

When Wall Street and Main Street Diverge

Insights
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Toby Warburton

Global Head of Active Portfolio Management
Systematic Equity

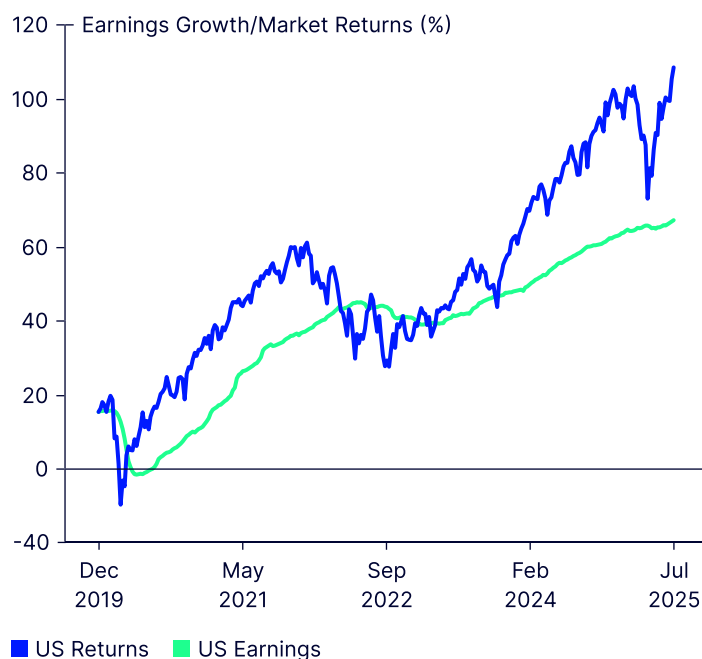
Equity markets continued their inexorable march upwards in the first half of 2025, shrugging off everything thrown at them. This journey has been supported by robust corporate earnings, but there are signs of caution from company management that suggest there may be some bumps in the road ahead for equity investors.

Global equity markets demonstrated remarkable resilience in Q2 2025, rising through the fog of uncertainty that lingered over macroeconomic and geopolitical landscapes. While tariff announcements and renewed trade war rhetoric resurfaced during the quarter, equity markets largely shrugged off the doubts surrounding global trade stability. Investors appeared to discount the long-term impact of these developments, focusing instead on robust corporate earnings and signs of supply chain adaptation. The muted market reaction suggests that participants viewed the headlines more as political posturing than policy-shifting, reinforcing the broader narrative of markets looking through the short-term and opaque outlooks and focusing on a future nirvana.

The strength of corporate earnings, particularly in the US, has been one of the key pillars supporting equity markets in the post-COVID period. Europe, meanwhile, has lagged in terms of both earnings expectations and market returns until this year, at least, when a dose of self-help from European governments supported a rebound for both.

Stock market returns by their nature are inherently uneven over the short term but should reflect fundamentals over the medium to long term. Periods of prolonged dislocation from the fundamentals can be cause for concern. The first three quarters of 2022 serve as a case in point — returns had run far ahead of earnings growth during and after the COVID period, and a dose of painful recalibration was required. The was most notable in the US but it had echoes globally. Since that time, US earnings growth has continued to impress. However, stock market returns have once again far exceeded earnings growth expectations for the year ahead (Figure 1).

Figure 1: US 12m forward earnings expectations and stock market returns



Source: FactSet, State Street Investment Management, MSCI as at July 3, 2025. Growth in 12m Forward Consensus aggregate Earnings Expectations for constituents of MSCI USA Index and MSCI USA Stock Market Returns (both in local currency). Past performance is not a reliable indicator of future performance. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income as applicable.

In Europe, by contrast, the level of earnings growth in aggregate has been considerably lower than that of the US. Unlike in the US, where a lot of AI-related hype has driven stock market gains, European returns have tracked earnings expectations much more closely. In the US, over this period, stock market returns have outpaced growth in earnings expectations by 80% in the US, while in Europe the disparity has been a more reasonable 21% (Figure 2).

Figure 2: Europe 12m forward earnings expectations and stock market returns



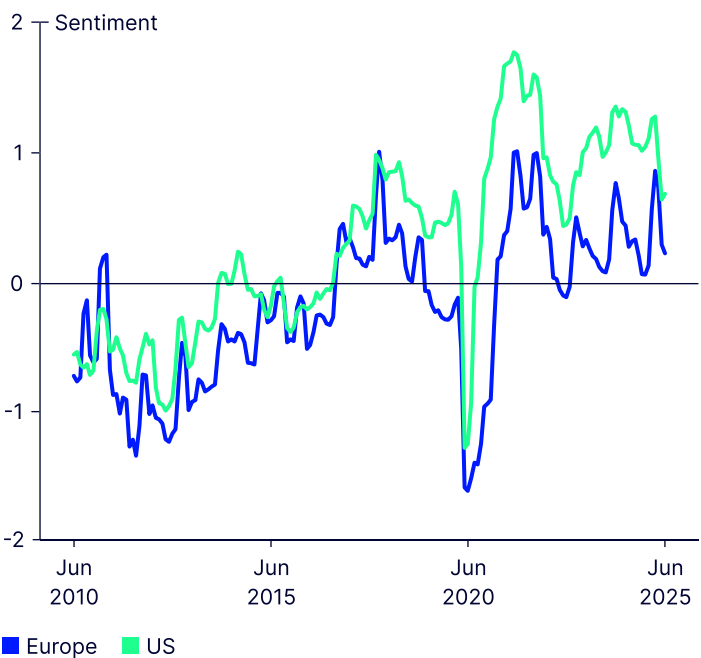
Source: FactSet , State Street Investment Management, MSCI as at July 3, 2025. Growth in 12m Forward Consensus aggregate Earnings Expectations for constituents of MSCI Europe Index and MSCI Europe Stock Market Returns (both in local currency). Past performance is not a reliable indicator of future performance. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income as applicable.

