Yardeni Research

May 28, 2025

Morning Briefing

On The Euro, Brexit
& US Stock Performance

Check out the accompanying chart collection.

Executive Summary: The Trump administration's protectionist policies have undermined the US dollar's strength, but do they put its global supremacy at risk? No, there is no realistic contender among global currencies. Today, Melissa debunks the notion that the euro has a shot at usurping the dollar's dominance. … Also: With Brexit five years in the past, EU/UK relations seem to be shifting. New agreements suggest the EU is softening its stance toward sharing member-state benefits with the UK. … Also: Joe discusses ytd performance data for major segments of the stock market, highlighting how their performances have diverged over the past few volatile months.

Weekly Webcast. If you missed yesterday's live webcast, you can view a replay *here*.

Europe I: Euro Not Ready To Challenge the Dollar. The notion of American exceptionalism—that elusive blend of economic scale, institutional credibility, and open-market orthodoxy—is under fresh scrutiny. Political gridlock, massive deficits, and trade protectionism have cast doubt on the durability of the dollar's dominance. But for all the grumbling, there's still no real alternative.

In a May 22 *op-ed* in *The Economist*, Greece's central bank governor Yannis Stournaras reminded readers that the dollar's supremacy isn't just about size—it's about credibility. The US remains the anchor of global finance because it offers transparency, liquidity, and a reliable policy framework. The greenback funds countries' budget deficits, recycles into US Treasury bonds, and keeps the gears of global trade turning.

Yes, the Trump administration's protectionist push to reduce the US trade deficit by manufacturing more goods domestically is testing those long-standing attributes of the dollar. As the US turns inward, some observers see an opening for the euro to gain market share and become the world's dominant currency. But they will likely be disappointed: The dollar may be imperfect, but its crown is still secure. Until Europe can unite behind a shared fiscal future, the euro will remain a strong regional currency but not a rival of the dollar on a global scale.

Here's why the dollar still reigns supreme and what's holding the euro back:

(1) *A global euro moment?* European Central Bank President Christine Lagarde called it out directly in a Berlin lecture: "The euro will not gain influence by default—it will have to earn it." And earn it fast. The US is flirting with protectionism currently, but not necessarily beyond Trump's second term. So Brussels has a narrow window to elevate the euro's global standing.

Stournaras argues the roadmap to euro dominance is well marked: adopt the European integration blueprints advanced by Europhiles like former Italian Prime Minister Mario Draghi, as commissioned by European Commission (EC) President Ursula von der Leyen; complete the Savings and Investments Union that facilitates cross-border investment and provides fiscal support for national governments; simplify the European Union's regulatory maze; and centralize its energy policy. (For more on these reforms, see our February 19 *Morning Briefing*.)

But clarity of vision doesn't guarantee political execution. Deeper integration of the EU's member states is an idea floated in various forms since 2010, and it faces formidable opposition from member states with entrenched interests of their own that wouldn't be served by integration.

(2) *Short-term volatility; long-term uncertainty.* The euro has had a decent run lately. Its value relative to the dollar has regained some lost ground in recent weeks, thanks to a planned boost in defense spending within the region and improving industrial output (*Fig. 1*).

The EUR/USD exchange rate is highly sensitive to trade diplomacy. It quickly retreated when on Sunday US President Donald Trump threatened to slap a 50% tariff on EU goods. Then on Monday it recovered after Trump held talks with EC head von der Leyen and postponed the tariff hike until July 9.

No doubt, the euro's near-term performance will continue to be highly dependent on trade diplomacy. But its long-term ascent? That depends less on US trade negotiations and more on whether European nations can ever be fully integrated.

(3) *The integration illusion.* Unfortunately for the euro, we assign a less than 50% probability that Europe achieves meaningful integration—defined as fiscal union, capital markets union, and reserve currency muscle—within the next three to five years. Why? Politics, economic disparity, and debt divide the EU nations.

Germany and France, the largest EU economies, recently have been consumed by domestic political crises. In Berlin, after the government collapsed, Friedrich Merz needed two rounds of votes to win the chancellorship—a postwar first. In Paris, President Emmanuel Macron reset his Cabinet after a budget-driven failure and still governs without a parliamentary majority.

The EC's spring 2025 *forecast* underscores the wide divergence among Eurozone economies' outlooks. The GDP growth forecasts for 2026 range from below 1.0% to above 3.0%. And two of the biggest economies—Germany and France—are forecasted to grow GDP at roughly 1.0%, barely above stall speed. Integration is hard enough for Europe. It's even harder when its core economies aren't growing.

Generally speaking, the weaker economies have more to gain from integration than the stronger ones. Germany's projected 2026 debt as a percentage of GDP is just 64.7%. Greece's ratio sits at 140.6%. That divergence explains why Athens wants a fiscal union—it needs it. Germany historically has been fiscally conservative, but it recently showed its willingness loosen the country's debt-limit rules by adopting large domestic defense and infrastructure spending plans. But would it be willing to assume other countries' fiscal larger burdens? That's unclear.

