# US Exceptionalism: Shaken But Not Stirred

**Hani Redha, CAIA,** Global Multi-Asset Portfolio Manager

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After chatter about "US exceptionalism" reached fever pitch at the end of 2024, a sudden shift to the *opposite* view has become the market's narrative. Erratic trade policy and a spike in tariffs, along with erosion of governance structures, are among the reasons cited for the change in sentiment. Investors are also concerned about outflows due to rebalancing by global investors, which have accumulated high exposures to US assets through both allocated flows and asset price outperformance.

Trade policy is working its way through the US legal system and is likely to reach all the way to the Supreme Court, which will reveal the boundaries of executive power. The US system of checks and balances is certainly undergoing a test. Yet the evidence thus far indicates that the US president is demonstrably constrained by the bond market and the courts. We expect policy uncertainty to remain elevated, yet it has probably peaked, as evidenced by various policy uncertainty indexes.

An additional factor, which is top of mind now, is the growing awareness of the US's large and unsustainable fiscal deficits. The Congressional Budget Office (CBO) projects that the US fiscal deficit could reach 7% of GDP in fiscal 2026-2028, pushing the US debt-to-GDP ratio from 98% to 128% over the next decade. This marks a notable shift from the pandemic period, where elevated debt was more easily absorbed in a low-rate context. Yet we would caution against alarmist calls for a "break" in the bond market. The projected deficits do not include tariff revenues or any savings at all from the DOGE program, which could pay for most (if not all) of the tax cuts. The deterioration of the US balance sheet is more likely to be a slow-burn phenomenon than a sudden heart attack.

A high public sector deficit equates to a high private sector surplus, and given the focus on tax cuts and investment incentives, the fiscal mix is shifting toward more productive growth. That higher growth will require a higher financing rate. But we note that repricing has already come a long way, with yields at recent highs up around 75 basis points since April. The trajectory is certainly unsustainable over the long term, yet we remind ourselves that most governments globally face unfunded long-term deficits and rising debt trajectories, many with higher levels of debt than the US.

Investors' concerns about capital flows rebalancing away from the US call into question a fundamental understanding of what drives markets and how they behave. Over the intermediate and long term, fundamentals drive prices, which in turn lead flows. Flows do *not* lead prices. Investors typically chase returns rather than predict them accurately beforehand. Beyond *short*-term rebalancing of concentrated portfolios, we expect fundamentals to reassert themselves, leading to flows back into the US as its fundamentals outperform relative to most markets over the intermediate term.

The question then becomes, of course, "Why do we expect US fundamentals to outperform?" Several key factors that underpinned US exceptionalism remain fully intact and are perhaps even strengthening further. Productivity and innovation have been the hallmarks of the US economy, encouraged by a light regulatory environment with deep capital markets. Further deregulation under the Trump administration is likely and will continue to support the US's productivity supercycle – unique among global peers – and its lead globally. The competitive landscape of the economy, across multiple sectors, rewards incumbents, which sustain higher pricing power than global peers. This, in turn, contributes to US businesses' higher profitability, quality, and cash flow stability, giving them a competitive advantage over other markets, particularly when it comes to shareholder returns and therefore asset prices.

### About This Report

PineBridge believes that not only do differences of opinion make markets, but they also foreshadow substantial moves ahead as these differences are resolved. Once a month, investment leaders from our global multi-asset, equities, and fixed income teams meet to share their diverse viewpoints. This report reflects those discussions and debates by providing insight on the topic of the month along with snapshots of our asset class views and convictions across the firm.

Overall, the policies of this US administration are a mixed bag and certainly create challenges for investors. Yet the fundamental underpinnings of US exceptionalism are robust, difficult to compete with, and unlikely to be subsumed by global competitors. Prices will follow those fundamentals, and flows will then ensue. Be wary of any purveyors of “flow-based” arguments to the contrary.

## Conviction Score (CS) and Investment Views

The Conviction Scores shown below reflect the investment team’s views on how portfolios should be positioned for the next six to nine months. 1=bullish, 5=bearish, and the change from the prior month is indicated in parentheses.

### Global Macro

**Sam McDonald**
Sovereign Analyst,
Global Emerging Markets
Fixed Income

CS 3.25 (unchanged)

Tariff de-escalation with China reduces the downside tails for the economy, but activity is still expected to slow in the coming months. Despite the détente with China, the average weighted tariff remains roughly 10 percentage points higher than at the start of the year, and policy uncertainty will continue to undermine the economy via delays to capital plans. The contrast between the hard and soft data continues, but some signs indicate that inflation data are likely to see some tariff impact from May onward. Given the relatively improved growth outlook and firming near-term inflation outlook, the Fed can wait and see how the tariff impacts on the US economy evolve.

