*March 2025 Market Commentary*

## ***American Exceptionalism***

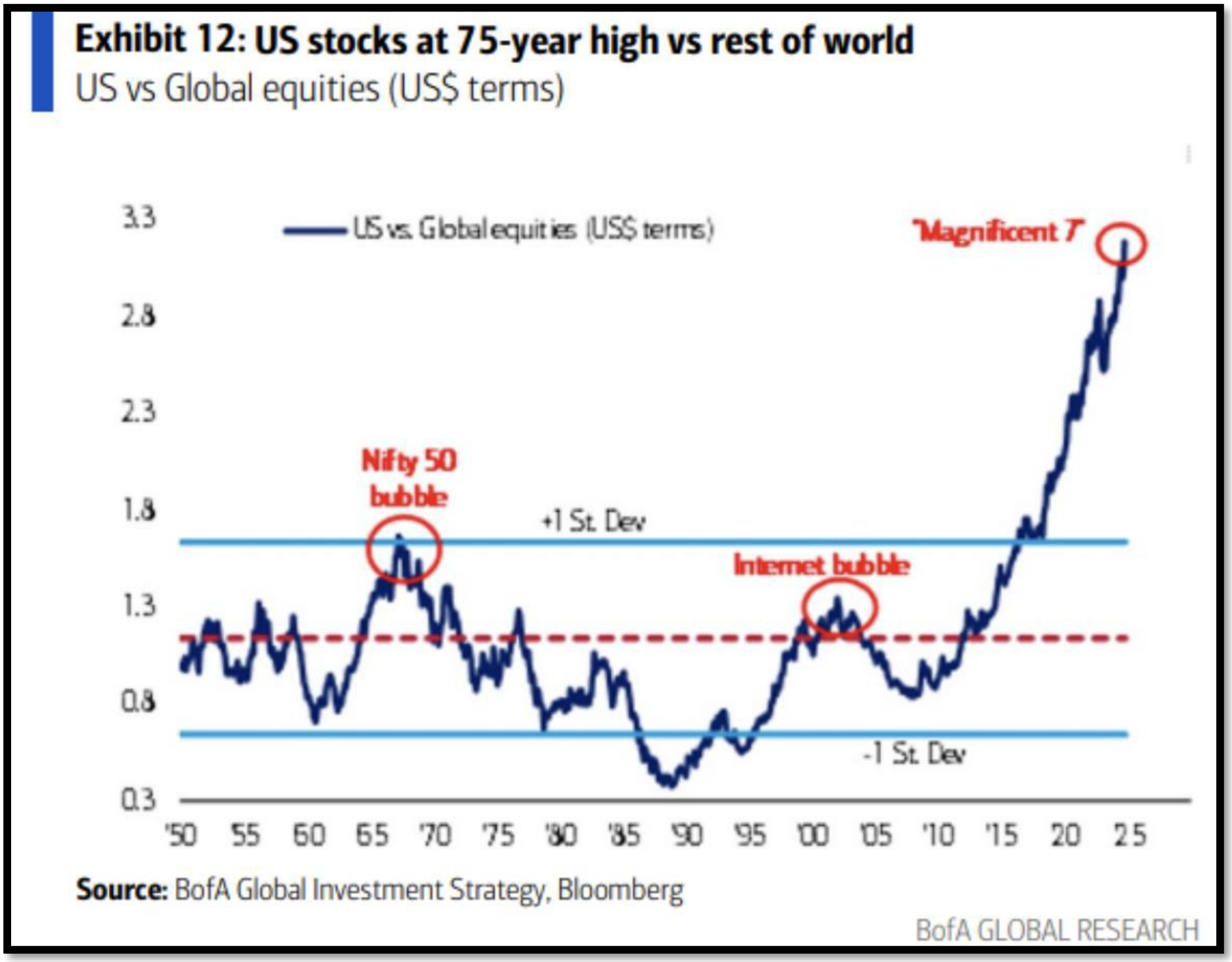
https://www.youtube.com/watch?v=sjzZh6-h9fM

**“The Star Spangled Banner” by Jimi Hendrix at Woodstock 1969**

Without saying a word, Jimi Hendrix’s soaring, dive-bombing reconstruction of “The Star Spangled Banner” encapsulates both U.S. history and its future, a future that is equally fearsome and inspirational. His rebel spirit and limitless innovation communicates all that is great about America. Played shortly after dawn on the last day of the 1969 Woodstock music festival, it awakened a nation to rock-and-roll and to our own unbridled potential.

