But that will not happen this time. Just yesterday, Fed Chair Jerome Powell clearly reiterated that restoring full employment (no easy feat) has absolute priority and the Fed will use all available means to achieve that. In other words, even if the inflation rate should increase due to accommodative monetary policy, growing capacity utilization, and increasing employment, the Fed will continue to give priority to combating unemployment, not inflation.

That need not mean now that the Fed will watch every small increase of US government bond yields like a hawk and immediately take countermeasures. But it does mean that the Fed has a basic and structural interest in low interest rates and yields and there seems to be at least an implicit upper limit on yields from which point the Fed will intervene more strongly in market events. That should free the stock market from worrying, for one thing, that a too rapid advance of yields and interest rates against the background of rising inflation might reduce the upside potential of US stocks. Instead, the United States is already heading back to a Goldilocks scenario. In particular, growth stocks are benefiting from continuing low interest rates, while a heightened inflation rate is giving profits an additional boost – and that with the prospect of a covid-free autumn. Everything simply argues again in favor of overweighting US stocks!

Market Data Overview

Stock marktes	As of 12.02.2021 11:58	Change versus 05.02.2021 -1 week	11.01.2021 -1 month	11.11.2020 -3 months	11.02.2020 -1 year	31.12.2020 YTD
Dow Jones	31431	0,9%	1,4%	6,9%	7,4%	2,7%
S&P 500	3916	0,8%	3,1%	9,6%	16,6%	4,3%
Nasdaq	14026	1,2%	7,6%	19,0%	45,5%	8,8%
DAX	13976	-0,6%	0,3%	5,7%	2,6%	1,9%
MDAX	32514	0,4%	4,5%	14,5%	11,4%	5,6%
TecDAX	3536	0,8%	8,0%	16,8%	8,8%	10,1%
EuroStoxx 50	3667	0,3%	1,3%	5,8%	-4,2%	3,2%
Stoxx 50	3185	0,7%	0,1%	3,0%	-9,2%	2,5%
SMI (Swiss Market Index)	10852	0,9%	-0,2%	3,0%	-2,2%	1,4%
Nikkei 225	29520	2,6%	4,9%	16,5%	24,6%	7,6%
Brasilien BOVESPA	119300	-0,8%	-3,2%	13,8%	3,4%	0,2%
Russland RTS	1434	0,1%	-2,2%	16,2%	-6,9%	3,3%
Indien BSE 30	51544	1,6%	4,6%	18,2%	25,1%	7,9%
China Shanghai Composite	3655	4,5%	3,5%	9,4%	26,0%	5,2%
MSCI Welt (in €)	2807	0,2%	3,3%	7,9%	4,4%	5,8%
MSCI Emerging Markets (in €)	1428	1,3%	6,3%	17,7%	16,9%	12,1%
Bond markets						
Bund-Future	176,43	26	-50	213	217	-121
Bobl-Future	135,06	12	2	-10	41	-12
Schatz-Future	112,27	1	0	-2	26	-1
3 Monats Euribor	-0,54	2	2	2	-13	4
3M Euribor Future, Dec 2017	-0,56	0	0	-4	-12	0
3 Monats $ Libor	0,20	1	-2	-2	-151	-4
Fed Funds Future, Dec 2017	0,08	0	0	0	-117	0
10 year US Treasuries	1,15	-2	2	21	-44	24
10 year Bunds	-0,46	1	6	4	-8	11
10 year JGB	0,07	1	4	3	13	5
10 year Swiss Government	-0,37	0	6	7	36	13
US Treas 10Y Performance	701,70	0,3%	0,0%	-1,5%	7,0%	-2,0%
Bund 10Y Performance	678,59	0,2%	-0,3%	-0,3%	0,9%	-0,9%
REX Performance Index	497,73	0,1%	-0,3%	0,0%	0,3%	-0,3%
US mortgage rate	0,00	0	0	0	0	0
IBOXX AA, €	0,09	-2	4	3	-5	7
IBOXX BBB, €	0,54	-2	2	-15	-16	-1
ML US High Yield	4,72	-6	-26	-74	-120	-26
Convertible Bonds, Exane 25	8369	0,0%	-0,4%	3,0%	6,2%	0,5%
Commodities						
MG Base Metal Index	376,91	3,9%	4,0%	14,7%	34,8%	6,3%
Crude oil Brent	60,79	2,2%	9,2%	38,6%	12,1%	17,2%
Gold	1820,30	0,7%	-1,6%	-2,4%	16,3%	-4,1%
Silver	27,05	0,3%	7,2%	11,6%	53,6%	2,5%
Aluminium	2076,50	3,2%	3,4%	9,4%	21,5%	5,2%
Copper	8289,25	4,6%	5,6%	20,7%	44,7%	7,0%
Iron ore	160,08	4,0%	-5,3%	31,7%	92,0%	2,7%
Freight rates Baltic Dry Index	1313	-1,5%	-25,4%	15,1%	214,1%	-3,9%
Currencies						
EUR/ USD	1,2108	1,0%	-0,5%	2,9%	11,1%	-1,3%
EUR/ GBP	0,8776	0,2%	-2,6%	-1,5%	4,1%	-2,0%
EUR/ JPY	127,07	0,3%	0,2%	2,4%	6,1%	0,5%
EUR/ CHF	1,0805	-0,2%	-0,3%	0,1%	1,3%	0,0%
USD/ CNY	6,4542	-0,2%	-0,4%	-2,7%	-7,4%	-1,2%
USD/ JPY	104,75	-0,6%	0,5%	-0,6%	-4,6%	1,4%
USD/ GBP	0,73	-0,5%	-2,2%	-4,3%	-6,1%	-0,9%

Source: Refinitiv Datastream

Carsten Klude
+49 40 3282-2572
cklude@mmwarburg.com

Dr. Rebekka Haller
+49 40 3282-2452
rhaller@mmwarburg.com

Martin Hasse
+49 40 3282-2411
mhasse@mmwarburg.com

Dr. Christian Jasperneite
+49 40 3282-2439
cjasperneite@mmwarburg.com