Equity Outlook: Navigating the crosscurrents of policy, profit and premia

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Key Takeaways

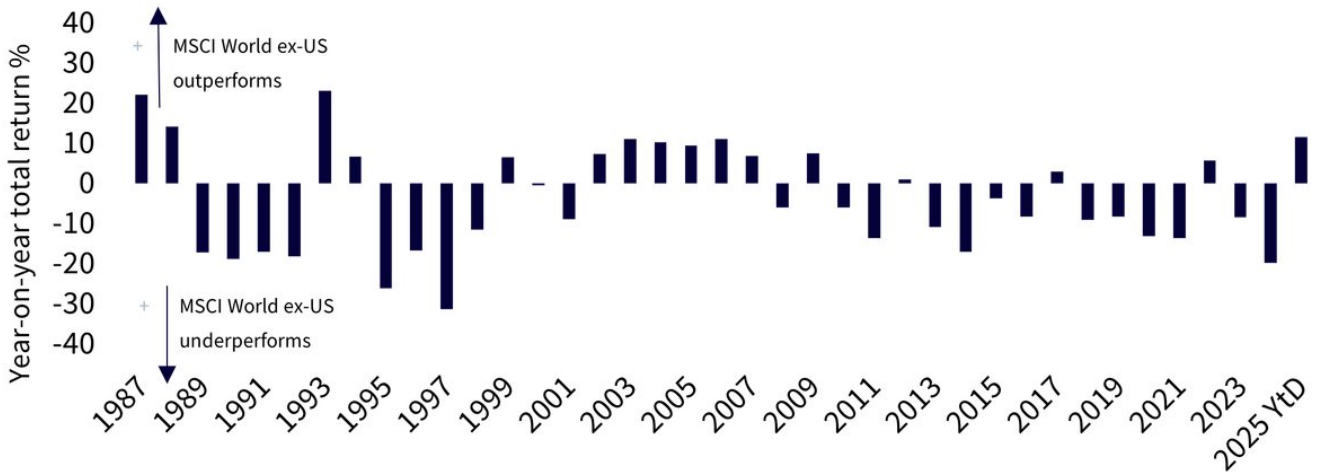
- US markets saw their widest underperformance versus global peers since 1993, driven by tariff shocks and fading exceptionalism.
- Europe, Japan, and emerging markets offer more attractive valuation cushions, supported by fiscal stimulus, governance reform, and domestic demand growth.
- A shift in global leadership suggests investors should diversify beyond US equities to capture broader market strength.

The first half of 2025 delivered a paradox. Headline inflation eased, yet tariff and geopolitical risks spiked. In aggregate, equity indices increased, but leadership was narrow, and market breadth weakened. Long-dated bond yields churned, and the dollar slipped as the Federal Reserve paused (the Fed) after its initial 100-basis-point cut. Equity-risk premia now show a wide gap: roughly two percent in the United States, six percent in Europe, and seven percent in Japan and the broader emerging-market universe. Over the next twelve months, allocation decisions will hinge on these valuation cushions, diverging policy paths, and evolving trade alignments.

United States: Great earnings, thin valuation buffer

2025 was the year when US stock markets underperformed their international rivals by the widest margin since 1993. Suddenly, it became fashionable to talk about how the era of US exceptionalism was ending, as uncertainty around Trump's tariff policies alongside the widening fiscal deficit rose, the US dollar weakened, and DeepSeek was unveiled.

Figure 1: Global equities ex-US outperform US equities by the highest gap since 1993



Source: Bloomberg, WisdomTree from 1 January 1987 to 22 July 2025, Year-on-year total return difference between MSCI World ex-US index versus MSCI USA Index. **Historical performance is not an indication of future performance, and any investments may go down in value.**

A sharp 12% correction followed the April "Liberation Day" tariff shock, though the index later rebounded on renewed enthusiasm for Artificial Intelligence (AI) leaders. Five mega-cap stocks (Nvidia, Microsoft, Apple, Broadcom and Oracle) account for 22%[1] of market value and most of the expected 7-9% earnings growth for 2025. Smaller companies and cyclicals still struggle with high refinancing costs and rising input prices.