For over a decade now, U.S. stocks have consistently outperformed international markets by ever increasing margins. And just as consistently, pundits have said that U.S. stocks are over-valued versus international stocks and therefore investors should be buying internationally. And they’ve been consistently wrong.

The chart below is certainly eye-popping, and a casual observer could easily be led to believe that indeed U.S. stocks may have run too far versus Global equities. While that may be true, let's take a bit of a deeper dive into why this may have happened, and whether it can continue.



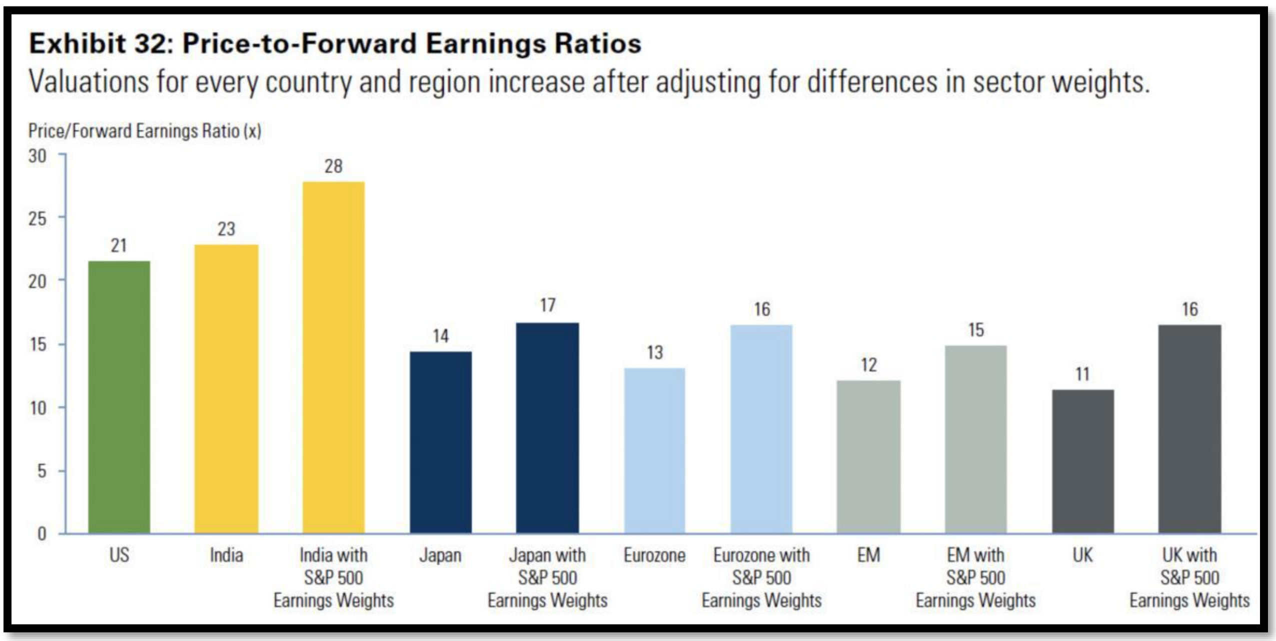

In my last missive, I spent a lot of time talking about the construction of the S&P 500 and how dramatically it has changed over the decades, reflecting the dramatic changes in the U.S. economy. My conclusion was that we shouldn't spend too much time trying to compare today's valuations to the past since our economy is unrecognizable to history. Instead, we should focus on looking at today and trying to determine if trends can be sustained or not.

