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Part of HOWDEN

Can US exceptionalism still deliver returns for investors?

For decades, the United States has been the unrivalled global superpower, dominant not only militarily but economically. This unique position has been labelled 'US exceptionalism'.

Since the global financial crisis, the phrase has taken on an extra meaning: US economic growth has consistently outperformed other developed markets, and US equities have outpaced both developed peers and many faster-growing emerging markets such as China, India and Brazil.

However, since Donald Trump was inaugurated in early 2025, investors have begun to question whether the US will retain this dominant position. High tariffs, rising fiscal deficits, and policy uncertainty appear to undermine America's traditional strengths.

In this note, we explore whether US exceptionalism is coming to an end. We do not believe it is – and we consider what this means for our investment outlook.

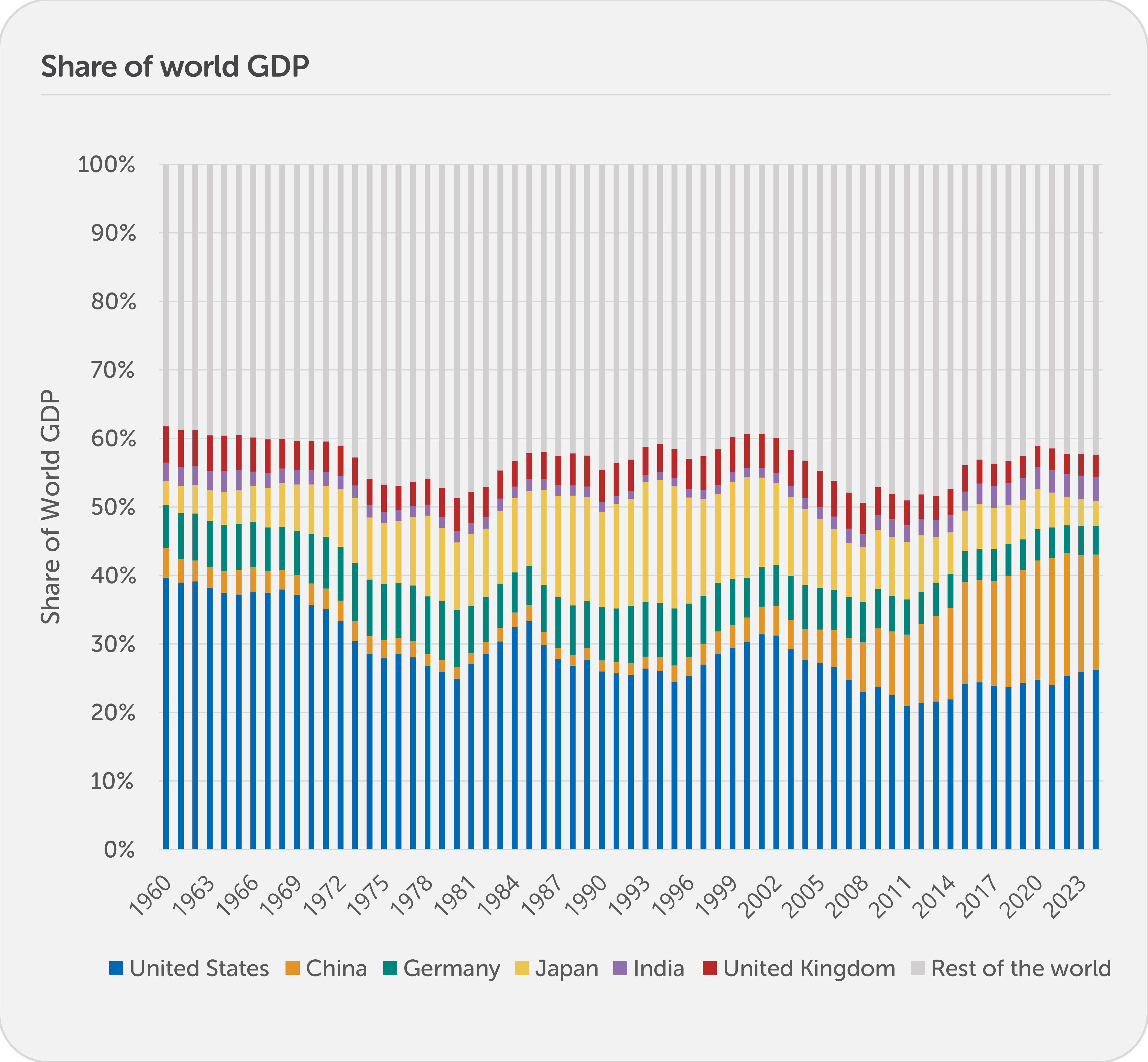
US exceptionalism: an economic superpower

