Rally Relieves—but Does Not Reassure

July 21, 2025

Key Takeaways

- A quick survey of global equity performance shows that not only did American equities become *worth less* in the first six months of 2025, they also *significantly underperformed* global markets. Despite such underperformance, they continue to trade at a record premium to foreign markets.
- With U.S. markets at all-time highs, foreign markets relatively cheaper than they have ever been and global investors over-indexed to U.S. markets, it is easy to envision cascading outflows.
- With inflation expectations becoming entrenched and stagflation a growing concern, we view diversified portfolios of high-quality dividend growers as especially attractive, with real assets in particular one of the few safe havens relative to the overall market.

U.S. Investors Must Not Become Complacent

When I reflect on year-to-date performance, I feel like pinching myself. Despite trade wars, battlefield wars and deteriorating fiscal policy, the U.S. market *rose* in the first half. Stocks really do climb a wall of worry.

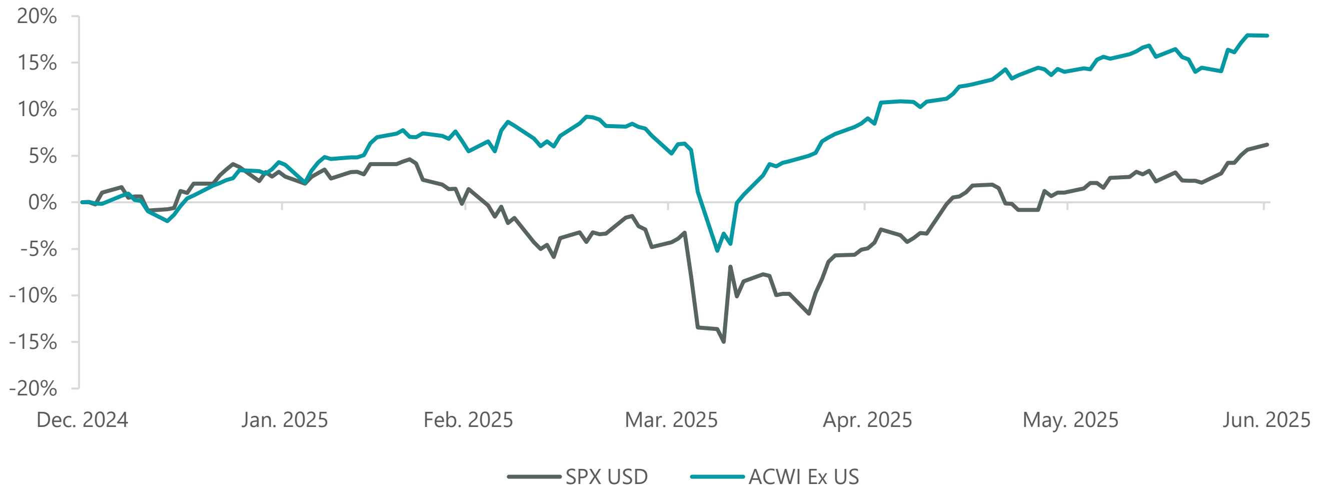
Investors looking at their June statements must feel good — unless they live outside the U.S. While U.S. investors saw a 6.2% return year to date, the S&P 500 Index is down in most foreign currencies due to the significant decline in the U.S. dollar (Exhibit 1). S&P 500 investors in Japan lost 1.2% in yen; in euros that would be a 5.3% loss; while the S&P 500 declined 16.4% relative to gold. Indeed, the dollar is the only commonly used yardstick that flatters U.S. returns.

Exhibit 1: S&P 500 Performance by Currency (Jan. – June)

As of June 30, 2025. Source: ClearBridge Investments, Bloomberg Finance.

A quick survey of global equity performance drives home the point. Not only did American equities become *worth less* in the first six months of 2025, they also *significantly underperformed* global markets (Exhibit 2), with the S&P 500 up 5.5% versus the MSCI ACWI ex US Index's 17.9%. Yet despite considerable underperformance, U.S. stocks, with a trailing P/E of 23.8x, continue to trade at a *record premium* to foreign markets, at 15.3x (Exhibit 3).

Exhibit 2: U.S. vs. Global Market Returns



As of June 30, 2025. Source: ClearBridge Investments, Bloomberg Finance.

Exhibit 3: U.S. and Global P/E Ratios

As of June 30, 2025. Source: ClearBridge Investments, Bloomberg Finance.

For U.S.-focused investors, it is easy to lose sight of global dynamics. But for foreign investors, these issues are front and center every day. Rising U.S. equity markets may make American investors feel good, but they will not do any good if those investors are unable to maintain and grow their purchasing power. Continued U.S. underperformance also risks becoming self-reinforcing. With U.S. markets at all-time highs, foreign markets relatively cheaper than they have ever been and global investors over-indexed to U.S. markets, it is easy to envision cascading outflows.

Suddenly, those warm and fuzzy feelings about first-half performance seem misplaced.

The S&P 500 currently trades at 22x forward 12-month earnings, a level matched only twice in the last 35 years: in 2021-2022 and in 2000 (Exhibit 4). Investors who put cash to work in those periods lost money over the ensuing 12 months.

Exhibit 4: S&P 500 P/E Near Historical Highs

As of June 30, 2025. Source: ClearBridge Investments, Bloomberg Finance. On a blended forward 12-month basis.

The past is, of course, no guarantee of the future. AI could prove wondrous, tariff revenues could pay for tax cuts and geopolitics may be the risk that never comes home to roost. But with the demanding odds embedded in current stock prices, are investors sufficiently incentivized to bet that way?

Given all the challenges we face (tariffs, deficits, wars, etc.) and, more importantly, the inherent uncertainty of investing, buyers should demand better. U.S. equities offer little margin of safety. If stocks returned to long-term average multiples, they would be 30% lower than they are today.

Suggesting the market could decline 30% undoubtedly sounds provocative, but is it crazy to suggest the market could trade in line with historical averages? To be bullish today, one must believe the market will sustain levels never previously sustained, rather than trade at the levels it usually trades at. When phrased like that, why would any risk-averse investor bet heavily on the former?

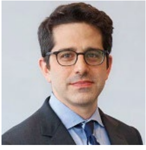
Against such a challenging backdrop, we recommend diversified portfolios of high-quality dividend growers. Touting diversification may sound trite, but diversification today is anything but commonplace. The most well-known benchmarks have become absurdly concentrated, and most portfolios mimic those benchmarks. Concentration leads to increased volatility, but robust dividends can provide an anchor to windward in stormy seas. Valuations for high-quality dividend growers are also, generally, less demanding.

Real assets stand out. With inflation expectations becoming entrenched and stagflation a growing concern, we believe real assets offer one of the few safe havens relative to the overall market. Real assets recoup increasing costs through price increases, while their in-place assets accrete value as replacement costs rise.

We particularly like energy and apartment REITs. Energy companies screen reasonably on current earnings, despite weak commodity prices, and offer torque to rising oil prices. Apartment REITS benefit from higher interest rates and the residual effects of Covid-era inflation. Developers have slashed new projects as costs have increased, while rising mortgage rates keep home ownership out of reach and tenants renting longer. Apartment REITs offer reasonable dividend and cash flow yields, and rising rents are poised to drive earnings growth.

Investors pouring into AI, crypto and everything new remind us of past episodes of complacency and euphoria. Buyers frequently gravitated to the correct companies in those moments yet still walked away disappointed because of the prices they paid. Given the tremendous uncertainty and change we face today, U.S. investors should be relieved with first-half performance; but, given record valuations, record concentration and attractively valued opportunities elsewhere, U.S. investors must not become complacent.

About the Author



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