Have we reached peak U.S. exceptionalism?

From the Field

Key Insights

- U.S. stocks typically have featured higher valuations but also stronger earnings fundamentals than non-U.S. stocks since the 2008–2009 global financial crisis.
- While U.S. relative valuations remain high, future earnings may not support that premium. International value stocks could offer more attractive opportunities.

Tim Murray, CFA®
Capital Markets Strategist
Multi-Asset Division

The T. Rowe Price's Asset Allocation Committee recently lowered its allocation to U.S. stocks in favor of international value stocks. The thinking behind this move is outlined below.

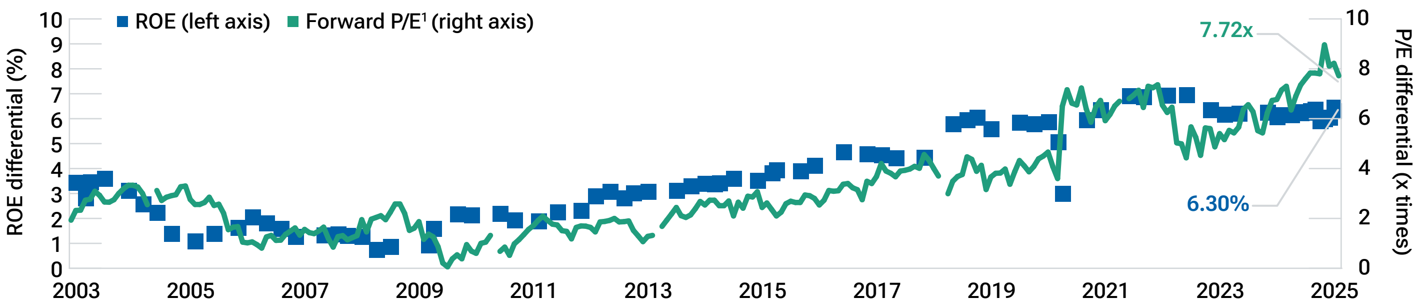
For the better part of the past two decades, U.S. stocks have outperformed non-U.S. stocks, often by a considerable margin. This has led some analysts to view the U.S. market as exceptional—structurally superior to other world markets.

Relative valuation trends have also reflected that view (Figure 1). The valuation premium for U.S. stocks over non-U.S. stocks rose steadily following the global financial crisis that ended in 2009. But that growing gap was supported by strong U.S. fundamentals, notably free cash flow growth and profit margins.

Now that special advantage may be fading.

Peak U.S. exceptionalism?

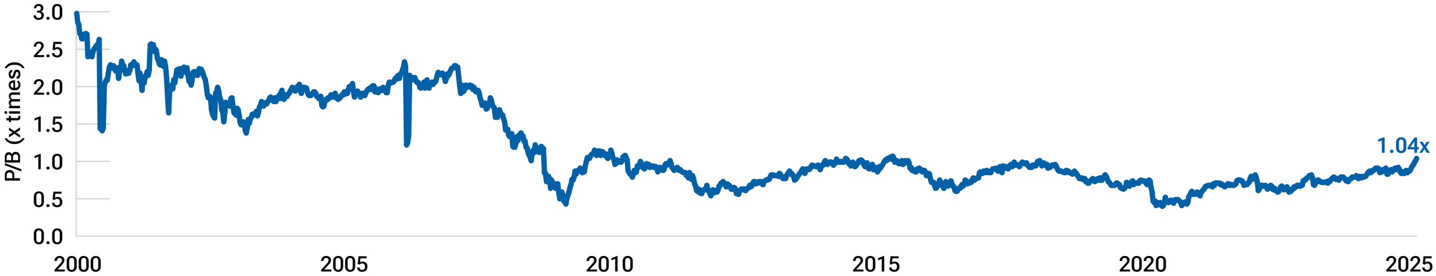
(Fig. 1) Return on equity (ROE) and forward price/earnings (P/E) differentials, Russell 3000 Index vs. MSCI All Country World ex US



December 31, 2002, to February 25, 2025.
Sources: FTSE/Russell, MSCI (see Additional Disclosures) via FactSet.
[1] Forward P/E = Next 12-month consensus estimate.
Actual future outcomes may differ materially from estimates.

Steady improvement in European bank stock valuations

(Fig. 2) MSCI Europe Banks Index price-to-book (P/B) ratio



February 1, 2000, to February 21, 2025.
Source: Bloomberg Finance L.P.