We find this apparent divergence between Wall Street (stock market returns) and Main Street (actual corporate earnings) interesting and worth investigating further. There may be genuine reasons for this significant multiple expansion, such as stock markets being anchored to much longer-term earnings expectations, economic growth differentials, or a strong belief in the innovative capacity of the US corporate sector to drive ongoing growth. Alternatively, it could be that the same innovation capacity and a surge in productivity improving technologies in the realms of AI, automation, and cloud computing may have fuelled the fire of investor enthusiasm leading to an unsustainable rally in hype.

Our research has shown that information in the language and tone of communications from company management, if processed skilfully, can have powerful insights into relative returns for stocks. Within the Systematic Equity team, we embed signals capturing such insights in the Alpha (returns forecasting) model we use for our active strategies. At an aggregate level, we can use these capabilities to derive a collective sentiment measure from company management and learn from their hidden linguistic jockeying.

Figure 3 shows a standardised measure of sentiment, distilled from company conference calls, which we have detrended to adjust for the fact that the average sentiment has increased over the past 15 years. By instead focussing of the ups and downs in the period, we can see the general pattern that management confidence in the US and Europe tends to follow a similar path, with US management on average being more positive than Europeans.

Figure 3: Standardised conference call sentiment



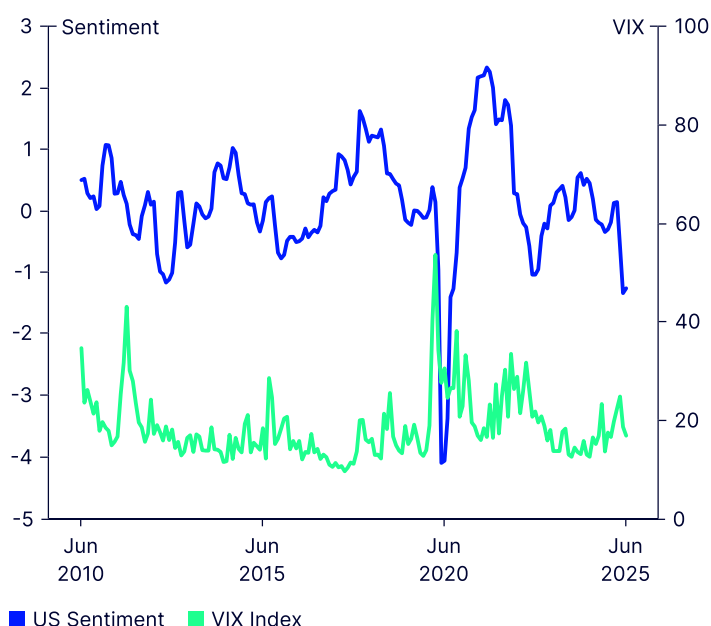
Source: State Street Investment Management as at July 3, 2025. Standardised conference call sentiment, averaged by market for stocks within Systematic Equity Core Alpha universe.

Whilst not at extreme levels by any means, it's noticeable how sentiment has fallen in both Europe and the US since the end of March 2025 as trade wars and tariff fears have escalated uncertainty about the future. In the US, sentiment is the weakest it has been in the past 15 years, excepting the lows around the COVID pandemic, suggesting that companies themselves are

either wary about the future, or perhaps truly unsure of what will play out over the next few months. It is very hard to be confident about the future when almost any path seems possible and the road ahead so uncertain.

There is also a notable correlation with dips in sentiment and market volatility. Sentiment has been negatively correlated to volatility, as measured by the VIX, and lagging it by 2–3 months on average (Figure 4). It remains to be seen whether the current data point is a natural reaction to the recent spike in volatility or something deeper.

Figure 4: Standardised US conference call sentiment and the VIX



Source: CBOE, State Street Investment Management as at July 3, 2025. Standardised, de-trended conference call sentiment, averaged by market for stocks within Systematic Equity Core Alpha universe vs implied volatility as measure by the VIX Index.

The bottom line

Equity markets globally have continued to climb, and in the US become more dislocated from shorter-term earnings expectations. The potential for volatility has risen once more as trade and policy uncertainty mounts. Much hope appears to be resting on the shoulders of corporate America to plow on with an innovation agenda that can overcome the headwinds and deliver on lofty earnings growth expectations. Management at many companies, however, are signaling waning sentiment, which should warrant caution.

A continued softening in the tariff narrative, earnings resiliency in the US, and further clarity on the potential for a soft landing for the US economy could all lead to benign outcomes for global equity markets. But the path may not be smooth and could be peppered with bouts of volatility. We believe building diversified portfolios, explicitly taking account of risk to balance return expectations, as well as assessing alpha potential from disparate and increasingly sophisticated and nuanced sources will be the keys to navigating this environment, as they so often are.

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* This figure is presented as of June 30, 2025 and includes ETF AUM of \$1,689.83 billion USD of which approximately \$116.05 billion USD in gold assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Investment Management are affiliated. Please note all AUM is unaudited.

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