Europe II: The Brexit Reset. It's been five years since the UK walked out of the EU. At the time, fears ran high that Brexit might trigger a domino effect of departures. That didn't happen. But neither did deeper EU integration. Europe remains more patched together than unified.

Last week's post-Brexit agreement between the UK and EU suggests something new: not a rekindling of union, but a relationship that's rebalancing, aided by greater EU flexibility. The deal may offer a blueprint for future EU arrangements with non-members—or even with members reconsidering full participation.

Brussels long has warned there would be no "cherry picking" for Britain: The UK won't get the benefits of the EU if it isn't willing to rejoin as a full member. Yet two key features of the post-Brexit agreement hint at a shift—the EU may be softening its stance. Here are two EU "cherries" that Brussels has agreed to give the UK:

(1) *Rearmament funds*. The EU's €150 billion SAFE initiative was intended to boost defense spending among member states and benefit defense companies in the EU. But now, under the post-Brexit agreement, the EU's SAFE defense dollars can be spent on goods provided by UK defense firms—a controversial twist that could undercut EU-based defense industries and blur the lines between insider and outsider.

(2) *Youth mobility*. The post-Brexit agreement also proposes easing restrictions for young people to study and work across the UK and EU. Historically, the UK was a magnet for EU youth. Whether the new program revives that flow—or reverses it—remains to be seen.

If such hybrid arrangements proliferate, the EU may be drifting toward a more flexible relationship with the UK rather than insisting on unity or nothing.

Strategy: Stocks' Wild Ride. It has been an interesting year for the US stock market to say the least. Many indexes traded at record highs right up until Trump's inauguration, but those animal-spirits-driven gains dissolved after he turned up the heat on tariffs.

The Magnificent-7 group of stocks, with a ytd drop of 7.3% in its collective market capitalization, has greatly underperformed the S&P 500's 1.3% decline. If the Mag-7's underperformance continued until the end of 2025, it would mark only the second time in 13 years that the group lagged the broad index. The S&P 500 without the Magnificent-7 (a.k.a. the "S&P 493") has risen 2.9% ytd. The "SMidCaps" (our nickname for the S&P MidCap 400 and the S&P SmallCap 600 collectively) is down ytd and lagging its larger-cap counterparts. The S&P MidCap 400 has dropped 4.6% so far this year, and the S&P SmallCap 600 has tumbled 10.0%.

Despite the mixed price performance for the three capitalization-size indexes this year, the fundamentals remain generally stronger for the LargeCaps. Below, Joe details the strides that the companies in each index collectively made in forward fundamentals so far this year (as a reminder, forward revenues and earnings are the time-weighted averages of analysts' consensus estimates for the current and following year; the forward profit margin is derived from forward revenues and earnings):

(1) *Forward revenues.* The Magnificent-7's forward revenues forecast has risen 3.0% ytd, about double the rises for the S&P LargeCap 500 (1.5%) and the S&P 493 (1.4%) (*Fig. 2*). The S&P MidCap 400 has outperformed its larger-capitalization counterparts with a 3.6% ytd gain in forward revenues, but the S&P SmallCap 600 lags considerably with a ytd decline of 4.4% (*Fig. 3*).

SmallCap's forward revenues is now 9.4% below its September 2022 record high. Those of LargeCap and MidCap are just 0.2% and 1.5% below their respective highs in early April. Those compare to 0.2% below for the S&P 493 and 1.6% below for the Magnificent-7.

(2) *Forward earnings.* Forward earnings forecasts were at record highs during April for all but the S&P SmallCap 600, which last hit that mark nearly three years ago in June 2022. Leading the way so far in 2025 is the Magnificent-7, with its forward earnings up 5.2% ytd, well ahead of the gains for the S&P LargeCap 500 (1.5%) and the S&P 493 (0.9%) indexes (*Fig. 4*).

The SMidCap's forward earnings have underperformed: The S&P MidCap 400's is down 1.6% ytd, and the S&P SmallCap 600's has dropped 3.1% (*Fig. 5*). SmallCap's forward earnings is now 14.6% below its June 2022 record high. Those of LargeCap and MidCap are 0.4% and 3.1% below their respective record highs in early April. That compares to 1.2% below for the S&P 493 and 1.5% below for the Magnificent-7.

(3) *Forward profit margin.* The Magnificent-7's forward profit margin had risen 0.9ppt ytd from 25.4% to a record-high 26.3% during the May 6 week. It has given up nearly half of its gain since then, falling 0.4ppt to 25.9% during the May 20 week.

The S&P 500's margin had improved 0.1ppt from 13.5% at the start of the year to another record high of 13.6% during the April 8 week but has stalled at 13.5% since then (*Fig. 6*).

The S&P 493's forward profit margin had ticked up from 11.9% at the year's start to a 24-month high of 12.0% in mid-January. It has since dropped back down to 11.9%.

