Insight INVESTMENT

GLOBAL MACRO RESEARCH

US EXCEPTIONALISM: AT A CROSSROADS

JUNE 2025

GLOBAL MACRO RESEARCH

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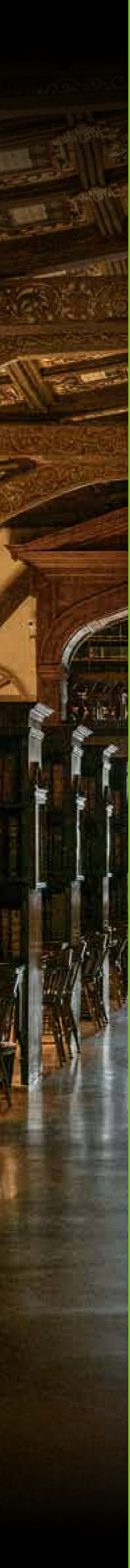


EXECUTIVE SUMMARY

The US is in a unique position. Since the second World War, its structural advantages, growth-orientated policy framework, entrepreneurial zeal and a dynamic efficiency in the deployment of capital have created the world's most powerful economy. It has used its strength to good effect. Higher levels of economic growth and productivity have resulted in higher levels of profitability and investment, facilitated through a lower cost of capital by virtue of the US dollar's position as the reserve currency of the world. This in turn has led to stronger growth, greater profits and higher rates of investment. This virtuous circle has ensured its predominant position is maintained.

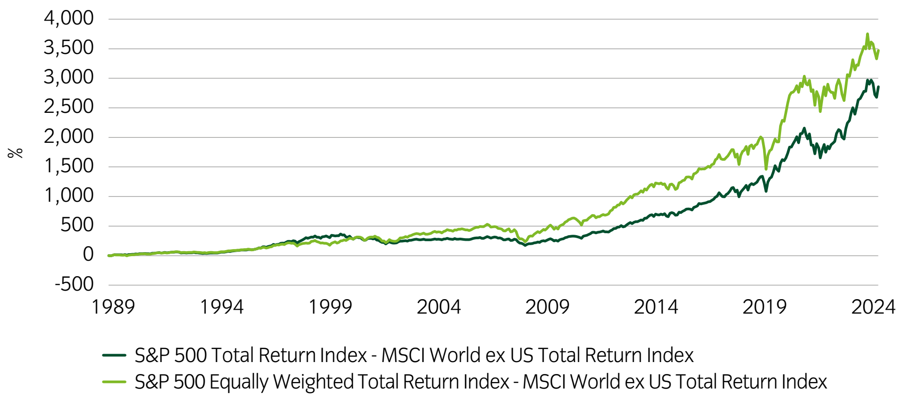
- **An exceptional period for US assets:** Over the past 15 years, US equities, bond markets and the dollar have outperformed due to the country's dynamic, innovation-driven economy. US assets now dominate many indices, reshaping global asset allocation and hedging behaviour.
- We highlight five key factors that have underpinned US exceptionalism and assess the potential for them to be sustained in the future.
  - **Innovation leadership:** The US has long been a global leader in innovation, driven by high research and development (R&D) investment (from both the corporate sector and federal agencies), a strong framework for the registration of patents, and a culture that attracts global talent. However, China is rapidly closing the gap, particularly in artificial intelligence (AI) and patent filings.
  - **Superior startup ecosystem:** The US excels at commercialising innovation through a robust venture capital market, thriving innovation hubs like Silicon Valley, and a business-friendly regulatory environment. China is emerging as a serious competitor, while the EU lags due to its regulatory fragmentation.
  - **Dollar dominance:** The US dollar's role as the global reserve currency has provided financing advantages and geopolitical leverage. While this "exorbitant privilege" remains intact, its strength has been increasingly tied to unsustainable fiscal policy rather than safe-haven demand.
  - **Corporate earnings power:** US firms, especially tech mega-caps, have delivered superior earnings growth and returns on investment. This has led to higher equity valuations. However, future growth may be constrained by deglobalisation, a lack of further tax cuts and already elevated expectations.
  - **Stronger economic performance:** Over the past two decades, the US has outpaced other developed economies in both economic and capital investment growth. However, much of this is population-driven, and analysis of per capita GDP growth shows a narrower gap. Fiscal stimulus has also played a key role, but debt sustainability concerns are rising.
- **Policy change could undermine these factors:** While the US has historically leveraged structural advantages and innovation to maintain global economic leadership, recent policy shifts under the Trump administration, marked by increased volatility, trade restrictions, tighter immigration, and potential R&D funding cuts, threaten to erode the foundations of US exceptionalism. These changes risk disrupting the virtuous cycle of growth, investment, and innovation that has long underpinned US dominance.
- **US equities face structural and cyclical headwinds, but mega-cap tech may prove resilient:** US equity markets may face valuation pressure as deglobalisation, policy uncertainty, and slower growth challenge the drivers of past outperformance. While mega-cap tech firms remain resilient due to scale and reinvestment in AI and digital ecosystems, broader market returns could be constrained by trade tensions, earnings risks, and a potential retreat by foreign investors.
- **The long dollar bull market may be ending:** While the US dollar is expected to weaken over time as central banks continue to diversify and amidst political pressure to support domestic industry, its global reserve status and lack of viable alternatives suggest the decline will be slow and non-linear. However, if confidence in US growth falters, the risk of capital flight could accelerate dollar depreciation.

