# Blue Magic

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**The Reformed Broker** is a blog about financial markets and the economy.

From Josh Brown's website: My blog is about markets, politics, economics, media, culture and finance. I'll use statistics, satire, anecdotes, pop culture references, sarcasm, fact, fantasy, and any other device that I feel necessary to get my points across.

What I don't do on this site is give financial advice or tell anyone what to invest in. The Reformed Broker is a forecast-free blog. What I will do on this site is provide you with a running commentary of my market-related insights and thoughts as events unfold. I'll point you toward other interesting content around the web. I'll challenge your perceptions, call it like I see it and, occasionally, I'll make you laugh.

A link to the blog's website is provided here: http://www.thereformedbroker.com/.

**Joshua Brown** is with Ritholtz Wealth Management, a New York City-based investment advisor, whose clients are high net worth individuals, charitable foundations, retirement plans, and corporations. He helps people invest and manages portfolios for them. He is the author of the book *Backstage Wall Street*, from publisher McGraw-Hill. He is a regular contributor to: CNBC, Investment News, The Daily Beast, TheStreet.com, Forbes, CNNMoney, Fortune, Christian Science Monitor, The Faster Times, Marketplace Radio, The Wall Street Journal, and The Business Insider.

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By Josh Brown
January 28, 2019

Meb Faber and I had a little back and forth this past week about whether or not U.S. stocks are "special" as compared to the rest of the world – he says no they are not special and I say yes they are.

By special, I don't mean they always out-perform. I just think it is impossible to ignore the fact that U.S. stocks have traded at a premium valuation to the rest of the world since 1990, the year the Cold War was won, and we became the sole super-power on the planet. The dollar became the de facto reserve currency, the 401(k) supplanted the pension as the retirement vehicle of choice, and the birth of the internet and wireless communications helped to cement our technology sector as an unstoppable world-beating force of innovation, revenue growth, and enormous profitability, with only small pockets of competition coming from anywhere else around the world.

In short, we have got a hundred million people adding money to their stock market accounts every two weeks, buying mostly more U.S. company shares. We have got 20% of our markets composed of the most profitable high tech and consumer tech firms in history. And we have got, structurally speaking, the deepest, widest, most liquid, and dynamic market environment anywhere on earth. Nothing in London, Frankfurt, Hong Kong, or Tokyo can touch it.

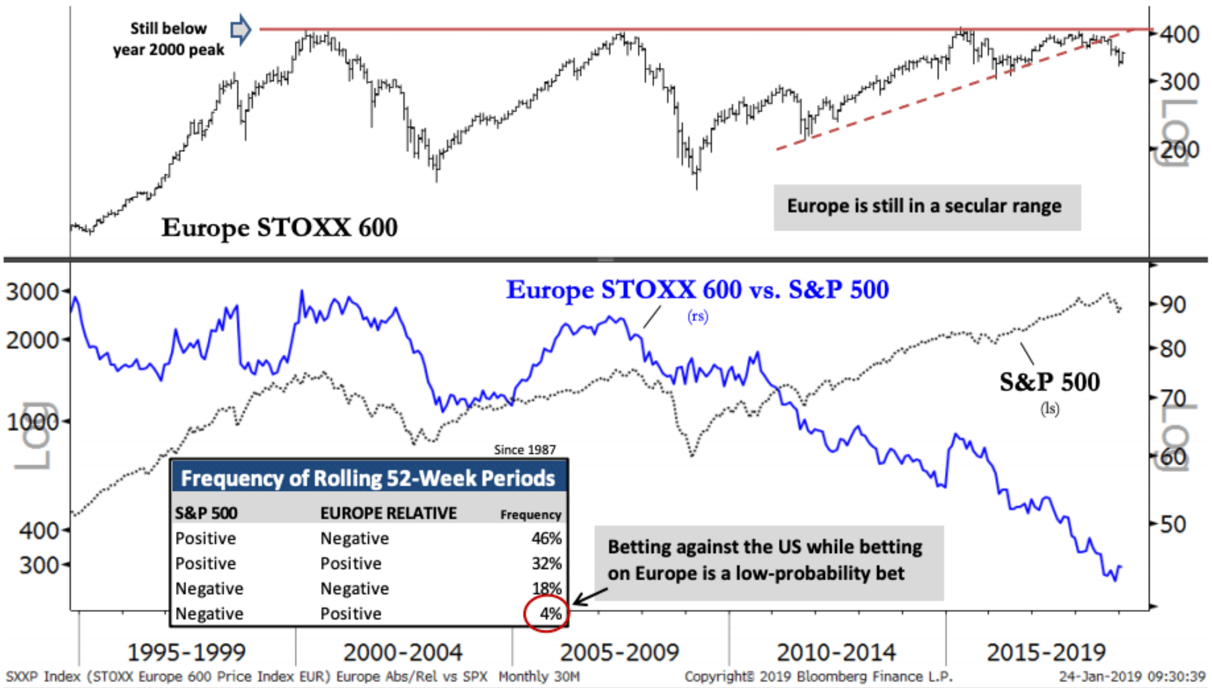
With these tailwinds in force, it makes perfect sense to adopt the narrative that U.S. stocks are more highly regarded by global investors, generally speaking, than the equities of any other country – and, therefore, they are priced at a near-permanent premium multiple to earnings.

