March 19, 2025

# Morning Briefing

## Global Rotation

*Check out the accompanying chart collection.*

**Executive Summary:** With the US stock market underperforming many international equities markets, we've been warming to a "Go Global" stance—though we don't advise a major shift given the possibility of a punishing global trade war. Today, Eric assesses the stock market fundamentals in major economies. We still aren't keen on China. … Also: Melissa reports on the green shoots evident in European and Asian economies. … And: Joe reports that February's net earnings estimate revisions by analysts were downward in the extreme, sending the S&P 500's NERI index to a 25-month low. Such rapid NERI deterioration suggests analysts have shaved estimates broadly for reasons beyond company fundamentals. They may be getting the tariff memo!

**Strategy: Going Global.** Both Chinese and Eurozone stocks have been significantly outperforming the US stock market so far this year. The MSCI China index, which includes LargeCap and MidCap listed equities, is up 21% ytd. The MSCI European Monetary Union (EMU) index is up 17.5% ytd. Meanwhile, the US MSCI is down 3.4% ytd.

Last year, the US stock market dramatically outperformed the others: The US MSCI was up 23.4%, while the China MSCI rose 16.3%, and the EMU MSCI gained 6.8%.

The rotation trade from the US to China and the Eurozone reflects a combination of macroeconomic, geopolitical, and technological factors. Perversely, President Donald Trump's America First policies have been an important driver of the rotation.

In China's case, the Chinese government has been stimulating domestic demand in response to concerns that Trump's tariffs will depress exports to the US. In addition, stocks have benefitted from ongoing waves of stimulus targeted at halting deflation and releveraging the economy that's suffering from bad debts. Also, the emergence of DeepSeek brought the AI trade to China and added concerns regarding US tech companies' earnings (*Fig. 1*).

In the Eurozone, the central bank's monetary *easing* (six rate cuts since mid-2024) has aided the financial markets, and now fiscal stimulus (including a landmark spending bill in Germany) has buoyed sentiment toward the real economy. Geopolitically, Trump 2.0 has also been a boon. The light at the end of the Russia-Ukraine war tunnel is becoming brighter, and proposed US tariffs have inspired more bloc unity and a commitment to increasing trade among EU members. Trump's ambiguous support for NATO is also causing European governments to scramble to spend more on defense.

Recently, we cooled off on our long-held "Stay Home" (in US stocks) stance and warmed up to a "Go Global" one, suggesting that allocating more to select international markets is appropriate. Yet we're hesitating on a significant shift, as US fundamentals continue to be strong and Trump's reciprocal tariffs on April 2 could upset the global rotation trade. However, thus far market action suggests that investors generally believe a global trade war would weigh more heavily on the US economy than those targeted by US tariffs.

With that said, let's evaluate the market fundamentals abroad, and whether the case for investing there makes sense for long-term investors:

(1) *Valuation*. One of the primary selling points global markets have going for them is relatively cheap valuations. We've noted that most of the correction in the S&P 500 stems from the Magnificent-7 stocks' collective valuation multiple compressing. Cheaper stocks, both within the US and abroad, have been holding up much better.

The China MSCI stock price index currently trades at less than 12 times forward earnings (*Fig. 2*). China's latest stock rally brings it back only to pre-pandemic levels. The EMU MSCI stock price index is trading at 14 times forward earnings, steadily climbing from its trough when Russia invaded Ukraine in 2022 but still somewhat low (*Fig. 3*). Eurozone stocks have been climbing to new record highs for several quarters.

(2) *Forward revenues*. Chinese companies' forward revenues has been declining steadily since 2018 (*Fig. 4*). That's particularly troubling given that China's export-led model to stimulate economic growth has failed to keep manufacturers' profits from turning negative recently (*Fig. 5*). This suggests that China's economy cannot sustain itself without substantial government support and subsidies. Forward revenues in the Eurozone have surged since 2021 and is near record highs (*Fig. 6*).

(3) *Forward profit margins*. The aggregate forward profit margin of China MSCI companies is at a record high despite the weakness of manufacturers' profits (*Fig. 7*). That's likely because of the increasing dominance of technology stocks such as Alibaba, Tencent, and

JD.com, which represent large chunks of China's stock market. However, the forward margin, while high for China, is still relatively low at just 5.3%.

The EMU MSCI forward profit margin has climbed recently but seems to be stuck around 9.5% (*Fig. 8*). In comparison, the US MSCI forward profit margin stands at a record high of 13.4% (*Fig. 9*).

