



**ALLIANCEBERNSTEIN®**

MAY 2025

# The End of US Exceptionalism?

We take a view in this paper that will be unpopular—defending the case for US exceptionalism.

Hence, we also defend the case for a strategic overweight in US equities. This is not necessarily the case for US dollar exposure in general nor US bonds, where risks are different. We do think there is a case for non-US investors to hedge more of their US dollar exposure.

In recent meetings with clients, the question of the status of US assets has dominated conversations. The new consensus appears to be to exiting US positions.

We recognize that more capital might be going into other regions tactically, given the unanimity of pro-US consensus earlier this year. But investors need a position in US equities as a key strategic part of an allocation to try and eke out positive real returns in a low-return world.

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In a series of recent meetings in Asia, one of the key questions that kept coming up was: “Is the US still exceptional?” The implicit follow-up question is: “If the US is indeed less exceptional, then how large should the reallocation away from the US be?”

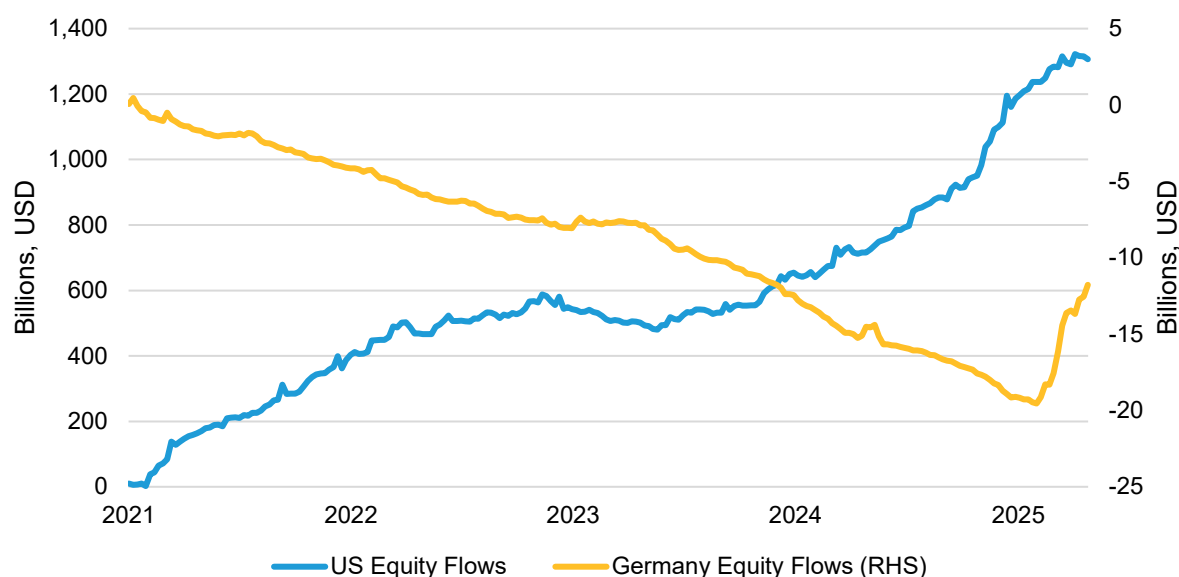
The new consensus, and at least the sense in meetings and three weeks of flow data that can be analyzed, indicate that sentiment has clearly turned against the US. Given the unanimity of the pro-US view among investors after Donald Trump won the presidential election, and the scale of the flow into US assets that resulted, this new anti-US consensus implies that more outflow from US assets is to come in the short term. But what about strategically? Also, is it really the case that US exceptionalism has suddenly ended? And do investors need to think differently about what this means for equities, bonds and the US dollar?

