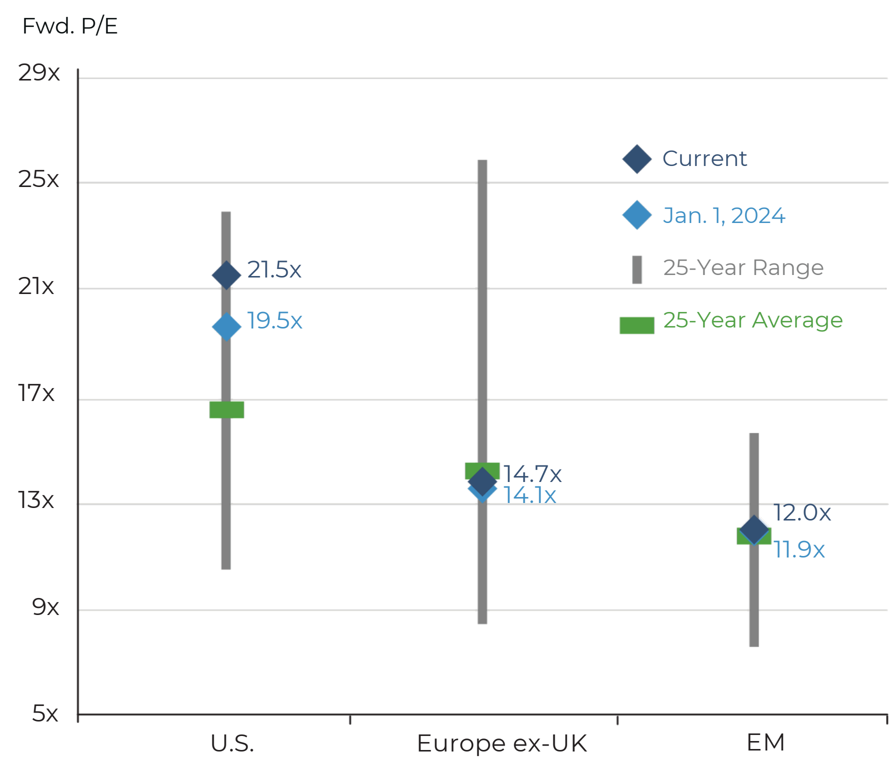
CAPTAIN AMERICA:
U.S. EXCEPTIONALISM

The familiar narrative of foreign markets poised to outshine the U.S. has once again emerged, Yet, time and again, America's markets have proven these expectations wrong. Fueled by relentless innovation, world dominating companies, and an unparalleled ecosystem for success, the U.S. continues to set the standard for resilience and growth. Amid global challenges, the U.S. remains the steadiest and most powerful vessel in rough waters, providing stability, opportunity, and leadership in an unpredictable international market.

> What drives this enduring exceptionalism, and will the U.S. once again defy expectations next year?

As we head into 2025, the valuation gap suggests an opportunity for foreign markets to outperform the U.S., on paper.

Global Valuations



Source: JPM Guide to the Markets. P/E on 12-month forward earnings. Green bar for EM shows 20-year average due to lack of data. As of 12/31/2024

But looks can be deceiving, and the reality has been starkly different. While strategists across Wall Street have long advocated for holding a meaningful allocation to foreign and emerging markets as a portfolio diversifier, the outcomes have fallen short of expectations. Instead of reducing risk or enhancing returns, foreign exposure has often acted as a "de-worsifier," weighing on portfolio performance. Over the past decade, domestic markets have outpaced their international counterparts in eight out of ten years.