The US remains the largest economy in the world, with annual output of over $30 trillion – more than 50% larger than its nearest competitors, the European Union and China. It benefits from developed institutions, a well-defined rule of law, and strong property rights. Even relative to other developed countries, it has significant advantages:

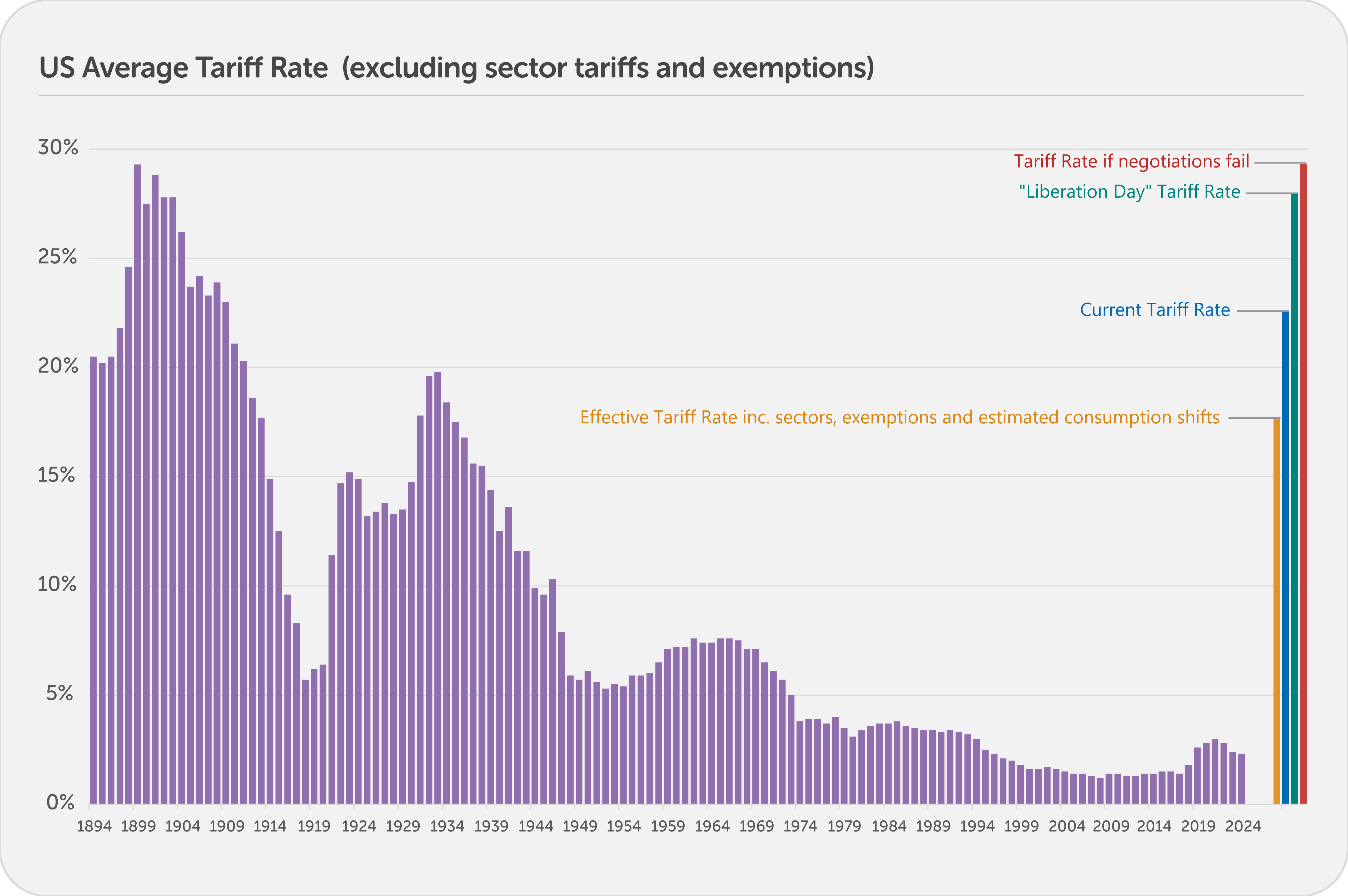
- The world's third-largest population, with **better demographic prospects** than most other developed countries. The US old-age population is 28% of the working age population, compared to 35% in the EU and 51% in Japan.
- The world's **highest research and development spending** in absolute terms, and one of the highest shares of GDP (behind only Israel and South Korea), supported by 30 of the world's top-ranked research universities.
- **A large unified market with a lighter regulatory environment**, encouraging entrepreneurship and attracting foreign capital. The cost of trading goods between US states is three times lower than between EU member states.
- **Energy security**: the US became the world's largest oil producer in 2018 and a net energy exporter for the first time in 2019.
- **Food security**: the US is the world's largest food exporter, accounting for 13% of global exports.

