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## Executive summary

- *We believe the US economy is positioned to experience a prolonged slowdown and possibly a recession.*
- *US equity markets appear expensive relative to other markets and to their own history.*
- *With inflationary pressures likely to remain higher for longer, investors may be able to benefit from expanding the global reach of their portfolios.*

As global markets react to central banks' efforts to control persistent inflation, the opportunity set is changing across international equities. Due to several factors, including recent significant stimulus and hopes over artificial intelligence, a handful of US stocks are experiencing significantly high valuations. In our view, there are several underlying reasons to be optimistic about equity markets outside the US. In order to diversify<sup>1</sup> their investments and find new opportunities, investors can consider incorporating global equities into their portfolios.

## Continued tightening ahead

Today's market backdrop is characterized by the ending of a comparatively long, 12-year period of quantitative easing that has dominated the markets and created distortions in asset prices. Central banks' movement back to a normalized monetary policy and reduced liquidity are the primary reasons for the major market correction we saw in 2022. It also led to the explosion of bank reserves. In some cases, banks improperly invested these reserves, leading to a handful of bank failures in 2023. While we expect core inflation to continue to trend lower, it remains elevated. This will likely lead central banks to keep interest rates higher for longer in an effort not to repeat the events of the 1970s, when central banks lowered rates at the first sign of a market slowdown and encouraged further inflation.

## A relatively poor outlook for the US

In recent years, a bias toward US stocks has rewarded investors; particularly over the last 15 years, the growth-focused US market has outpaced the globe and generated attractive returns. This phenomenon has persisted recently as certain mega-cap growth stock returns have been fuelled by speculation surrounding trends in artificial intelligence, which has only led to further concentration in US markets.

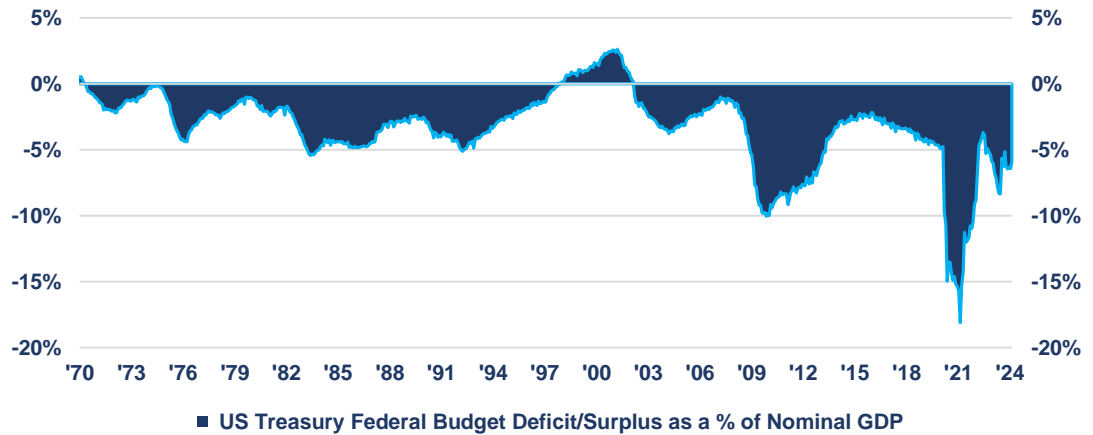
In addition, the combination of US ultra-loose fiscal and monetary policies that now have to be normalized has created an illusion of good economic performance at the cost of a growing federal debt and exorbitant deficits. The normalization has started for US monetary policy and will have to happen also on the fiscal side, contributing to an increased risk of hard landing.

