All We Need Is Earnings
Newsletter for Q4 2024

"*All we need is earnings, earnings is all we need*". This corny twist on a famous Beatles song has been the consistent tune the markets have hummed for investors. Especially over a long enough time frame, all other parameters become inconsequential. In fact, parameters like valuations, over a cycle, are simply amplifiers of earnings trends. They increase when earnings accelerate and reduce when earnings decelerate. Hence, strong 5-7 year earnings growth is a great predictor of market revaluation.

Why are we making the above point? It is simply to explain a stark difference in performance of the US market compared to the rest of the world in the past 10-15 years, and also to explain its stark underperformance in the 5-10 years preceding that.

The Consensus On US Exceptionalism – Is It Justified? Is It Permanent?

The US markets have had a stellar run since the early 2010s. Since the end of 2010, the S&P index is up 360%, whereas the rest of the world is up only 35%. Consequently, the weightage of the US in the MSCI World Index has moved up from about 45% then to over 65% now (as shown in the table alongside). Over the same time frame, the US share of global GDP has only modestly moved up from 21% to about 26%. It is just that corporate America has become extraordinarily profitable and has grown profits at a much faster pace than the rest of the world has done. Hence, our first conclusion is that US exceptionalism, based on the past fifteen years, is justified.

The second and probably more important question is whether this is permanent and whether this trend is expected to continue? Here, the answer is not clear. One fact to remember is that this high weightage of US stocks in the MSCI World Index is not unidirectional and has come down in the past. Its weightage dropped from above 62% in 2000 to less than 45% in 2011. So, the US can underperform for long periods. We will come back to this question once we understand the underlying drivers of the exceptionalism in the past fifteen years.

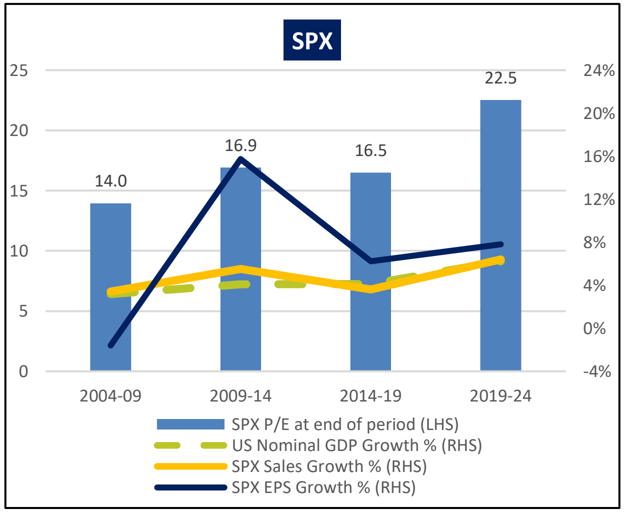
MSCI World country weighting (%)

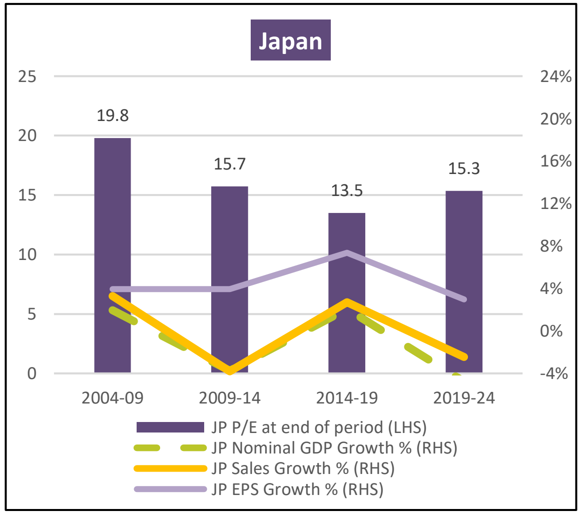
As of -->	Oct 2011	Mar 2021	Dec 2024
USA	44.80	57.80	65.60
Japan	7.70	6.40	4.78
UK	7.50	3.70	3.04
Canada	4.50	2.80	2.80
China	2.20	4.90	2.46
Switzerland	3.60	2.40	2.27
France	3.50	2.90	2.23
Germany	3.00	2.50	1.92
Taiwan	1.20	1.80	1.92
India	1.00	1.30	1.90
Australia	3.40	1.80	1.54
Netherland	1.70	1.10	1.09
South Korea	1.90	1.70	0.88
Sweden	1.10	0.90	0.74
Hong Kong	0.60	0.90	0.57
Spain	1.30	0.60	0.56
Brazil	2.20	0.60	0.41
South Africa	1.20	0.60	0.26
Others	7.60	5.30	5.03