Import prices (excluding gasoline) rose by 0.4% month over month (m/m) in April as overseas manufacturers choose not to absorb tariff impacts via margins. Consumer Price Index (CPI) changes in import-intensive sectors (e.g., electronics) saw larger m/m gains in April compared to recent average momentum; core goods inflation has turned positive once again. New auto prices were flat, but list prices are expected to rise in the coming months as dealers absorb cost increases. Weak services inflation kept headline CPI low in April (2.3%) but we expect the number to move higher from May onward as the tariffs feed through the economy.

Given de-escalation in the trade war and a resumption in some China trade from restrictive levels, the probability of a hard-stop on activity has lessened, and the market is pricing in two Fed rate cuts for the remainder of 2025 (down from three to four cuts at the start of May).

The fiscal picture is beginning to come into focus as budget negotiations continue. The reconciliation package is expected to cut taxes by 0.1%-0.2% of GDP, more than initially thought, while the headline deficit is expected to increase by around 0.8% of GDP in 2026. There is risk around deficits remaining wider for longer, with the Moody’s downgrade highlighting this concern.

While a slowdown is expected over the coming months, with a peak drag in the third quarter, near-term hard data remain relatively robust. Retail sales in April were up a solid 0.1% m/m despite the strong March figure and weak survey/soft data in recent months. Similarly, the labor market has so far weathered tariff and policy-related uncertainty, with the quits rate rising and non-farm payrolls (on a three-month moving average basis) climbing to 155,000 in April. Tentative signs of a softening in labor demand are emerging, however, with the one-month average for initial claims increasing by 10,000 and JOLTs and Indeed new job postings downshifting once more.

### Rates

**Gunter Seeger**
Portfolio Manager, Developed
Markets Investment Grade

CS 4.00 (unchanged)

Since the March meeting, when we changed our CS to 4.0, the 10-year note is higher at 4.48% and the long bond (30-year) hit the 5% level several times in late May. As we’ve said before, this year has been incredibly volatile so far, and we see no reason for volatility to abate. In fact, it may get far worse.

Other observations: After Moody’s downgraded the US to Aa1, there are now only nine other countries with AAA ratings, including Canada, Australia, and New Zealand. Atlanta Fed Governor Raphael Bostic is worried about inflation and thinks that one rate cut should suffice for 2025. Banks are rapidly changing their bullish calls on US Treasuries and hiking their rate forecasts.

Our forecast continues to call for the 10-year note to soon join the 20-year and 30-year in touching 5% this year.

## Credit

**Steven Oh, CFA**
Global Head of Credit and Fixed Income

CS 3.25 (+0.25)

De-escalation of trade tensions, particularly with respect to China, has spurred a reversal in sentiment, with the market embracing risk assets once again. While clarity on outcomes remains limited, a pullback from the worst-case scenarios has imparted greater confidence that trade policies will ultimately settle at levels that avoid material negative economic and market impacts. There are also expectations that the parts of the Trump administration's agenda relating to taxes and deregulation will be stimulative.

Fed members are indicating that they may stay on hold for longer and be slower to provide rate relief. Moody's downgrade of the US is based on expectations of deteriorating fiscal balances and debt levels.

Amid the renewed optimism, valuations have retraced much of their widening, with investment grade (IG) credits now in the +mid-80s range and high yield (HY) at +300 levels. While spreads are no longer at earlier tights, they are trading through our fair value range and do not reflect a potential economic deceleration in the second half. Therefore, we have moved our score toward a more defensive posture and are reverting to favoring IG over HY. While fixed-rate debt again possesses a defensive element, we favor floating spreads. Emerging markets (EM) are providing a diversification element as much as a pickup in incremental spread.

## Currency (USD Perspective)

**Anders Faergemann**
Senior Sovereign Portfolio Manager, Emerging Markets Fixed Income

CS 3.50 (unchanged)

The US dollar has decoupled from rate differentials in recent weeks, suggesting that flows and other technical factors may gain more power in determining exchange rates for longer than previously envisioned. Looking purely at rate differentials, the US dollar is due an upward correction on a cyclical basis, yet other factors – such as increased trade protectionism, the US downgrade, and demand for a higher risk premium on US assets – will continue to weigh on the dollar.