I can use a similar argument when we try to compare the U.S. market to global markets. Not only has the makeup of the U.S. market changed dramatically, but global markets have also changed in equally if not more dramatic fashion.

Does it actually make any sense to simply compare the historic performance of the U.S. stock market to various global stock markets without looking at how those markets are constructed and how they've been constructed?

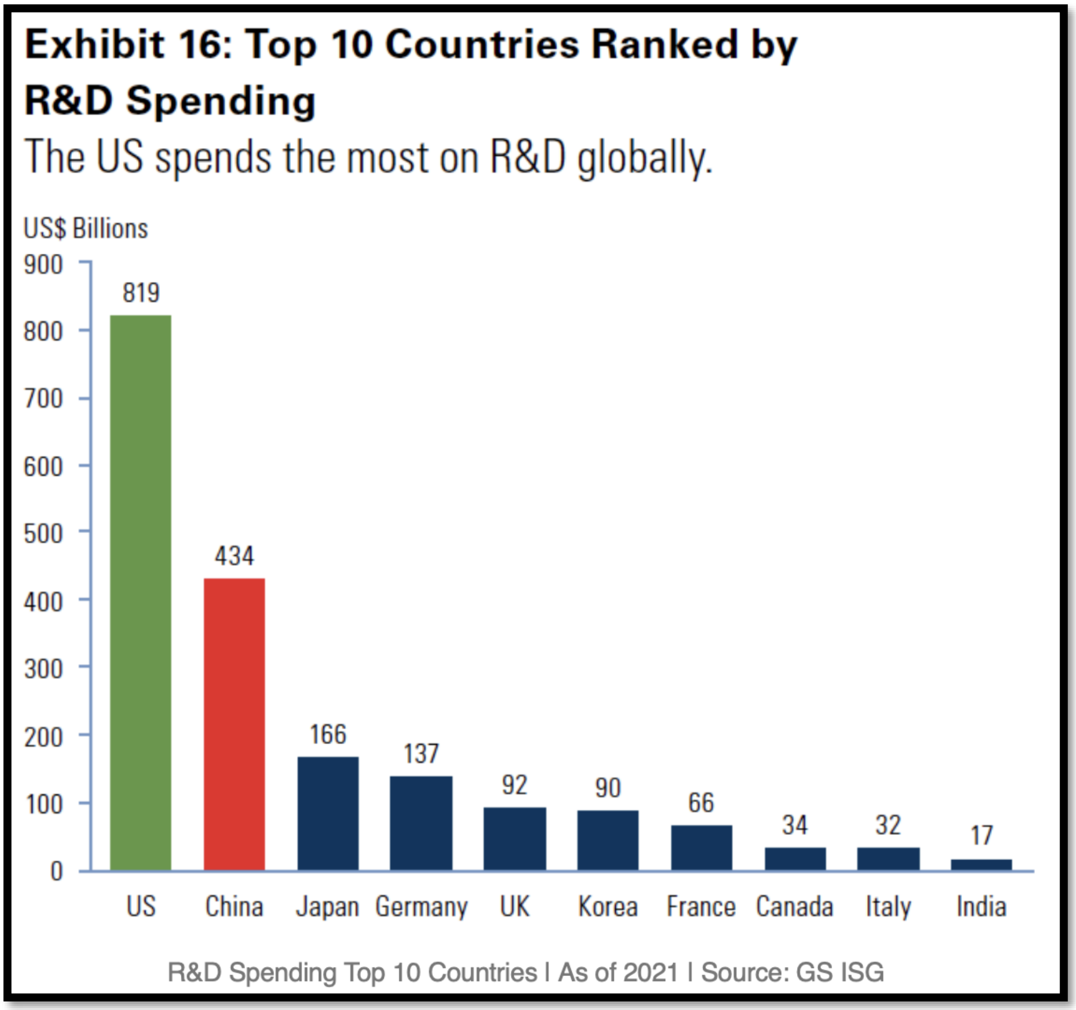
For example, technology companies make up only **1% of the U.K. market, whereas it's 32% of the S&P 500.** Given that tech companies have higher growth rates and inherently higher valuations, shouldn't the U.S. market trade at higher valuations? At the end of 2024, the U.S. had 48 tech companies generating more than $1 billion in profits. To put this in perspective, that's more than all the other countries combined (Japan 8, Europe 7, China 7, Taiwan 5, Korea 4, France 2, Germany 2).