US EXCEPTIONALISM IN ACTION

The outperformance of US assets has been a dominant feature in markets over the past 15 years. This trend has been most evident in the relative outperformance of the US equity market (Figure 1), but the performance of the US dollar and US bond markets is also impressive. The United States' strong commitment to capitalist economic principles, which emphasise free markets, competition, and private enterprise, has driven this phenomenon. It has created an economic model that has fostered significant innovation, technological advancement, and entrepreneurship, contributing to the nation's prosperity and global influence. The success of Silicon Valley and other innovation hubs exemplifies the dynamic and adaptive nature of the American economy.

Unsurprisingly, this relative outperformance has both naturally increased the weight of US assets within indices and drawn investors to allocate assets to the US. At the end of April 2025, US assets represented 73% of the MSCI World Index, 45% of the Bloomberg Global Aggregate Bond Index[1] and a significant proportion of private assets. The relentless rise of the US dollar has also impacted hedging behaviour, and our sense is that many international investors have kept the bulk of their dollar currency exposures unhedged. After all, why hedge when the US dollar is strong and higher US rates makes hedging expensive?

Figure 1: US equity markets have significantly outperformed the rest of the world[1]



[1] Source: Insight and Bloomverg. Data as at 31 May 2025.

FIVE KEY FACTORS THAT HAVE UNDERPINNED US EXCEPTIONALISM

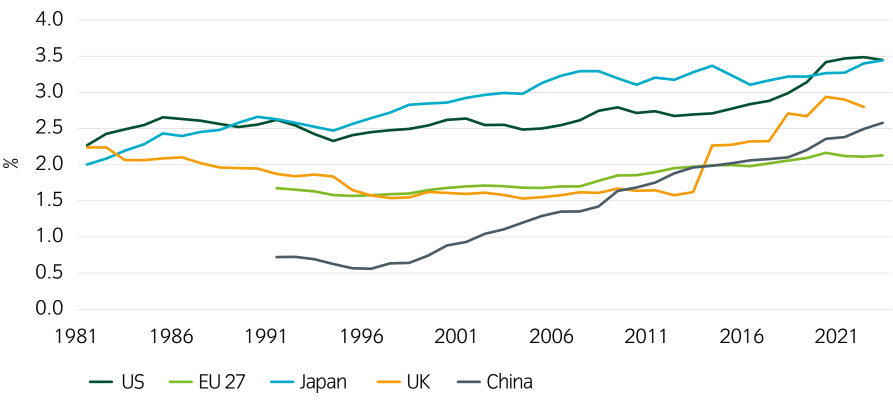
In trying to assess whether the US has reached 'peak exceptionalism' in economic and market terms, it is important to understand what has driven its significant asset outperformance. We see five key drivers: more innovation, a superior ecosystem for start-ups, the US dollar's 'exorbitant privilege', more robust corporate governance and stronger underlying economic performance. Although there is some overlap, we investigate each and assess whether they are sustainable into the future.

1 INNOVATION LEADERSHIP

Over the past fifty years, the United States has established itself as a global leader in innovation, particularly in technology and healthcare. This remarkable transformation has led to groundbreaking advancements that have changed the way we live and work. This exceptional capacity for innovation has been underpinned by investment in R&D and a culture of innovation.

- **Investment in R&D:** At an aggregate level, the US, alongside Japan, boasts one of the highest levels of R&D expenditure globally (Figure 1). This has primarily been funded by the corporate sector, but with federal support. Some federal agencies have specific mandates to innovate, such as the Defense Advanced Research Projects Agency (DARPA), which is focused on the development of cutting-edge technologies for military use. This agency has been instrumental in the development of technologies, such as the internet and the Global Positioning System (GPS).

Figure 2: Research and development as a % of gross domestic expenditure[2]



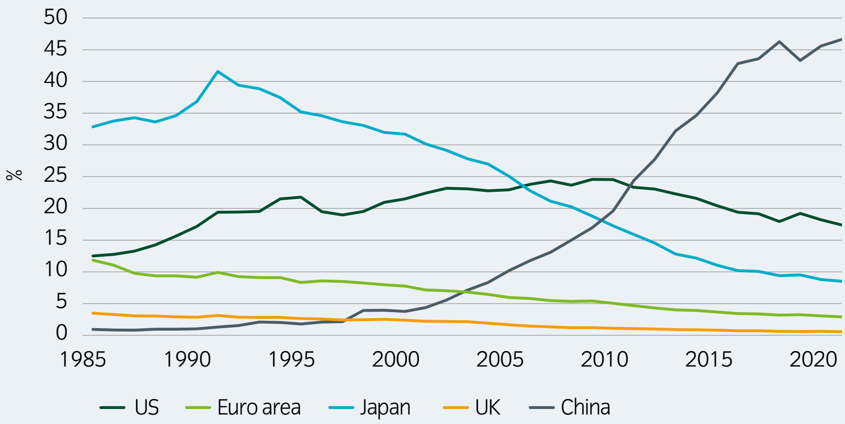
- **A culture of innovation**: In the early part of the twentieth century, many scientists, researchers, and academics sought refuge in the US from political instability and persecution in their home countries. The US provided a safe haven where they could continue their work in relative freedom and security, appreciated for their expertise. This culture of innovation, intellectual migration and high R&D investment has led to the US being at the forefront of global patent applications. In 2023, 598,085 patent applications were filed in the US, accounting for around 17% of the global total[3].

