Flash Economics

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Why have European stocks risen while American stocks have fallen since the beginning of 2025?

The anticipated growth in earnings per share for U.S. companies in 2025, according to all analysts, stands at 9.3%, with 78% of companies having reported profits above expectations in the first quarter of 2025.

In the eurozone, the consensus EPS growth for 2025 is only 3.1%; however, 61% of European companies reported results above analysts' expectations. This difference in earnings growth between U.S. and European companies is explained by GDP growth forecasts and a revenue distribution that favors companies in the United States.

Yet, as of May 26th, the Euro Stoxx 50 index has risen by 10.1% since the beginning of the year, while the S&P 500 index has fallen by 1.3% and the Nasdaq Composite index has declined by 2.9%. Where does this discrepancy come from, seemingly inconsistent with the expected earnings growth?

- Concerns about the effects of the Trump Administration's policies;
- The decline of U.S. tech stocks, due to concerns about their valuation and the profitability of investments in Artificial Intelligence;
- The rise of defense stocks in Europe, for example, since the beginning of the year: +57% for Dassault Aviation, +90% for Thales, +202% for Rheinmetall, +102% for Leonardo. These stocks represent 5% of Europe's market capitalization;
- Excessive optimism regarding Europe's ability to rebound.

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Despite weak European economic growth and modest corporate earnings increases, European stock indices have risen significantly more than U.S. stock indices since the beginning of the year.

The projected growth for the eurozone in 2025 (0.7% to 0.8%) is lower than the forecasted growth for the United States (around 1.5%), especially following Donald Trump's policy reversal on tariffs. Analysts forecast earnings per share to rise by 9.3% in the United States and by 3.1% in the eurozone in 2025.

These projections should have led to an outperformance of U.S. stocks relative to European stocks. However, the opposite has occurred: since the beginning of 2025, the Euro Stoxx 50 index has risen by 10.1%, while the S&P 500 index has declined by 1.3%, and the Nasdaq Composite index has dropped by 2.9%.

This raises questions about **the apparent inconsistency between the expected trajectories of the economies and those of their respective stock market indices.**

First explanation: concern over the effects of decisions made by the Trump Administration

Even though the initially planned tariffs—particularly on U.S. imports from China—have been significantly reduced, uncertainty surrounding the Trump Administration's economic policies remains high. This includes concerns about immigration policy, the scale of tax cuts, and the resulting public deficit, especially given Donald Trump's demonstrated unpredictability and the abruptness of his decisions.

As a result, the U.S. stock market has lagged the European stock market since the beginning of 2025 (**Chart 1**), despite the rebound following the rollback of most tariffs, **due to ongoing uncertainty around U.S. economic policies.**

Chart 1
Stock market indices (01.01.2024 = 100)

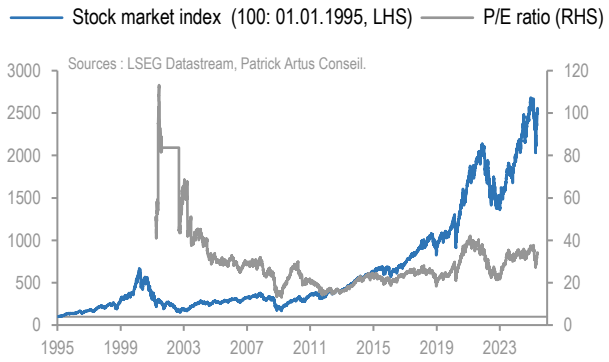


Second explanation: concern over the valuation of U.S. tech companies

The valuation of American tech companies is high (**Chart 2**), which may concern some investors:

- In absolute terms, because such high valuations could be subject to downward corrections, as seen after the dot-com bubble correction (?);
- Because these high valuations persist despite the fact that the **massive investments in Artificial Intelligence** made by U.S. tech companies may prove difficult to make profitable.

Chart 2
NASDAQ : Stock market index and P/E ratio



Third explanation: the rise of defense stocks in Europe

Defense stocks' valuations have increased significantly in Europe (**Chart 3**) since European countries consensually agreed to increase their military budgets (**Chart 4**) and to place more weapons orders with European defense manufacturers.