While peak uncertainty appears to be behind us, the US dollar remains vulnerable to structural forces implying that investors need to increase their long-term ratios for FX hedging in US assets. The US dollar's reserve status remains intact, but confidence in the currency's role as a safe haven has taken a temporary blow.

The risk of a US recession has declined with US-China trade agreement to reduce import tariffs and downscale the mutual embargo, which had threatened to sever ties between the nations and cause serious economic disruption. This reaffirmed our base case expectation for a "Soft Landing" over the next 12 months. We expect financial markets to look past signs of economic weakening in coming months.

US exceptionalism and a lack of alternatives have strengthened the US dollar in recent years. Signs that Europe is intent on increasing its defense spending are providing a platform for the euro's appreciation. Likewise, the US-China tariff ceasefire serves to stabilize China's economic growth, and we have seen a willingness by Chinese authorities to keep the renminbi stable and out of trade negotiations.

## Emerging Markets Fixed Income

**Sam McDonald**
Sovereign Analyst, Global Emerging Markets Fixed Income

**USD EM (Sovereign and Corp.)**
CS 2.75 (-0.25)

**Local Markets (Sovereign)**
CS 3.00 (unchanged)

Following the 90-day tariff pause and subsequent de-escalation with China, we have seen a significant recovery in EM assets, as elevated risk premia have now been priced out. While this may leave spreads looking tight relative to history, we see few short-term macroeconomic reasons for spreads to widen again, as we expect the market to look through the tariff-distorted economic data. This leaves us with a preference for adding quality carry to portfolios.

The domestic macro environment is favorable for most EMs, and we expect sovereign credit metrics to improve throughout 2025. As we look to credit rating agency actions, the balance of upgrade candidates far outweighs downgrade candidates in number and aggregate index weight. These numbers include several potential rising stars (Oman, Serbia, and Azerbaijan). However, given the geopolitical and commodity price backdrop, we expect the pace of upgrades to slow, with rating agencies holding a higher bar for positive actions.

For EM corporates, first-quarter earnings are broadly coming in neutral, with a slight skew to positive beats of analyst expectations. These beats are being seen in the manufacturing and mining, consumer goods, industrial, and utilities sectors. Oil and gas is underperforming. Our distribution of credit trends has a slight skew positive in IG and is neutral in HY. Primary activity remained busy in April, with $29 billion in deals priced as market sentiment improved. The net financing for the month, factoring in $39 billion of scheduled cash flows and $6 billion of liability management exercises, was -$16 billion. Primary activity remained busy in May, with $9 billion deals priced through mid-month and a healthy pipeline of names to come. Due to improved macroeconomic conditions and investor sentiment, Argentina is becoming an area of issuance focus. We expect $31 billion of scheduled cash flows in May to come back to investors. Even with the flow of new deals, net financing could remain negative or neutral.

The mood at April's annual spring IMF meetings could best be described as cautiously optimistic. Sentiment improved as the week went on, even if investors acknowledged a more uncertain path for the Bretton Woods Institutions. IMF forecasts for EM countries showed a manageable growth slowdown from prior IMF forecasts, although in meetings, country heads were keen to stress the wide confidence intervals for their forecasts. Given the trade war de-escalation, we expect the next round of updates to show forecast improvements. The outlook for US fiscal policy, Fed independence, the path of the war in Ukraine, and the upcoming Iran nuclear talks were also at the top of investors' minds at the meetings.

## Multi-Asset

**Deanne Nezas, CFA**
Portfolio Manager,
Global Multi-Asset

CS 3.00 (unchanged)

The de-escalation of tariff rhetoric has joined global monetary easing and an emerging OPEC+ price war in soothing markets. These healthy forces are in a race against the clock to reduce recession odds arising from the coming weakening in fundamentals. While still a close call, we see recession odds as unlikely and falling, and we believe peak uncertainty is now likely behind us as well. We are maintaining our Conviction Score for now, but with a positive bias.

De-escalation commenced on 9 April and has continued, with a handful of new accommodations nearly every week. Agreements in principle (AIPs) with trading partners are on their way. This will still not stop the softening of the hard data, yet de-escalation can steer expectations toward a slowdown, not a recession.

Global monetary policy is also turning increasingly dovish. Here, too, the US is lagging global peers thus far in 2025 given its more stagflationary backdrop. Increasingly, Fed speakers are suggesting in their personal views that tariff-driven inflation will likely prove transitory, while an employment slowdown, if triggered, could be more difficult and lengthy to reverse. Although the recent bump in inflationary expectations is not easy for any central bank to look through, we still believe the Fed is likely to rejoin the global easing cycle later this year.

