The Technological Divergence: Why are European stocks so far behind, and how can they catch up to the US?

25.5% versus 3.7%. The difference in year-to-date (YTD) growth rates for the S&P 500 and the Euro Stoxx 600 respectively only begin to tell the story of how the US stock market is continuing to push on and leave Europe in the dust. The S&P 500 holds an impressive weighting of technology stocks, with just over 26% of its total market capitalisation belonging to technology companies. The Euro Stoxx 600, on the other hand, only holds a 7% weighting toward technology stocks. Whether it is the American emphasis on technological growth stocks over traditional value stocks, the concentration of large-cap tech stocks in the US, or even a deregulated business friendly environment, the underlying theme of technology remains constant among the reasons for this transatlantic divergence.

The Magnificent Seven stocks (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia & Tesla) are seen as the biggest seven technology companies in the world. They are known for their AI innovation, strong financials, and impressive growth over the last few years with advancement in machine learning. However, there is another common denominator between these companies – all seven are American. The US evidently has a technology-friendly environment which is not only home to the big players, but also boasts the most tech-related startups in the world. Top universities concentrated in tech-friendly ecosystems such as San Francisco, New York and Boston provide a talent pool of international workers, all of whom are highly educated. But the United Kingdom and Ireland are both ranked as better-educated than the US according to OECD, as well as Sweden and Luxembourg in mainland Europe – the education hypothesis does not hold. So, what gives the US an economic environment which is conducive to growth through technology?

Historically, the US has maintained the pre-conditions necessary for technology companies to grow, particularly in their venture capitalist phases. The US has always held a relatively low rate of corporation tax in comparison to their transatlantic counterparts in mainland Europe. With a current rate of 21%, which may well drop further to 15% under the Trump administration in 2025, the environment for tech startups to grow in America is strong. Whereas Europe's rates are significantly higher, 29.9% in Germany, 25.8% in France, and 25% in the UK (recently increased from a previously competitive 19%). The Tax Cuts and Jobs Act of 2017 exemplifies Trump's business-friendly stance. The steep slashing of the corporation tax from 35% to 21% has incentivised both domestic growth, but has also effectively attracted international startups to invest, develop, and grow in the US. With Trump securing a second presidential term, this influx of tech startups to the US may very well continue after he is sworn in at this presidential inauguration on the 25th of January. A potential reduction in corporation tax, paired with his heavy bias towards a deregulated business environment will catalyse this "brain drain" of technology companies out of other countries. With the Dow Industrials, S&P 500, and most topically the NASDAQ all climbing to record highs after Trump secured the presidency on November 6th, it seems promising in regards to technology related growth to continue to surge in the USA.

The notable 2023 initial public offering (IPO) of ARM is a significant example of this. The Cambridge-based semiconductor firm opted for an IPO directly in the US, as opposed to staying home in the UK. The biggest US listing of the year, jumping $6/share to $57 proved the decision to list in the US was sensible. Despite the best efforts of British ministers to lobby an IPO on the London Stock Exchange, the tech-friendly environment in the US was too good to turn down for ARM. A more bullish investor sentiment, particularly in the technology sector, also provided fair rationale for ARM to go public on the other side of the pond. This is not a standalone example either. Companies including Wise plc and Argo blockchain similarly chose a US-based IPO. To make matters worse for Europe, a number of firms delisted from European exchanges in favour of pastures new in the USA – namely Flutter Entertainment, CRH and Smurfit Kappa. Flows of technology-related capital are flooding into the states, and simultaneously leaving Europe.

Even the scarce few European based tech companies are struggling in comparison to their American rivals. The US tech index surged 55% this past year, its best results since the infamous dot-com boom of 1999. In comparison, the EURO STOXX technology index experienced a more modest increase of 33%. Whilst 33% may seem impressive, the relatively lower weighting of tech stocks in Europe, and lagging performance of value stocks in the energy, healthcare and industrials sectors have dragged European performance down. This is where the great divergence has truly opened up over the last 5 years. If the current trend continues, it will be more bad news for Europeans.

Can Europe do anything to turn the tide? Lower corporation tax rates would be ideal, but unfunded tax cuts will not sit well with investors, especially against a strengthening dollar. Policies need to be more focused, as evidenced by the ARM IPO in the US. Whether it is greater export credit to tech startups in Europe, or a more favourable environment for technological innovation generally, there is work for Europe to do. Especially with the threat of Trump promoting further corporate tax cuts and deregulation, Europe needs to make its business environment more attractive. The EU single market has potential to achieve this. Whilst consumer markets are unified, regulatory framework makes it tough for companies to expand, which is even more significant in the start-up phase of tech companies. EU reforms across data privacy, tax policy and intellectual property rights would alleviate the issues it has experienced, and subsequently create a previously unachievable tech-friendly business environment. Europe has a long way to go if it wants to catch the US in the technology space, but it can certainly take small steps in the right direction.