Although Washington has reached a narrow tariff truce with the European Union (EU), the wider US tariff structure remains unresolved and now includes blanket duties on Swiss imports. The effective US trade tax rate has climbed from 3% to about 15%. Corporations have responded by boosting buybacks, which may reach one trillion dollars this year, and by accelerating supply-chain reshoring. With the ERP near a multi-decade low, further upside in US equities depends on continued earnings beats from a handful of giants or genuine progress on trade détente.

Europe: Policy catalyst meets attractive valuations

Europe became 2025's comeback region. Eight of the world's best-performing stock markets were European as energy costs eased and Germany loosened its fiscal rule. The US outperformed Europe over the past five years by nearly 23.5% in USD terms driven by higher earnings growth[2]. Financials delivered a 9% compound earnings growth rate over five years, three times the pace of US banks, while domestically oriented utilities, industrials, and materials outperformed export heavyweights.

Figure 2: Comparison of Europe vs US – performance gap and 5Y EPS CAGR

	Difference in 5 Year Cumulative performance	Change in 5 Year Earnings per Share CAGR
Indices	-23%	-2%
Financials	60%	6%
Information Technology	-78%	-6%
Healthcare	-7%	1%
Consumer Discretionary	-36%	-5%
Consumer Staples	-43%	-4%
Industrials	10%	2%
Energy	-52%	-5%
Utilities	10%	1%
Materials	-8%	-12%
Communication Services	-17%	-10%

Source: Bloomberg, WisdomTree from 2 June 2020 to 2 June 2025, based on MSCI Indices, calculations in USD terms. **Historical performance is not an indication of future performance, and any investments may go down in value.**

With a forward price-to-earnings (P/E) ratio near fifteen versus twenty-six in the United States, Europe offers a meaningful valuation cushion. Profit growth is expected to dip 4% in 2025 before rebounding 12% in 2026, thanks to a €500Bn spending program aimed at infrastructure, defence, and green investments[3]. Across the board, US tariffs on Swiss imports raise the relative competitiveness of German capital-goods producers, French and Italian luxury names, and pan-European pharmaceutical firms, providing an incremental tailwind. A stronger euro could offset some of this benefit, yet the 6% ERP and rising credit impulse keep Europe attractive for overweight positioning.

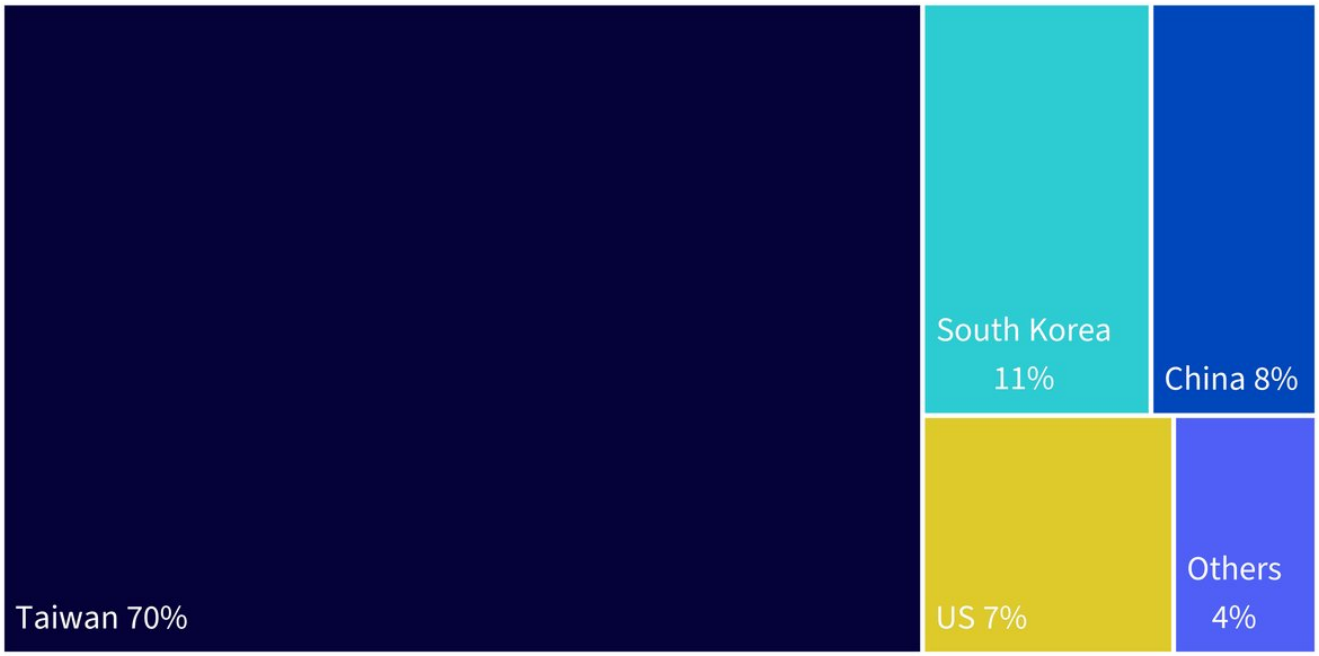
Emerging markets: Domestic demand takes the lead

