Flossbach von Storch

OWNERSHIP

The perspective of a long-term shareholder

Quality has its price the world over

Europe and the USA –
a comparison beneath the surface

#2
2/2025

Dear Readers,

In 2024, stocks of US companies have significantly outperformed European companies for the seventh year in a row, driven by a spectacular technology boom.

This ensues a discussion that repeats the same pattern year after year: according to this, US equities perform better, while European equities score with lower valuations.

Understandably, this makes some investors think. After all, pronounced differences in performance and valuation can indicate risks on the one hand and opportunities on the other.

But what should be used as a guide? Is a glance at indices, or more precisely at their valuation or past performance, really enough? We are sceptical. Just as the broad-based US S&P 500 equity index does not reflect the breadth of the US economy, the equally broad-based STOXX Europe 600 equity index cannot be a complete reflection of the opportunities and risks in Europe. They are two very different indices, no more and no less.

In our view, this does not help in deciding where investors would be better off investing. Relying solely on indices is like comparing apples with oranges. As with all purchasing decisions in life, it is worth taking a closer look to assess whether something is actually good value in comparison. And that can only be judged if you also consider quality. And such judgements do not occur at surface level.

We are finding opportunities for our portfolios in the USA and Europe. That's because we invest in companies. In the following text, we compare locations and provide examples – or compare apples with apples and oranges with oranges.

We hope you enjoy reading this edition of OWNERSHIP.

Kubilay Yalcin

Quality has its price the world over

Europe and the USA – a comparison beneath the surface

by Kubilay Yalcin

– I –

At index level

The US market has been convincing for decades

US equities significantly outperformed their European counterparts on average in 2024. This is hardly surprising given the US dominance in the technology sector, which is supported by numerous secular growth trends and has once again seen a notable increase in earnings.

Consequently, as of December 2024, eight US technology companies already accounted for over 25 per cent of the MSCI World Index, which is supposed to reflect the performance of almost 1,400 stocks from around the world.

Last year is by no means an isolated case. The fact is that both the performance and valuation differences between US and European indices have existed for decades.

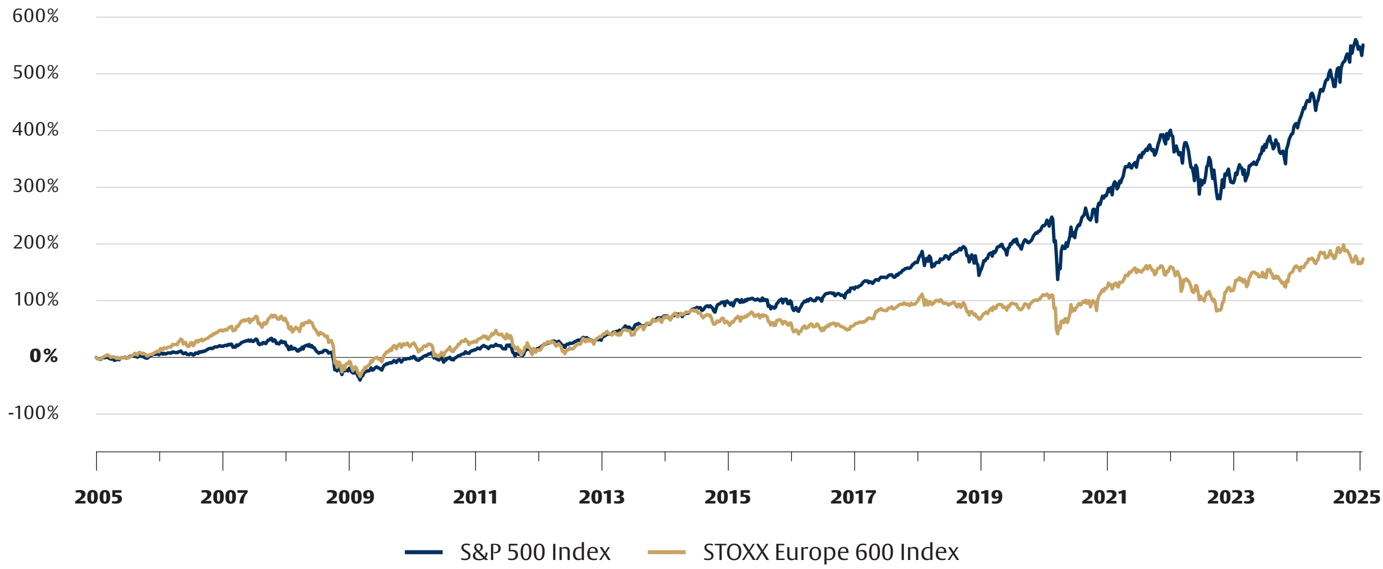
An investor who had invested in the S&P 500 20 years ago would have seen an impressive total return (including dividends) of 538 per cent. By comparison, the total return of its European equivalent, the STOXX Europe 600, was "only" 167 per cent – a marked difference of around 371 percentage points.