With the exception of Japan's epic, historic bubble in the late 1980s, there is no reason to think that the stocks of any other developed country will spend an appreciative period of time garnering higher average annual valuations.

I could be wrong, this is just my opinion. I am sure there are scenarios in which the euro currency soars while the dollar tumbles and Euro Zone stocks out-perform ours for years and years on end unto the point where there is a flip on relative valuation – I just can't picture it happening.

Maybe it could occur in a down-trend for both? In which case….hip, hop, hooray?

My friend Ari Wald is sticking with one of his big themes right now: U.S. stocks over European stocks. He makes the case that it is a very low-probability bet to think that the U.S. market could stumble while Europe makes you a lot of money to the upside. It has happened, but just not often.



Source: Oppenheimer & Co. and Bloomberg. Note: These results cannot and should not be viewed as an indicator of future performance.

As you can see, over rolling 52-week periods, Europe almost never out-performs while the S&P 500 is negative. Ari calculates that this has happened just 4% of the time, back to 1987. What has been more frequent is Europe lagging or even being flat-out negative while the S&P is up. This is the case 78% of the time.

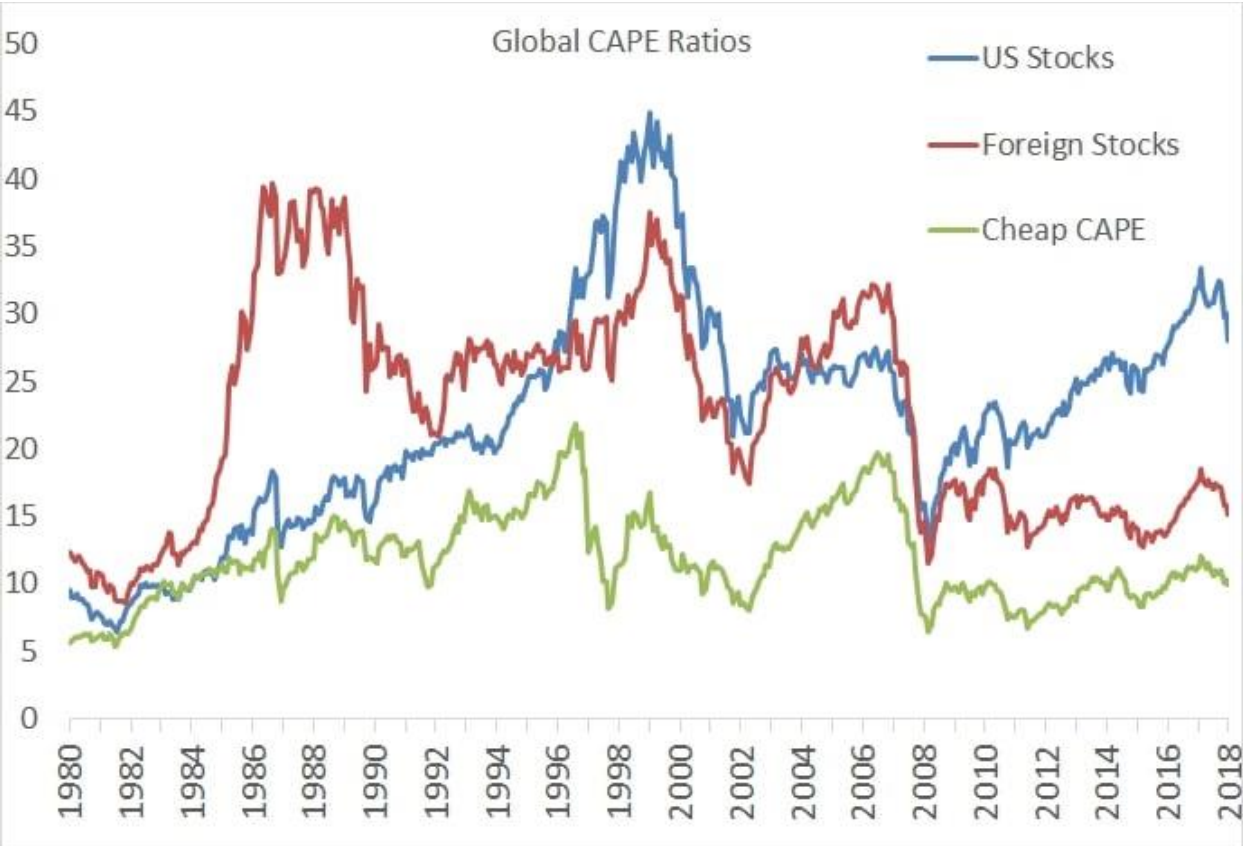
We build client portfolios that have exposure to the European stock market not because we expect it to massively outperform the USA for any specific period, but precisely because the periods during which it will are hard to foresee in advance. Usually, there is something going on with the currency – think 2003-2007, when supermodel Giselle Brady was publicly insisting on being paid for her runway gigs with euros, not dollars. Even Jay-Z was flashing stacks of euros in his videos at the time.