The MSCI Emerging Markets index is up 9% year to date and still trades at a 31% discount to developed markets[4]. Four factors underpin the rally. First, valuations entered 2025 at crisis-level lows. Second, many central banks tightened early and now have room to cut rates. Third, supply-chain realignment is redirecting trade and investment. Fourth, global portfolios remain under-allocated to emerging market equities.

Latin America illustrates the swing. The region was EM's worst performer in 2024 but has rallied 26.3% in 2025[5], led by Colombia's 54% surge and 31% rebounds in Mexico and Chile. Colombia, Mexico, and Chile led as copper and lithium demand expanded. Brazilian stocks remain cheap even after new US duties on steel exports because domestic rates are falling and fiscal accounts are improving.

North Asia benefits from an accelerating build-out of AI hardware. Korea and Taiwan dominate high-bandwidth memory and advanced foundry services, and the recent US-Korea chip accord removes a key policy overhang.

Figure 3: Taiwan is a global leader in the logic semiconductor foundry market



Source: Boston Consulting Group, Semiconductor Industry Association, 2024. **Historical performance is not an indication of future performance, and any investments may go down in value.**

India continues to grow by nearly 6%, supported by demographics and infrastructure spending, though valuations are no longer cheap. The 50% US tariffs threaten India's export competitiveness and raise questions about Prime Minister Narendra Modi's ambitions to transform the country into a major manufacturing hub, with exporters bracing for falling orders and possible job cuts. The economic impact may be helped by the fact that India's economy is driven by domestic demand rather than exports so government reforms to shore up consumer and business sentiment will be key to fostering growth.

The key risks to EMs remain the impact of higher tariffs alongside a sudden dollar surge. Even so, ERPs above 7% especially for countries geared to domestic demand and commodity exports remain supportive for EM equities.