Both the performance and valuation differences between US and European indices have existed for decades.

Figure 1

US stock market roars ahead

Performance in US dollars (incl. dividends; percentage change compared to 1 January 2005)



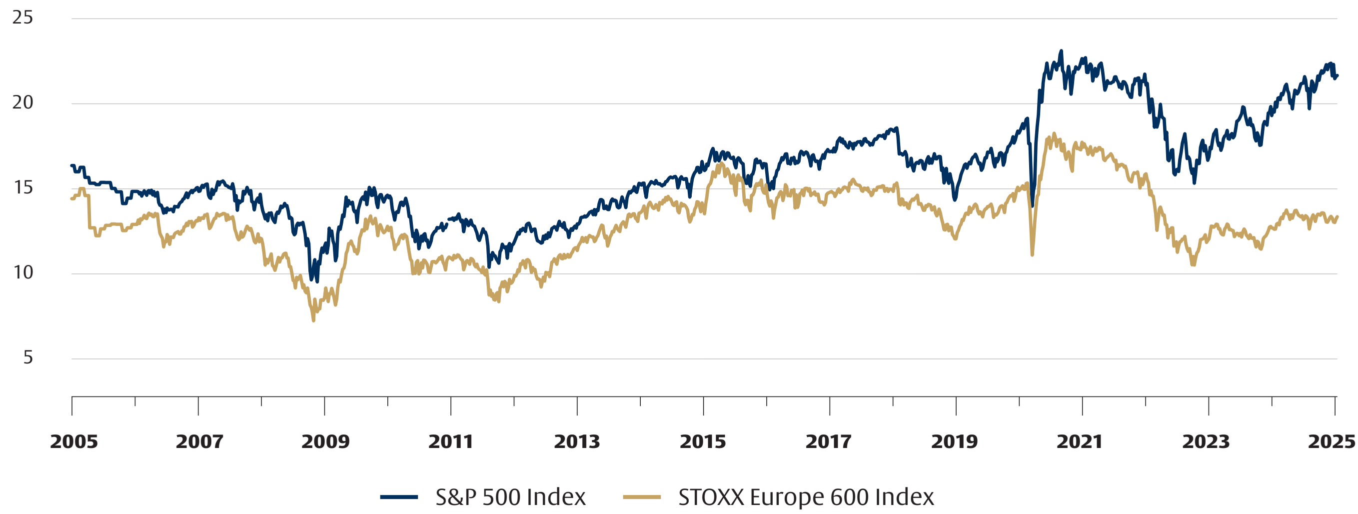
Source: LSEG Datastream, Flossbach von Storch, data as at 23 January 2025

Past performance is not a reliable indicator of future performance.

Figure 2

Stoxx Europe 600 vs. S&P 500: Share valuations over time

Price/earnings ratio (P/E ratio) based on expected earnings for the next 12 months



Source: LSEG Datastream, Flossbach von Storch, data as at 23 January 2025

Profit expectations are based on specific assumptions. Actual results may deviate significantly from these.

Past performance is not a reliable indicator of future performance.

– II –

At company level

Differences are often negligible – provided the comparison is correct

Assuming that the business models of two companies on the two continents are largely identical, the question then arises as to what differences there are between European and US companies.

First of all, the local conditions play a central role – these include sales markets, access to capital, the availability of qualified workers, and the legal and regulatory framework. These factors have a particularly strong influence when companies primarily operate in their local markets. However, as companies grow in size and often expand internationally, regional dependencies become less important. Companies take advantage of global opportunities, but then they are also exposed to global risks.

