



Continental drift

Are the US and Europe drifting apart?

Update
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There have been some fascinating twists and turns in the last 12 months' journey through the investment landscape, the rising price of gold, China's equity market surge, and the bond market's rebuke to the US administration being three that have attracted plenty of headlines. It would be an exaggeration to say that the interplay between the US and Europe has been less well covered, with the game of golf taking on an internationally significant role, but perhaps less so in terms of the interplay between US and European equities, which has quietly been one of the big themes of 2025. At the time of writing, the S&P 500 is up year-to-date by about 7% for a GBP investor compared to about 14% for European markets. Given the huge resurgence of the US market since April, one could be forgiven for not knowing these figures, and they certainly surprised us.

This difference is exacerbated by the polarisation in the S&P 500, where active managers are either long of the Magnificent Seven or are underperforming. In Europe, conversely, owning the GRANOLAS, a set of large-cap growth companies analogous to the Magnificent Seven, has been the wrong strategy, with a resurgence in more domestically orientated stocks, which some active managers have been quick to pick up on. Europe's equity market resurgence does seem to be partly powered by positive fund flows coming from global investors lightening up on the US, and thus it feels right to ask whether the two continents have drifted apart, or is this just a cyclical phase? Let's start by taking a short journey back in time and remind ourselves of how, perhaps only two years ago, we would have defined the US and Europe from a big picture investment perspective.

The US is a continental-sized economy united by a single language and with an abundance of natural resources. Its culture favours hard work and innovation. Further, it has an as-yet-unparalleled industrial military complex. Many individuals are directly connected to the equity markets through their savings and are acutely aware of the direction of the S&P 500. The country has an outstanding track record of growing world-leading companies that dominate or even monopolise their niche, as well as some outstanding domestic businesses that, although defined as 'small cap', would in any other country be a mid or large cap. Considering the US is a highly developed economy, it maintains a GDP growth rate that other developed economies just can't seem to match. All of this combines to make the US 'exceptional'.

Europe, by contrast, has a similar-sized population divided by several languages, borders, and varying political systems. Europeans are hard-working too, but take more holidays. Many Europeans are not very aware of stock markets, and they typically

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save through products where the links to stock and bond markets are opaque. Europe is innovative too, but often lacks the corporate ambition of the US, with companies often sold at an earlier stage. Far from being exceptional, Europe is seen as being a bit old and tired and probably too dependent on the US for its influence in the world.

Putting it more simply, let's imagine that Jeff Bezos had started his business in a European country. Would Amazon be what it is today, or would Jeff have been happy running a successful online bookstore? Perhaps to be bought out by one of the traditional retailers after a few years.

All of this adds up to an investment mindset for many of us, myself included, that means we invest in US equities partly because, well, it's the US and you just have to, right? Whereas Europe doesn't seem all that essential. But, well, we ought to have a bit there just in case. After all, Europe is big and old enough that it's bound to have grown a few large successful global companies. More recently, as Europe's largest companies got their own acronym and it seemed like Europe was finally about more than just expensive handbags, investors did start to take more of an interest, and a very similar pattern of very narrow



market leadership developed, with Europe's 'global champions' a.k.a. the GRANOLAS, being the essential ingredient in any portfolio.

In 2025, something very interesting happened, though. In Europe, those 'global champions' have not performed well, and instead, more domestically orientated stocks have been doing the driving. For example, banks, which many active fund managers shy away from, have been a standout sector. Engineering and construction companies have seen their share prices run up in anticipation of the German government's infrastructure spending, and Europe seems genuinely determined to build up its domestic defence industry. For the first time in a long time, European equities have risen because of Europe, rather than in spite of Europe, and it is perhaps no surprise that, in the short term, not all active managers have navigated this. It's hard to be optimistic about Europe after a career when it has paid not to be. Japanese equity fund managers probably feel the same way.

Some active managers have adapted rapidly, though, and one trust which we think has done an outstanding job is **JPMorgan European Growth & Income (JEGI)**. This trust aims to be an all-weather core holding in Europe and also pays a dividend partly funded from capital, which provides a yield on an asset class that income investors might otherwise be prevented from owning. You can read about why capital dividends can be a very good thing indeed [here](#). The team managing JEGI correctly identified the momentum building behind banks, for example, as well as anticipating the momentum going out of some of those global champions and have significantly outperformed the market as a result, extending a very good long-term track record.

Another very successful strategy in Europe is the succinctly named **European Smaller Companies (ESCT)**. As we noted above, the swing factor for investors shifting allocation to Europe has been a slightly better economic outlook for domestic economies. This has been incredibly helpful for ESCT's portfolio of mid and smaller companies, where again, we see performance coming from domestic areas such as construction and engineering and defence. We also observe that ESCT has been the subject of more corporate activity in the last year than most investment trusts see in a decade. First, for baffling reasons given its performance track record, ESCT was strong-armed into a tender offer by an activist investor, but then, in recognition of that same track record, became the merger host for one of its peers, **European Assets (EAT)**. In so doing, ESCT has also adopted a capital dividend policy and thus income investors have been given yet another extremely useful tool.

