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Can the decoupling of Europe and the United States ?

March 10, 2025

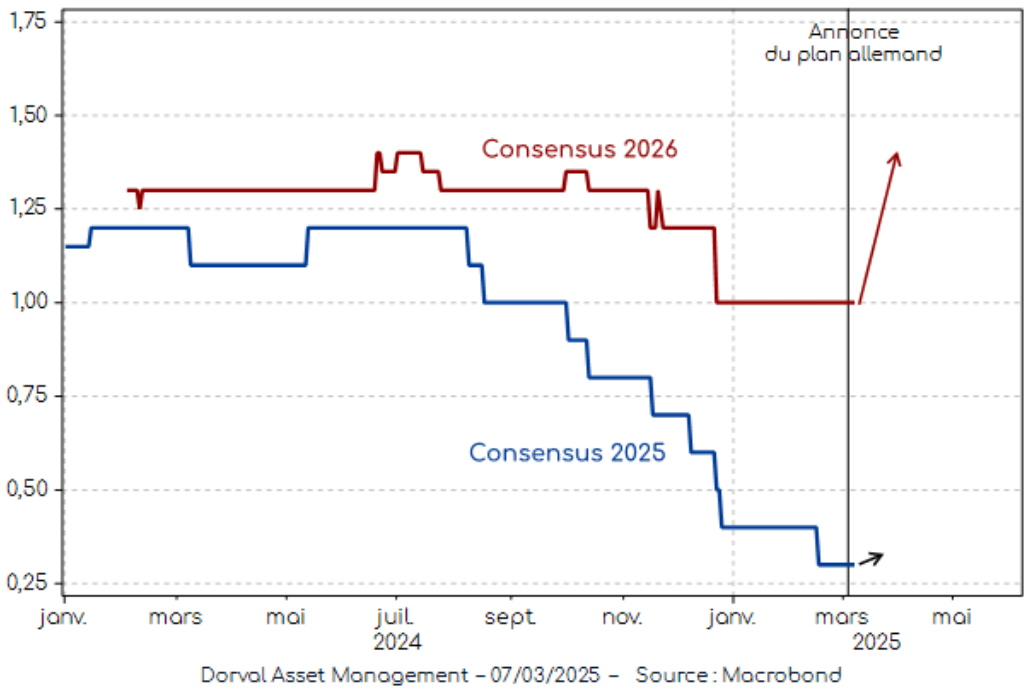
Dear clients, dear partners,

While American euphoria has given way to doubt and even sometimes to pessimism, the European economic depression has just received shock treatment with the announcement of an ambitious German budget plan. To what extent is this reversal already reflected in prices ?

Economic stagnation, the rise of the AfD, the double threat of US administration tariffs and disengagement in Ukraine have finally produced a German reaction that is up to the situation. By planning to amend a constitutional rule of balanced budgeting that bordered on sadomasochism, Germany would therefore increase its military spending to 3.5% of GDP in the coming years, compared with 1.3% in 2021 and 2.1% in 2024, and launch an infrastructure spending plan of around 1% of GDP per year for the next ten years. It is expected that a large part of these decisions will be made before March 25 by the outgoing Parliament, as the AfD has a blocking minority in the new Bundestag. This plan should enable Germany to counter the threats of recession linked to the weakening of its industry and employment, and to future US tariffs. After several quarters of downward revisions, economists have begun to revise their forecasts upwards, especially from 2026 onwards. In a scenario of gradual implementation of the plan, Goldman Sachs experts, for example, anticipate growth of +1.5% in 2026 (compared with 1% previously) and +2% in 2027 (compared with 1.5%).