(4) *Forward earnings*. The China MSCI forward earnings per share (EPS) has been tracking sideways (if not declining) since 2017 (*Fig. 10*). Net earnings estimate revisions have been persistently negative since late 2021. The EMU MSCI forward EPS is around record-high territory, and its net earnings revisions is turning positive (*Fig. 11*).

(5) *Sectors*. The China MSCI's rally has been entirely driven by its tech sector (*Fig. 12*). Looking at the Germany MSCI sector performance, the gains have been broader-based (*Fig. 13*). We feel comfortable with Europe from a long-term perspective but continue to think investors should underweight or avoid China given the unpredictability of government policies toward business.

**Global Economy: Green Shoots.** Global economic vibes beyond America's borders are humming louder than they have in a long while. The International Monetary Fund's (IMF) January playbook showed real global GDP growth ticking up in 2025 while US growth slows some. On a second-order basis, the improvement in global economic fundamentals bolsters the US economic outlook as well. We were beginning to wonder if/when a Eurozone recession and depressed demand in Asia would start to limit America's growth prospects—that no longer seems a worry. Other than Trump's trade war, everything is looking hunky-dory for the global economy.

The virtues of the US economy seem to be outperformed by those abroad for the first time in many years. Foreign fiscal firepower is being aimed at defense, productivity growth is starting to rise, and shoppers are opening up their wallets (rather than relying on American tourists to supply needed demand). Risks remain, however: Trade spats, lingering price pressures, and geopolitical gyrations still could put the brakes on the momentum overseas.

Today, we're dialing up the optimism and zooming in on the Eurozone and Asia. While recent economic data from Canada and Mexico have underwhelmed, and are especially disconcerting with tariff clouds looming, let's focus for now on the upbeat regional stats and forecasts that have been boosting sentiment in the Eurozone and Asia:

(1) *Eurozone's green shoots appear.* Recent macro data for the Eurozone and Germany show positive momentum, though they reflect trends before the US tariffs war escalated. With President Trump pushing Germany to boost defense spending, however, what once seemed unlikely in the Eurozone now seems more achievable. Consider the following:

- *Eurozone real GDP growth* is expected to rise to an annual rate of 1.0% in 2025 from results of 0.8% in 2024, the IMF predicted in January (*Fig. 14*). At the time, we had our doubts, especially regarding Germany's expected rebound to modest 0.3% y/y growth from a 0.2% contraction over the same time periods (*Fig. 15*).
- *Fiscal boosts*, however, like the Eurozone's 800-billion-euro defense spending plan announced in early March, could propel both Eurozone and German growth above the IMF's forecast.
- *Germany's real GDP growth* would likely increase to an annual rate of 1.5% in 2026, up from its December forecast of 0.9%, German forecaster IfW *said*, on the basis of the public spending boost.
- *German economic sentiment* jumped to 51.6 in March, the ZEW Indicator's best since January 2023, driven by hopes of fiscal stimulus (*Fig. 16*).
- *Eurozone economic sentiment* hit 96.3 in February, the highest in five months, reflecting improved industrial sentiment and reduced consumer pessimism, thanks in part to easing inflation and expectations of further rate-cutting by the European Central Bank (ECB) (*Fig. 17*).
- *German industrial production* *rose* 2.0% m/m in January, a positive sign after a slump (*Fig. 18*). This increase wasn't driven by tariff fears, as exports fell, but was led by a 6.4% rise in automotive production amid lower production and energy costs.
- *Eurozone industrial output* is expected to improve with higher sentiment throughout Q1 of this year, according to early estimates.
- *German inflation (harmonized)* was revised down to 2.6% y/y in February.
- *Eurozone overall inflation*, early *estimates* show, fell to a rate of 2.4% y/y, signaling that price pressures are easing toward the ECB's 2.0% inflation target.

(2) *Asia's indicators slowly rebound.* From China to Japan and India, Asian nations are deploying aggressive fiscal policies through increased capital expenditure, tax cuts, and defense spending initiatives. Early signs of a rebound are already sprouting across the region:

- *China's real GDP growth target* is 5.0% for 2025, Chinese leaders *confirmed* at the National People's Congress (NPC) meeting in early March (*Fig. 19*). To support this growth, more fiscal stimulus is coming. Officials indicated that they would raise the budget deficit to roughly 4.0% of GDP, the highest level in decades. For example, China's leaders announced on March 6 a trillion-yuan state-backed fund will support AI initiatives.