As a result, the US has maintained its position as the world's largest economy and even increased its share of global GDP since 2010, from 23% to 26%, despite the rise of China and India.

This economic strength has translated into global financial dominance. The US dollar makes up around 60% of global foreign currency reserves and is involved in nearly 90% of all foreign exchange transactions. For comparison, the euro is involved in around 30%. US equities are similarly dominant, accounting for around 65% of global equity market value (up from 30% in 2010). This includes 17 of the 20 largest global companies, heavily weighted towards technology. Similarly, around 64% of global debt is denominated in dollars.



Source: World Bank



Source: US International Trade Commision, Budget Lab @ Yale

What is putting pressure on US exceptionalism?

Since Trump's re-election, investors have questioned whether the tide has turned. Concerns stem from significant breaks with previous US policy – most notably on trade tariffs and government spending – and a broader degradation of political norms.

US trade war

The Trump administration has introduced sweeping tariffs, raising the average tariff on imports to the highest level since 1934, even when accounting for exemptions and shifting consumption patterns. While markets expected some action, the scale and justification for those announced on 2 April took markets by surprise, severely heightening concerns about the direction of US policy. Tariff levels have shifted repeatedly since, making the phrase "at the time of writing" more relevant than ever.

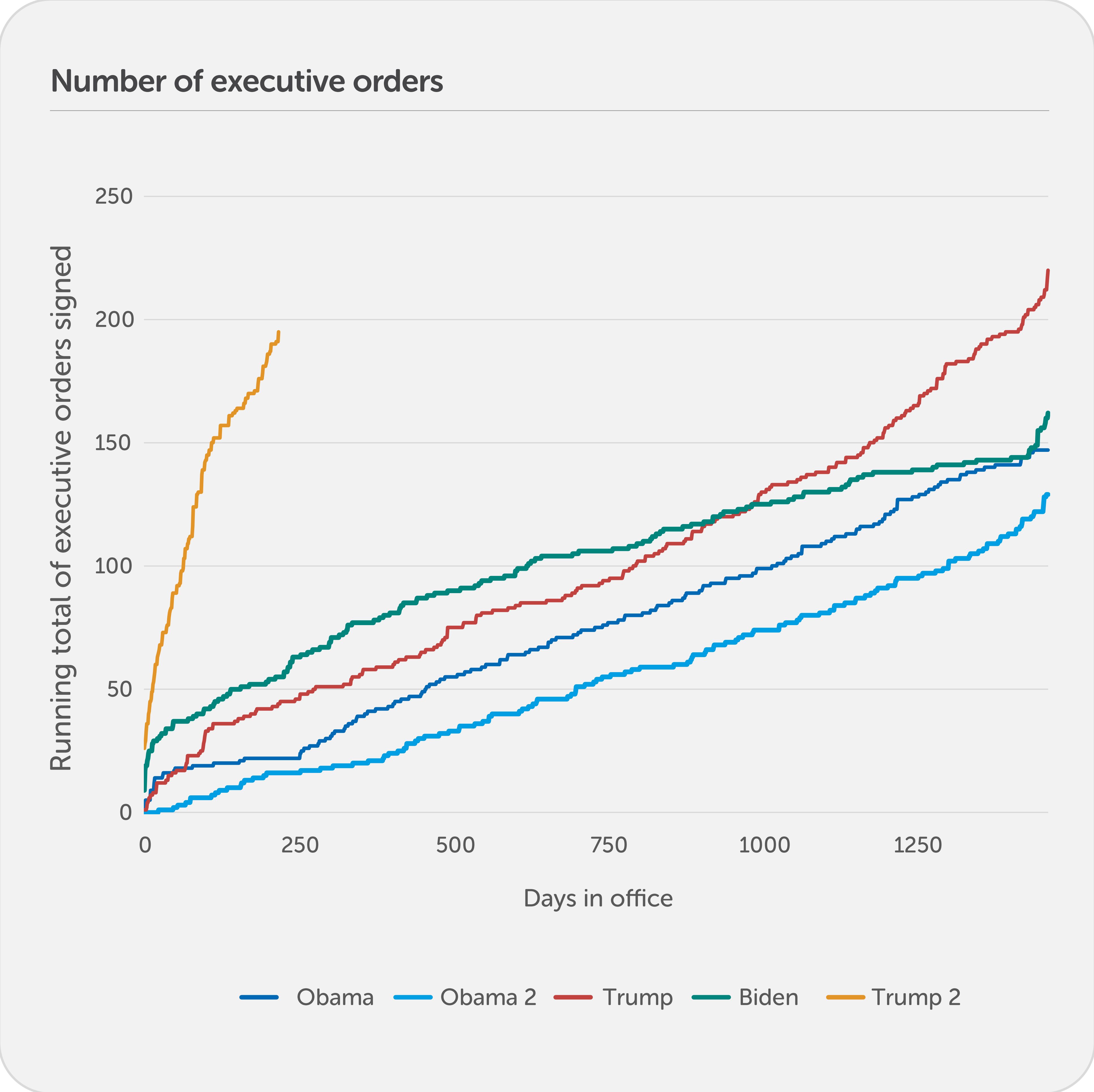
The One Big Beautiful Bill Act (OBBBA)

Trump's first major spending bill, signed into law on 4 July 2025, extended the 2017 tax cuts and introduced new measures projected to lift US national debt from an estimated 117% of GDP in 2034 to 127%. This raised serious questions about debt sustainability.

Another proposal in this bill – Section 899 – would have allowed the US to tax the income paid to foreign investors or companies deemed to impose "unfair taxes" on American companies abroad. While this was removed following backlash from market participants, it raised further concerns about the effect future policy changes could have on the attractiveness of the US as a place to invest.

Executive orders

The concern is not only the size and direction of change, but also the speed and methods of enactment. Despite Republican control over both the House of Representatives and the Senate, Trump has so far mainly acted through executive power, signing executive orders at an unprecedented rate. This contributes to a far less predictable policy environment and raises uncertainty. Beyond the executive orders, Trump continues to make outlandish statements, from annexing Canada and Greenland to threatening to fire Federal Reserve chairman Jay Powell. While these make for concerning headlines and raise geopolitical uncertainty, the market reaction tends to be muted with market participants more focused on real policy changes as they are implemented as we set out out in our geopolitics blog.