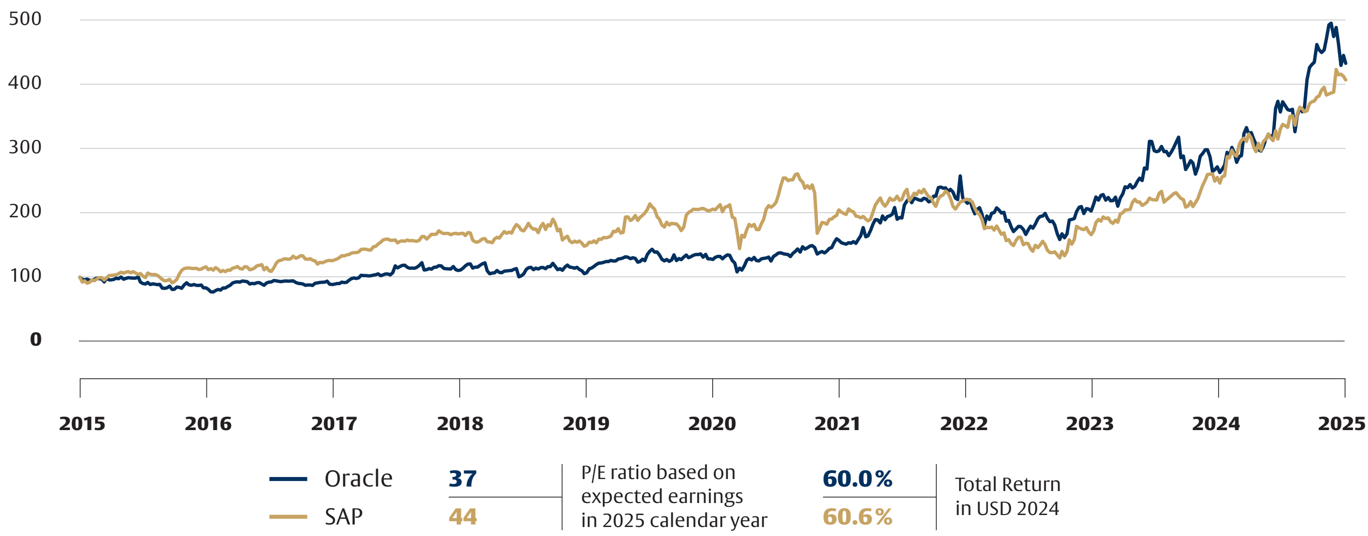
Example technology: Oracle versus SAP

Many US companies generate a significant portion of their sales outside the USA and are thus influenced by much more than just the economic and legal conditions in the USA. Take Oracle, for example, a direct competitor of the German-based tech group SAP. Both companies earn their money primarily from software and cloud services for companies. Oracle generates 45 per cent of its revenue outside its domestic US market. SAP, on the other hand, generates with 33 per cent a large share of its revenue in the USA.

Figure 3

Oracle vs. SAP

Performance in US dollars (incl. dividends; indexed to 1 January 2015 = 100)



Source: LSEG Datastream, Bloomberg, Flossbach von Storch, data as at 23 January 2025

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A company's location seems to be less important than initially assumed. Rather, the focus is on global (value) drivers and the question of how companies can set up their business models in such a way that they can benefit from these developments. The positive characteristics of many technology companies – including a growing market fuelled by digitalisation trends, scalable business models with comparatively low capital costs and high margins – do not apply exclusively to US companies. Rather, the decisive factor is that companies can successfully serve these markets with the appropriate products and services.

And SAP has impressively demonstrated this: a glance at the valuation (P/E ratio) and the development of the share price shows that SAP is in no way inferior to its American competitor in this respect.

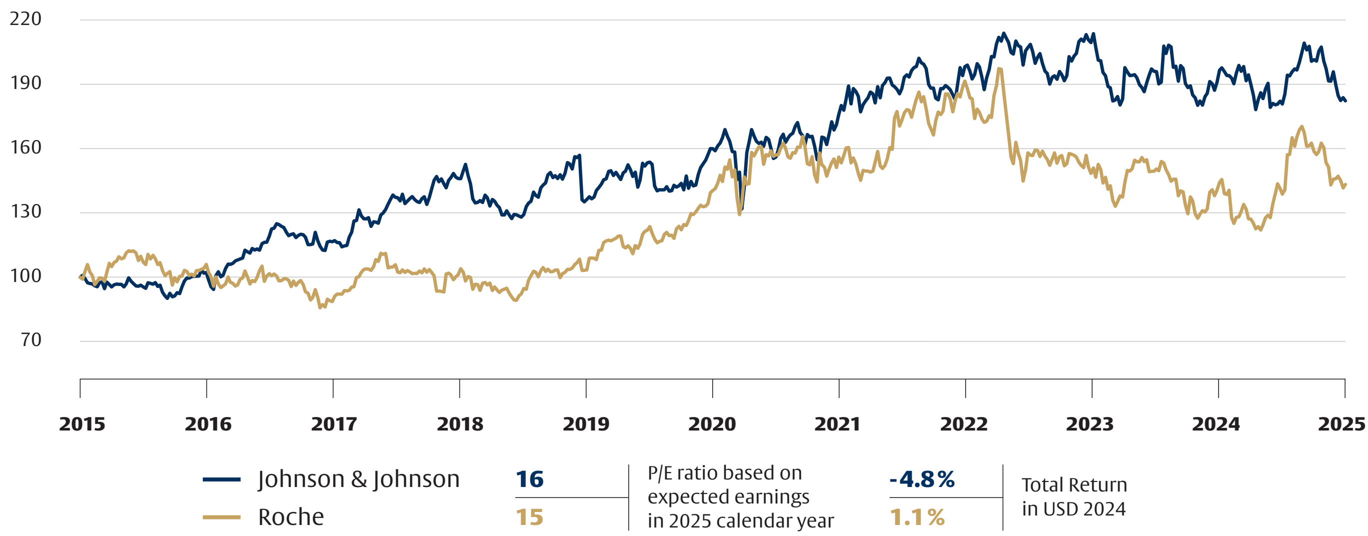
Example healthcare:
Johnson & Johnson versus Roche