Japan: Governance reform unlocks value

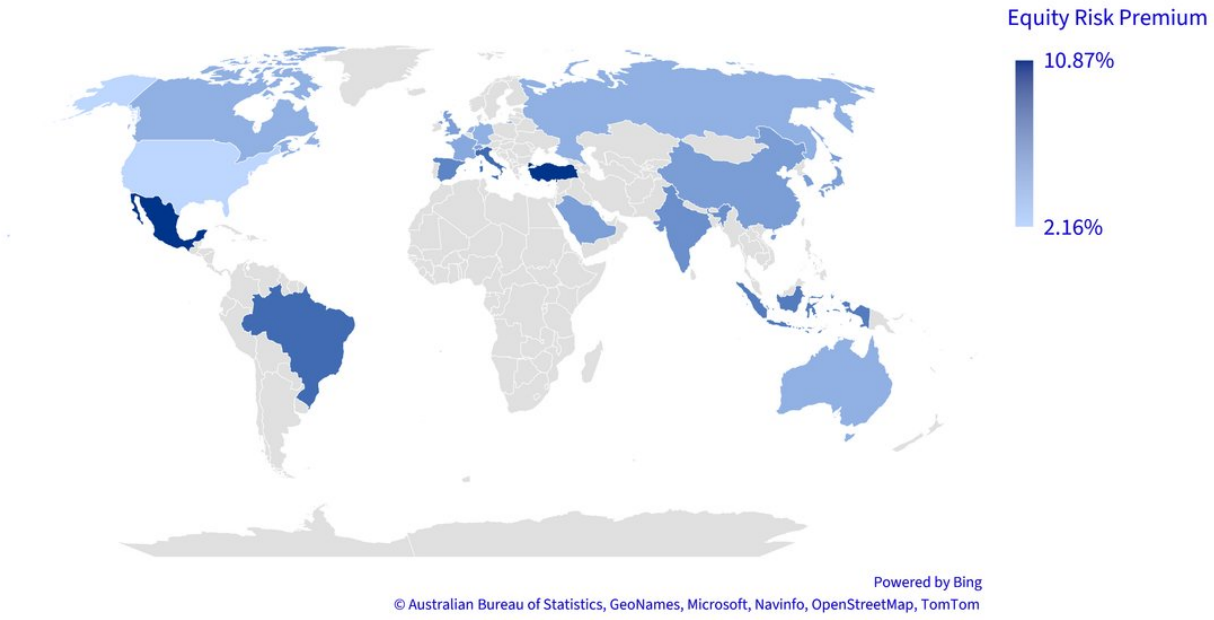
Corporate reform is transforming Japan from a currency story into a value-creation story. Buyback announcements surpassed ¥17Trn by May, and half of prime-market companies still trade below book value. The new US-Japan trade agreement secures duty-free access for critical auto, battery, and semiconductor components, removing a major external headwind.

Topix earnings are flat this fiscal year, but are projected to grow 3% in fiscal 2026 and 9% in 2027[6]. A forward multiple below 14X and an ERP near 7% make Japan one of the few developed markets offering quality at a reasonable price. Financials, domestic services, and industrial automation leaders look best placed as wage gains and a steeper yield curve lift domestic demand. The Bank of Japan's (BOJ) shift away from a hawkish stance remains supportive for Japanese equities. While US tariffs were the direct trigger, easing cost push inflation also played a role. The newly announced US–Japan strategic trade accord secured tariff-free access for critical auto, battery and semiconductor components while deepening joint R&D incentives, thereby removing a key external overhang for Japan's export champions, validating the market's governance led re pricing. We expect hikes to resume in April 2026, at a pace more in line with Japan's economic conditions.

Conclusion

In the United States, Europe, and the UK, 10-year yields have largely retraced to levels last seen before the financial crisis and are expected to remain supported as central banks' balance growth risks with persistent inflation concerns tied to tariff uncertainty.

Figure 4: Comparison of global equity risk premium



Source: Bloomberg, WisdomTree as of 30 June 2025. Please note the Equity Risk Premium is defined as forward earnings yield minus 10-year real yield. **Historical performance is not an indication of future performance, and any investments may go down in value.**

This is why global equities march into H2 2025 with risk premia that now looks radically uneven. The US, where a decade of multiple expansions has driven the ERP down to 2.2%, offers the least compensation for macro or policy shocks. In contrast, Europe's ERP sits near 6%, Japan's at 7% and broad emerging markets approach 7.5%. That gulf argues for a barbell allocation. Maintaining exposure to the US's structural innovators but redeploy incremental capital toward higher-premium regions where much of the risk is already discounted.

For WisdomTree's full Market Outlook, please click here.

1 Bloomberg as of 22 July 2025
2 Bloomberg, Performance of MSCI USA versus MSCI Europe from 30 June 2020 to 30 June 2025
3 Bloomberg as of 30 June 2025
4 Bloomberg, WisdomTree as of 30 June 2025
5 Bloomberg, MSCI Latin America Index from 31 December 2024 to 30 June 2025
6 Bloomberg, FactSet as of 30 June 2025

Important Risks Related to this Article

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