Goldman Sachs put together the chart below, to look at forward valuations of one market compared to another, as if they were all weighted by sector to match the S&P 500. While this does level the sector weights, it hardly comes close to comparing the growth prospects of the underlying companies making up each sector.



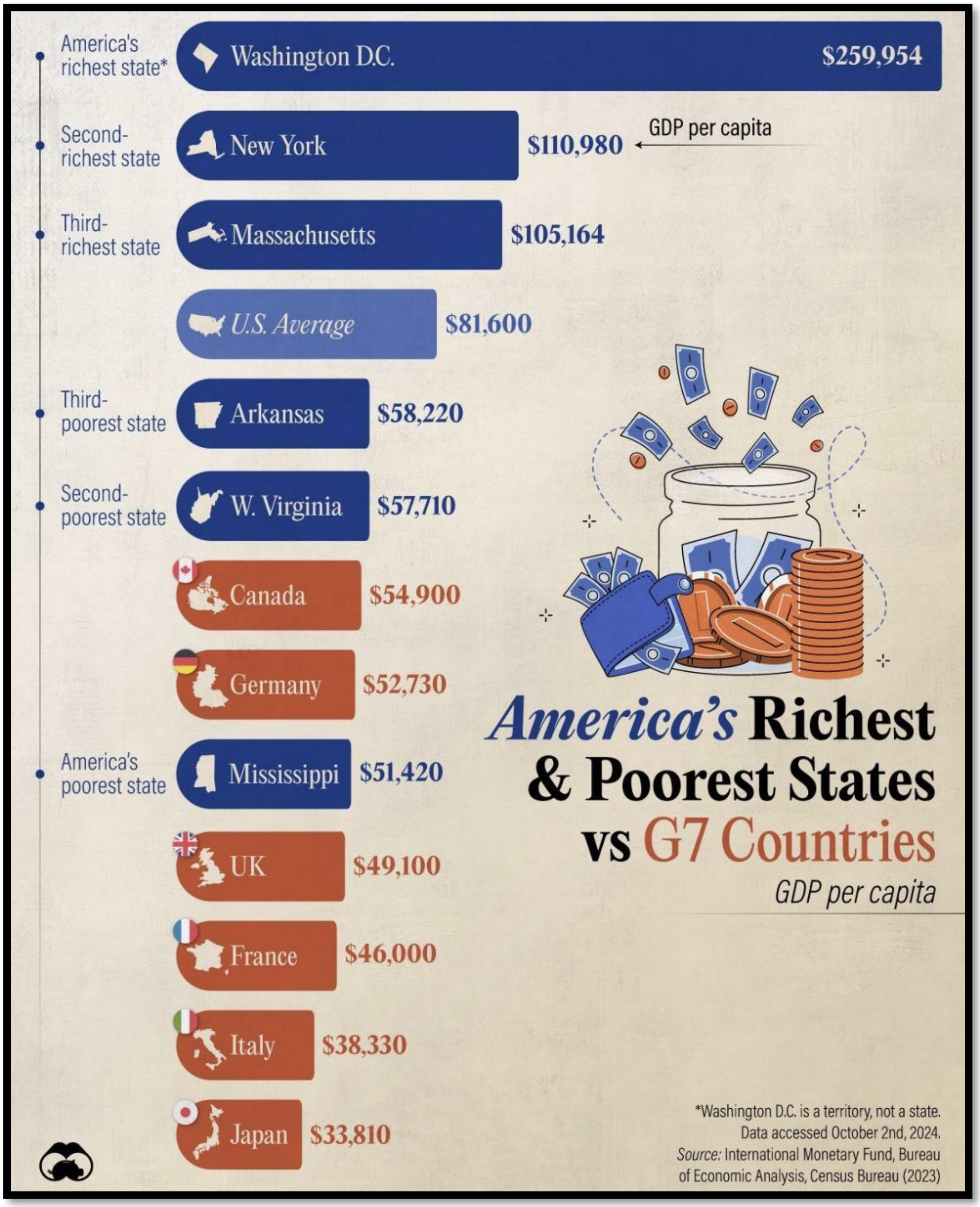

Everyone knows that the U.S. is the largest economy in the world, accounting for more than 25% of the world's GDP, and it's poised to continue this dominance in the near future. Why, you may ask? Because research and development are the lifeblood of economic growth, and the U.S. spends nearly twice as much as #2 China on R&D.

The U.S. is one of the few countries that still celebrates the success of the individual. We have strong property rights, where individuals can own not only property but ideas. This creates an environment where risk takers are rewarded if their dreams take hold. Then those dreams often create jobs, wealth, and taxes that lift society as a whole. This is the beauty of capitalism.




Many Americans often forget just how much wealth our capitalistic economic model has generated. While capitalism is not perfect, it is by far the best system for lifting the standard-of-living for the largest percentage of a population.

The average GDP per capita in the United States is $81,600 which is higher than every other G-7 country. Even our poorest state, Mississippi, has a GDP per capita of $51,420, which is higher than the UK, France, Italy, and Japan. (P.S. It is actually sad to see Washington DC at the top of this list since the main business in DC is the collection and redistribution of tax dollars).




Just because one country has outperformed others for a long time, doesn't mean that it's time to sell that country and buy the perennial underperformers. That is just lazy analysis. A serious analyst would look at the reasons for that outperformance and try and determine if those reasons will continue into the future.