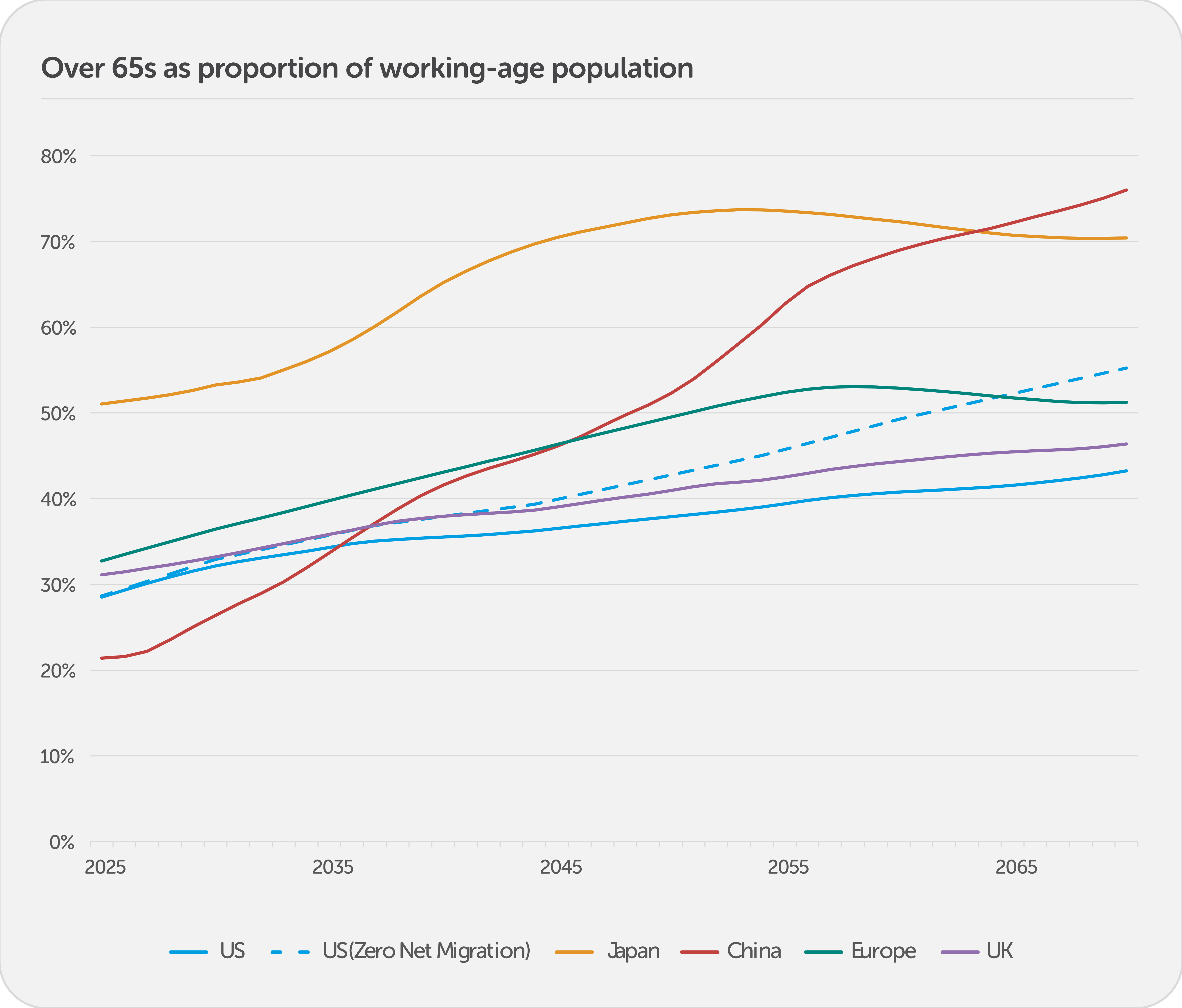


Source: The American Presidency Project, data as at 25 August

Immigration

After tariffs and taxes, the third key plank of Trump's policy proposals is immigration. As well as drastically reducing border crossings, the rate of arrests by Immigration and Customs Enforcement (ICE) has more than tripled and is likely to increase following a substantial increase in funding as part of the OBBBA. To the extent that this leads to a significant fall in the labour supply it raises the possibility of lower US employment, slower economic growth and structurally higher inflation.