Due also to the fiscal stimulus prompted by COVID-19; the Inflation Reduction Act (which included significant climate-related legislation); the Infrastructure Investment and Jobs Act; and the huge boost in interest rates, the US is experiencing historically large deficits at a time of economic expansion. We believe that the future normalization of these unbalances will likely produce a slowdown that exceeds that of other regions. Additionally, partially prompted by bank collapses and mismanaged bank reserves, lending institutions have tightened their lending standards. All of this has contributed to our outlook for a potentially hard landing for the US in the coming months (see Exhibit 1). Despite the apparent risks, such as the historical decline of earnings during recessions by about 30%, we do not believe markets are adequately pricing this risk.

We believe the impact of high interest rates will hit the US consumer more slowly and later than other regions, as 85% of existing mortgages in the US are fixed rate. However, when the impact to US mortgage holders increases, the country will have little margin in fiscal policy due to its extremely high budget deficit.

<sup>1</sup> Diversification does not guarantee a profit or protect against a loss.

**Exhibit 1: High US Treasury budget deficit leaves little room for fiscal maneuvering**



Source: U.S. Treasury, Bloomberg. US Treasury deficit/surplus as a % of nominal gross domestic product. Last data point 04/30/2024.

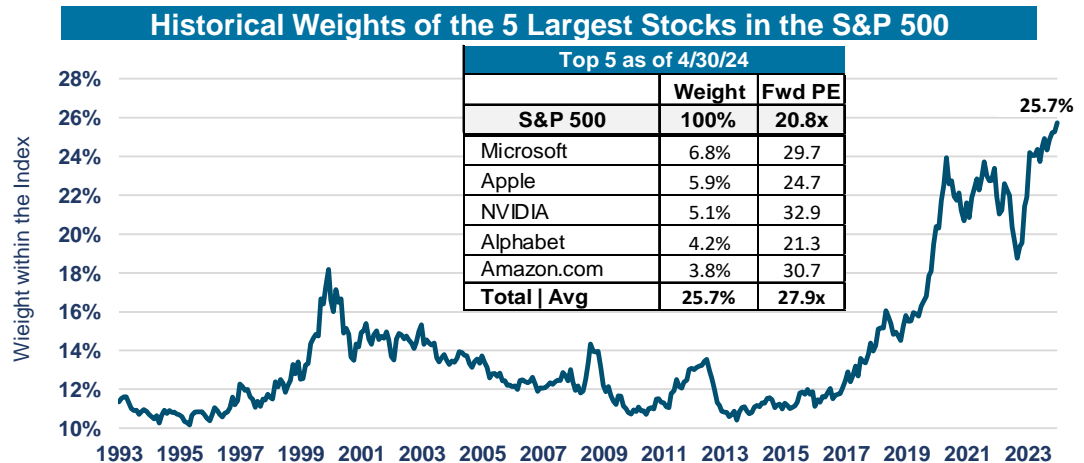
**Top US stocks could be overvalued**

We believe US markets overall are expensive relative to other markets, as well as to history. Most importantly, over the last 15 years, US equity outperformance has been fuelled not only by earnings, but by large multiple expansions.

Additionally, US megacaps are still expensive when compared to the S&P 500 (see Exhibit 2). These have a 50% premium to the overall market, and are unlikely to produce a growth rate that justifies premium valuations. These are great companies, with core strengths, but they are also so large that size will be their own worst enemy when it comes to growth. If we remove the most expensive 10 percent of stocks, the US market is trading at reasonable multiples similar to those we see in global markets.

Importantly, we believe markets may be poised to reverse the trend of the past 15 years of US stocks significantly outperforming those of Europe and Asia. We estimate that international valuations are generally too low. In today's world of global companies, where in all regions most of the earnings are achieved globally, we believe these discrepancies are excessive and likely to normalize.