Towards a reversal of the forecast momentum for German growth, especially from 2026 onwards

Vers un renversement du momentum de prévisions pour la croissance allemande, surtout à partir de 2026

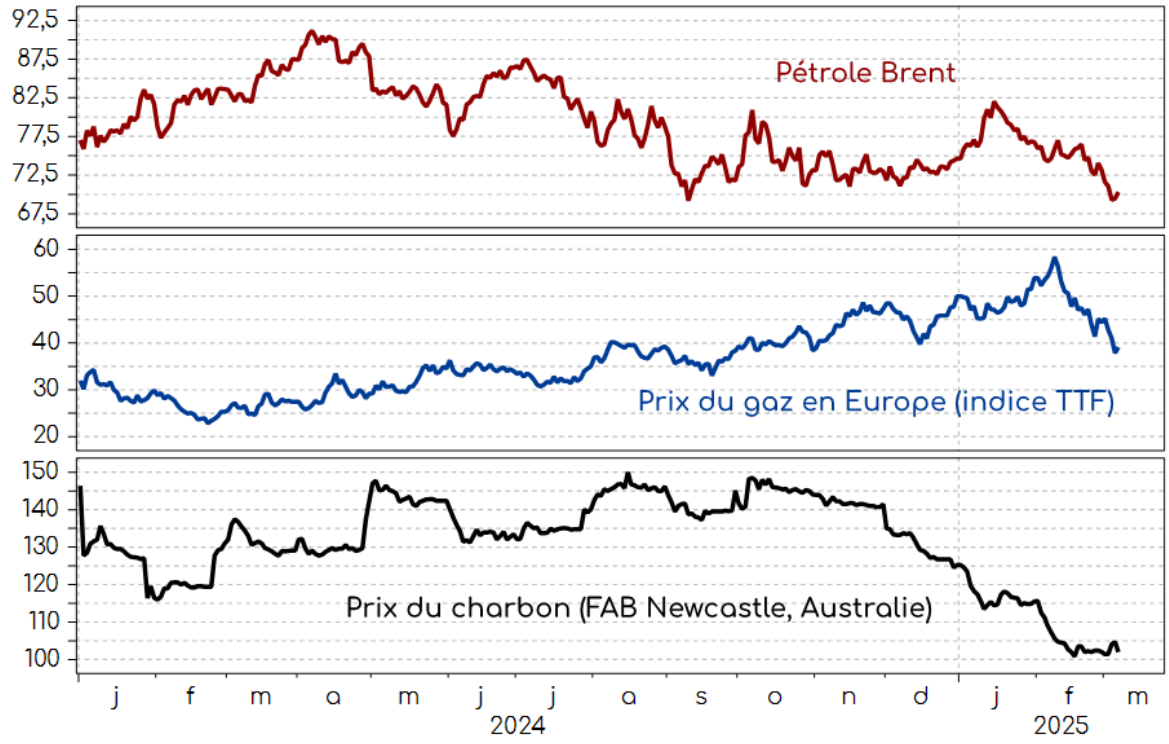


Announcement of the German plan

While the principle of a German plan was expected, its scale is pleasantly surprising. For the euro zone, there are good and not so good aspects, but the positive ones dominate. The expected recovery of the German economy and the increase in public spending certainly deteriorate some of the financial conditions of the euro zone through higher long-term rates and a less weak euro. However, this disadvantage must be put into perspective. Germany has room to grow without inflationary pressures, with its GDP, according to European Commission calculations, about 1.5% below its potential. This margin should limit the rise in long-term rates and leave the ECB with some potential for easing. Furthermore, the German plan – if it is voted through – comes at a favorable moment of decline in world energy prices (graph 2), which leaves intact the scenario of a recovery in purchasing power and normalization of inflation. Finally, the German plan will have (small) direct benefits for neighboring economies, but also indirect benefits by easing the political pressure for fiscal consolidation in the most indebted countries. In particular, Europe is moving towards excluding part of military spending in the calculation of common fiscal rules.