The same applies – albeit under different circumstances – to the healthcare sector. Even against the backdrop of significantly stronger growth in alternatives, the shares of pharmaceuticals companies such as US company Johnson & Johnson and Swiss company Roche have recently performed similarly – that is well below the broad market.

While this alone is not proof of direct comparability between the two companies, there are obvious fundamental similarities: both operate in the same industry and distribute their medical solutions worldwide. In addition, Roche conducts a significant portion of its research activities in the USA, which means that the company's access to top talent is not limited to Switzerland alone.

In this context, it is not surprising that Roche does not show a noticeable valuation discount compared to Johnson & Johnson. Hence the differences that could arise from a company's country of origin are often less marked in practice than one might expect.

Figure 4
Johnson & Johnson vs. Roche
Performance in US dollars (incl. dividends; indexed to 1 January 2015 = 100)



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Example automotive: Ford versus Mercedes-Benz

It is in the nature of things that companies that rely on local production have a stronger dependence on their location than globally oriented companies. German automakers such as Mercedes-Benz traditionally manufacture part of their fleet in Germany and are thus exposed to higher energy costs there than some competitors at other production sites. In the case of Mercedes, the choice of Germany as a production location is based on its historically home-grown expertise in the construction of luxury vehicles. This legacy continues to shape the company to this day and offers a clear differentiation. The situation is similar for some luxury goods manufacturers that traditionally manufacture their products in France or Italy.

Nevertheless, the boundaries between regional and global dependency are also becoming blurred here.

On the one hand, numerous European carmakers operate production sites abroad. Mercedes, for example, has plants in the USA, China, South Africa and Hungary in addition to its factories in Germany. This exposes the company to local cost structures and currency fluctuations in these countries. But given that the USA, for example, is an important sales market for the manufacturer, this in turn creates a certain independence from currency risks and also protects against potential tariffs imposed by the Trump administration.

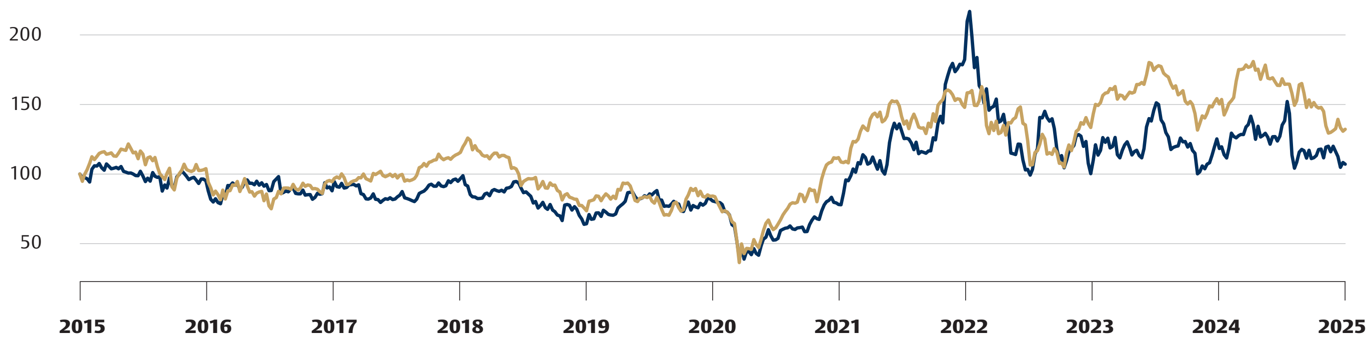
What is crucial, however, is that globally operating companies – regardless of their headquarters – are exposed to the same overarching trends and challenges. A US carmaker faces the same issues as a German company: electrification, increasing competition from Asia, and changing consumer behaviour. The procurement markets are also similar. For example, the semiconductor crisis in 2021 and 2022 hit carmakers worldwide equally.

If you look at the share price development and valuation of large, traditional manufacturers on both sides of the Atlantic, you will see major parallels. Despite all the differences between, for example, US company Ford and German company Mercedes-Benz, there is no evidence of a European valuation discount in this case, nor of a significant difference in the performance of the shares in recent years.