When I look at the performance of the U.S. market, really look at the underlying factors that drove that performance, I think it was entirely justified. From an economic perspective, there is no comparison. China is a communist state that abhors individual freedom or success. Most of developed Europe has tilted heavily towards socialism and stifled growth through ponderous regulation and bureaucracy. Japan is bogged down by an aging population and nearly zero immigration.

### ***Smells Like Hubris***

You may say, “Not so fast”, all this rah-rah U.S.A. talk smells like hubris. Since his election, President Trump has been pushing this American Exceptionalism non-stop. Renaming the Gulf of Mexico, reclaiming the Panama Canal, buying Greenland, annexing Canada, resettling Gaza, and negotiating the surrender of Ukraine. Is it swagger or hubris? Hubris, as defined by the ancient Greeks, is a kind of pride or arrogance of a mortal to defy the gods. And of course, Hubris is usually followed by Nemesis, the Goddess of divine retribution.

In the real world, a country’s pride in and of itself, is not necessarily a precursor of its demise. **What has been the demise of most great empires has not been arrogance, but debt**. Niall Ferguson had an excellent article in the February 22 Wall Street Journal, where he puts forward Ferguson's Law, named not for himself but for an essay written by Adam Ferguson in 1767. The essay was titled, “The History of Civil Society”, where he identified the perils of excessive public debt.

Ferguson defined “tax smoothing”, whereby a government borrows to pay for a war or some other emergency, and then that debt cost is spread over multiple generations of taxpayers. He recognized that this growing burden is “gradually laid” and that it is often not extinguished before the future generations encounter their own “emergency” that needs funded. He defined a country’s breaking point as where debt service exceeds defense spending, leaving a country vulnerable to a military challenge.