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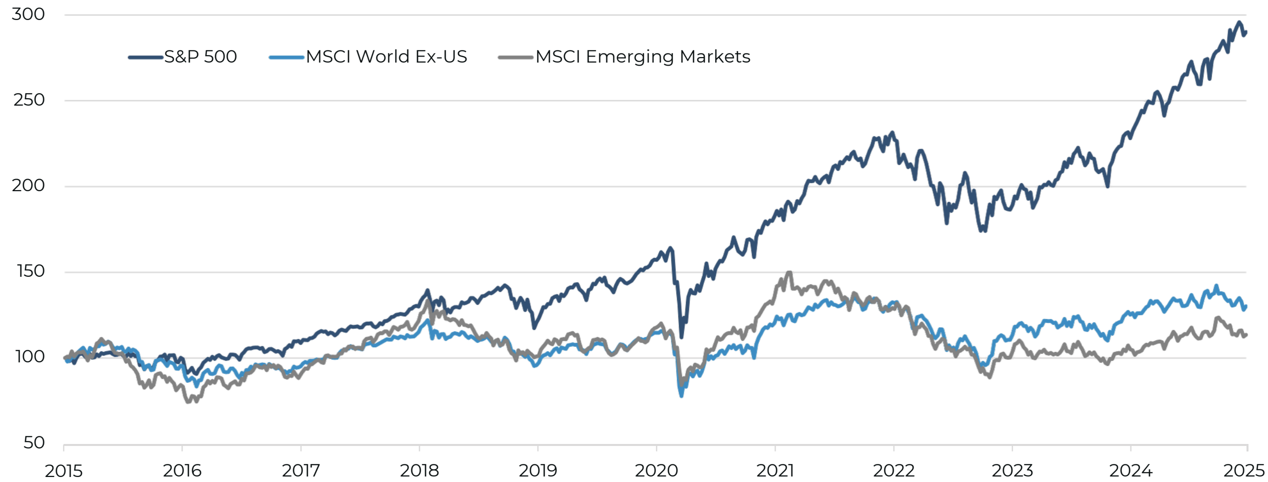
Index Performance Over the Last Decade



Source: Bloomberg. Waterloo Capital. Data as of 12/27/2024

It's a reminder that while valuations serve as a useful starting point for investing, they are far from reliable timing indicators. The underperformance of foreign equities highlights the importance of assessing not just relative valuations, but also factors like economic growth, currency trends, investor sentiment and their effects on companies. Next year, we are again stacking our chips on the U.S. side of the proverbial table, expecting another year of outperformance versus its foreign counterparts.

A key contributor to this outperformance, and why it might persist, lies in the structure of different markets. The U.S. stands out as the home of an outsized number of innovative, market-leading companies, and the disparity is striking. Seventeen of the world's largest twenty companies are based in the U.S., many of them technological giants leading advancement in their competitive fields. These firms are among the most efficiently run, boasting healthier margins, stronger profitability, and superior operational efficiency. Adding to this advantage is that present equity indexes, most of which are capitalization-weighted, amplify the impact of these dominant companies on market performance. This structural composition stacks the cards in the U.S. market's favor, creating an environment where the highest concentration of financially successful companies in the world can drive its outperformance.

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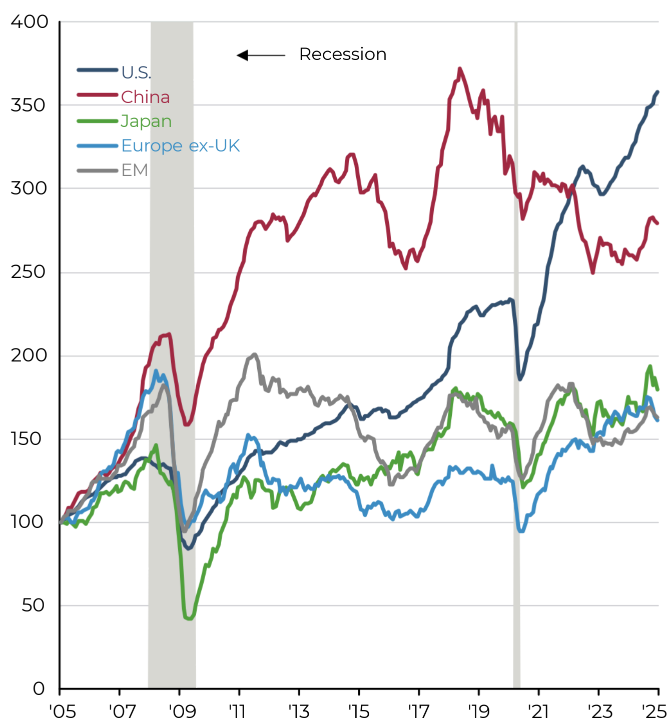
This concentration is no coincidence and, more importantly, has staying power in 2025. The United States has built a uniquely supportive ecosystem that fosters innovation at an unparalleled scale. Innovation hubs like Silicon Valley not only serve as launchpads for groundbreaking ideas but also as breeding grounds for companies to mature into global leaders. The large talent network, supportive economic policies, and a culture that rewards ambition creates an environment in the U.S. where innovation isn't just encouraged, it's fundamental. This goes somewhat counter to many other parts of the world where stricter regulations, less dynamic policies, and differences in cultural attitudes can hinder the ability of even highly skilled and ambitious professionals to build dominant, lasting companies.