Figure 5

Ford vs. Mercedes-Benz

Performance in US dollars (incl. dividends; indexed to 1 January 2015 = 100)



Ford	6	P/E ratio based on expected earnings in 2025 calendar year	-13.1%	Total Return in USD 2024
Mercedes-Benz	6		-13.5%	

Source: LSEG Datastream, Bloomberg, Flossbach von Storch, data as at 23 January 2025

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– III –

Structural advantages and disadvantages of US business locations
From an industry perspective

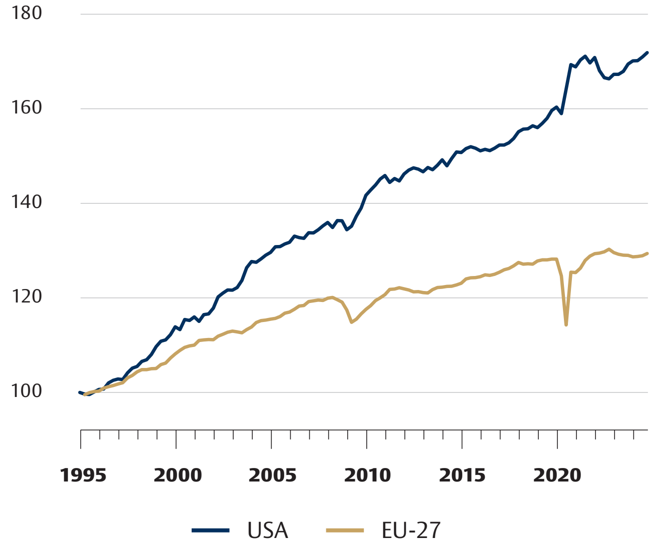
We have already discussed so-called American exceptionalism in various publications. However, a detailed discussion would go beyond the scope of this report. Nevertheless, it is crucial to understand where the key differences between the USA and Europe lie and why they are so important when observing the index level.

Productive, high-growth USA ...

First of all, productivity per hour worked in the USA is around 17 per cent higher than in the EU. Furthermore, the average weekly working hours in the USA are around four per cent longer than in Europe (source: FvS Research Institute). In addition, growth in Europe is constrained by other structural factors such as demographics and regulation. However, these points alone do not explain why Europe is underrepresented in intercontinental comparison, especially when it comes to large, high-growth companies, but also in terms of rapidly growing start-ups.

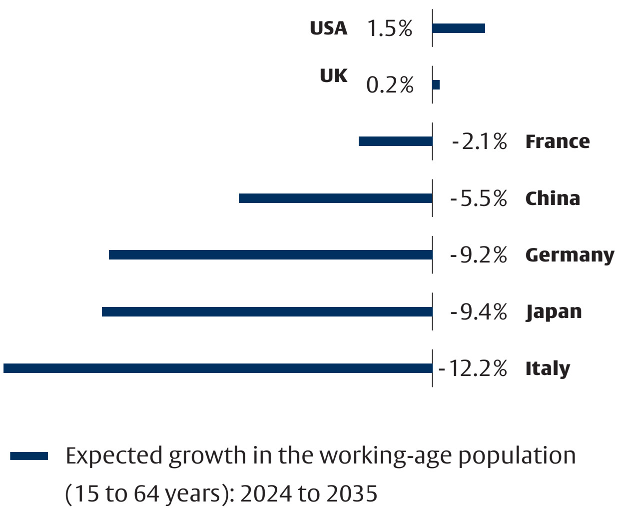
One decisive factor is the start-up-friendly environment that has been developing in the USA for decades. The close links between investors, universities and industry networks, as well as a culture that celebrates entrepreneurial courage, create an ideal environment for the development of digital business models. However, US companies are often ahead not only in terms of young companies and the technology sector. For decades, with a few exceptions, the USA has regularly produced the largest companies in the world – across all sectors.

Figure 6
US Americans with significant productivity gains
Output per worker (indexed to 1995 = 100)



Source: Eurostat, U.S. Bureau of Labor Statistics, Flossbach von Storch, data as at 23 January 2025

Figure 7
Demographic change reduces the labour supply
Many economies are facing a decline in the labour force



Source: United Nations World Population Prospects 2022, Flossbach von Storch, data as at 23 January 2025

… with most of the world's largest companies

There are many reasons for this, but some advantages of the USA stand out. It is a large market with a common language, a unified legal framework and largely similar customer needs. This makes it easier for the best companies to serve a broad market and achieve economies of scale and market power. Companies such as AT&T, General Electric, ExxonMobil, IBM and Walmart are just a few examples of this dynamic. These economies of scale free up additional funds for innovation and, not least, enable further growth to be financed.