- *China's "Special Action Plan for Boosting Consumption,"* including eight directives to do so, was issued by China's central planners on Sunday. In an earlier NPC address, China's premier Li said that the country would "move faster" to address inadequate domestic demand and make it the "main engine" of growth.
- *China retail sales data* released on Monday showed upward momentum even ahead of the latest fiscal efforts, increasing by 4.0% y/y for the two months ending February, higher than the 3.7% increase in December and the fastest rate of increase since November.
- *China's industrial output* accelerated to a rate of 5.9% y/y for the combined January to February period.
- *Japan's real GDP growth* advanced 2.2% y/y during the last quarter of 2024, the Cabinet Office *reported* last week (*Fig. 20*). It was down from the initial estimate, but up from 1.4% in Q3-2024. The faster pace of growth was driven by a rebound in private capital spending and sustained government spending.
- *Japan's government spending* is set to rise further now that the pace of growth has quickened, as the government has set a 2.0% target for defense spending as a percentage of output.
- *India's real GDP growth* should exceed 6.5% for fiscal 2025-26, up from 6.3% in fiscal 2024-25, Moody's Ratings *said* on Thursday. The growth is expected to be driven by increased government capital expenditure on domestic priorities, middle-class income-tax cuts, and monetary easing.
- *India's flash industrial production* indicates a gangbusters rise of 6.0% y/y during January, up from 3.2% y/y in December (*Fig. 21*).
- *India's CPI* dropped in February to 3.61%, which is below the Reserve Bank of India's (RBI) target of 4.0%, suggesting that the RBI is likely to *ease* monetary policy further (*Fig. 22*).

**Strategy: Analysts Widen Their Earnings Uncertainty Nets.** LSEG released its snapshot of the monthly consensus earnings estimate revision activity for the past month. While the company provides raw data for all its polled measures, we focus primarily on the revenues and earnings forecasts, captured in our *S&P 500 NRRI & NERI* report. There, the analysts' estimate revisions activity is indexed by the number of upward revisions in forward earnings less the number of downward ones, expressed as a percentage of total forward earnings estimates.

We look at this activity over the past three months because that timespan encompasses an entire quarterly reporting cycle. Since analysts' tendency to revise their estimates differs at different points in the cycle, three-month data are less volatile—and misleading—than a weekly or monthly series would be. A zero reading indicates that an equal number of estimates were raised as were lowered over the past three months.

Joe highlights what's most notable about the February crop of earnings revisions data below:

(1) *S&P 500 NERI weakened considerably m/m.* The S&P 500's NERI index, which measures the revisions activity for earnings forecasts, tumbled nearly 3pts in February to a 25-month low of -4.8% from -2.0% in January (*Fig. 23*). That was the biggest m/m drop since December 2023 and makes February the 34th worst month in the 40 years of data recorded.

February's rapid deterioration is a typical response from analysts when they broadly "nickel" their forecasts lower irrespective of a company's fundamentals. No corresponding broad deterioration in forward earnings has occurred yet; most sectors' forward earnings remain close to record highs (*Fig. 24*).

(2) *Just three sectors had positive NERI.* That's unchanged m/m, but down from four sectors in December and nine in June 2024. Still, it beats January 2024's result when only one sector, Tech, had positive NERI.

(3) Only *two sectors' NERIs improved m/m*. Nine of the 11 S&P 500 sectors had NERI deteriorate m/m, the broadest decline since all 11 did in November 2023. Energy's NERI was negative again in February (for the 22nd time in 26 months) but improved for a third straight month. Utilities was the only other sector to improve m/m in February.

Financials' latest NERI beat all other sectors' (*Fig. 25*). It was positive for a 13th straight month, the longest streak among the S&P 500 sectors, followed by Communication Services (11 months) and Utilities (10). Among the poorer performing sectors, NERIs dropped to 56-month lows for Consumer Staples and Materials, followed by Industrials (26 month-low) and Information Technology (22). Tech's NERI was negative for a second straight month.

Here's how the NERIs ranked for the 11 sectors in February: Financials (4.9%), Utilities (0.9), Communication Services (0.3), Information Technology (-2.7), S&P 500 (-4.8), Consumer Discretionary (-5.3), Real Estate (-5.7), Energy (-5.7), Health Care (-6.1), Industrials (-9.9), Consumer Staples (-10.9), and Materials (-20.2).