If confirmed, the wisdom of global energy prices should limit the rise in long-term rates in Europe

S'ils se confirment, la sagesse des prix mondiaux de l'énergie devrait limiter la hausse des taux à long terme en Europe

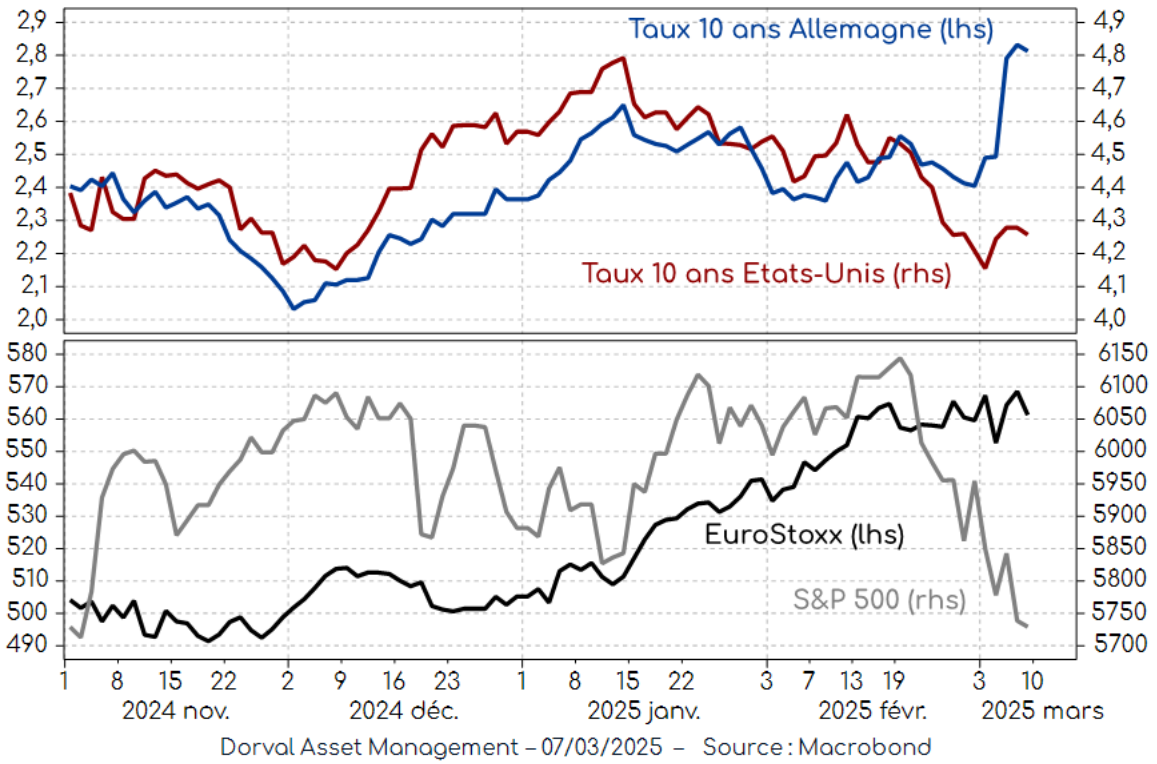


Brent oil / Gas prices in Europe (TTF index) / Coal price (FOB Newcastle, Australia)

While Europe is rightly celebrating the decisive turnaround in German politics, the United States is suffering from a severe hangover after the euphoria of the end of 2024. The AI monopoly threatens to escape the magnificent seven with the arrival of "low cost", and American households and business circles alike are beginning to worry seriously about the impact of the predicted explosion of customs duties on the economy. While the US economy remains strong, expectations are deteriorating, as evidenced by the fall in long-term rates and the US stock market, in stark contrast to what is happening in Europe (graph 3).