[2] Source: Macrobond. Data as at 11 April 2025.
[3] Source: World Intellectual Property Indicators 2024: Highlights, World Intellectual Property Organisation.

Assessing the outlook

Looking forward, the United States' leadership in innovation is not assured. Although the US has enjoyed a leading position in patent applications, China is now the market leader, accounting for around 47% of global patent applications (see Figure 2). China's advancements in technologies such as artificial intelligence are clear, and the US needs to enact policies that uphold its status as a hub of cultural innovation.

Figure 3: Patent applications as a % of total global applications[4]



2 SUPERIOR STARTUP ECOSYSTEM

Leading in global innovation is crucial but doesn't guarantee economic and financial success. The ability to efficiently commercialise that innovation is essential, and the US excels at this. The US leads the world in venture capital investment, with over $209bn in venture capital invested in 2024[5]. As a comparison, the EU's venture capital investment was just $62.4bn. Beyond merely accessing capital, the US boasts an unrivalled ecosystem that supports and nurtures startups, transforming them into established enterprises. Several factors underpin this ecosystem.

- **A thriving system of innovation hubs:** Such 'clusters' are geographical concentrations of interconnected business, academic institutions and research organisations that foster collaboration, knowledge sharing and innovation. With hubs like Silicon Valley, the US hosts a high concentration of tech startups and established tech companies, cultivating a culture of innovation and entrepreneurship. As illustrated in Figure 3, China and the US are significant leaders in innovation clusters.

Figure 4: Economies with three or more top 100 science and technology clusters, 2024[6]

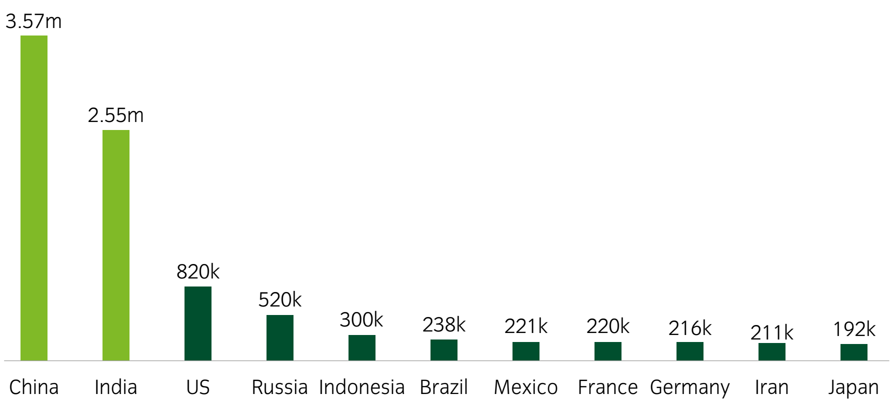
Economy	Top 100 clusters
China	26
United States	20
Germany	8
India	4
Republic of Korea	4

Economy	Top 100 clusters
France	3
United Kingdom	3
Japan	3
Canada	3
Australia	3

[4] Source: Macrobond. Data as at 11 April 2025.
[5] Source: 2024 global VC investment rises to $368 billion as investor interest in AI soars, while IPO optimism grows for 2025 according to KPMG Private Enterprise's Venture Pulse, January 2025, KPMG.
[6] Source: WIPO Statistics Database, April 2024.

- **Accessible and appropriate financing:** Access to capital is key to commercialising innovative ideas, and venture capital is the preferred and potentially more advantageous option for many startups, especially those in the tech sector with the potential for very high rates of growth. Venture capital firms don't just provide capital, they also provide a suite of services and access to a network of service providers. The US has one of the most sophisticated venture capital ecosystems, while in contrast, many countries outside the US rely on bank financing for startups. Interestingly, China's role is evolving here as well. Prior to 2024, the US and the UK were the dominant forces in venture capital, but in the past year, China has overtaken the UK.
- **Ease of doing business:** For businesses to develop and thrive, it is crucial that they aren't throttled by overly zealous business regulations. The US ranks 6 out of 190 countries in the World Bank's Ease of Doing Business Index[7]. In comparison, China ranks 31. The scale of the domestic market is also important, and size of the US market, with its population of 340 million people, provides significant scope to scale businesses. The EU has a larger population, at 450 million people, but has fragmented regulation and judicial rules, limiting the potential for startups to effectively grow to scale, while China has a much larger population but far less supportive regulatory environment.
- **Access to ample and affordable inputs:** For companies to thrive and expand, they need to have access to skilled labour and resources. The US has a highly skilled workforce, with a sizable pool of graduates with science, technology, engineering, and mathematics (STEM) degrees (see Figure 4). Only China and India have a larger pool of STEM graduates, but their far larger populations provide an advantage on this front. The second most important input for many businesses is the price of energy, where the US has a considerable advantage to most European countries. Export restrictions placed on Russia after its invasion of Ukraine have pushed European energy costs upwards, with China able to benefit from the redirection of cheap Russian oil exports.

Figure 5: Top countries by number of STEM graduates in 2020[8]



Assessing the outlook

While significant structural change will be required for the EU to compete head-to-head with the US, China is already a credible competitor. Government policy has played, and will continue to play, a crucial role in keeping US innovation at the forefront. Policies that hinder access to the best inputs, the most effective innovation hubs, robust government support and appropriate funding are likely to negatively impact the US's ability to maintain its innovation lead. Heightened policy volatility, emphasis on economic protectionism, and trade disruptions are expected to hinder, rather than help, the US in providing a supportive ecosystem for startup companies.