## Calendars

**US: Wed:** Fed Interest Rate Decision 4.50%; FOMC Economic Projections; MBA Mortgage Applications. **Thurs:** Leading Indicators -0.2%; Initial Jobless Claims 225k; Philadelphia Fed Manufacturing Index 9; Existing Home Sales 3.95mu. (FXStreet estimates)

**Global: Wed:** Eurozone Headline & Core CPI 2.4% & 2.6%y/y; Japan Industrial Production -1.1%; Japan Capacity Utilization; BoJ Press Conference. **Thurs:** EU Leaders Summit; Australia Unemployment & Participation Rates 4.1% & 67.3%. (FXStreet estimates)

## US Economic Indicators

**Industrial Production** (*link*): Industrial production beat estimates in February, boosted by robust growth in the manufacturing sector. *Headline* production advanced for the third successive month in February, jumping 0.7%, stronger than the consensus estimate of a 0.2% gain and more than double January's downwardly revised increase of 0.3%. Production increased 2.1% over the three months through February. The *manufacturing sector*, which accounts for three-quarters of total production, jumped 0.9% last month—accelerating from January's 0.1% uptick—led by an 8.5% surge in the production of motor vehicles & parts. It was the fourth consecutive monthly increase in manufacturing production, for a total gain of 1.6%. *Excluding motor vehicles*, manufacturing production rose 0.4% in February. *By market group*, *consumer goods* output increased 0.2% in February, as consumer durable goods production jumped 4.3%, led by auto output, more than offsetting the 0.8% decline in consumer nondurable goods output. *Business equipment* production rose for the fourth successive month, by 1.6% m/m and 7.0% over the period, led by *transit equipment*, which rose 7.9% and 33.7% over the comparable time periods. *Industrial equipment* output climbed three of the past four months, by 0.3% in February and 1.6% over the period, while *information processing equipment* output slipped 0.3% last month after rebounding 1.9% the prior two months. Production of *defense & space equipment* advanced 1.3% in February following no change in January and a 0.7% increase and a 0.9% decrease during December and November, respectively.

**Capacity Utilization** (*link*): The *headline* capacity utilization rate climbed for the third month in February to 78.2%, after slipping from 77.9% in August to 76.8% in November. February's rate is 1.4ppts below its long-run (1972-2024) average.
The *manufacturing* utilization rate rose to 77.0% in February, after hovering between 76.1% and 76.4% the prior four months, with the rate 1.2ppts below its long-run average. The utilization rate for mining rose to 90.3% last month—3.8ppts above its long-run average—after falling from 90.9% in December to 87.9% in January, while the utilities rate fell 2.2ppts to 73.9%, remaining well below its long-run average.

**Housing Starts & Building Permits** (*link*): Housing starts rebounded in February from January's weather-related plunge, though remain below year-ago levels. *Total housing starts* soared 11.2% to 1.501mu (saar) last month, following January's 11.5% plunge, well above both the consensus estimate of 1.380mu and January's downwardly revised tally of 1.350mu. Starts were 2.9% below year-ago levels. *Single-family starts* jumped 11.4% to 1.108mu (saar), while starts for multi-unit buildings, *with five units or more,* soared 12.1% to 370,000 units. Starts for the former were down 2.3% from February 2024, while the latter was down 6.6% from a year ago. *Regionally*, total housing starts in the Northeast (47.4% m/m & 20.2% y/y) posted the double-digit gains on both a monthly and yearly basis, while starts out West (5.9 & 26.2) posted increases in the low single-digits in February, but was the strongest region compared to a year ago. Meanwhile, starts in the South (18.3 & -5.6) posted an impressive gain in February but were below year-ago levels, while starts in the Midwest (-24.9 & -44.4) were the weakest by far, tumbling on both a monthly and yearly basis. Meanwhile, *building permits*, an indicator of future construction, sank 1.2% in February to 1.456 mu (saar), with single-family permits ticking down 0.2% to 992,000 units, while multi-family buildings with *five or more units* sank 4.3% to 404,000 units. *Versus a year ago*, total permits were down 6.8%, led by a 15.7% plunge in buildings with five or more units, while single-family permits fell 3.4%.

**Import Prices** (*link*): Import prices were a surprise on the upside in February, with higher fuel and nonfuel prices accounting for the overall increase. *Import prices* climbed 0.4% last month—above consensus estimates of a 0.1% dip—matching January's upwardly revised gain, to 0.4% from 0.3%. *Imported fuel prices* advanced 1.7%, after jumping 3.5% at the start of the year, while *food prices* were flat following January's 0.2% uptick. *Excluding fuels and food*, import prices accelerated 0.4% after being unchanged in January. Prices for imported capital goods slipped 0.2% following January's 0.1% uptick, while prices for imported automotive vehicles, parts, and engines were unchanged. *Excluding autos*, the imported consumer goods price jumped 0.4% after two months of decline. The *yearly percent change in import prices* remains on an accelerating trend, rising from -6.1% in mid-

2023 to 2.0% y/y in February, remaining around the recent peak 2.1% in December—which was the highest since December 2022. *Excluding petroleum prices*, the yearly rate has been hovering around 2.0% recently, up from -2.1% in April 2023.

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