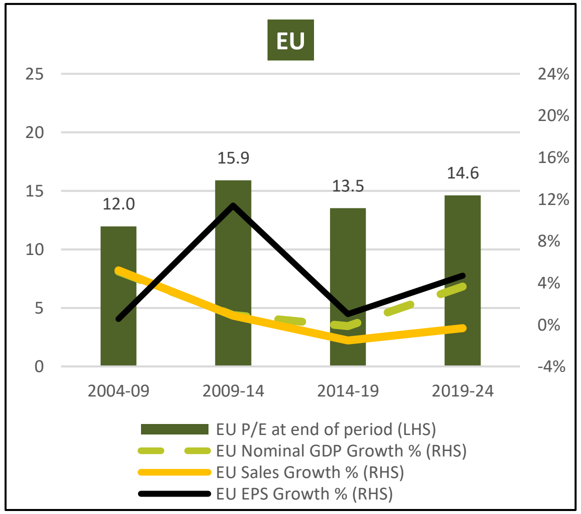
Source: Bloomberg

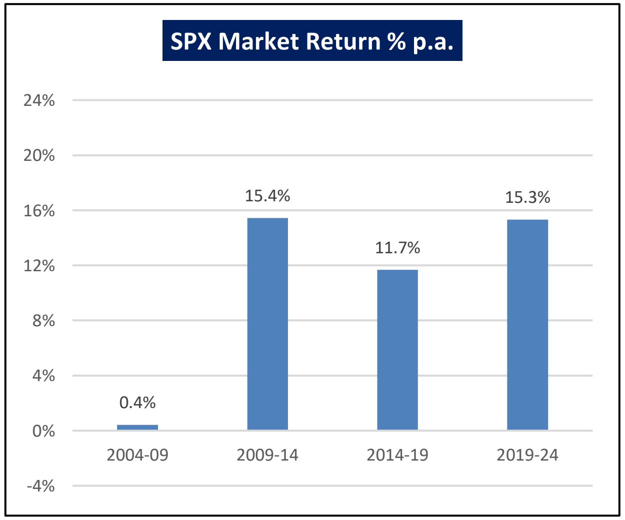
Drivers Of Market Outperformance: Primarily Earnings

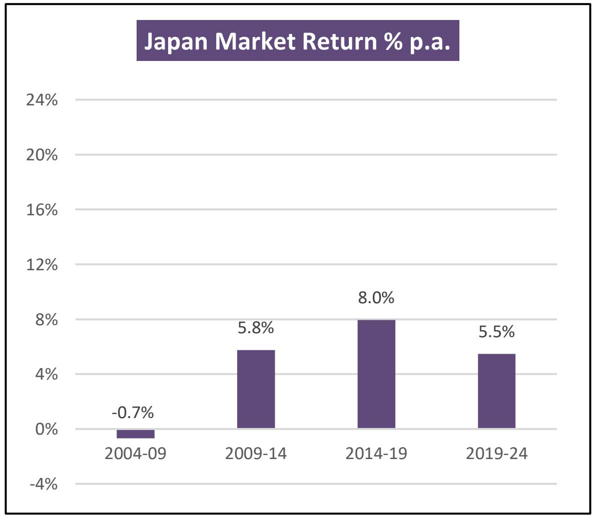
PE, EPS/Revenue/Nominal GDP growth across markets (in USD, MSCI indices) across time frames