[7] Source: Ease of Doing Business rankings, World Bank.
[8] Source: Center for Security and Emerging Technology.

3 DOLLAR DOMINANCE

It is often argued that countries issuing the international reserve currency enjoy an 'exorbitant privilege', a term coined in the 1960s by Valéry Giscard d'Estaing, then the French Minister of Finance. This privilege stems from the US provision of safe assets via US Treasuries, which are perceived as risk-free and its pivotal role in international trade and finance. These factors have enabled the US to secure financing at lower rates by reducing the term premium by as much as 160 basis points[9], lowered hedging costs for firms operating internationally and provided significant international power through the threat and use of financial sanctions.

Assessing the outlook

While estimating the US' 'exorbitant privilege' is complex, its role in reducing the cost of capital for US entities, both governmental and private, along with its geopolitical influence, has been significant and is unlikely to change any time soon. However, our sense is that the strength of the dollar has been driven by the US's unsustainable fiscal trajectory rather than its status as a safe haven. Had fiscal policy been less expansionary over the past decade, US interest rates would have most likely been lower, the dollar weaker, and the US trade deficit smaller.

4 CORPORATE EARNINGS POWER

The US culture of entrepreneurial spirit and focus on shareholder returns has been a powerful combination, fostering an environment where US companies can re-invest more heavily and more successfully than other countries. Critically, US companies have also generated a higher return on investment on average than companies in other countries. Higher levels of investment, generating higher returns, has resulted in higher profits. This has resulted in faster relative growth in corporate earnings, underpinning a considerable outperformance of US equity markets relative to the rest of the world (see Figure 6).

Pivotal to this trend has been the emergence of US tech mega-caps. The Magnificent 7 (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla) have delivered average annual profit growth of over 20% per annum over the last decade, with profit margins well in excess of even the broader US market. This rapid growth in earnings has propelled these stocks upwards (see Figure 7).

Figure 6: Higher relative earnings growth in the US has driven higher relative equity performance[10]

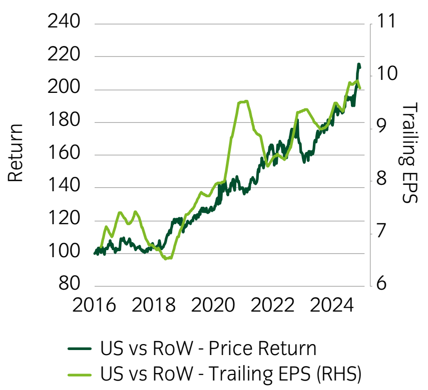
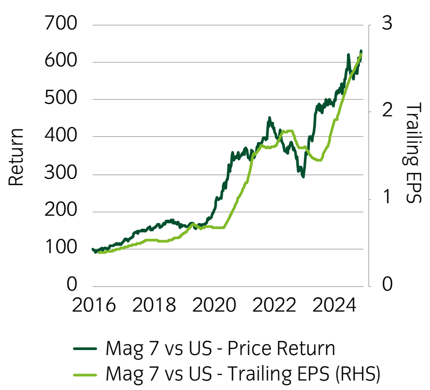


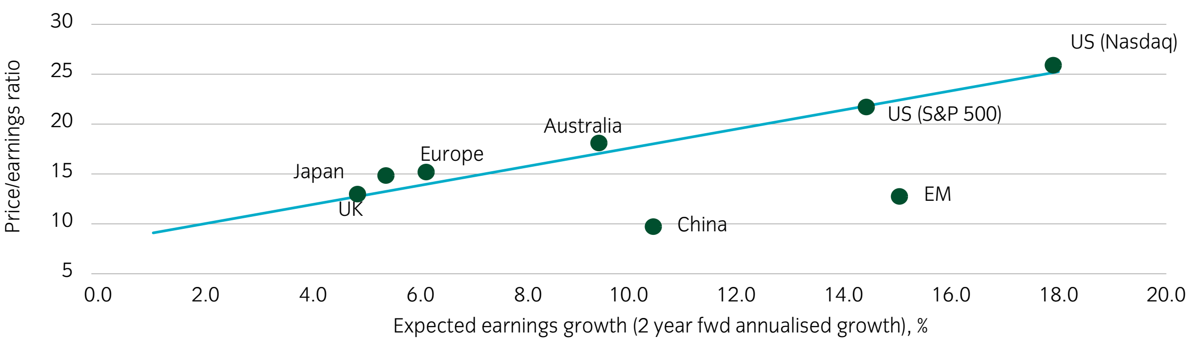
Figure 7: The link between rapid profit growth and equity performance is especially notable in the Magnificent 7[10]



[9] Source: The International role of the euro, June 2019, European Central Bank.
[10] Source: Insight and Bloomberg. Data as at 30 April 2025.

The higher level of earnings growth has in turn led to a re-rating of US stocks relative to the rest of the world, with markets rewarding their faster growth with higher valuations. This means that US stock markets trade at a premium to international rivals, which has further boosted their relative outperformance.

