From American exceptionalism to European wake up call

Didier Bouvignies
General Partner, CIO

The start of the year is marked by a multitude of announcements that are not, strictly speaking, economic. However, the measures taken by the new US administration are significantly reshuffling the deck.

The announcements about tariffs, and then the ensuing twists and turns, as well as the attitude towards Europe and Ukraine in resolving its conflict with Russia are destabilising the markets. This context has prompted the Member States of the European Union, Germany in particular, to take historic steps that represent a major turning point for their defence and beyond.

In the United States, while macroeconomic data weakened slightly, the St. Louis Fed's Economic Policy Uncertainty Index has more than doubled compared to its average over the last forty years. A level reach only during the Covid-19 crisis. This situation reflects the dismay of manufacturers in the face of contradictory announcements by President Trump.

In Europe, Friedrich Merz took advantage of a window of opportunity following the publication of the Letta and Draghi reports to try to get the current parliament to vote on an ambitious recovery plan before the new one takes office on 25 March. The German Chancellor was thus doing an about-face to take up the subject of defence in Germany and gain a degree of independence from his historical American ally. This plan is based on a special fund of 500 billion euros over 10 years, dedicated to defence and infrastructure, representing 11.6% of GDP[1], as well as on reforming the ‘debt brake' for defence spending to exclude it from the calculation of public debt.

At the same time, the European Community will offer a derogation from the Stability and Growth Pact allowing Member States to increase defense spending by 1.5% of GDP[2] without being penalised by an excessive deficit procedure. If used to its full potential, the Commission believes this could result in additional spending of up to 650 billion euros over four years[3]. At the same time, the Union was creating a new instrument to provide its members with a €150 billion loan facility guaranteed by the European budget for defense expenditure.

What does this mean for growth?

Fiscal stimulus changes zones t. While the US is used to financing its growth through a large deficits, Germany, which has historically been much more austere, is embarking on a spending plan that is likely to increase growth prospects from 0.3% to 0.7% over the next 2 years[4]. The uncertainty lies in the elasticity of this spending on growth, which is a function of the imported share of defence spending (currently two-thirds for the European Union) and the additional private investment.

More generally, the real challenge for Europe will depend on its ability to redirect the zone's overabundant savings towards a more productive objective than financing the US deficit. Europe has been built through its crises and the union of Germany, France and even the post Brexit United Kingdom in building a European defence is noteworthy.

At the same time, the US faces a risk of scepticism among all economies, breaking the virtuous circle that has been in place for some years. This is all the more true because tariffs are like a tax that will have to be paid either by the American consumer through inflation, or by companies via reduced margins. The risk of weaker growth and higher inflation is becoming greater.

The markets echoed this complete reversal of perception, with sharply contrasting performances. In the US, the Trump Rally was completely wiped out, both for equities and the dollar. The uncertainties surrounding the US technology sector, and particularly investment in artificial intelligence following the "DeepSeek Moment[5]", remain high. Europe, which had been suffering from extremely depressed valuation levels, has recovered. As a result, the S&P 500 recently fell by 10%, while the Eurostoxx rose by 10%, with sharp divergences between sectors benefiting from the latest capital spending announcements and those bearing the full brunt of rising interest rates[6].

As the European markets catch up, we can see that European and US markets have performed similarly since December 2023 and over three years in euro. It should also be noted that, over these periods, the banking and insurance sectors have outperformed the Magnificient 7s[7], dividends included. On the fixed-income markets, we have seen the Bund rise by 44 basis points in the space of a week - the first time this has happened since German reunification in 1990 - taking it to 2.8%, a quite reasonable level reached in autumn 2023[8].

However, the recovery in European equities, despite an eroding outlook for corporate earnings growth, has contributed to increasing valuations. In a world awash with liquidity and where the discount compared to other asset classes remains significant, the Old Continent's comeback is nonetheless moderate given its underweight in asset allocation and the massive outflows seen over the last three years.

Completed writing on 11 march 2025

Check this document on our website

[1] Source: World Bank, March 2025.
[2] Source: Public Life, European Defence: A 800 billion euros Plan for 'Rearming Europe ',5 March 2025.
[3] Source: European Union, Statement by President von der Leyen on the defence package, 4 March 2025.
[4] Source: JP Morgan, March 2025.
[5] DeepSeek moment refers to the breakthrough of DeepSeek R1, a Chinese open source AI model competing with market leaders at a much lower cost.
[6] Source: Bloomberg, 11/03/2025, in euros, dividends reinvested.
[7] The Magnificent 7 include seven US technology stocks: Microsoft, Nvidia, Tesla, Meta, Apple, Alphabet and Amazon.
[8] Source: Bloomberg, 11/03/2025.

Disclaimer

The comments and analyses in this document are provided purely for information purposes and do not constitute any investment recommendation or advice. Rothschild & Co Asset Management cannot be held responsible for any decisions taken on the basis of the elements contained in this document or inspired by them (total or partial reproduction is prohibited without prior agreement of Rothschild & Co Asset Management). Insofar that external data is used to establish terms of this document, these data are from reliable sources but whose accuracy or completeness is not guaranteed. Rothschild & Co Asset Management has not independently verified the information contained in this document and cannot be held responsible for any errors, omissions or interpretations of the information contained in this document. This analysis is only valid at the time of writing of this report.

Rothschild & Co Asset Management, organized under the laws of France, registered with the Trade and Companies Register of Paris RCS Paris 824 540 173. A management company licensed by the Autorité des Marchés Financiers under N° GP 17000014, having its registered office 29, avenue de Messine, 75008 Paris, France.

About the Asset Management's division of Rothschild & Co

As the specialised asset management division of the Rothschild & Co group, we offer personalised asset management services to a broad client base of institutional investors, financial intermediaries and distributors.

Our development is focused on a range of open-ended funds, marketed under five strong brands: Conviction, Valor, Thematic, 4Change and OPAL, leveraging our long-term expertise in active management with conviction as well as in delegated management. Based in Paris and established in 9 European countries, we manage more than 38billion euros and employ nearly 170 people.

More information at: www.am.eu.rothschildandco.com

France

29, Avenue de Messine
75008 Paris
+33 1 40 74 40 74

Belgium – Netherlands – Luxembourg

Rue de la Régence 52
1000 Bruxelles
+32 2 627 77 30

Switzerland

Rothschild & Co Bank AG
Rue de la Corraterie 6
1204 Genève
+41 22 818 59 00

Italy

Passaggio Centrale 3
20 123 Milano
+39 02 7244 31

Germany - Austria

Börsenstraße 2 - 4
Frankfurt am Main 60313
+49 69 299 8840

Spain

Paseo de la Castellana 40 bis
28046 Madrid
+39 02 7244 31

Visit our internet site

Follow us on LinkedIn