A lot of the commentary that we hear is based on the idea that US exceptionalism has ended. However, this belies a misunderstanding. The true exceptionalism is strategic, not tactical. Yes, US corporations enjoyed a particularly strong business cycle in recent years (does anyone still recall the hard-versus-soft landing debates of early 2024?), with US earnings growth exceptional compared with the rest of the world. The shock of tariffs with the knock-on dramatic curtailment of capex plans and a hit to consumer expectations has rapidly undone that cycle, and the US now faces a 40% chance of recession this year, and consumers and businesses face sharply higher prices on some goods. There is even the possibility of empty shelves in shops later this year, given the rapid drop-off in shipments from China. At the same time, though, the near-term growth outlook is declining elsewhere in the world as well. We don't mean to belittle this at all, as it is hugely important, but it is a tactical development, not strategic. Does the strategic US exceptionalism still stand?

It will be unpopular for us to say “yes,” as we sense that view is not in line with the new post “Liberation Day” new consensus, but we think that US exceptionalism with respect to equities still stands. Yes, it has taken a knock, but some elements are genuinely sticky. For US bonds, the reason to own them and hence the risks are somewhat different, as we discuss below.

The scale of the recent change is apparent in the relative net flows into the US and Germany since the US election. The euphoric flows into US equities abruptly stopped around the date of the tariff announcements. Germany, meanwhile, which had been deeply unloved by investors (for many good reasons), saw inflows that in one go unwound all outflows since the end of 2023 (Display 1). It should be noted that while both domestic and international investors bought German (and other non-US) equities, the picture in the US was split. US domestic retail aggressively “bought the dip,” institutional and international investors sold.

**DISPLAY 1: US AND GERMAN EQUITY FLOWS**



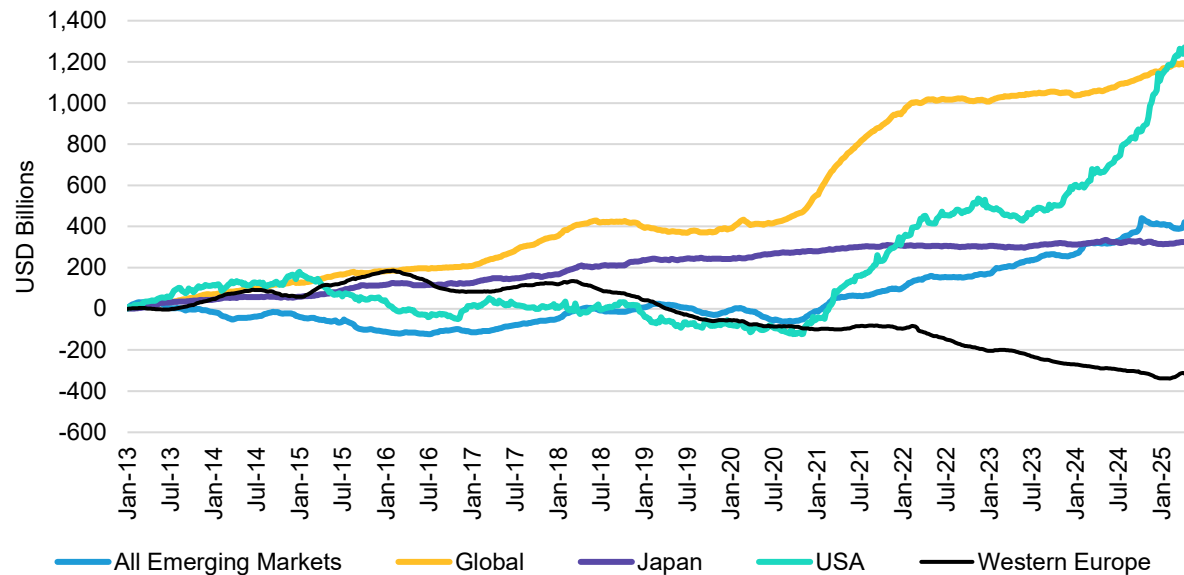
**Current analysis does not guarantee future results.**

As of April 30, 2025

Source: EPFR and AB

The US has certainly been exceptional when it comes to equity flows and valuation. For bearish investors, this is not a happy combination: it implies that a loss of exceptionalism means that the market has a long way to fall. Although the flows have somewhat reversed over the last month, the US is still far ahead of other regions in terms of cumulative flows (*Display 2*). This means that in the near term, there is potential for more outflows from US equities, given an abrupt decline in the near-term growth outlook and a piercing of the sense of perfection of US stocks. However, as we outline below, we do not think that the cumulative flow difference between the US and the rest of the world (when it comes to equities) needs to reverse.

