DORVAL ASSET MANAGEMENT
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“America takes all” - until when?

06 January 2025

Dear Clients and Partners,

“America takes it all” - until when?

As the U.S. economy and stock market triumph, U.S. President Donald Trump promises to take it all in. His “pro-business” policies at home (lower taxes, deregulation) and commercially aggressive policies abroad are leading the consensus to anticipate a new asymmetric shock favorable to the USA and unfavorable to the rest of the world. What factors are likely to disrupt this scenario?

Is Wall Street levitating dangerously?

The valuation of US equities looks increasingly strained. Excluding the Covid year, it is at its highest since 2001 in terms of forward-looking P/E (21.7 at December 31, 2024), even though long-term real interest rates are at their highest for over fifteen years. The risk premium on equities relative to government bonds ( ) has thus fallen to just over 2% today, half its historical average. However, this premium is still higher than its low point in 1999/2000, when it fell below 1%.

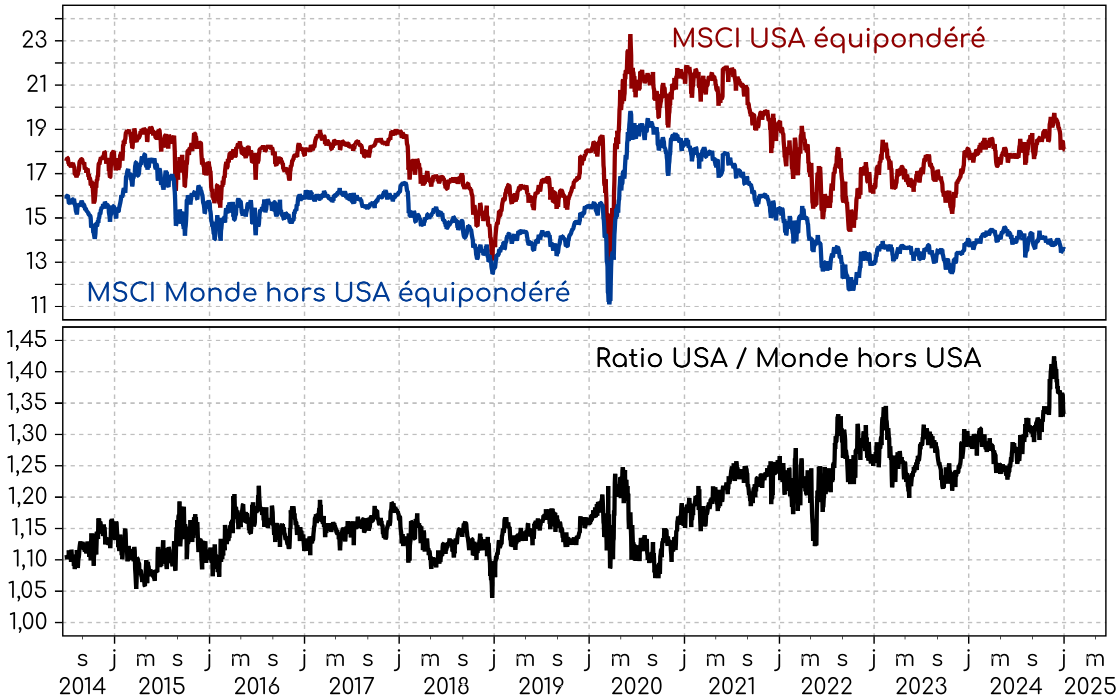
Wall Street's soaring valuation today has two distinct components. The first stems from the growing weight (33% of the S&P 500 today, unprecedented) of a small dozen ultra-profitable and therefore expensive global giants (Nvidia, Apple, Microsoft, etc.). Their hyper-earnings growth - more than three times that of the rest of the S&P 500 since the start of the decade - is bound to wane one day, but the artificial intelligence boom seems unlikely to bring an immediate landing.

The second component involves the entire stock market. It can be estimated using the S&P 500's weighted P/E, which, at around 17 versus 16 on average over the past ten years, is certainly high, but does not argue in favor of a bubble diagnosis. Nevertheless, Wall Street's equal-weighted P/E has become 35% more expensive than the rest of the world, a record (graph 1). In relative terms, the “America takes all” theme seems to be increasingly integrated into market prices.