Figure 8: Current price/earnings ratio versus expected earnings growth[11]



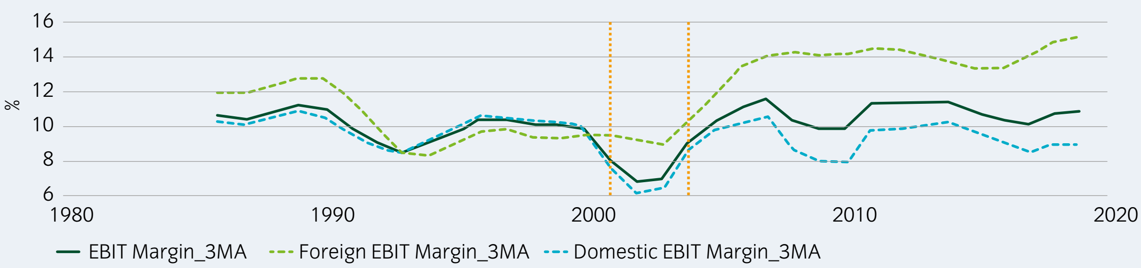
Assessing the outlook

The Magnificent 7 have firmly established dominance across leading technologies (including across the AI supply chain), and their global reach, and the extent to which other companies are rushing to embrace new technology, should underpin their position. That said, expectations are already high and the 'law of large numbers' makes it hard for the Magnificent 7 to sustain such high levels of earnings growth indefinitely and market expectations for future growth have already started to moderate.

More broadly, some of the forces that have driven US earnings growth are either coming under pressure or are unlikely to deliver an additional boost looking forward.

- **The shift to deglobalisation:** The significant reduction in trade barriers following China's admission to the World Trade Organization (WTO) boosted US profitability and coincided with the point where US equity outperformance became more pronounced. As illustrated in Figure 9, analysis by the Centre for Economic Policy Research found that the average aggregate foreign earnings before interest and taxation (EBIT) margin of firms within the S&P 500 Index increased by 48% from the pre-globalisation period, rising from 10.7% to 15.8%[12]. With the US administration shifting to a more radical trade policy, higher tariffs and potential retaliatory measures are likely to exacerbate the trend towards deglobalisation, creating a more challenging environment for both costs and the foreign earnings of US corporations.

Figure 9: Trends in aggregate, domestic, and foreign profitability of US firms[12]



- **Corporate taxation:** US corporation tax has steadily declined from above 45% in the early 1980s, to around 35% in the 1990s, and then to 21% via the 2017 Tax Cuts and Jobs Act (TCJA), enacted by President Trump in his first term. This allowed the effective tax rates for major US corporates to fall to an average of 13% (from 22% prior to the legislation). The TCJA also included provisions for additional deductions, which further boosted after tax profits. Although President Trump plans to make these cuts permanent, this will simply maintain the status quo. The strain on the US fiscal position makes further tax cuts unlikely.

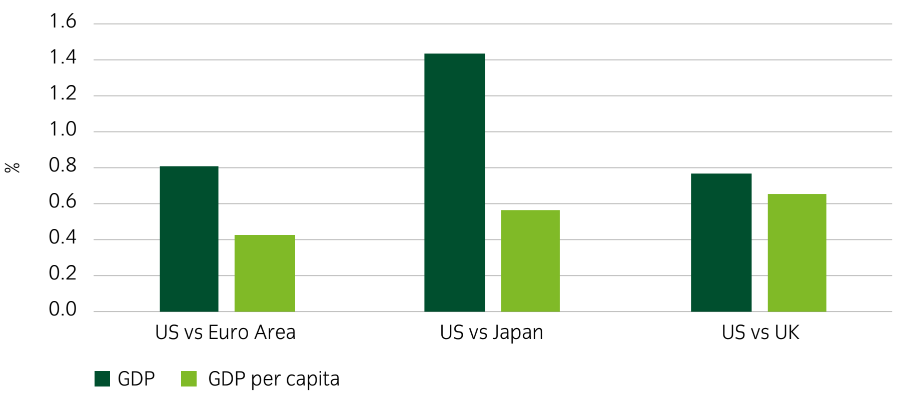
[11] Source: Insight and Bloomberg. Data as at 30 April 2025.
[12] Globalisation and profitability of US firms, 3 May 2024, Centre for Economic Policy Research. Note: EBIT Margin denotes the aggregate EBIT ratio of US publicly traded non-financial firms to their corresponding aggregate Sales. 3MA denotes a three-year moving average. The vertical-dotted lines in orange correspond to the years 2001 and 2004.

5 STRONGER ECONOMIC PERFORMANCE

When comparing the economic performance of the US to some of its main trading partners, the first point that stands out is that the US economy has grown significantly faster than other developed economies. Over the past 20 years, the US has achieved an average annualised growth rate of approximately 1.8%, compared to just 1% in the eurozone and the UK, and 0.3% in Japan[13]. Equally noteworthy is the extent to which this growth has been driven by capital expenditure. Gross capital fixed formation (GFCF), which is the level of investment, grew at an annualised rate of 2.4% in the US over the same period, compared to 1.2% in the UK, 0.6% in the eurozone and -0.2% in Japan. This trend underscores the US position as a leading source of innovation and efficient corporate management.

However, when we dig deeper into the drivers of growth, the picture is more nuanced. Over the last 20 years, the population of the US has expanded rapidly, at an average annual pace of 0.8%. Only the UK is close to this at 0.7%, with the population of the eurozone expanding by just 0.1% per annum, while Japan's shrank by 0.2% per annum. When we look at real per capita GDP growth, it shows that the economic outperformance of the US drops substantially relative to the eurozone and Japan (see Figure 10). Taking this into account, US exceptionalism looks less formidable.