Sharp decoupling of expectations between Europe and the United States

Brusque découplage des anticipations entre l'Europe et les Etats-Unis

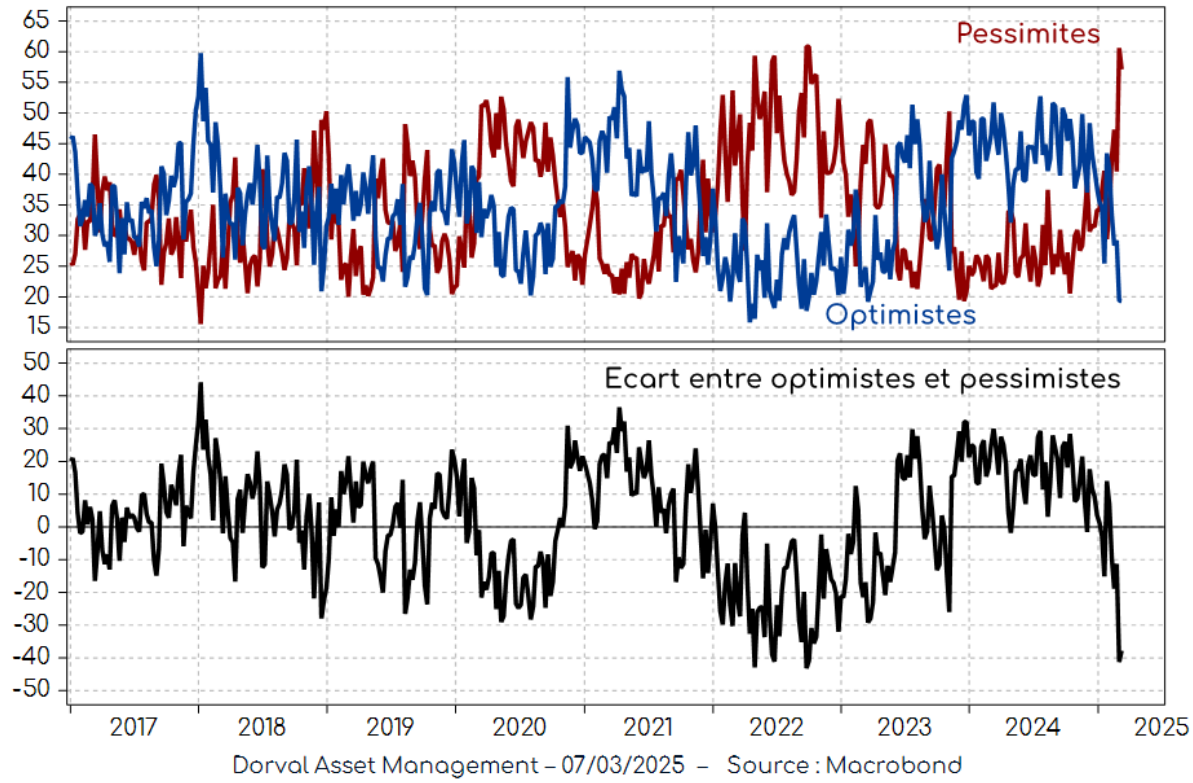


Germany 10-year rate (lhs) / United States 10-year rate (rhs) / Eurostoxx (lhs) / S&P 500 (rhs)

Hopes have therefore shifted, with investors betting on the reflationary effects of European and Chinese firefighting policies in response to Donald Trump's blows, and on the negative effects of potential tariffs on the North American economy. This logic makes sense, but it is probably already largely in people's minds, as suggested by the now very depressed level of morale among individual investors in the United States (graph 4). 60% of them are negative about the US stock market, compared with only 20% who are positive, a rather rare gap that is generally (but not always) observed at times close to upward market reversals.