Beyond 2025, we see far more scope for the structural growth rate to rise in the US than in Europe or China – largely because of technology's impact on productivity and the demonstrated US edge in creating, funding, and embracing new technologies.

## Global Equity

**Rob Hinchliffe, CFA**
Head of Global Sector Cluster Research, Equities

CS 3.00 (unchanged)

Markets have rebounded as tariff pressures have eased, and time will tell if this is justified. To date, a trade deal with the UK has been announced, along with a pause with China.

First-quarter results have been solid, with tech companies pacing the gains. Relative to past quarters, the results have been generally “normal” from the perspective of earnings beats. Forward guidance, however, has been anything but normal. Companies have been more hesitant to raise guidance than in the past and have frequently included caveats with their outlooks. Themes to date in earnings include the continuing steady pace of underlying economic activity, strong AI activity, and a widespread belief among industrial companies that they can offset potential tariffs, along with some pulling forward of sales in autos.

## Global Emerging Markets Equity

**Taras Shumelda**
Portfolio Manager, Global Equities

CS 3.00 (unchanged)

Markets year to date (YTD) have been balanced in terms of sector or factor returns. The last six weeks, however, have seen some return to sector dominance, where quarter-to-date benchmark returns were concentrated in four of 11 sectors. Still, investors seem to have priced in tariffs and other uncertainties last year, as stock performance has been much more closely aligned with earnings delivery, which we find supportive of our investment methodology. Volatility has increased amid difficulties in the Ukraine-Russia peace process, ongoing trade disputes, and the US sovereign debt downgrade. Perhaps as a dollar hedge, and supported by previously low valuations, global EMs have performed quite well in 2025 to date. However, for this to continue, investors will need to see earnings upgrades or top-down developments that support more equity upside.

In India, earnings in the fourth quarter of fiscal 2025 have been mixed, with most earnings beats driven by banks and downstream oil marketing companies. Most sectors saw a mix of challenges to growth and profitability. Consumer companies reported light volume growth, margin headwinds, and restrained demand commentary; banks reported weak credit growth; and IT services companies indicated disappointing bookings ahead. In China, economic activity remains subdued, especially in the property sector. After some signs of lesser trade tensions, tariff negotiations seem to have slowed. The US removal of restrictions on advanced chip sales to the Middle East may be supportive of earnings at Taiwanese and Korean manufacturers.

In Latin America, first-quarter earnings were mixed, with significant beats but also large misses. Notably, no sector dominated or lagged; stock-specific developments caused differences from expectations. Post-earnings, average estimate reductions were about 2%. In EMEA, all eyes are on the failing Ukraine-Russia peace process. The Trump-Putin phone call suggested an abandonment of Ukraine by the US and a near-complete withdrawal by Trump from the peace process, and the next steps are not clear. The earnings season in EMEA thus far has been mixed, with Turkey almost uniformly missing expectations.

## Quantitative Research

**Haibo Chen**
Portfolio Manager and Head of Fixed Income Quantitative Strategies

Our US Conviction Score improved slightly, as the impact of a 20-bp yield curve steepening more than offset a 17-bp widening in BBB credit spreads.

Global credit forecasts remain negative and favor emerging markets over developed markets (DM). In DM, the industries favored by the model are natural gas, electrics, communications, and banking and insurance. The model dislikes basic industry, consumer cyclicals, transportation, and energy. Among EM industries, our model likes financials and pulp and paper; it dislikes real estate and diversified industries.

Our global rates model forecasts slower yield and a steeper curve for the US and the UK, and higher yields/a flatter curve for Japan and the euro area.

The rates view expressed in our G10 Model portfolio is overweight global duration. It is overweight UK, the euro area (with an overweight in peripheral countries and an underweight in core countries), and Oceania. It is underweight North America (with an overweight in Canada and an underweight in the US) and Japan. Along the curve, it is overweight the six-month, 10-year, and 20-year and is underweight the five-year.

All market data, spreads, and index returns are sourced from Bloomberg as of 20 May 2025.

## About PineBridge Investments

PineBridge Investments is a private, global asset manager focused on active, high-conviction investing. We draw on the collective power of our experts in each discipline, market, and region of the world through an open culture of collaboration designed to identify the best ideas. Our mission is to exceed clients' expectations on every level, every day. As of 31 March 2025, the firm managed US$188.9 billion across global asset classes for sophisticated investors around the world.

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