Global Earnings Estimates

Jan. 2005 = 100, next 12 months consensus estimates, U.S. dollars



Source: JP Morgan Guide to the Markets, FactSet, MSCI, Standard & Poor's.

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Migration of talent is a critical piece of this puzzle. Although innovative and driven workers originate across the globe, the U.S. consistently attracts these individuals with the promise of prestigious educational opportunities, higher probability of success, elevated financial potential, and even lower tax burdens in many cases. This creates a virtuous cycle: the inflow of skilled labor fuels innovation within the U.S., which further enhances its appeal to global talent. Meanwhile, countries that are unable to foster this ecosystem face a more uphill path to dominate the competitive global market on the same scale. We believe this dynamic will sustain the U.S.'s competitive edge and drive market outperformance for another year.

With artificial intelligence (AI) rapidly emerging as a transformative force, this cycle might be even more resilient. Beyond attracting global talent, the U.S. stands out as the undeniable center of the AI revolution, contributing significantly to the outperformance of domestic markets. Unlike many other parts of the world, the U.S. private and public sectors have been extremely helpful of this new frontier. Policies like the Chips Act and Inflation Reduction Act illustrate this support and provide strong advantages for innovation to flourish domestically.

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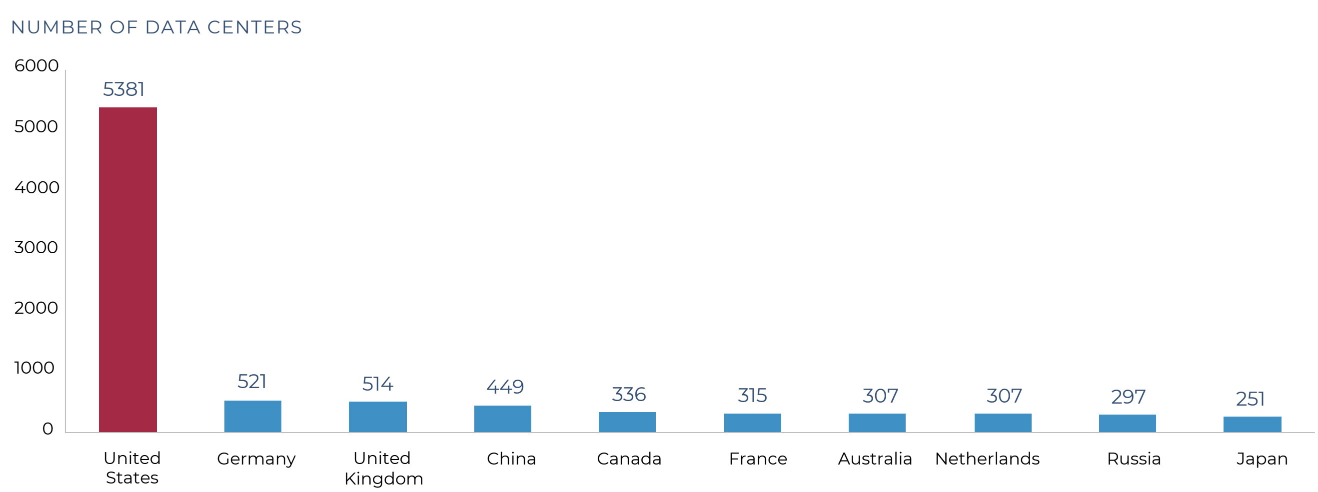
The gap is striking. As of early 2024, the U.S. boasts more data centers than all other major countries combined. These facilities, housing the advanced computing infrastructure necessary for AI, cloud computing, and real-time analytics, are critical to driving breakthroughs across industries. This structural edge accelerates innovation and enhances productivity on an unmatched global scale. Such advantages are poised to translate into stronger relative investment returns in the coming year, as domestic markets benefit from the compounding effects of AI-driven innovation and productivity gains.