During the Lost Decade for U.S. stocks, between 2000-2009, all sorts of weird stuff was going on and international diversification paid off for investors coping with zero gains from the S&P 500.

Meb Faber took a look at the CAPE ratios of the United States, the global stock market ex-US, and the cheapest 25% of all country markets. He notes a huge disparity that has been growing for years now…

Today marks one of widest valuation spreads in history, with foreign markets trading at much cheaper levels than that of the U.S.A.

This spread only intensifies if we zero in on the cheapest quartile of countries around the globe. They are trading at a CAPE ratio of about 11 – that is a whopping 62% lower than the U.S.A.!




Josh here – going back to 1980, almost 40 years ago, this is the biggest valuation spread ever recorded (on this measure of cyclically adjusted price earnings ratios, which I have all sorts of issues with, but that is a story for another day).

So, I will close by saying that there is room for everyone to be right. I could be right that U.S. stocks maintain their valuation premium to the rest of the developed world, but mean reversion could still offer massive gains to those who have the guts to underweight the S&P 500 while overweighting the MSCI EAFE. It is a hard trade to put on, for many reasons, but Ari's low probability calculation adds an additional wrinkle – if you believe the U.S. bull market is wobbly, you have even less of a reason to want to add more Europe to your portfolio based on history.

Sources:
*Emerging Markets for Overseas Exposure*

*Oppenheimer & Co – January 26th, 2019*

**The Biggest Valuation Spread in 40 Years? (Meb Faber Research)**

**Supermodel Gisele Bundchen: 'I won't get out of bed for US dollars' (Daily Mail)**

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**See ABOUT THE AUTHOR on the following page.**

# ABOUT THE AUTHOR

Josh Brown is a New York City-based financial advisor and the CEO of Ritholtz Wealth Management.

We help people align their investments with their financial goals and manage portfolios for them. Our clients range from high net worth households to corporations to retirement plans to charitable foundations. For younger investors and those just getting started, we've created the Liftoff automated advisor – a simple, low-cost way to access a professionally managed portfolio selected just for you.

He is also the author of the books *Backstage Wall Street* and *Clash of the Financial Pundits* from publisher McGraw-Hill. In addition, he serves on the advisory board of financial technology firms Riskalyze , Vestwell, Digital Assets Data Corp as well as CNBC's Financial Advisor Council.

In 2015, he was named to the Investment News "40 Under 40" list of top financial advisors.

# ABOUT THE REFORMED BROKER

The Reformed Broker began in November of 2008 and has become one of the most widely-read sites on the financial web.

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## In the Media

I have been featured in or have written for Fortune, Forbes, the Wall Street Journal, MarketWatch, Dow Jones Newswires, Bloomberg, Reuters, CNNMoney, Bloomberg, CNBC, the New York Post, Crain's New York Business, Investment News, Registered Rep, Financial Planning, Fortune, RIA Biz, Business Insider, American Public Media, NPR, TheStreet.com, the Washington Post, Buzzfeed, Barron's and the New York Times.

I am an on-air contributor to CNBC. My show, *The Halftime Report*, airs weekdays at 12 PM ET.
Our YouTube Channel, The Compound, is blowing up. Check us out!

Follow our latest updates with the Market Moment skill on Amazon's Alexa!

I am available to comment on most topics for print, web, television and radio. Get in touch.
Do you want me to speak or moderate at your next event? More info here.

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