Despite this, the US is likely to remain demographically exceptional relative to its competitors. Even if the US experienced zero net migration in the future, it would still have a lower old-age dependency ratio than Europe, Japan or China by the mid-2030s.



Source: UN Population Division

Key takeaways

Each of these developments place pressure on the US economy. However, many also affect the global economy. And while US strengths face headwinds, they have not been fundamentally altered:

- **Demographics** – despite the attack on the immigrant workforce, the US remains in a structurally better position than most other major economies.
- **Research and development** – spending received support through tax relief under the OBBBA.
- **Regulation** – Trump has allowed federal agencies to rescind rules without a notice-and-comment period.
- **Energy and food security** – largely unaffected despite a changing global trade picture.
- **Rule of law and policy stability** – perhaps one of the most important preconditions for economic growth, a slow breakdown in the rule of law, pressure on central bank independence and volatile fiscal policy represent significant risks for the US economy. Over time, the erosion of these preconditions could hamper some of the other core benefits previously mentioned. Alternatively, if the risk is pervasive enough, the market could move to price a weakening of 'exceptionalism'.

Although it is impossible to predict Trump's next move, we do not believe the era of US economic dominance is ending. Growth prospects remain strong relative to other countries. Productivity, one of the primary drivers of long-term growth, remains strong, with business sector productivity growing at over 2% a year since the pandemic, compared with stagnation in Japan and Europe.

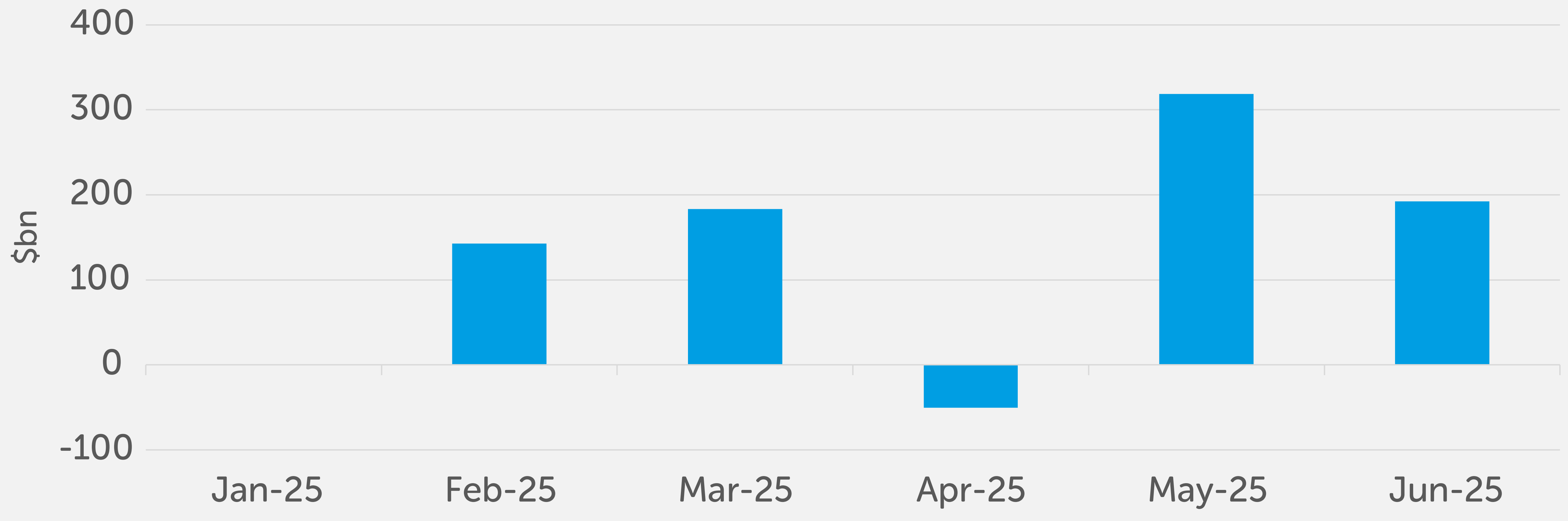
Market reaction

It is now five months since the 'Liberation Day' tariffs shocked markets. However, disruption has proven short lived. The S&P 500 is back at record highs after an initial 11% fall in early April, and corporate bond spreads have reversed their April rise returning to historic lows.