Particularly in the technology sector, this has proved to be a decisive competitive advantage over European companies. Amazon, for example, was able to optimise its processes over years, build relationships with retailers, hire qualified personnel, and focus initially on the US market before expanding into Europe. In addition, US investors were willing to finance growth over longer periods of time – even without early profits (Amazon first made a profit in 2003 – nine years after its foundation and six years after its IPO).

A fragmented Europe …

In contrast, Europe has a highly fragmented competitive landscape resulting from the large number of countries and markets on this continent. Many companies have emerged from former state monopolies, such as some telecommunications providers. The privatisation of these monopolies, together with regulatory intervention, encouraged the emergence of additional providers. At the same time, however, pan-European consolidation was prevented, resulting in one of the most competitive telecommunications markets in the world. This in turn resulted in low returns on capital, which significantly hindered urgently needed investment in infrastructure, i.e. for fast internet connections.

… often with highly competitive, less lucrative industries

In the USA, by contrast, there are three large listed telecommunications providers (AT&T, Verizon and T-Mobile USA) that are largely able to operate profitably and are thus able to invest in innovation and growth and monetise it.

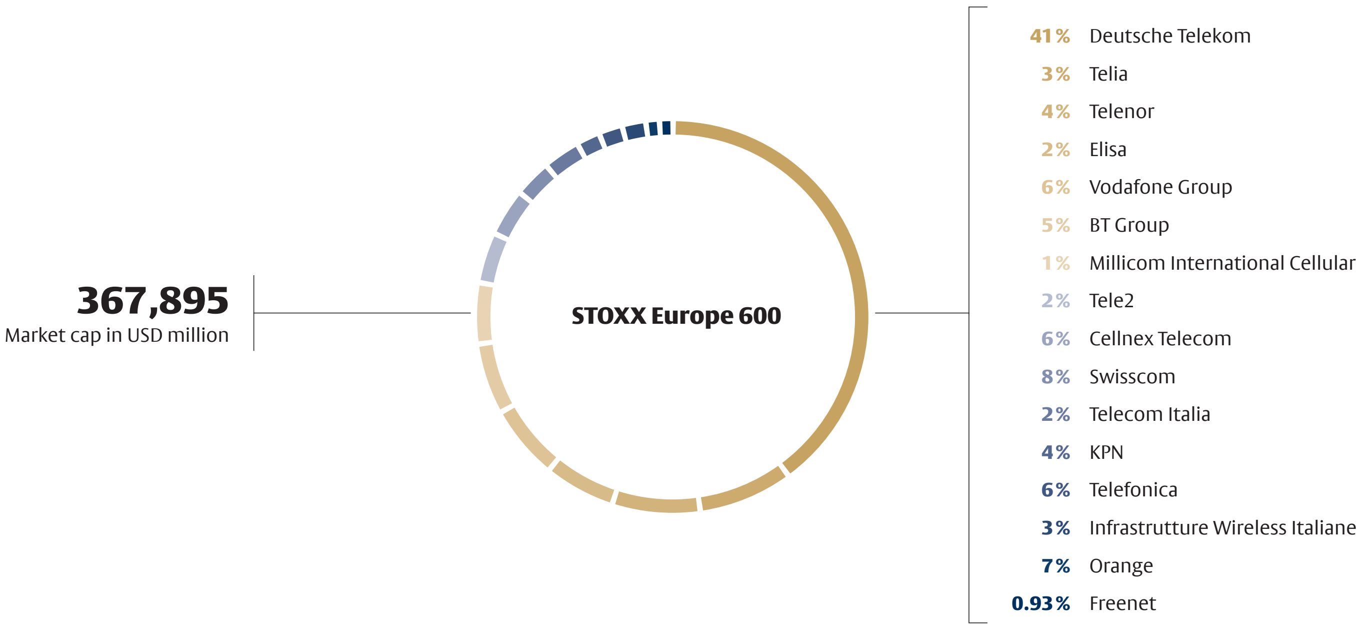
Financial institutions are another example. Many banks in Europe, which have historically emerged as regional or state banks, are fighting for limited market potential in a highly competitive market. The low profitability of these institutions reduces their global competitiveness, which means that often they have remained confined to their regional markets. It is therefore no wonder that the most profitable and valuable banks in the world are to be found in the USA.