Optimism among individual American investors has collapsed

L'optimisme des investisseurs individuels américains s'est écroulé



Pessimists / Optimists / Difference between optimists and pessimists

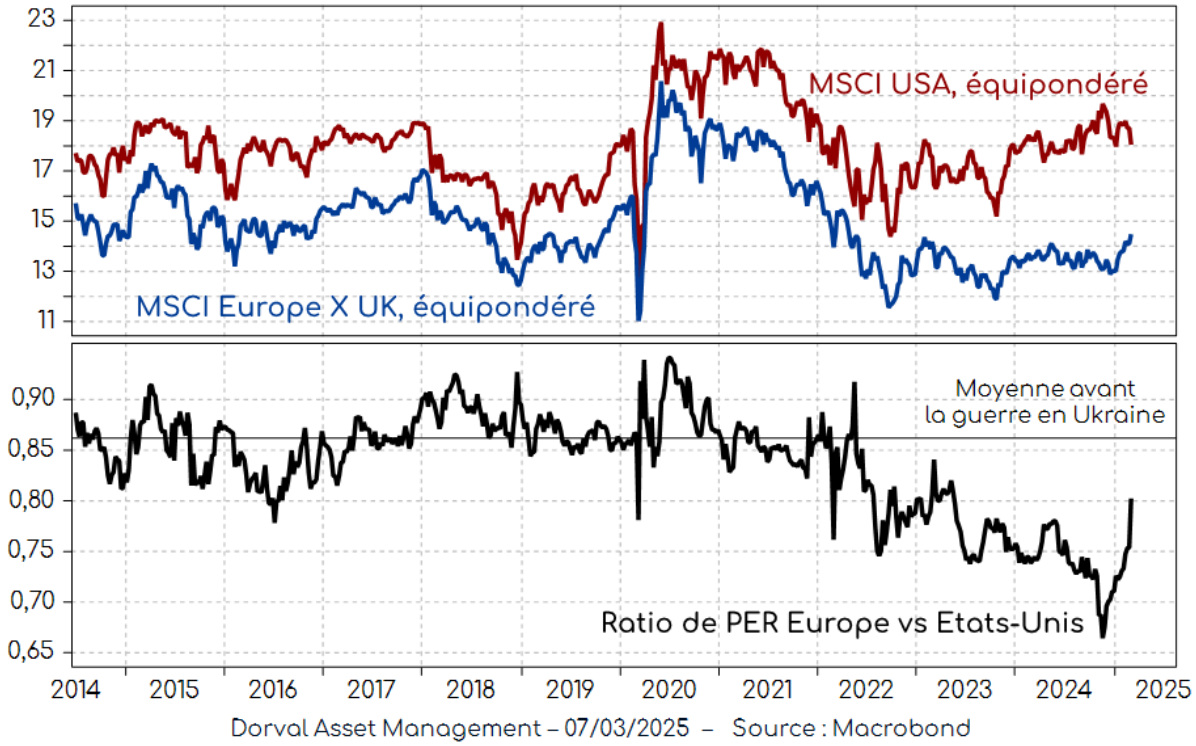
Underweighting the US market on the basis of recent events could therefore prove to be quite dangerous tactically, especially as the US administration could (temporarily?) reassure the markets and the business community, as it did recently by postponing the tariffs on Canada and Mexico by one month. In a longer-term perspective, the relative valuation of European equities compared to American ones still favors the former, but the gap has now narrowed significantly, to 20% compared to an average discount of 15% before the invasion of Ukraine (graph 5).

Discount on European equities narrows compared with US equities

Forward P/E ratios calculated by Bloomberg

La décote des actions européennes se réduit par rapport aux actions américaines

PER prospectifs calculés par Bloomberg



MSCI USA, equally weighted / MSCI Europe X UK, equally weighted / Average pre-war in Ukraine / **P/E ratio Europe vs. USA**

We are therefore maintaining a geographically very diversified approach in our global funds, with a slightly reduced equity exposure. Our basket of stocks most sensitive to AI has underperformed, but the one linked to the prospect of an industrial recovery is benefiting from the German plan, and the basket of European and Japanese financial stocks is still doing well. Our bond duration remains very modest for the time being, and we remain hedged against currency risk. In our European flexible funds, we have tactically reduced our equity exposure somewhat after the strong rise in recent weeks.

Our exposure rates are as follows:

- **Dorval Convictions:** 55% net exposure to equities, including Euro Stoxx 50 SRI core basket 60%, financials basket 3%, small caps basket 2%. Hedging with Euro Stoxx 50 futures and options.

Dorval Asset Management

Public limited company with share capital of €493,876

Paris Trade and Companies Register No. B 391392768
APE 6630 Z - AMF accreditation no. GP 93-08

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