## DISPLAY 2: CUMULATIVE REGIONAL EQUITY FUND FLOWS



**Current analysis does not guarantee future results.**

January 1, 2013, through April 23, 2025

Source: Emerging Portfolio Fund Research and AB

Valuation does matter and does imply a drag on US performance relative to the rest of the world over the medium to long term. It is perhaps the Achilles heel of the US market. However, growth matters, too. Over the last 30 years, the relative performance of regions has been predominantly determined by relative earnings growth. Therefore, using valuation as a way to determine regional allocations has not worked for a long time. Put another way, to underweight the US strategically would be to implicitly forecast that US earnings growth will underperform the rest of the world. We do not think that is likely.

## Demographics: a US advantage in workforce growth

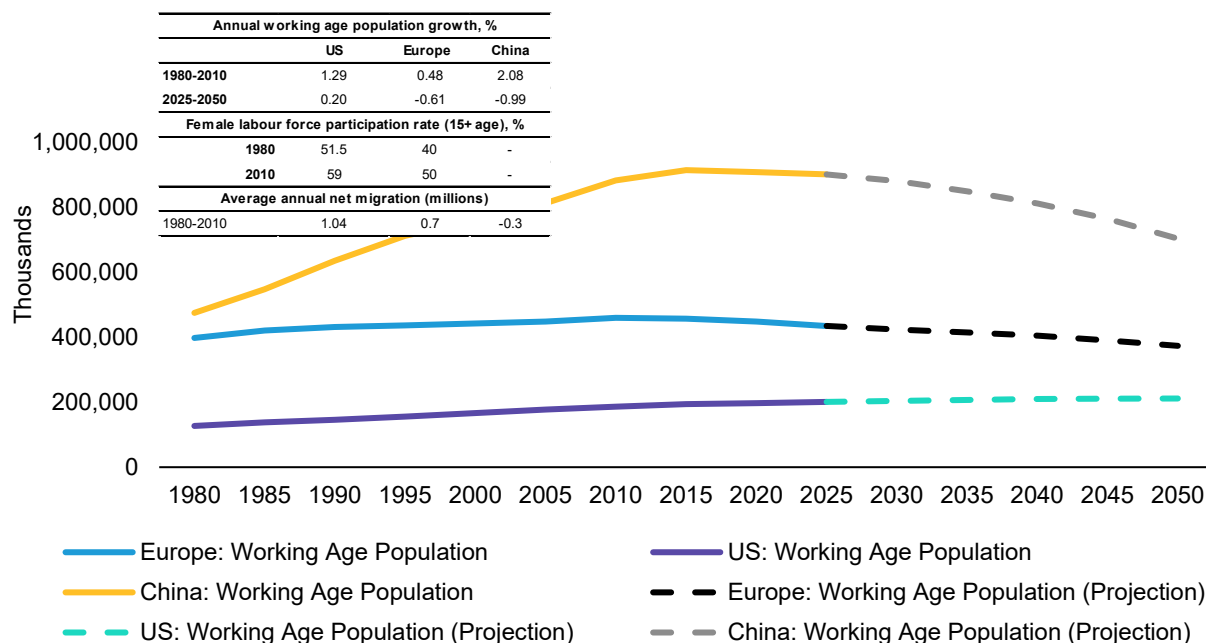
Probably the clearest case for US exceptionalism is demographics. Compared with other large economies, the US has a workforce that is expected to grow. We note that this growth is significantly less than the rate that people have become accustomed to over the last 40 years. This period saw all the Baby Boomers enter the workforce; it also saw a significant increase in the female participation rate and plentiful migration. These are forces that have either run their course or now going into reverse. Nevertheless, the US working age population<sup>1</sup> is expected to grow by 0.2% annualized between now and 2050 (compared with a 1.3% growth rate from 1980 through 2010).