Longer-lasting market moves are more visible in the dollar, which was weakened significantly year to date, and in government bond markets, where long term yields continue to rise. The latter likely reflects uncertainty over how the Federal Reserve will manage inflationary pressures from tariffs and expansionary fiscal policies outlined in the OBBBA.

It would be easy to assume the decline in the dollar could be attributed to an exodus from US assets as investors lose confidence in the world's largest economy. However, as shown in the chart below, foreign flows into US assets have far outweighed the outflows year to date. Even following the net sale of $51bn in April, foreign appetite has rebounded strongly, with a net purchase on $511bn over the following two months.

Monthly foreign net purchases of US securities ($1bn)



Source: TIC SLT holdings report

Why then, has the dollar declined? This can largely be explained as a global shift to increase currency hedging. After years of dollar strength, global investors had increasingly chosen not to incur the additional cost of hedging. This has changed in 2025, global investors reassessed their hedging positions and increased their hedging of the currency risk, placing downward pressure on the dollar.

As the dollar falls other currencies must rise and, so far, we have seen the euro benefit most. This has been aided by Europe's reaction to Trump. European countries have agreed to significantly raise their defence spending, with Germany also changing its budget rules to allow it to raise infrastructure investment.

Implications for investors

While we do not believe the era of US exceptionalism is over, it is certainly facing greater threats than it has in the previous decades. Should this reduced confidence in the US impact on investment decisions, and if so, how?

Given the size and reach of the US economy, investors will typically have a large exposure. This can be directly, as US companies now make up around 65% of global equity indices, or indirectly via exposure to the dollar. The key questions for investors are:

1. Are they comfortable with holding c.65% of their equity investments in the US market?

2. Should they alter their approach to hedging US dollar exposure?

Allocation to US assets

Equity returns aren't a zero-sum game; weak performance in one market does not guarantee strong performance in another. European stocks may benefit from significant fiscal stimulus in Germany, but US equities may still outperform given their strength in areas such as AI. Moreover, European companies generate 20% of revenues in the US, meaning economic weakness in the US can quickly spread, amplifying global vulnerabilities.

For now, we continue to believe that the true drivers of return are the underlying sources of revenue, which are far less dependent on the country of listing than they are on which sector and which long-term economic trends that company is exposed to, such as those outlined in our 2024 note Megatrends: building a sustainable investment portfolio. Therefore, simply adjusting exposure away from the US may have a small or even undesired effect on this underlying exposure, and we continue to believe a global market-cap approach is appropriate in most circumstances.

Currency hedging

Our core views on currency and exposure to the dollar remain unaltered:

- We still recommend hedging currency exposure, provided it can be done efficiently.

- We advise against tactical management of currency exposure in response to market events (changes in an investor's preferences).

- For very long term investors, they may wish to avoid the cost associated with hedging currencies and hold an unhedged postion.