Figure 10: Adjusting relative growth in GDP for population erodes the US growth advantage[14]



In addition, the US has run a more expansionary fiscal policy than other developed countries in recent years. US government expenditure has grown by an annualised 4.2% over the past 20 years, compared to 2.9% in the eurozone and -0.2% in Japan[13]. Taking a simple long-term relationship between the US fiscal deficit and unemployment rate suggests the current level of unemployment should be in the region of 8-9%, versus the actual level of just over 4%[15]. This suggests that fiscal policy has been excessively lose relative to where the economy is in the business cycle, and growth has been stronger as a consequence. It is also possible that this may deteriorate further given current discussions on tax cuts.

Assessing the outlook

According to the United Nations, the growth rate of the US population is expected to decelerate in line with global population trends in the coming years. This highlights the importance of productivity growth in sustaining the US's economic outperformance. Our sense is also that a steeper yield curve and the potential loss of investor confidence in the long-term fiscal sustainability of US policies could negate any advantages gained from loose fiscal policies. This scenario could undermine two critical factors that support the US's growth advantage.

[13] Source: Insight and Bloomberg. Data as at 30 April 2024.
[14] Source: Macrobond, United Nations and Insight Investment. Data spanning 2004 to 2024.
[15] Insight estimate.

NEW SHERIFF, NEW RULES: WHAT'S NEXT FOR US EXCEPTIONALISM?

In the post-war period, the US has found itself in a unique position, leveraging its structural advantages, growth-oriented policy framework, entrepreneurial zeal, and dynamic efficiency in capital deployment to create the world's most powerful economy. This strength has been used to good effect, with higher levels of economic growth and productivity leading to increased profitability. This, in turn, has facilitated higher rates of investment, supported by the lower cost of capital resulting from the US dollar's status as the world's reserve currency. This virtuous cycle has ensured the US's predominant position has been maintained.

However, many of the post-war norms are changing for complex reasons, including the rise of China, a strong mercantilist desire to reduce the trade deficit and efforts to re-shore manufacturing. Critically, China's position in most rankings is strong and improving and, despite its state-controlled growth model, it now poses a significant competitive challenge to the historical dominance of US innovation.

The eurozone's capacity for innovation, as highlighted in the report by former European Central Bank President Mario Draghi on European competitiveness[16], requires substantial structural modifications to support and commercialise innovation at the scale and efficiency seen in China or the US. The UK demonstrates strong innovation and commercialisation but faces challenges with scale. In summary, while the US clearly has a strong position, its lead is not unassailable. The key question for US exceptionalism is whether the Trump administration's policies will enhance or impede US growth and asset performance.

ASSESSING THE POLICIES OF THE INCOMING ADMINISTRATION

The latest US policies aim to ensure US innovation dominance, particularly against China, improving economic resilience by reshoring manufacturing and creating a level playing field for US companies internationally. It can be argued that the goal of these policies is, at its heart, to support and extend US exceptionalism.

Unfortunately, we believe the outcome is likely to be less benign for several reasons, and think these policies could damage US growth prospects:

- **Increased policy volatility:** A stable regulatory regime is essential for companies to be successful. Sudden policy changes and frequent amendments hinder planning, investment, and long-term US capital expenditure and innovation. Recent policy volatility and the uncertainty that has followed is almost certain to undermine business confidence.
- **Tension between the branches of government:** Although the government has checks and balances designed to promote stability, recent frictions between the executive and judicial branch, coupled with the perception of a more malleable legislative, are creating an uncertain environment for rule and regulations. A lack of clarity on how rules should be interpreted also deepens the uncertainty and is likely to further dampen activity.

[16] Source: https://commission.europa.eu/topics/eu-competitiveness/draghi-report_en

- **Increasing input costs:** Three distinctive factors have supported US companies, which are now being called into question:
  - the ability to produce in the most cost effective and efficient location through international production chains,
  - access to ample skilled and unskilled migration, and
  - access to ample capital.

  Trade restrictions, tighter immigration rules and the threat of taxing foreign capital are all policies that are either in play or reported as in discussion[17].
- **A reduction in public funds available for R&D:** There are reports that the administration wants to cut the National Institutes of Health (NIH) budget by 40%. The $47bn budget of the NIH easily overshadows that of other research institutes – it is 37 times larger than the UK's Wellcome Trust – and has aided key breakthroughs such as the gene editing and mRNA technology[18]. There are also concerns that conditions will be applied to future funding, a fear that prompted 224 academic leaders to sign a statement highlighting concerns around academic freedom[19].

While it is too early to fully grasp the implications of President Trump's new policies, the magnitude of change underway – essentially upending the post-World War II economic order that the US was integral in constructing – combined with frequent amendments and reversals, suggests that the current direction of travel is likely to harm rather than help US exceptionalism if these policies are maintained.

INVESTMENT IMPLICATIONS

US EQUITIES: FACING STRUCTURAL AND CYCLICAL HEADWINDS, BUT MEGA CAP TECH MAY PROVE RESILIENT

Equity markets potentially face multiple headwinds in the years ahead.

- **A reversal of key trends that have driven equity exceptionalism:** US corporates have been a key beneficiary of the trend towards globalisation; it is not a coincidence that the period of US equity outperformance coincided with China's accession to the WTO. If the trend towards deglobalisation accelerates, those companies that have enjoyed the greatest benefits are likely to be those with the most to lose. At the same time, the tax regime is unlikely to be as important a driver of growth in the future as has been in the past.