American expsionalism already well integrated into prices

L'exceptionalisme américain déjà bien intégré dans les prix

PER des indices équipondérés MSCI USA et Monde hors USA



Dorval Asset Management – 03/01/2025 – Source : Macrobond

PER of equal-weighted indices MSCI USA and World ex-USA / Equal-weighted MSCI USA / Equal-weighted MSCI World ex-USA / Ratio USA / World ex-USA

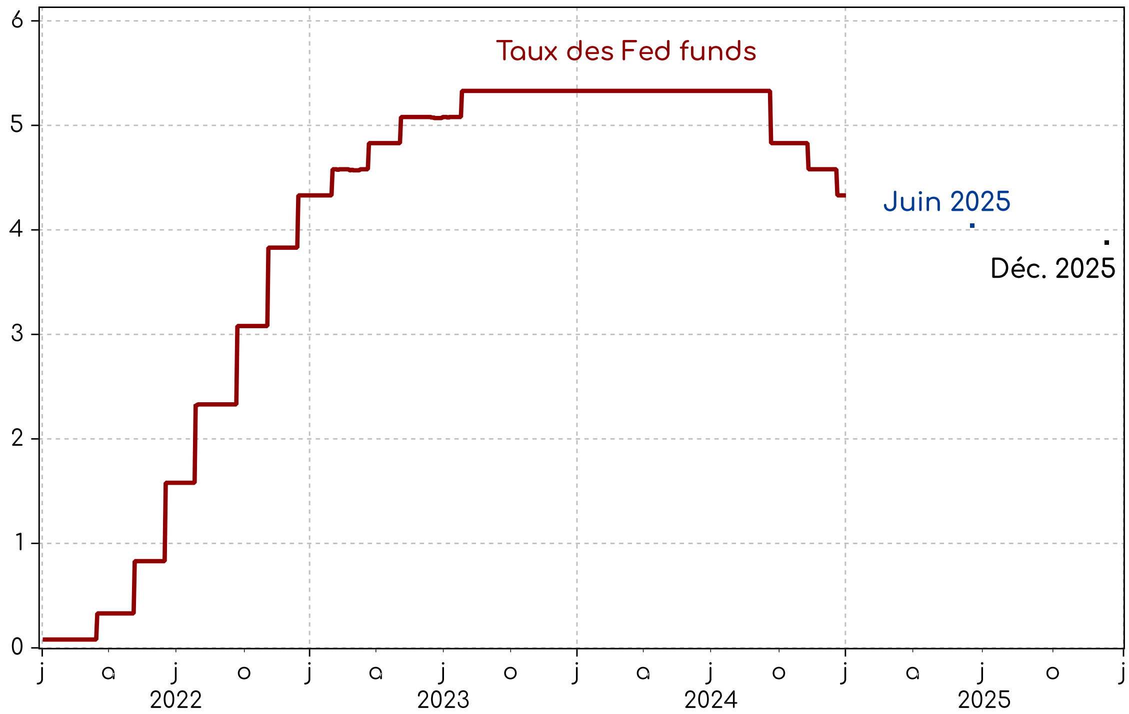
The US growth-interest-rate mix in question

The "Goldilocks" scenario of a US economy neither too hot nor too cold has been unfolding before our eyes since 2023. The maturity of the disinflation process and the arrival of Donald Trump call into question the continuation of this scenario. His policies - whose exact contours and agenda are currently unknown - could prove ill-suited to the current phase of the cycle. Combined with a marked slowdown in immigration and sharp increases in customs duties, tax cuts could revive the theme of overheating and halt, or even reverse, the downward trend in short-term interest rates (graph 2). Given the sensitivity of the global financial cycle to the dynamics of interest rates and the US currency, this would not bode well.

Should the FED continue to cut rates?

La Fed doit-elle continuer à baisser ses taux ?

Taux Fed et taux anticipés par les marchés pour 2025



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FED rates and market expectations for 2025