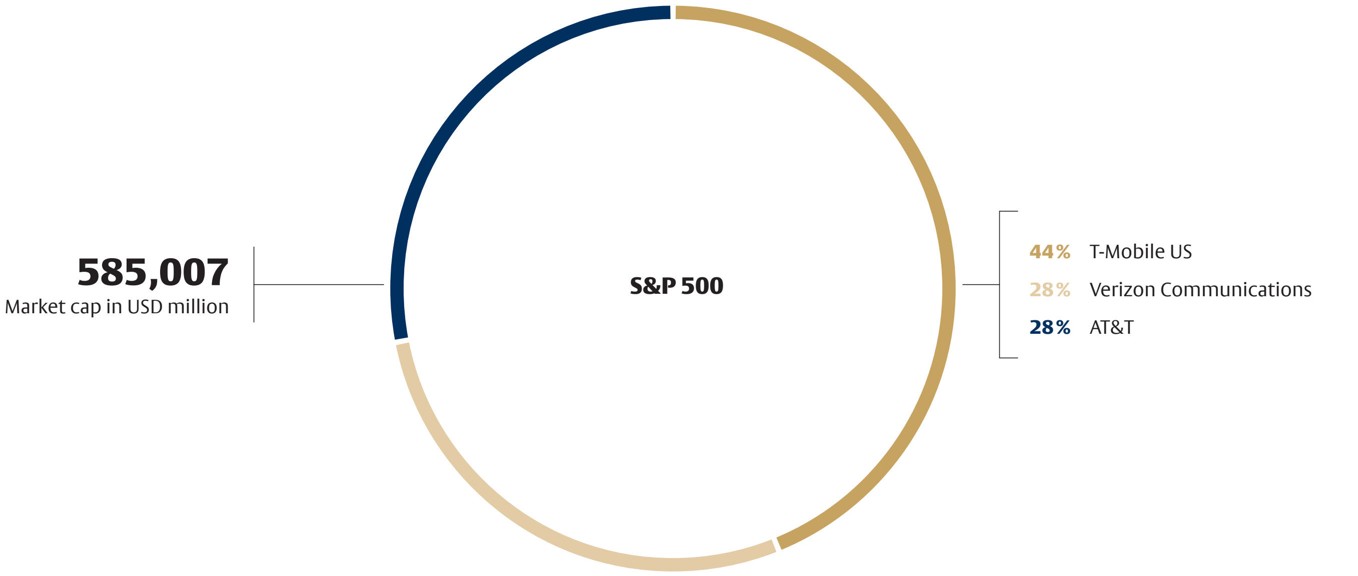
> In the USA the close links between investors, universities and industry networks, as well as a culture that celebrates entrepreneurial courage, create an ideal environment for the development of digital business models.

Figure 8

Communication services

Market capitalisation STOXX Europe 600 vs. S&P 500





Source: Bloomberg, Flossbach von Storch, data as at 31 December 2024

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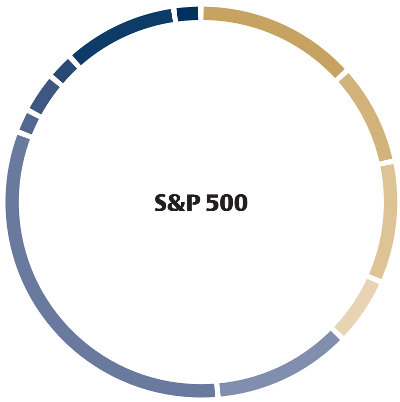
Conclusion

Company assessment beats index decision

A glance at the sectoral breakdown of the two leading indices immediately reveals a significant difference. On the one hand, the proportion of more cyclical sectors, such as financials and industrials, is significantly higher in Europe. By contrast, the information technology sector, which dominates the S&P 500, has a low weighting in Europe. Different growth profiles between these sectors already explain a large part of the valuation gap at index level.

Figure 9
Sector weighting
STOXX Europe 600 vs. S&P 500

STOXX Europe 600	Sector	S&P 500
21.0 %	Financials	13.6 %
17.9 %	Industrials	8.2 %
14.5 %	Health Care	10.1 %
10.0 %	Consumer Staples	5.5 %
9.7 %	Consumer Discretionary	11.3 %
7.6 %	Information Technology	32.5 %
5.8 %	Materials	1.9 %
4.8 %	Energy	3.2 %
4.0 %	Utilities	2.3 %
3.3 %	Communication Services	9.4 %
1.3 %	Real Estate	2.1 %



Source: STOXX, S&P, Flossbach von Storch, data as at 31 December 2024
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In Europe the proportion of more cyclical sectors is significantly higher.

In addition, the structural factors described above are having a positive impact on the growth prospects of the US economy and the profitability of many companies and sectors. We have already mentioned the telecommunications sector and banks as examples of the latter. In addition, locally active companies in the USA enjoy better growth prospects than their European counterparts. Both factors – higher profitability and better growth prospects – also justify the higher valuations of US companies in relation to their current earnings.

Sweeping judgements don't help …

Despite the structural disadvantages of many European companies, it is not possible to make any sweeping statements about opportunities or risks. This is because the observations mentioned do not apply to globally active European companies with attractive business models. It is therefore only logical that such companies are not generally valued at a discount to their US counterparts.