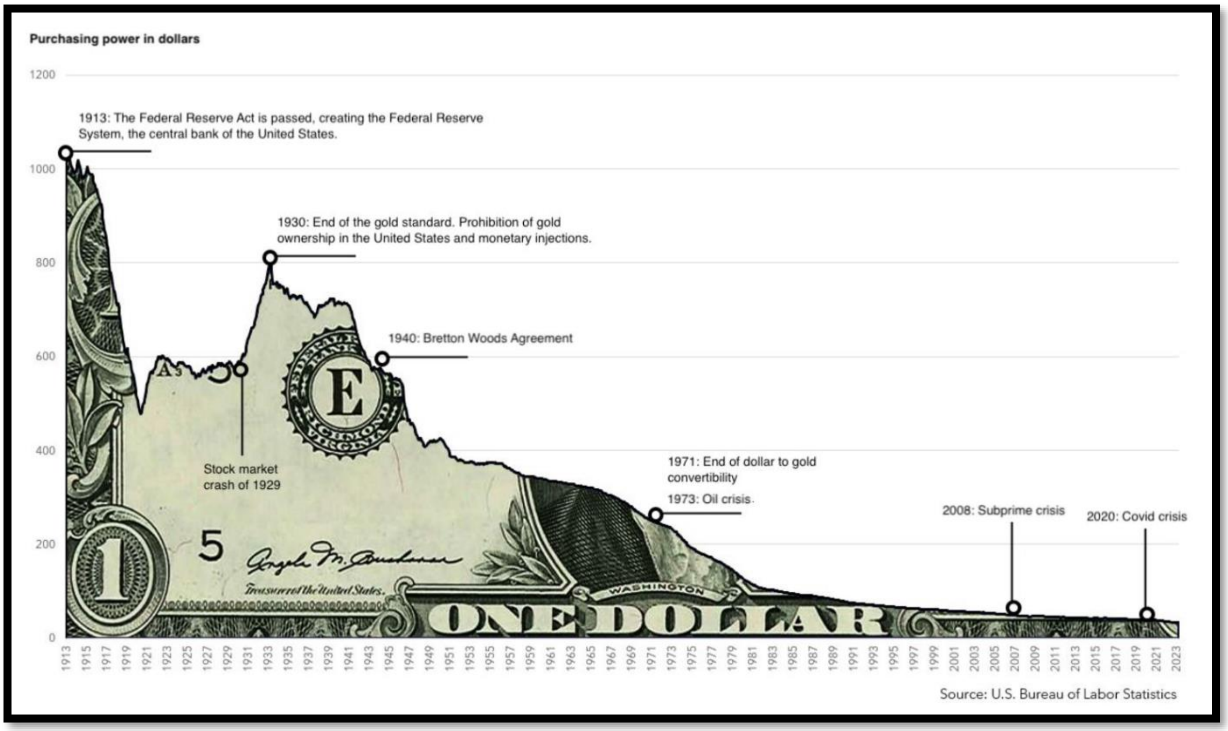
In case you hadn’t heard, last year was the first time that the U.S. has spent more money on paying the interest on its debt ($1.124 trillion), than it did on defense spending ($1.107 trillion). And to be clear, this is just interest payments, the U.S. has long ago stopped paying down any principal.

The weight of America’s debt and deficits have long been a risk that investors worry about, but this is the first time that Ferguson’s Law has been violated. As a refresher, debt can be extinguished in three ways:

- Growth, where tax revenues exceed spending and debt is retired. This is what most individuals do.
- Inflation, where the value of a country's currency is devalued so the debt burden is reduced.
- Default, where a country simply refuses to repay its debts.

While growth is the preferred method of repaying debts, it is often very difficult for a large economy to grow faster than the politicians promises to their constituents. Therefore, the most widely used strategy is inflation, or the devaluation of the currency. Devaluation is the main strategy employed by the U.S.; in fact, the Federal Reserve has a stated goal of 2% annual inflation/devaluation.