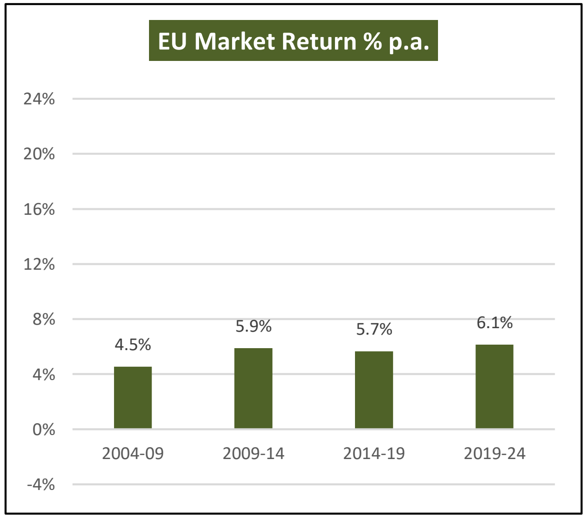


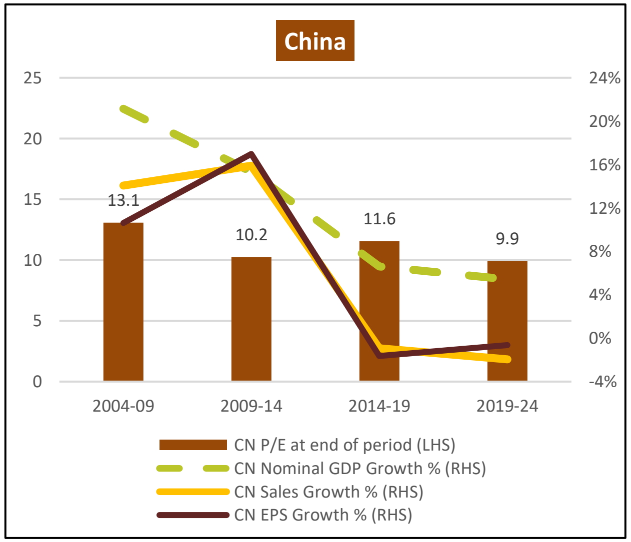


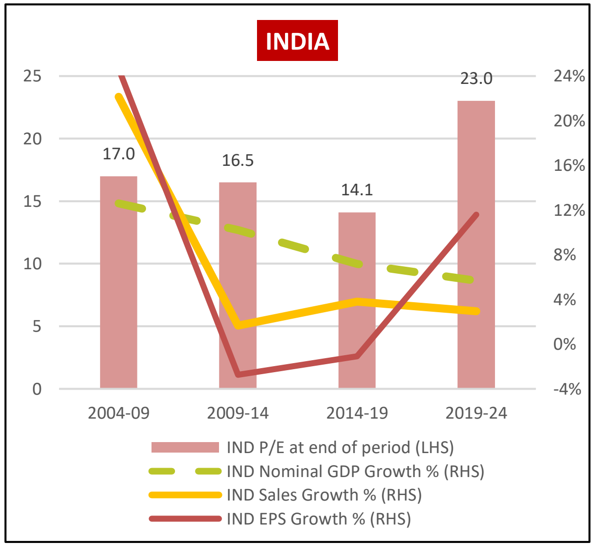


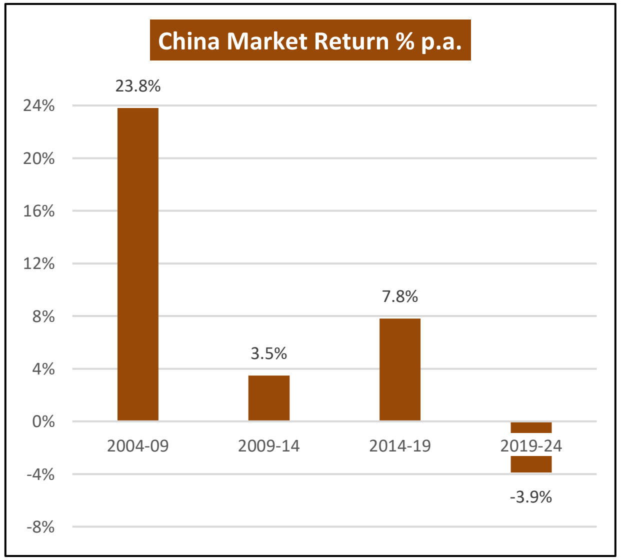


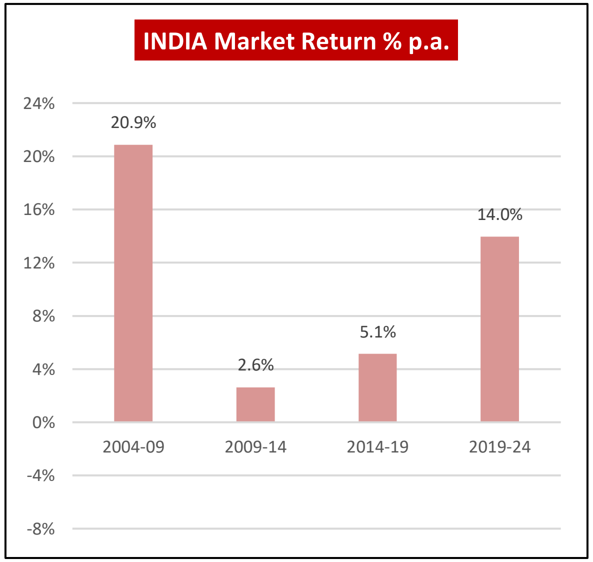












Source: Bloomberg

Growth analysis across markets and time periods		5 Yr Time Frame				10 Yr Time Frame		15 Yr Time Frame
		2004-09	2009-14	2014-19	2019-24	2004-14	2014-24	2009-24
SPX	US Nominal GDP Growth % (RHS)	3.2%	4.1%	4.1%	6.2%	3.6%	5.3%	4.8%
	Sales Growth % (RHS)	3.4%	5.5%	3.6%	6.4%	4.5%	5.0%	5.2%
	EPS Growth % (RHS)	-1.6%	15.7%	6.2%	7.8%	6.7%	7.0%	9.8%
	Market Return %	0.4%	15.4%	11.7%	15.3%	7.7%	13.5%	14.1%
	P/E at end of period (LHS)	**14.0**	**16.9**	**16.5**	**22.5**	**16.9**	**22.5**	**22.5**
IND	Nominal GDP Growth % (RHS)	12.6%	10.2%	7.2%	5.7%	11.4%	6.3%	7.7%
	Sales Growth % (RHS)	22.1%	1.7%	3.8%	2.9%	11.4%	3.4%	2.8%
	EPS Growth % (RHS)	24.7%	-2.7%	-1.1%	11.6%	10.1%	5.1%	2.4%
	Market Return %	20.9%	2.6%	5.1%	14.0%	11.4%	9.5%	7.1%
	P/E at end of period (LHS)	**17.0**	**16.5**	**14.1**	**23.0**	**16.5**	**23.0**	**23.02**
EU	Nominal GDP Growth % (RHS)	5.1%	0.9%	-0.1%	3.7%	3.0%	1.8%	1.5%
	Sales Growth % (RHS)	5.2%	0.9%	-1.5%	-0.3%	3.0%	-0.9%	-0.3%
	EPS Growth % (RHS)	0.5%	11.4%	1.0%	4.7%	5.8%	2.8%	5.6%
	Market Return %	4.5%	5.9%	5.7%	6.1%	5.2%	5.9%	5.9%
	P/E at end of period (LHS)	**12.0**	**15.9**	**13.5**	**14.6**	**15.9**	**14.6**	**14.62**
CN	Nominal GDP Growth % (RHS)	21.1%	15.3%	6.6%	5.4%	18.2%	6.1%	9.0%
	Sales Growth % (RHS)	14.1%	15.9%	-0.9%	-1.9%	15.0%	-1.4%	4.0%
	EPS Growth % (RHS)	10.6%	17.0%	-1.6%	-0.6%	13.8%	-1.1%	4.6%
	Market Return %	23.8%	3.5%	7.8%	-3.9%	13.2%	1.8%	2.4%
	P/E at end of period (LHS)	**13.1**	**10.2**	**11.6**	**9.9**	**10.2**	**9.9**	**9.92**