**Exhibit 2: Historical weights of the five largest stocks in the S&P 500**



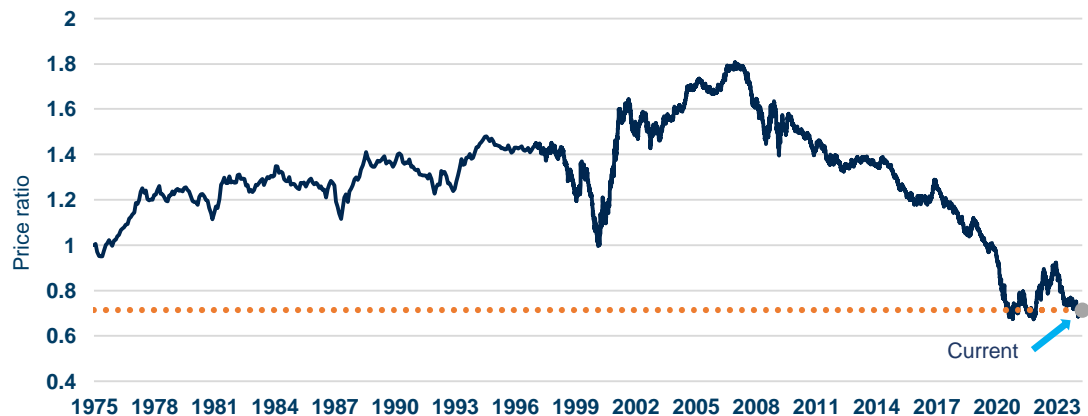
Securities listed are not meant to represent any current or future holding of an Amundi US portfolio, and should not be considered recommendations to buy or sell any security.

Source: Bloomberg and Amundi Research as of April 30, 2024. There is no guarantee that forecasts discussed will be realized. **Past performance is no guarantee of future results.**

## Attractive valuations in Japan

The opportunity in Japan has improved, as we believe equities in this region should benefit as inflation is likely to drive assets from bonds into equities. Japan is also presenting several low-priced companies with strong balance sheets in tandem with the country's push for more shareholder-friendly policies including the expansion of buybacks and increasing dividends. Companies with new management teams hold particular promise, as they appear committed to restructuring their business portfolios and unlocking fundamental value by emphasizing their market-leading businesses and de-emphasizing those businesses that are not performing. Furthermore, a strong US dollar and a weak yen is making Japanese manufacturers generally more competitive.

### Exhibit 3: A bottom in global value? The ratio of MSCI World Value Index to the MSCI World Growth Index



Source: Bloomberg and Amundi US as of April 30, 2024. Indices are unmanaged and their returns assume reinvestment of dividends and do not reflect any fees or expenses. It is not possible to invest directly in an index.

## Where to find global market opportunities

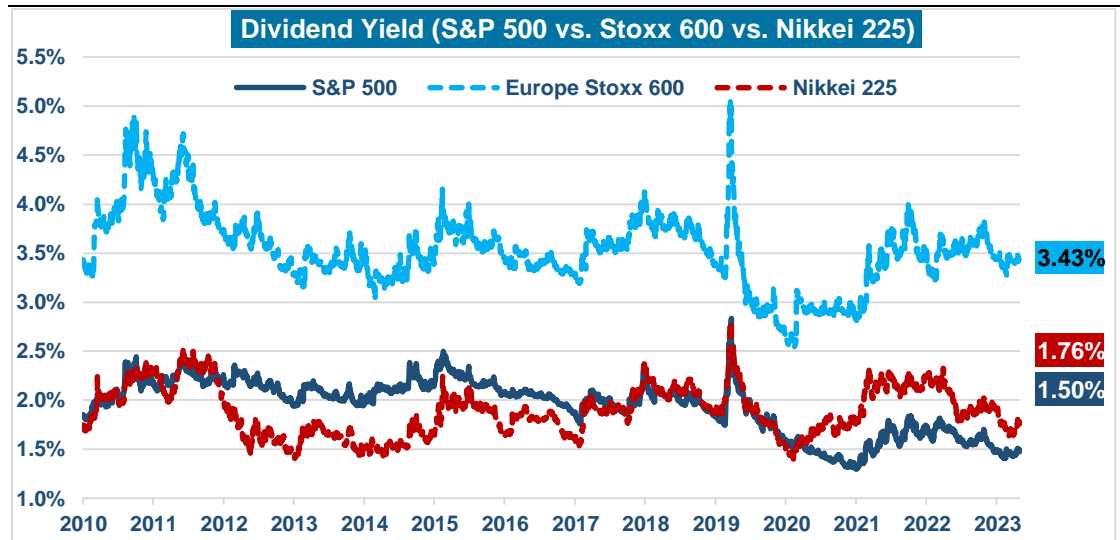
In this economic backdrop of higher inflation and interest rates, investors may be able to benefit from expanding the global reach of their portfolios. As they seek to potentially benefit from the opportunities in ex-US markets, we suggest investors consider several key points:

- **Interest rates:** As we move from quantitative easing to tightening, some sectors can benefit from higher interest rates.
- **European banks:** While US banks have experienced weakness, financial sectors outside the US are in much better shape, and for the most part have not experienced the investment losses and bank runs seen in the US. We believe that there are stronger and better-capitalized banks outside the US than inside the US. This will likely affect economic growth.
- **High-valuation stock bubble possible:** We suggest underweighting high-valuation stocks as their longer duration may lead to underperformance as real rates normalize and economic growth slows.
- **Potential recession ahead:** As a recession may be near, consider avoiding distressed companies, focusing on fundamentals, and maintaining a less cyclical portfolio.
- **Energy transition and electrification:** The global economy has a greater need for a more powerful electric infrastructure, as more electricity is needed to power cars and supercomputers.
- **Risk management:** To mitigate downside risk, focus on quality stocks at attractive valuations to capitalize on potential price appreciation, incorporate diversification<sup>2</sup> across sectors and countries, and emphasize rigorous risk management.

<sup>2</sup> Diversification does not guarantee a profit or protect against a loss.

- **Higher dividends:** European stocks have generally offered higher dividends<sup>3</sup> than US stocks, allowing investors to benefit from higher income (see Exhibit 4).

**Exhibit 4: Stocks outside the US can offer higher dividend opportunities, as shown by dividend yield of S&P 500 (US) vs Stoxx Europe 600 vs Nikkei 225 (Japan)**



Source: Bloomberg as of April 30, 2024. There is no guarantee that forecasts discussed will be realized. Past performance is no guarantee of future results.

### Conclusion

While US investors should continue to have exposure to domestic stocks, the outlook for international stocks appears to be improving. With global valuations unjustifiably low, a potential recession ahead, and top US stocks currently posting excessive valuations, investors may wish to consider expanding the global reach of their portfolios in order to benefit from opportunities in Europe and Asia.

### Additional Contributor:

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<sup>3</sup> Dividends are not guaranteed.

## Index and Term Definitions

- **Forward price-earnings ratio:** The current price of a stock divided by the consensus analyst estimates of 1-year projections of its earnings per share.
- **Gross domestic product:** The standard measure of the value added created through the production of goods and services in a country during a certain period.
- **MSCI EAFE (Europe, Australasia, and Far East) Growth Index:** A commonly used measure of international growth stocks.
- **Monetary policy reaction function:** A function that gives the value of a monetary policy tool that a CB chooses, or is recommended to choose, in response to some indicator of economic conditions.
- **Quantitative tightening:** A contractionary monetary policy aimed at decreasing the liquidity in the economy. It means that a CB reduces the pace of reinvestment of proceeds from maturing government bonds. It also means that the CB may increase interest rates as a tool to curb money supply.
- **Quality stocks:** Stocks whose characteristics indicate the potential for above average growth and low default risk.
- **Russell 1000 Growth Index:** A stock market index that tracks the highest-ranking 1,000 stocks in the Russell 3000 Index.
- **Russell 1000 Value Index:** A stock market index that tracks the highest-ranking 1,000 stocks in the Russell 3000 Index.
- **S&P 500 Index:** A stock market index that tracks 500 publicly traded domestic companies and serves as the foundation for a wide range of investment products.

## Important information

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