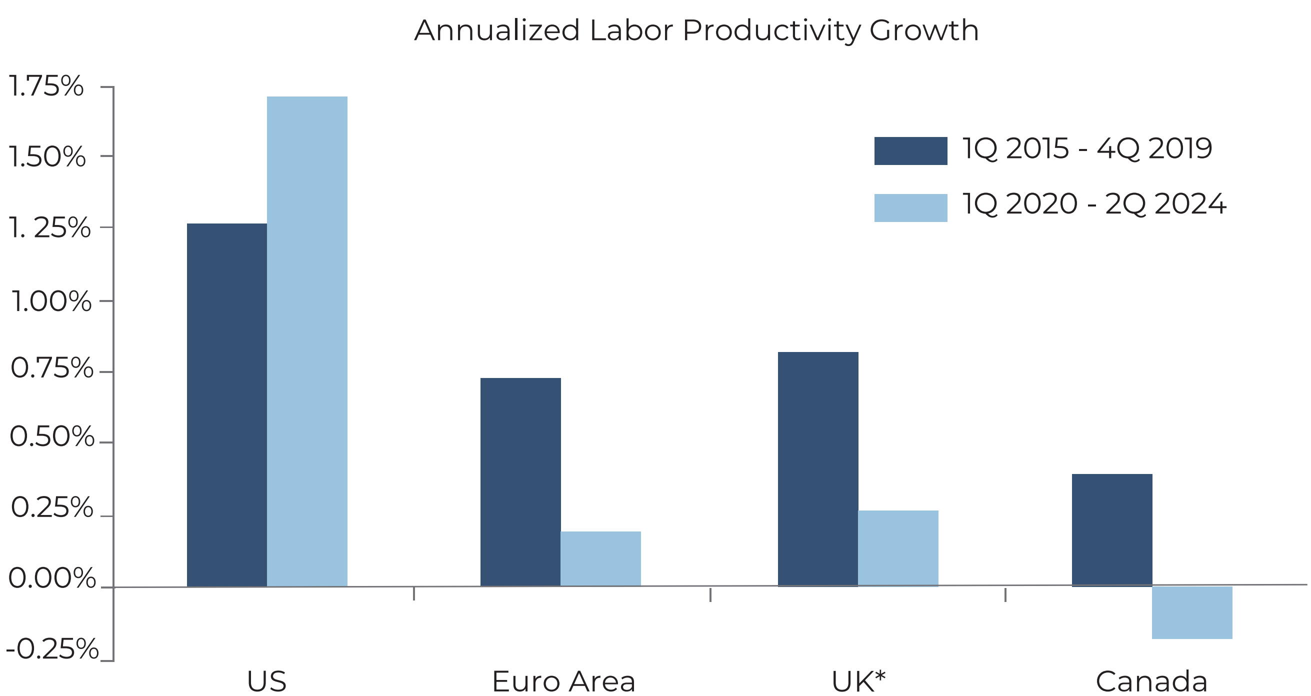
No One Even Comes Close to the United States



Source: Statista , Cloudscene, Apollo Chief Economist. Data as of March 2024.

The ultimate result of these perennial and emerging trends is driving a clear divergence in productivity growth between the U.S. and its global counterparts. Technological innovation, a skilled workforce, and a pro-business environment all elevate productivity within a given economy. The U.S.'s position in these domains translates into higher economic output, stronger growth, and – most critically for investors - greater earnings growth. Historically domestic earnings growth has consistently outpaced most international markets. With structural shifts like AI advancements and talent migration adding further momentum, this outperformance is poised to persist.

Productivity Growth Has Outperformed in the US, Underperformed Elsewhere



Source: Haver Analytics, Goldman Sachs Global Investment Research.
*Labor productivity is defined as total-economy real value-added per hour worked. *UK Q2 2024 is GS Forecast*

We expect the incoming Trump administration to provide some tailwinds for U.S. outperformance, however, the headwinds it poses for other parts of the world are more intense. Markets outside of the U.S. are particularly vulnerable to the large spanning effects of potential hostile trade policies between the U.S. and China. These policies not only damage foreign companies' competitive positions, but also create structural hurdles to their growth. Proposed tariffs from President Trump would place intense pressure on foreign firms' ability to compete in the U.S., but the real punch comes from how these U.S.-first policies strengthen the dollar. A stronger U.S. dollar leads to higher import costs and places downward pressure on the value of global and emerging market currencies.

To make matters worse, foreign markets' economic proximity to rising geopolitical tensions via the escalation of both trade and hot wars adds to the potential headwinds in 2025. These factors elevate risks for the profitability and competitiveness of ex-U.S. firms in the global marketplace, reinforcing the likelihood of underperformance relative to the U.S.

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While we expect the U.S. equity market to channel its inner Captain America, leading the charge and heroically outperforming developed market peers, it's important to maintain balance, as even the most valiant hero needs a team. Leaning too far to one side of the boat risks losing your footing entirely. Maintaining an allocation to global markets is prudent, as there are scenarios where other regions could shine. That said, our outlook supports tilting toward the U.S. market and capturing its distinct, superhero-like relative advantages.

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