JP	Nominal GDP Growth % (RHS)	2.0%	-3.7%	2.1%	-4.8%	-0.9%	-1.7%	-2.2%
	Sales Growth % (RHS)	3.3%	-3.8%	2.7%	-2.5%	-0.3%	0.1%	-1.2%
	EPS Growth % (RHS)	3.9%	3.9%	7.4%	3.0%	3.9%	5.1%	4.7%
	Market Return %	-0.7%	5.8%	8.0%	5.5%	2.5%	6.7%	6.4%
	P/E at end of period (LHS)	**19.8**	**15.7**	**13.5**	**15.3**	**15.7**	**15.3**	**15.34**

Source: Bloomberg, RVAM analysis

We have analysed the drivers of market returns over the past twenty years by dividing this period into four periods of five years each. The parameters we have analysed are nominal GDP growth, revenue growth and EPS growth (all in USD). Against that, we have observed the market return over the same time frame and the end of period PE.

Some of our primary observations are:

1. **EPS growth over the medium term** is a good predictor of market return and valuation.

2. **Analysing the US market**: The stellar returns of the US market are supported by consistently high EPS growth over the past fifteen years. EPS growth has been over 10% p.a. since 2009, and has been so with relatively low volatility. This is, by far, the strongest growth over this time frame amongst the five markets we discuss here. This has led to P/E moving from 14x in 2009 to 22.5x in 2025 – a 50% re-rating. This explains the US market's stellar return of over 14% p.a. over these fifteen years. Before we anoint the US as infallible, however, it would make sense to have a look at the numbers from the period 2004-2009. Here, the EPS growth was -2% p.a. and the market was broadly flat. So, the US market does not have a birthright to keep outperforming. For that, it will need to continue to show the kind of EPS growth it has shown in the past fifteen years.