Take, for example, return on equity, or ROE, a key measure of company profitability. The ROE advantage for U.S. stocks over non-U.S. stocks climbed from less than one percentage point in March 2009 to almost seven percentage points by June 2022. But, over the past two years, the ROE gap has moved roughly sideways. Meanwhile, the U.S. valuation advantage—as measured by the forward price-to-earnings ratio—has continued to climb.

That rising trend likely was due to market expectations that U.S. large-cap technology companies would see big ROE improvements once their massive capital expenditures on artificial intelligence (AI) begin to pay off. That still might happen, but investors are growing more skeptical about the timing and magnitude of those future ROE gains.

Recent news flow has also been troublesome for the handful of mega-cap stocks that dominate the U.S. tech sector. In late January, reports that a Chinese company had developed an extremely efficient, open-source AI application called DeepSeek cast doubt on how much computing power ultimately will be needed to run AI applications. However, on February earnings calls, executives at several mega-cap tech companies told analysts their capital spending budgets will rise even higher going forward.

A rosier backdrop for Europe

The growing skepticism about the U.S. earnings outlook stands in sharp contrast to an incrementally more positive environment for non-U.S. stocks, particularly in Europe. The list of favorable developments there includes movement toward a resolution of the war in Ukraine and a positive turning point in economic momentum.

The potential combination of economic acceleration and a more supportive interest rate environment has been particularly encouraging for Europe's banking sector, which has been out of favor with investors for much of the past two decades (Figure 2). It is notable that the price-to-book value ratio for the MSCI Europe Banks Index climbed above 1 times in February for the first time in more than seven years. Despite this steady rise, valuations remain well below the levels typically seen before the global financial crisis sent them crashing downward.

Conclusion

The bottom line is that with U.S. stocks facing skepticism over the near term, there may be more attractive opportunities elsewhere—particularly in regions offering more attractive valuations combined with an improving macro outlook.

INVEST WITH CONFIDENCE®

T. Rowe Price identifies and actively invests in opportunities to help people thrive in an evolving world, bringing our dynamic perspective and meaningful partnership to clients so they can feel more confident.

Additional Disclosures

CFA® and Chartered Financial Analyst® are registered trademarks owned by CFA Institute.

London Stock Exchange Group plc and its group undertakings (collectively, the "LSE Group"). © LSE Group 2025. All rights in the FTSE Russell indexes or data vest in the relevant LSE Group company which owns the index or the data. Neither LSE Group nor its licensors accept any liability for any errors or omissions in the indexes or data and no party may rely on any indexes or data contained in this communication. No further distribution of data from the LSE Group is permitted without the relevant LSE Group company's express written consent. The LSE Group does not promote, sponsor or endorse the content of this communication.

Source: MSCI. MSCI and its affiliates and third party sources and providers (collectively, "MSCI") makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, reviewed, or produced by MSCI. Historical MSCI data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. None of the MSCI data is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such.

Important Information

This material is provided for informational purposes only and is not intended to be investment advice or a recommendation to take any particular investment action.

The views contained herein are those of the authors as of March 2025 and are subject to change without notice; these views may differ from those of other T. Rowe Price associates.

This information is not intended to reflect a current or past recommendation concerning investments, investment strategies, or account types, advice of any kind, or a solicitation of an offer to buy or sell any securities or investment services. The opinions and commentary provided do not take into account the investment objectives or financial situation of any particular investor or class of investor. Please consider your own circumstances before making an investment decision.

Information contained herein is based upon sources we consider to be reliable; we do not, however, guarantee its accuracy. **Actual future outcomes may differ materially from any estimates or forward-looking statements provided.**

Past performance is no guarantee or a reliable indicator of future results. All investments are subject to market risk, including the possible loss of principal. **International investments** can be riskier than U.S. investments due to the adverse effects of currency exchange rates, differences in market structure and liquidity, as well as specific country, regional, and economic developments. **Financial services companies** may be hurt when interest rates rise sharply and may be vulnerable to rapidly rising inflation. The **value approach** to investing carries the risk that the market will not recognize a security's intrinsic value for a long time or that a stock judged to be undervalued may actually be appropriately priced. All charts and tables are shown for illustrative purposes only.

T. Rowe Price Investment Services, Inc., distributor. T. Rowe Price Associates, Inc., investment adviser. T. Rowe Price Investment Services, Inc., and T. Rowe Price Associates, Inc., are affiliated companies.