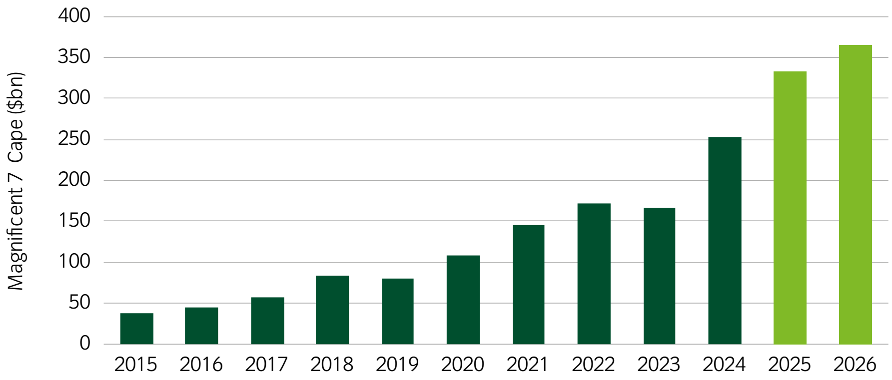
- **Slower economic and earnings growth:** Many economic forecasters agree that the likely impact of higher tariffs includes slower growth and higher, albeit transitory, inflation. Ignoring the role of comparative advantage in the production chain, the process of reshoring manufacturing as envisioned by the Trump administration is complex and would take many years. The cost of implementing this change is likely to weigh on corporate earnings for some time, with tariffs applicable until the transition is complete.

[17] For example, see: Will a 'user fee' on US Treasuries actually work?, 25 February 2025, FT.
[18] Scientific Breakthroughs, March 2025, NIH.
[19] Leaders of America's Colleges, Universities, and Scholarly Societies Call for Constructive Engagement in Response to Ongoing Government Intrusion into Higher Education, 22 April 2025, American Association of Colleges and Universities.

- **Secondary impacts:** Aside from the direct short-term impact of tariffs on corporate earnings, there will also be secondary impacts from recent announcements, although these are hard to gauge. For example, firms within the S&P 500 Index derive around 28% of their revenues from outside the US[20], and retaliatory measures could disrupt supply chains and potentially reduce demand for the goods of US companies, wherever they are manufactured. US margins are high.

- **Potential valuation derating:** US equity markets trade at a premium valuation to their global counterparts on the expectation of faster future earnings growth. If US exceptionalism is under threat, this premium is likely to diminish and if international investors retreat from US assets this could exacerbate this shift. One sector which may prove more resilient is mega-cap tech, epitomised by the Magnificent 7. Given their monopolistic control of key markets including cloud computing and digital advertising, they should be able to continue to operate at higher margins than their competitors, which commands a valuation premium. It is also likely that these companies continue to re-invest at much higher rates. Figure 11 shows the forecast capital expenditure of the Magnificent 7, which is in the process of re-accelerating after a dip in 2023. This is being driven by AI, a key area for future growth and faced with a pronounced challenge from China.

Figure 11: Capital expenditure of the Magnificent 7 companies is reaccelerating[21]



We would highlight three key technologies which need to be closely monitored over the medium to long-term:

- **Artificial intelligence:** Although advances in Chinese AI reinforce that China is now a real challenger to US dominance, many companies will be reluctant to use systems that could be subject to Chinese government scrutiny. US firms will also be able to integrate AI into existing products and business systems, creating barriers that should help them maintain leadership.

- **Consumer digital integration and advertising:** The digital marketplace rewards scale. From a user standpoint, combining search, e-commerce, social media, and cloud services on a single platform creates a powerful ecosystem that makes it difficult for new entrants to break into. US mega-cap companies have established massive user bases and set industry standards, providing them with structural and strategic advantages built up over decades. Apple exemplifies this ecosystem approach by seamlessly integrating hardware, software, services and advertising opportunities, helping to drive interconnected and recurring revenue. With near-monopoly-like profits and high R&D spending, these companies benefit from economies of scale and a proven ability to operate across national boundaries and regulatory regimes. Consequently, US dominance in this area is unlikely to be challenged anytime soon.

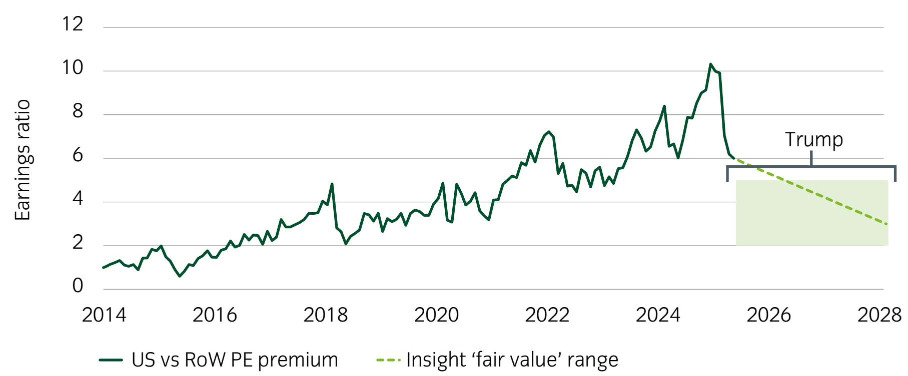
[20] Source: Bloomberg. Data as at 31 March 2025.
[21] Source: Goldman Sachs research, published April 2025.

- **Electric vehicles and autonomous technology:** This is an area where the leading position of Tesla and Western manufacturers more broadly is already challenged by Chinese electric vehicle manufacturers. Chinese car manufacturers account for more than 50% of global electric vehicle production and exports have been rising sharply. Low production costs, generous government subsidies, technical innovation and advanced battery production are factors driving growing market share. The western response has been to impose tariffs to protect domestic manufacturers. Even this doesn't assure US leadership.