Among the SMidCaps, margins went in different directions (*Fig. 7*). The S&P MidCap 400's forward profit margin initially ticked up 0.1ppt ytd to 8.3% but is now down 0.4ppts ytd to a four-year low of 7.8%. The S&P SmallCap 600's forward profit margin had improved 0.3ppt ytd to a two-year high of 6.7% in early May, but it since has edged down to 6.6%.

Calendars

US: Wed: MBA Mortgage Applications; Richmond Fed Manufacturing Index -9; FOMC Minutes; Williams; Waller; Kashkari. **Thurs:** Real GDP & GDP Price Index -0.3% & 5.9%; Headline & Core PCED 3.6%q/q & 3.5%q/q (saar); Initial Claims 229k; Pending Home Sales -1.0%; Daly; Goolsbee; Logan. (FXStreet estimates)

Global: Wed: Germany Unemployment Rate 6.3%; France GDP 0.1%. **Thurs:** Spain Retail Sales; Italy Business Confidence; Japan Industrial Production -1.4%; Japan Unemployment Rate 2.5%; Japan Household Confidence 31.8; Bailey. (FXStreet estimates)

US Economic Indicators

Consumer Confidence (*link*): Consumer confidence jumped in May after five consecutive months of declines. The report notes, "The rebound was already visible before the May 12 US-China trade deal but gained momentum afterwards. The monthly improvement was largely driven by consumer expectations of all three components of the Expectations Index—business conditions, employment prospects, and future income." *Headline consumer confidence* soared 12.3 points to 98.0 in May after tumbling 27.1 points from 112.8 in November to 85.7 in April (which was the lowest level in nearly five years). The expectations component (to 72.8 from 55.4) soared 17.4 points in May but remained below the threshold of 80, which typically signals a recession ahead, while the current conditions component rose 4.8 points (135.9 from 131.1). Consumers' assessments of *current business conditions* were more positive in May, with 21.9% stating business conditions were good, up from April's 19.2%, while 14.0% said conditions were bad, down from 16.3% last month. *Consumers' assessment of present labor conditions* weakened a bit this month, with 31.8% of consumers saying jobs were plentiful, up only slightly from 31.2% in April, while 18.6% of consumers said jobs were hard to get, up from 17.5% in April. Consumers' assessment of the *short-term labor market* was less negative this month, with 19.2% of consumers anticipating more jobs to be available, up from 15.9% in April, while 26.6% anticipated fewer jobs, down from 32.4% last month. Consumers' outlook for *short-term business conditions* six months from now were less pessimistic, with 19.7% expecting conditions to improve, higher than April's 15.9%, while 26.7% expected conditions to worsen, down from 34.9% last month. Consumers' outlook for their *income prospects* turned positive this month, with 18.0% expecting their incomes to increase, up from 15.9% last month, while 13.8% expected their incomes to decrease, down from 17.7% last month. As for *inflation expectations*, the 12-month expected inflation rate eased to 6.5% after jumping to 7.0% in April—which was the highest since November 2022, when the US was experiencing extremely high inflation. *Write-in responses* showed that tariffs were the top concern for consumers this month, reaching an all-time high, while inflation and high prices were also major worries.

Durable Goods Orders & Shipments (*link*): Durable goods orders fell in April for the first time in five months, posting the sharpest decline since January 2024. Durable goods orders tumbled 6.3% in April, though softer than the consensus estimate of a 7.8% drop. That followed a four-month surge of 9.7% during the four months through March. Orders for transportations equipment tumbled 17.1% in April, mainly on a sharp drop in nondefense aircraft & parts, which plunged 51.5% during the month—as tariff concerns caused airlines to halt demand for Boeing planes (Boeing received only eight orders last month). *Excluding transportation*, durable goods orders were little changed, ticking up 0.2%. *Nondefense capital goods orders* plunged 19.1%, while the comparable shipments measure climbed 3.5%. Meanwhile, *nondefense capital goods orders excluding aircraft* (a proxy for future business investment) slipped 1.3% following a 0.3% uptick in March, while *shipments of core capital goods*, used in the calculation of the GDP component of business equipment spending, slipped 0.1% in April following March's 0.5% gain.

Global Economic Indicators

Eurozone Economic Sentiment Indicators (*link*): Europeans' economic sentiment rose in May for the first time in three months. Economic Sentiment Indexes (ESIs) for both the EU and the Eurozone improved, with the EU's rising 0.6 points to 95.2 and the Eurozone's rising 1.0 to 94.8. ESIs among the six largest EU economies were mixed, with Italy (+2.8 point to 98.6) and Germany (+1.5 to 91.5) in the plus column, while France (-3.5 to 93.1) showed a noticeable decline. Meanwhile, the Netherlands (-0.8 to 96.8), Poland (-0.6 to 100.3), and Spain (-0.4 to 103.4) showed smaller downticks. By sector for the overall EU, consumer (+1.4 points to -14.5) and retail (+1.4 to -5.7) confidence posted the largest gains, followed by construction (+0.5 to -5.3) confidence. Meanwhile, both services (-0.3 to 2.5) and industry (-0.2 to -10.0) confidence held broadly stable, ticking only slightly lower.

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