3. **Analysing the China market**: This market has been the opposite of the US. EPS growth, which was a very strong 14% p.a. from 2004-2014, was a shockingly low -1.1% p.a. over 2014-2024. Ten years of negative EPS growth is obviously a disaster for valuation and market return. Market P/E fell from 13.1x in 2009 to 9.9x in 2024 – a 25% derating. Consequently, market returns at 23.8% p.a. over 2004-2009, were only 2.4% p.a. in 2009-2024. This includes dividends; without this the return is about zero. There are many factors why the EPS growth has slowed down so dramatically, but one of the main factors is a sharp slowdown in nominal GDP growth and corporate revenue growth. The other is a regulatory environment which turned capital unfriendly from 2014.

4. **Analysing the India market**: The Indian market has a valuation comparable to that of the US, but its long-term EPS growth, revenue growth and nominal GDP growth are not as strong. India had a very strong 2004-2009 period. But, its 2009-2024 growth numbers are comparable to those of China and are much worse than those of the US. The one important positive about India is that the momentum has clearly inflected upwards in the past five years (2019-2024). These strong near-term earnings, sales and nominal GDP growth have led to world-leading valuations and strong market returns over this same time frame. The question remains on what is the long-term earnings growth for India - is it the trend from 2009-2019 or the stronger numbers from 2019-2024? The market has re-rated from mid-teens to about 23x now, so it clearly believes that it is the latter, stronger trend. This creates risks for India.

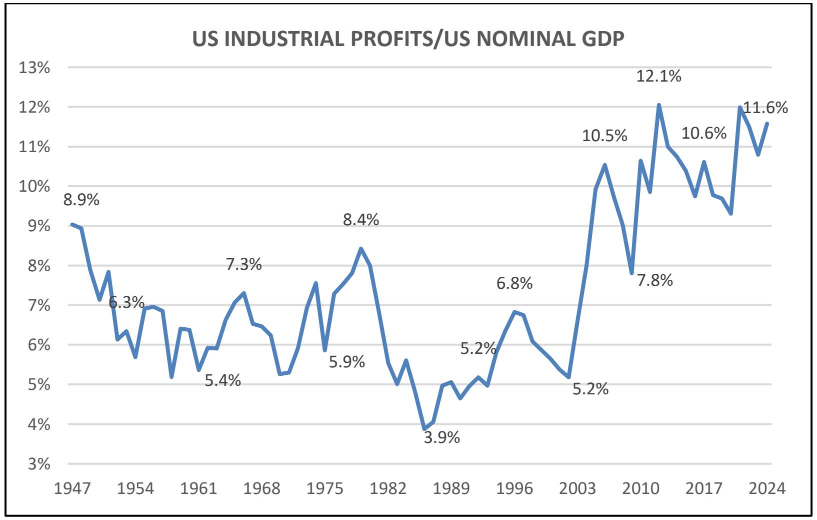
5. **Analysing the EU market**: The EU has had middling returns for most of the past twenty years. Its nominal GDP growth has only been 1.5% p.a. over the past fifteen years and sales growth has been marginally negative. Its earnings growth at 5.6% p.a. over these fifteen years (2009-2024) has far outpaced the top line. With negligible re-rating, the market returns have followed EPS growth. One interesting point being brought out here is that market re-rating is strongly influenced by top line growth, more than just EPS growth. This makes intuitive sense as EPS growth that outpaces revenue growth is not sustainable and will not lead to market re-rating.

6. **Analysing the Japan market**: Over the 2009-2024 period, Japan looks similar to the EU in many aspects - poor nominal GDP and sales growth, EPS growth clearly outperforming sales growth, zero re-rating, and market returns the same as EPS growth. In fact, despite the positive narrative over the past few years about Japan showing strong signs of structural change, its earnings and sales growth, market returns and valuation have all failed to break out of long-term trends.