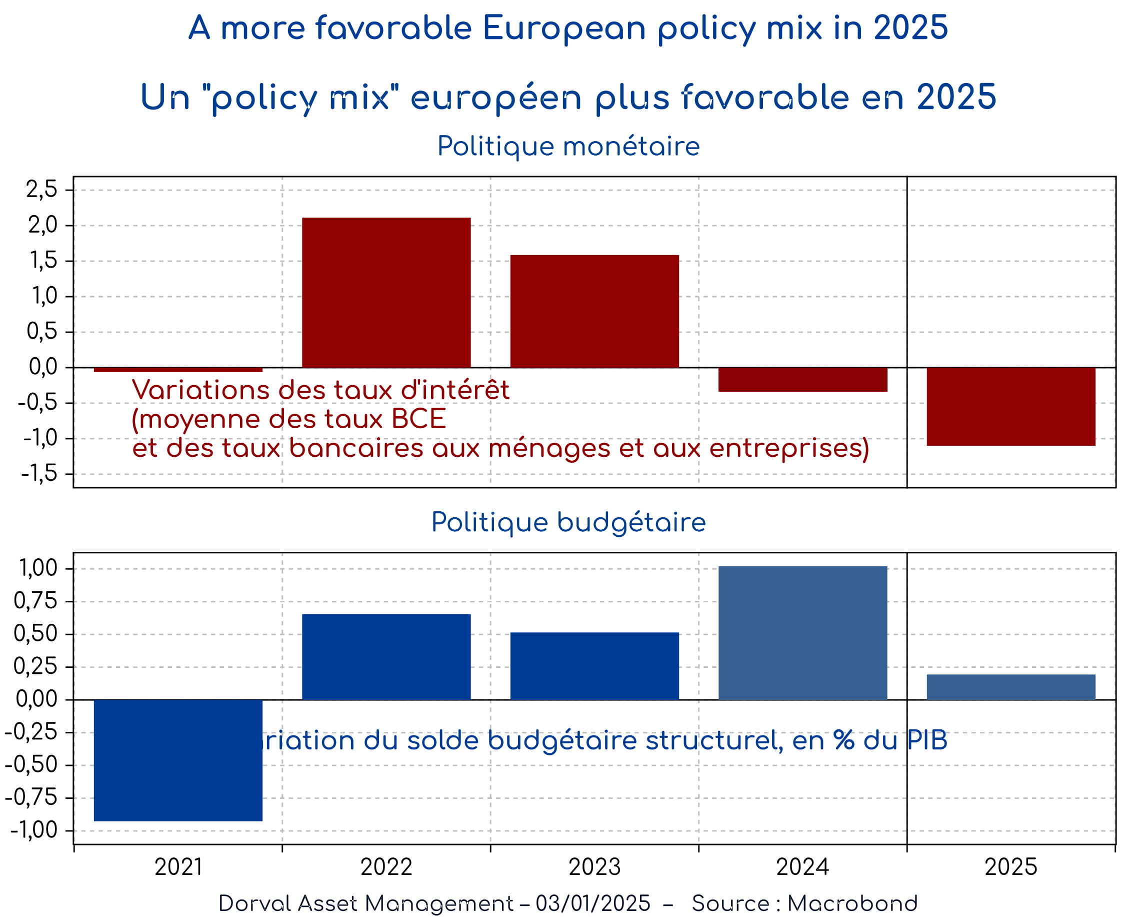
This risk scenario is already partly priced in, with markets anticipating that the Fed will not be able to cut rates below 4% in 2025, compared with 4.25-4.50% today. As for long-term real rates, they have already returned to their pre-2008 crisis level of over 2%. Finally, the labor market has slowed significantly in 2024, reducing the risk of a rapid return to the overheating scenario. But there is no doubt that US inflation figures will be closely scrutinized by investors.

Outside the US, counter-measures are being organized

Donald Trump's policy of using tariffs to create uncertainty is a downside risk for global economic forecasts. However, these fears are pushing China and Europe in the direction of an economic policy more favorable to domestic growth. China, weighed down by its property crisis but boosted by its exports, has had a stimulus plan since September 2024, which it is preparing to step up in order to lend credibility to its growth target of around 5% by 2025, come what may.

As for Europe, weakened economically and politically but now (almost) free of the inflation problem, it is moving towards a more accommodating monetary policy and a less restrictive fiscal policy (graph 3). This will have to be the case, as forecasters, based on the precedent of 2018 and 2019, estimate that the trade war could cost the

Eurozone GDP between 0.3% and 0.7% by early 2026 - although much will depend on the course and level of trade tensions to come.