When it comes to the question of "USA or Europe", a well-founded look at the respective business model remains essential – as with all investment decisions. We believe it is wrong to assume that European companies of the same quality are fundamentally cheaper than their US counterparts. Or, to put it more plainly: companies with higher risk can also be found in the USA at low valuations, while high-quality companies in Europe can be valued just as highly as in the USA.

… it depends on the company

In other words, you should look carefully at the shopping basket to make sure that you are actually comparing apples with apples and not apples with oranges.

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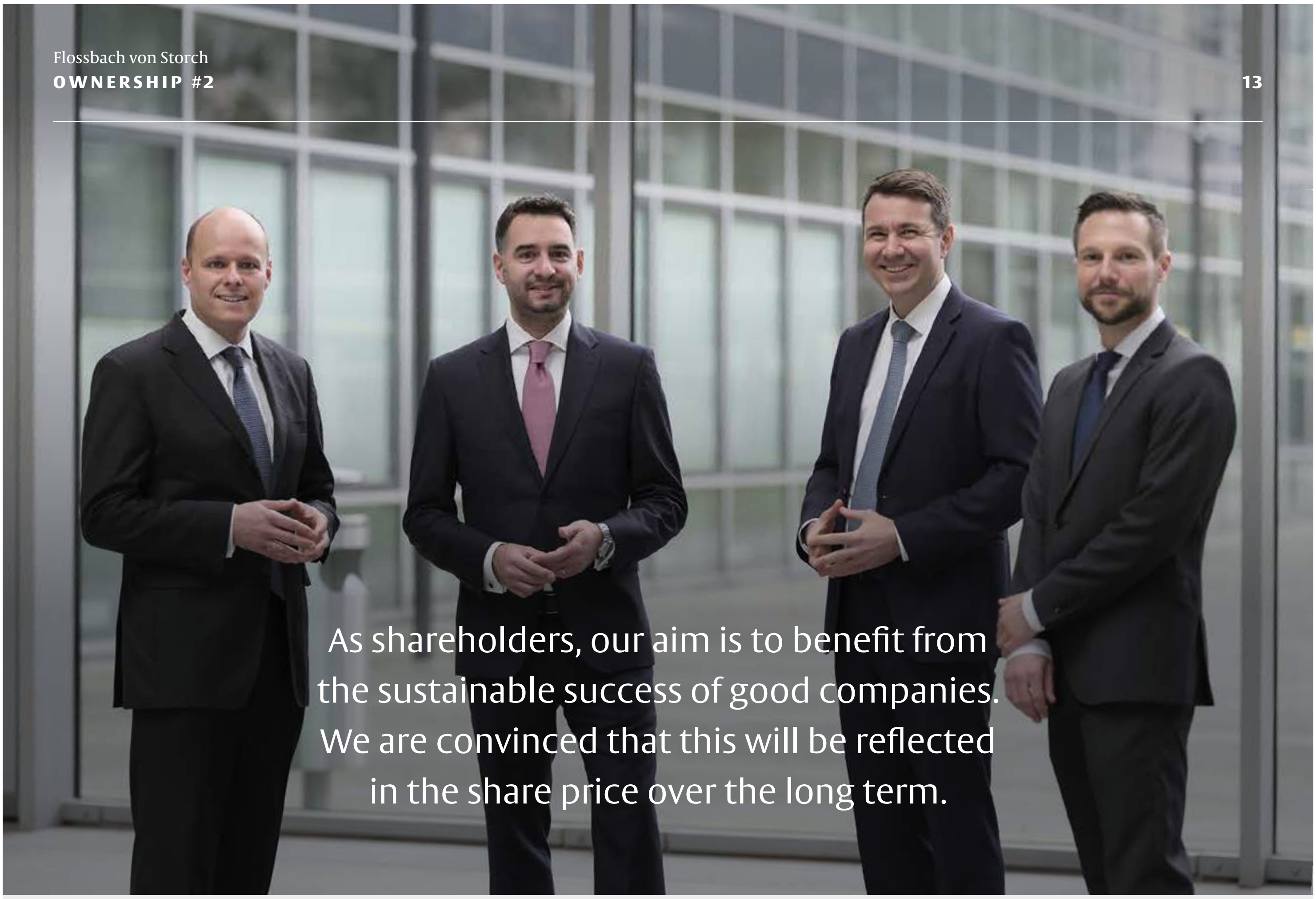

Our Equity Fund Management Team

(from left: Fund Managers Ludwig Palm and Michael Altintzoglou, Portfolio Director Kubilay Yalcin and Head of Fund Management Equities and Partner Michael Illig)

With an average of over 16 years' professional experience and more than eight years with the company, we are building on a strong foundation.

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