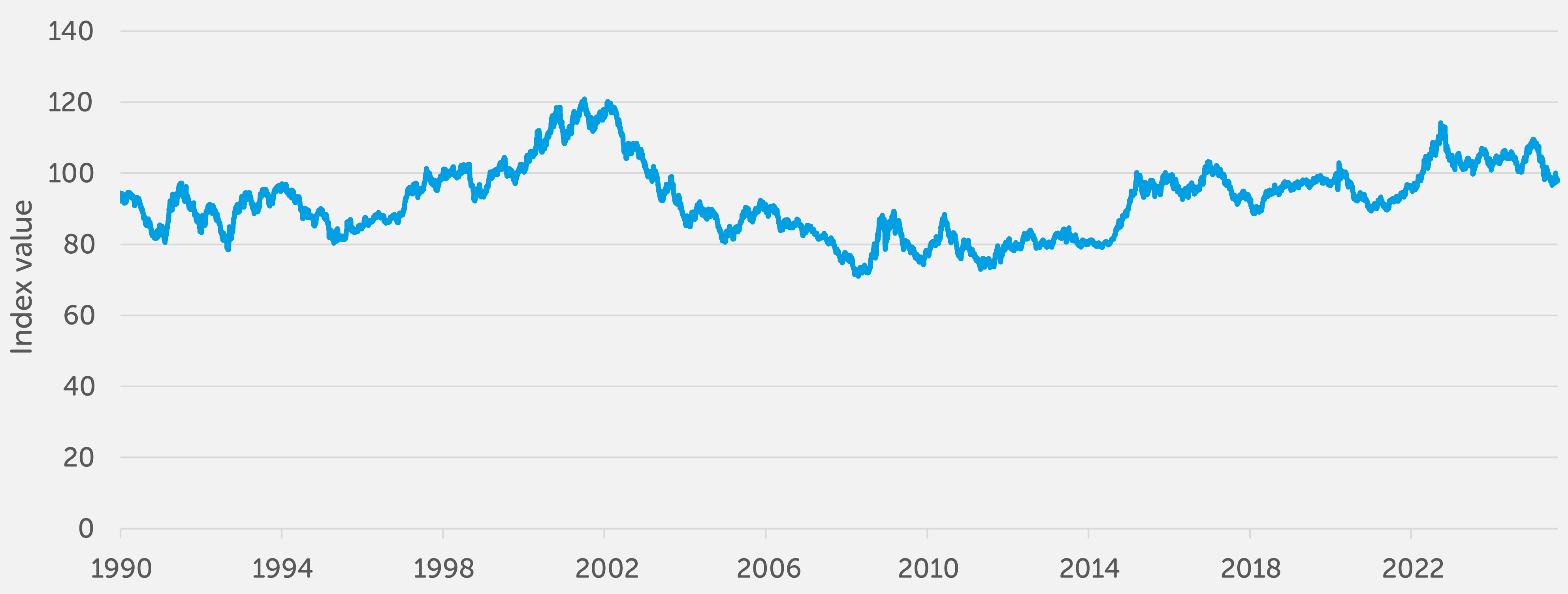
Our rationale for this unchanged view is based on two key structural tenets, we set these out on the next page.

Firstly, despite headwinds, we do not believe the underlying strengths of the US economy have been fundamentally altered. The same holds true for the dollar, which has no obvious challengers. The Chinese Renminbi is not easily tradeable in global markets, and the Euro first requires significant further integration of its national markets. While many central banks are aiming to reduce their dollar exposure to lessen the impact of Russia-style sanctions, this is confined to a select group and dwarfed by the dollar's commercial use.

Secondly, while the discussion over whether the current administration prefers a structurally weaker dollar has made headlines, this matters little to the dollar's actual value. Several administrations have expressed preferences for a weaker or stronger dollar but, given the importance of the dollar to the global economy, this is rarely achieved without a globally coordinated effort. At a time when the US administration seems to be alienating its allies, we find it hard to believe such global agreement will be forthcoming.

Overall, while the dollar has seen a significant decline since Trump took office, it remains well within its range from over the last decade and similar sized movements up or down have been common. Taking these points together, we continue to believe our long term structural views on currency hedging, as outlined in [this blog], remain appropriate.

US dollar index



Source: LSEG Datastream

Conclusion

It is important to look beyond the headlines and consider the longer-term factors at play. Growth in the US has been strong and is expected to continue to outpace other major economies. The US stock market hosts the largest, and some of the most profitable, companies in the world which have consistently generated profits from well diversified streams. The dollar remains the world's primary reserve currency and, despite the emergence of some competitors, is likely to remain so for the foreseeable future.

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