Over long periods of time this devaluation looks like this:

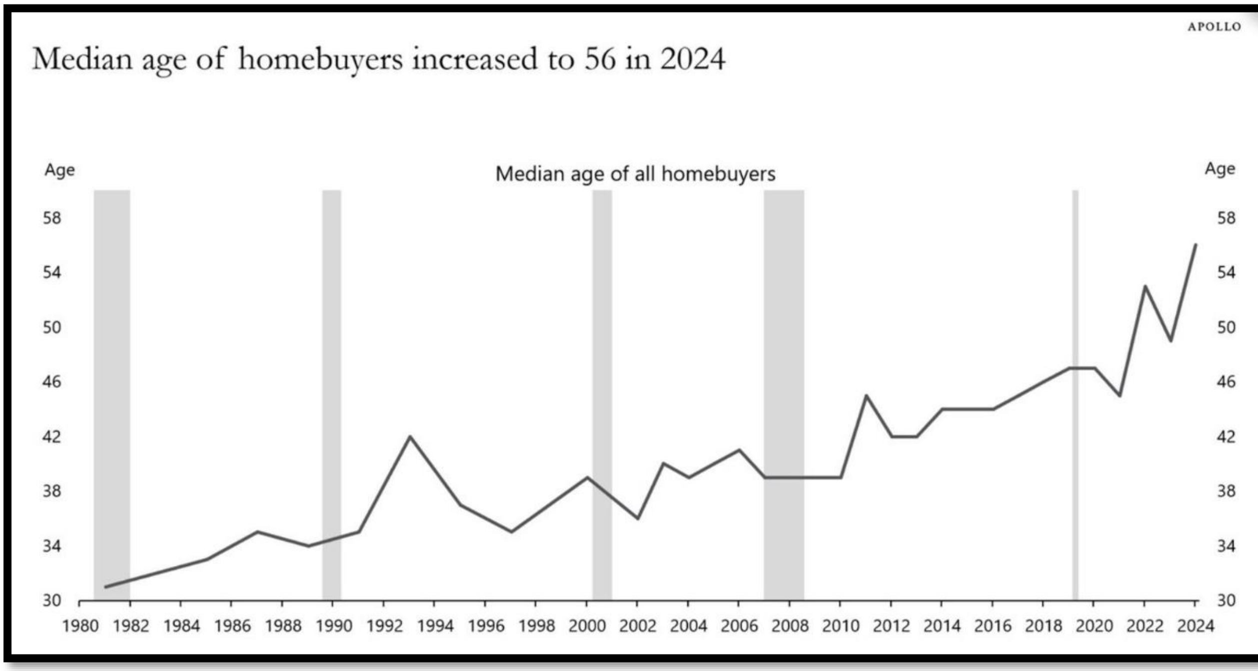



In Warren Buffet's most recent letter to Berkshire Hathaway shareholders, he talks about his excessive cash holdings, his unwillingness to own long-term bonds, and his commitment to owning common stocks (especially American companies).

He states, *"Paper money can see its value evaporate if fiscal folly prevails. In some countries, this reckless practice has become habitual, and in our country's short history the U.S. has come close to the edge. Fixed-coupon bonds provide no protection against runaway currency. Businesses, as well as individuals with desired talents, however, will usually find a way to cope with monetary instability as long as their goods or services are desired by the country's citizenry."*

He continues, *"Berkshire shareholders can rest assured that we will forever deploy a substantial majority of their money in equities - mostly American equities although many of these will have international operations of significance. Berkshire will never prefer ownership of cash-equivalent assets over the ownership of good businesses, whether controlled or only partially owned."*

The cumulative impact of our compounding debt and devaluing currency finds its way into many aspects of our daily lives, none more relevant than housing. This chart encapsulates just how brutal long-term inflation/devaluation is to a society. When I purchased my first house the average age of a home buyer was 32 years old, today it is 56!




America as a nation is riding high, it has been exceptional, but while a lot of that exceptionalism is built upon our unique capitalistic foundation, a growing portion of it has also been built on debt. DOGE is an attempt to reign in some of our governments excessive/wasteful spending, and we should all hope they use any savings to pay down debt and not to increase spending. Warren Buffett concluded his letter, *"So thank you, Uncle Sam. And never forget that we need you to maintain a stable currency and that result requires both wisdom and vigilance on your part."*

In the rebellious spirit of Jimi Hendrix, may we all have the wisdom and fortitude to protect our American Exceptionalism, but also have the humility to realize that our propensity for debt and deficits is a two-edged sword.

As always, be careful out there.

Chris Wiles, CFA

Where trust is Earned