7. **The US is the clear outlier in EPS growth**: Over the past fifteen years, the US's EPS growth of 9.8% p.a. and market return of 14.1% p.a. is 75-100% higher than that of the other markets. Amongst the other four markets, the EPS growth (in USD) is bunched together, with the EU at 5.6% p.a., Japan at 4.7% p.a., China at 4.6% p.a. and India, surprisingly, last at 2.4% p.a. (however, India's EPS growth has inflected up dramatically in the past five years). Also, some of these numbers partly reflect currency depreciation as we are looking at USD EPS. The currency depreciation p.a. over the past fifteen years are, respectively, INR 4.2% p.a., JPY 3.6% p.a., EUR 2.1% p.a. and CNY 0.44%.

8. **The US is the clear winner in market returns**: The US's stronger EPS growth has led to a much stronger market return of 14.1% p.a. over the 2009-2024 timeframe. Compared to this, the other markets have done much more poorly, with India at 7.1%, Japan at 6.4%, EU at 5.9% and China at 2.4%. Again, a part of this is explained by the weakening of all currencies against the USD. But a large part is because of the higher US EPS growth and re-rating. India is the outlier here as its earnings growth is the poorest but returns are highest among these four, and it is the only market other than the US that has re-rated. This is again potentially explained by its near-term strong earnings momentum in the last five years and a change in the structural story in India; but questions remain on the sustainability of this momentum. China, on the other hand, has dramatically underperformed its peers and its own history. Also, it is the only market that has derated. This again can be explained by poor near term (2014-2024) EPS growth and a very negative structural narrative.

Power Of The Owner Of Capital – US v/s China – Are They Inflecting?



Source: US Bureau of Economic Analysis

Source: National Bureau of Statistics of China/ Bloomberg

The capital owner in America has steadily gained at the expense of other stakeholders like labour, customers, etc. Consequently, Profit/GDP has sharply increased over the past twenty-five years. This ratio was consistently between 4% and 8% of GDP for the fifty years between 1950 and 2000. But since 2000, it has broken out of that range and has reached about 12% of GDP in 2023. This sharp increase is a consequence of multiple factors like huge consolidation in industries (leading to quasi-monopolistic industry structures), increasing contribution from the tech sector where there is more of a “winner takes all” profit distribution, slight increase in contribution of profits from the international market, etc. However, international revenue contribution to S&P earnings has only moved marginally from 25.4% of earnings in 2000 to 28% in 2023. Hence, the first two reasons are the primary ones for the sharp increase in the corporate profit/GDP ratio in the US. In the long term, this creates social and political issues which could lead to the kind of sharp political reset we are seeing in the US now.

In China, the opposite has happened. We have reliable data only for the past ten years. But even here, the ratio of corporate earnings/GDP has dropped from about 10% in 2014 to only about 5.6% in 2024. This is as dramatic a change as in the US, but in the negative direction. This again coincides with the coming to power of the current dispensation led by Xi Jinping. This government has been clearly less favourable to owners of capital than the one preceding it. But we feel this trend has inflected since September 2024 and that is where the opportunity lies.

We discuss the above two points to get some context on whether the sharp earnings growth in the US and the poor earnings growth in China can be extrapolated into the future. Also, the factors that would need to be monitored as lead indicators of these trends. Our conclusion is that both these trends (in the US and China) could be directionally inflecting.

Conclusion

Our broad conclusion is that market returns have a strong connection to earnings growth over a longer period of time. Also, markets with strong historic earnings growth tend to steadily re-rate up.

Over the past fifteen years, the US has been a strong outlier in terms of earnings growth and, hence, has strongly re-rated. This has led to outsized returns compared to other markets. Consequently, its weightage in global indices has gone up from 45% to nearly 65% - a historic high.

China has been the opposite. Earnings growth has been the poorest. This has combined with significant derating and hence led to very poor market returns. India, though it has had poor earnings growth over the past fifteen years, has had a strong acceleration in the last five. This has led to one of the highest valuations in the world which, we believe, has created vulnerabilities for the market.

All markets get punished during periods of poor earnings growth. Even the mighty US gave very poor returns during 2004-2009 because of poor earnings growth over that period. Earnings growth can have large periods of weakness and strength for all markets. Nothing is permanent.

The US and India are sitting on very high valuations, reflecting the strong earnings growth over the 5–15-year period preceding today. The future margin of error for these markets is thus low. There is a high chance that the medium-term return from these two markets will be much below their long-term averages.

China sits on low valuation. But, without a genuine upward inflection in earnings growth, this market could remain a value trap or, at best, a trading market. We believe we are seeing the green shoots of a turnaround in the long-term earnings trend in China. While this inflection will be a slow and volatile process, we believe the risk-return is favourable in this market.

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