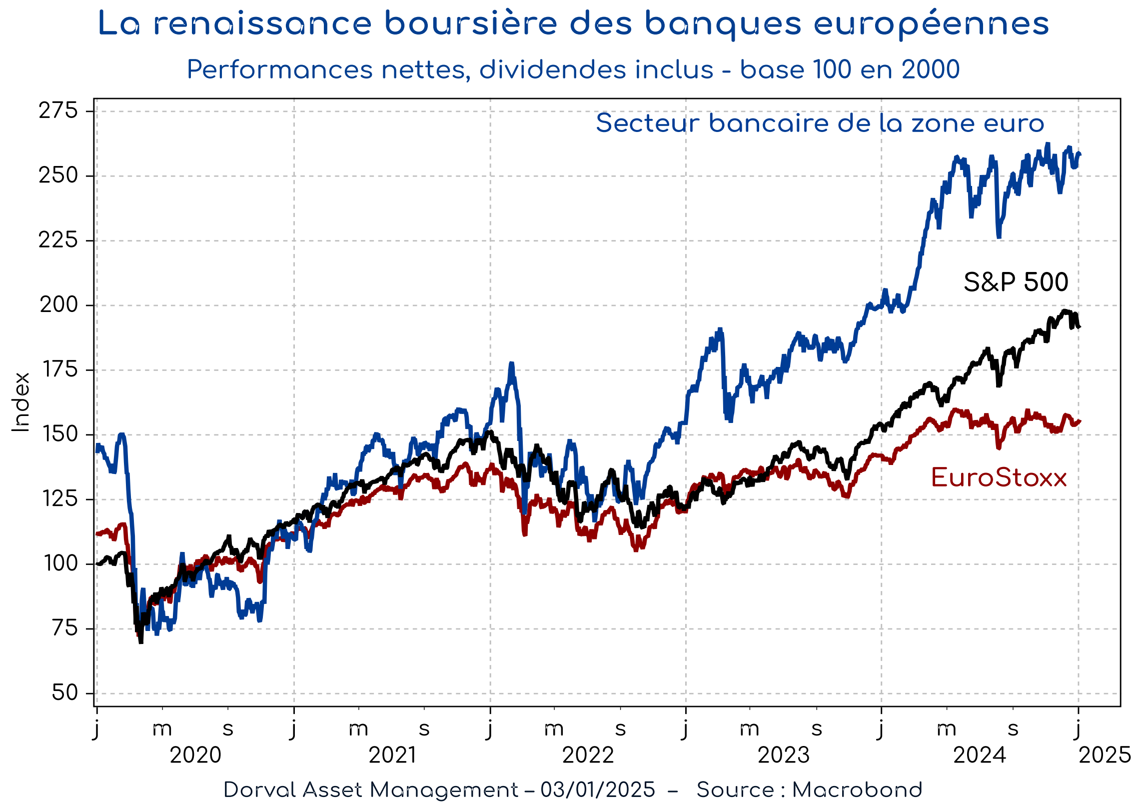
Monetary policy / Change in interest rates (average of ECB rates and bank rates for households and businesses) / Fiscal policy / Change in structural budget balance, as % of GDP

In the short term, we'll also have to keep an eye on the employment dynamic, which is weakening dangerously in Germany and France - but not in the rest of the eurozone. The ECB's revival of the credit channel, the recovery in purchasing power and the expected fall in the household savings rate - which is currently very high - will, however, support growth. And let's not forget that the investment plan agreed at the time of Covid continues to produce positive effects in the countries of southern and eastern Europe. Last but not least, a ceasefire in Ukraine, still very hypothetical, could ease the pressure.

Unprecedented thematic rotation in Europe

On the stock market, the impression of Europe's vulnerability was reinforced by structural questions about certain leading sectors, such as French luxury goods and German automobiles. However, the financial sector, which had penalized European stock markets from 2006 to 2020, is continuing its stock market renaissance (graph 4) thanks to a profitability-solvency-valuation triptych which, according to Dorval AM, remains highly favorable. This is crucial, as the sector accounts for over 20% of eurozone capitalization.

The stock market renaissance of European banks



Net performance, including dividends - Base 100 in 2000 / Eurozone banking sector

As for small caps, which are highly discounted with an average P/E of less than 11, they are still a very cheap option if the European domestic economy, especially industry, does not suffer the fate predicted by the Cassandras. Disinflation, falling interest rates and high savings could end up creating opportunities in consumer goods and real estate.

Dorval AM's "global macro" funds well invested in equities on diversified themes

In its international strategies, Dorval AM remains invested in a core basket reflecting the regional and sector breakdown of the MSCI World, which is equally weighted. Equal weighting provides satisfactory diversification, with the United States at 45% instead of 75% in the classic MSCI World. Alongside this core basket, we invest in baskets of equi-weighted equities on the following themes: new corporate investments (including AI), European and Japanese financials, and defensive "anti-fragile" growth stocks. These baskets are complemented by a basket of stocks that are most likely to bounce back from an industrial recovery scenario in 2025. In these funds, the portion not invested in equities remains invested in money-market instruments, as government bond markets are not yet sufficiently attractive. However, opportunities may arise in this segment over the course of the year.

European flexible funds, for their part, favor the large stocks in the EuroStoxx 50, which are benefiting from dynamic global growth, which should reach or exceed 3% again in 2025. We remain overweight in financials (banks and insurance), and invest in a basket of smaller stocks likely to benefit from an improved monetary and economic environment in Europe.

Our exposure rates are as follows:

- **Dorval Convictions: 65% net exposure to equities, comprising 60% Euro STOXX 50 SRI core basket, 6.5% financials basket, 6% small-caps basket. Hedged using Euro STOXX 50 futures.**

Dorval Asset Management

Public limited company with share capital of €493,876

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