Chart 3
Stock market index: Euro Stoxx aerospace and defence
(01.01.2022 = 100)

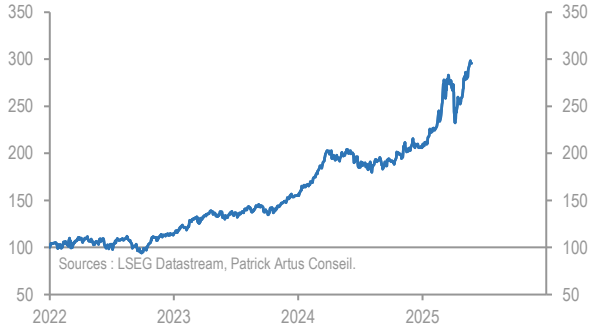
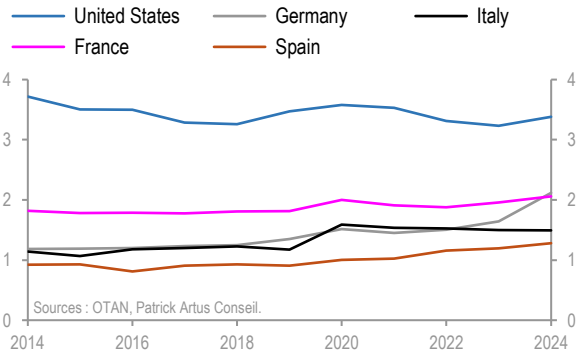


Chart 4
Military expenditures (as % of GDP)



Fourth explanation: excessive optimism about Europe's ability to recover

There is talk of a "European moment," with expectations that **policies in Europe will be significantly revised** (military spending, budgetary flexibility, etc..) **due to the shock caused by Donald Trump's election**.

While this is true regarding military spending and European budget rules (the maximum deficit of 3% of GDP may be exceeded if it is due to increased military expenditures), **many structural factors remain unfavorable for Europe:**

- Weakness in skills across many countries (**Table 1**);

Table 1: Results of the OECD PIAAC survey (by decreasing score from the 2023 survey, overall score*)

Country	2016	2023
Japan	292	285
Sweden	279	281
Canada	269	267
Germany	271	267
England (UK)	267	266
France	258	253
Spain	249	246
Italy	249	240

Source : OCDE
*In 2016, average score in numeracy and literacy

- Weakness in Research and Development spending (Chart 5) and in business investment in New Technologies (Chart 6);

Chart 5
Total R&D spending (as % of nominal GDP)

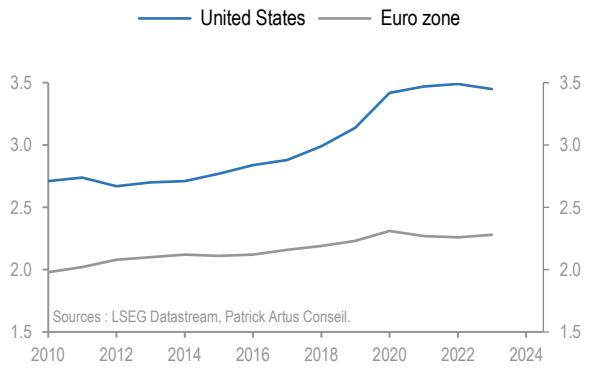
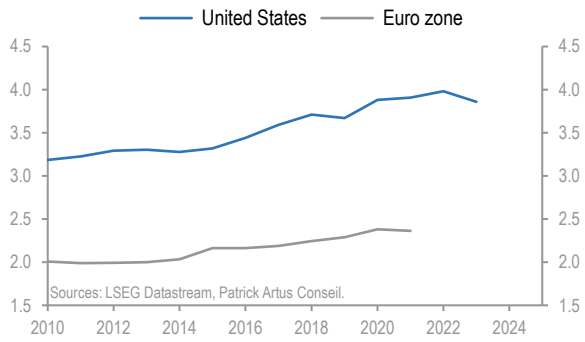


Chart 6
ICT investment including software
(in value terms, as % of nominal GDP)



- Demographic aging;
- Lack of coordination in industrial and fiscal policies;
- Fragmented financial markets (due to the absence of a capital markets union) and the absence of federal debt for the European Union.

There are concerns that investors' optimism about Europe's recovery may be greatly exaggerated.

Summary: The outperformance of the European equity market compared to the U.S. equity market has some reasonable explanations but is likely also linked to excessive optimism about Europe's situation.

Some legitimate causes for the European equity market's outperformance over the U.S. equity market include:

- The uncertainty created by Donald Trump's economic policies;
- Doubts about the profitability of Artificial Intelligence investments by U.S. Tech companies;
- The rise of Defense stocks in Europe.

However, confidence in Europe's ability to recover and make the necessary investments is greatly overestimated, due to demographic aging, weak skills, low spending on Research and Development and investments in New Technologies, fragmented financial markets, and the lack of coordination in industrial and fiscal policies.

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