In our view, the US valuation premium likely peaked in 2024 (see Figure 12). The first 100 days of Trump's presidency have shaken foreign investor confidence, with aggressive trade policies expected to hurt domestic growth more than global. Concurrently, a shift towards a more stimulative fiscal stance in both Europe and China, along with rapid technological advancements in the latter, means that US equity is no longer seen as the only game in town.

However, higher profit margins, higher reinvestment rates, and the established market dominance of mega cap tech suggest that a higher multiple is still warranted, with fair value likely in the range of 2-5 points on the price/earnings scale. Given the substantial foreign allocation in the US equity market, a reversal of this multi-decade trend could become self-fulfilling, potentially leading to an overshoot on the downside.

Figure 12: We've likely seen the peak in the US valuation premium[22]



THE US DOLLAR: THE LONG DOLLAR BULL MARKET IS ENDING, BUT IT'S UNLIKELY TO BE A SMOOTH RIDE

There is growing speculation that less 'exceptional' asset performance will lead to a period of sustained dollar weakness. Although we would agree that the US dollar is likely headed lower, a downward path for the dollar is unlikely to be linear and could take time to unfold.

The structural bearish case for the US dollar is powerful: it is an overvalued currency with an unsustainable fiscal policy, while recent policy measures risk severely damaging the 'goose that lays the golden eggs.' Given the substantial foreign exposure to US assets, amounting to around $30trn, even a minor reallocation away from these assets could significantly impact the dollar.

Another worry for the dollar is that both President Trump and Vice President Vance have expressed their discomfort with the strength of the currency, and the challenge a strong currency presents for US industry. At the same time, proposals from some key economic advisers have gone much further, suggesting intervention to weaken the dollar, even suggesting that the threat of tariffs and removal of security guarantees should be used to force global central banks to extend the maturity of their Treasury holdings.

We share the sentiment that the dollar's bullish trend has likely come to an end, with a longer-term decline ahead. However, it is unlikely that this process will be either quick or smooth:

[22] Source: Bloomberg historical data and Insight forecast. For illustrative purposes only.

- Although the trajectory of US policies is likely negative for the performance of US companies, there remains considerable uncertainty as to where things will settle and the ultimate impact. As such, we believe changes to US allocations will be slower than many believe.
- If US assets are unlikely to perform as well as they have in the past, there is still considerable uncertainty about which alternative assets would fare better. Without a clear alternative, it's unlikely that investors will rush to leave US assets. This is true for both equity and bond markets. For the latter, although the US faces fiscal headwinds, many other countries appear just as challenged, including the UK, Japan and several countries within the eurozone.
- Not all of President Trump's policies are negative for the dollar. One notable source of support could come from the $2trn of pledged investment into the US from foreign companies[23]. Considering the likely decline in foreign direct investment (FDI) from the US given tariff uncertainty, a combination of more inflows and less outflows could support the US balance of payments and help to offset any capital outflows.
- The dollar is still the lynchpin of global payments and financial system -- It is used in around 50% of SWIFT transactions[23].

While the risk of reduction in allocation to US assets is real but likely to take time to unfold, the risk of changes in the hedging behaviour foreign holders of US assets is greater. Any such changes could generate a notable supply of dollars without requiring any change to the underlying asset allocation. While hedging behaviour changes depending on the correlation of the base currency with the underlying asset and industry regulation, our sense is that hedge ratios have been low.

Changes in hedging, while still somewhat slow, are easier to implement than changes to asset allocation. One of the key considerations in making such decisions is the cost of hedging – which amounts to the interest rate differential between the base currency and the dollar. Given the high carry level the dollar currently offers, our sense is that changes to hedging behaviour will also take some time to unfold. One event that could change this is a dovish shift at the Fed. While Fed officials have continued to stress the need for caution in forecasting a change in policy, a more dovish Fed could accelerate a downward trend in the dollar. In this regard, the Fed is likely to have notable influence on the currency's trajectory.

[23] Source: US Dollar's Use in Global Transactions Tops 50%, Swift Says, 20 February 2025, Bloomberg. SWIFT (Society for Worldwide Interbank Financial Telecommunication) is the messaging system used by international banks to communicate payment information.

CONCLUSION

The United States' outperformance over recent decades has been underpinned by a powerful combination of innovation leadership, a world-class startup ecosystem, strong economic fundamentals, superior corporate profitability and the enduring advantages of the US dollar's reserve status. These factors have created a virtuous cycle of growth, investment, and global influence that has reinforced the narrative of US exceptionalism.

However, this position is no longer unassailable. Structural shifts, such as the rise of China, the retreat from globalisation and growing fiscal imbalances, are challenging the foundations of US dominance. Meanwhile, recent policy directions under the Trump administration introduce new uncertainties, including heightened regulatory volatility, rising input costs and potential erosion of the innovation base through reduced public R&D funding.

While the US retains significant strengths, particularly in technology, capital markets and corporate dynamism, the outlook is more contested than at any point in the post-war era.

The sustainability of US exceptionalism will depend not only on its ability to adapt to a more multipolar world but also on the coherence and consistency of its domestic policy choices. Investors and policymakers alike must now grapple with a more complex and less predictable environment, where past performance is no longer a guarantee of future dominance.

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16380-06-25