This surge in more domestically orientated stocks has led to others in the peer group underperforming slightly. The largest trust in the group, **Fidelity European (FEV)**, has an outstanding long-term track record, but over the

last year has just missed the benchmark. Others, such as **Baillie Gifford European Growth (BGEU)**, **BlackRock Greater European (BRGE)**, and **European Opportunities (EOT)** have been caught on the same side of the trade. This is, though, a short period of time, and as we'll look at further on, has Europe really changed all that much? It seems likely that first, active managers will adapt, but second, perhaps it's also good to reflect that some of those global businesses that have performed less well this year are successful for a reason.

In the US, the polarisation between the Magnificent Seven and 'the other 493' (constituents of the S&P500) is well known, and the investment stalwart **JPMorgan American (JAM)** has done an exceptionally good job of outperforming the index over the last five years, without relying on full Magnificent Seven exposure. We think this is what an investor in a core product should be looking for, and while JAM has trailed the index in the nine months elapsed in 2025, in our opinion it's a relatively small price to pay for the lower volatility and outperformance it has delivered over five years. A less commented upon divergence in the US market is the underperformance of small caps as an asset class, and while this has persisted for several years, this year's strong bounce back by the S&P 500 after April's sharp falls was not matched by small caps, which broadly speaking fell at the same time but failed to bounce.

Again, while corporate activity in investment trusts isn't always timed as an exact contrarian signal, it's interesting that, for example, **Brown Advisory US Smaller Companies (BASC)** very recently introduced a conditional tender offer linking performance to an opportunity for investors to get up to 100% of their money back. BASC's closest peer, **JPMorgan US Smaller Companies (JUSC)**, did hold a tender offer in 2024, and while this was likely driven by activist investor Saba, it's still a signal that other investors have lost interest in US smaller companies. Contrarian signals like this are, if nothing else, good prompts to re-examine an asset class. Both these trusts' managers have really good long-term track records investing in the quality growth domestic businesses that are at the core of the US small-cap universe, and which have not been rewarded by investors at all for quietly compounding, while a few mega-cap stocks undergo explosive growth phases that may, or may not, prove to be rooted in long-term reality. US small caps have had such a tough time getting attention from stock market investors for a long time now that anyone with an ounce of contrarianism ought to be looking more closely.

In a similar vein, **North American Income (NAIT)** offers investors a real alternative to the concentrated performance of the index and could be, as the name implies, a very good option for income investors otherwise put off by the US's relatively low dividend yield. Although not its intention, we can see this trust as a natural diversifier from the Magnificent Seven-led index.



A permanent change?

With the polarisation in investment trust performance discussed above seemingly driven by that switch in the fortunes of Europe and the US in investors' minds, it's fair to ask whether this really is a case of continents drifting apart, or something more cyclical? Uncomfortable scenes at golf clubs on both sides of the Atlantic this year are representative of a strained relationship between the US and Europe, but perhaps also serve as a reminder of the incredible importance of the relationship between the two. One conclusion we might reach from the last year as investors is that there has been an irreversible shift in the balance. Before, we invested in US equities because of the US, and in European equities, in spite of Europe. Every day that the gold price goes up and the dollar goes down helps confirm this year's narrative that the rest of the world is seeking to diversify its investment exposure. And now, we are investing in Europe as an 'improver' and being more selective about our investments in the US, focussing on its 'global champions' that are less reliant on its domestic economy. If true, that's quite the reversal.

If, on the other hand, we had a slightly contrary streak, we could look at it differently. The shift is real enough. Given the polarising nature of the current US administration, it's incredibly difficult to compose short sentences that don't imply some bias, so we're going to trust our readers to see the next statement as a non-partisan comment. As a dispassionate investor, it is important to acknowledge that it is very likely true that, on average, a negative perception among global investors is an important part of the shift. But perhaps the sheer volume of noise generated means that it's easy to miss, for example, that the US has made some extremely positive pro-business revisions to the tax system that will encourage more investment.

In contrast, what is driving optimism in Europe? German infrastructure spending is often cited as one of the swing factors, and it's true that Germany's very conservative balance sheet does allow it to borrow more to fund this. But infrastructure in democratic countries is notoriously difficult to do at scale, and we don't think it's too cynical to point out that politicians' plans often include previously announced spending to make up the total. Europe's new determination to spend more on defence is also cited as a positive factor for markets, and while it does seem likely there will be an increase, one can easily imagine there will be wavering once it becomes clear that this comes at the cost of what? Spending on health care? Social care? These are highly prized parts of European society. In short, it's not hard to see how backtracking from today's very positive outlook could occur.

Make no mistake, though. A lot of capital has flowed into Europe, and it's hard to dismiss it all as 'hot money' seeking a quick, safe haven from an, ahem, non-conformist

US administration. We think European equities deserve to be pushed up the rankings in terms of the attention they receive. But are we really so confident that those two opening descriptions of the US and Europe have changed all that much? It's a strange world indeed when US equities might be the biggest contrarian bet in global markets, but that's the world we find ourselves in.



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