In other advanced economies, such as Europe and Japan, the working-age population is in outright contraction. Europe's is expected to contract by 0.6% annualized between now and 2050. The political turn against migration means that migrant labor

<sup>1</sup> This assumes, for the purposes of argument, that people still retire at 65. They won't, but that is a narrative we have explored elsewhere and doesn't alter the relative regional conclusions on this point.

is not a realistic option to offset this decline. In China, the situation is even worse, with a contraction in the work force of a full 1% annualized expected over this period.

### DISPLAY 3: THE US IS STILL A DEMOGRAPHIC EXCEPTION AMONG LARGE ECONOMIES—JUST LESS SO



#### Current analysis and forecasts do not guarantee future results.

As of January 17, 2025

Source: UN, LSEG Data & Analytics and AB

We can express the expected growth rate of the economy as the number of workers multiplied by their productivity. We have written elsewhere<sup>2</sup> about why we would not be confident making a forecast that the aggregate productivity improvement of AI can offset other downward forces on growth. Anyway, forecasting productivity has proven almost impossible in recent decades. Thus, this relatively better outlook for the number of workers sets the US up for better growth than other major regions.

### Counterargument on demographics

There are possible counterarguments here. For example, a very harsh turn in immigration policy could decrease the growth rate of the US working-age population. The projections in the above table assume that future migration patterns for the US and other regions continue as they have historically. Given the political sensitivity of migration in many countries, this trend cannot be assumed.

The Brookings Institution recently updated population growth-rate assumptions incorporating different immigration scenarios. The “main” scenario assumes a continuation of recent migration patterns with annual net immigration levels into the US of between 850,000 and 980,000 people. The “high” immigration scenario assumes annual net immigration of 1.5 million people per year—a level only occasionally approached in the recent past. The “low” scenario assumes between 350,000 and 600,000 net migrants annually, which occurred during the latter years of the first Trump presidency. There is also a “zero” immigration scenario. In *Display 4*, we show what these scenarios imply for the annual change in the total population growth rate to the year 2100. The forecasts show that the recent trend rate of immigration is a requirement to maintain the US demographic advantage over other major economies. A low immigration scenario pushes the US into a net declining population, although still less so

<sup>2</sup> [Machines, Democracy, Capitalism and Feudalism - Five Books for a Different Age, and What It Means for Investing](#)

than in China and Europe. A zero net migration policy shrinks the population at a faster rate, but still perhaps no worse than other economies.

However, the Brookings forecasts are for 2100. If we take the United Nations (UN) population forecasts for 2050, which underpin the rest of our demographics analysis, then the zero-migration scenario for that time frame shows a 0.05% annualized reduction in total population. These are forecasts for the total population, because immigrants tend to be working age; the impact on the total working-age population would be worse than this. Actually achieving zero migration would be hard, but although this implies a significantly harsher outlook in terms of absolute growth rates than recent levels, relative to China and Europe it still is somewhat “exceptional.”

#### DISPLAY 4: POPULATION GROWTH-RATE ASSUMPTIONS

	Growth Rate (% pa) by 2050	Growth Rate (% pa) by 2100
<b>UN</b>		
Medium	0.38	0.27
Zero Migration	−0.05	−0.33
<b>Brookings</b>		
High		0.36
Middle		0.13
Low		−0.05
Zero Migration		−0.47

#### Current analysis and forecasts do not guarantee future results.

As of November 30, 2023

Source: The Brookings Institution and AB

The other possible counterarguments relate to health. If there was a mass move away from vaccination, then that could conceivably have a negative impact on population growth via higher child mortality, for example. However, the potential scale does not seem to be significant enough. We would have cited obesity as a significant factor that would undermine US demographic advantages, but recent medical developments have ameliorated that problem.

### Structurally higher and more persistent corporate profitability

It has long been obvious that US companies have enjoyed profitability and productivity advantages that overseas rivals lack, however much they try to emulate them. Some of this gap appears to stem from organizational and management choices of US firms; some also comes from a supportive regulatory and tax environment. Both of these are hard for other regions to emulate, however much they try.

The basis of the productivity advantage is deep-rooted and hard to emulate. For example, Bloom<sup>3</sup> showed in 2012 that US companies had a productivity advantage over European companies due to the productivity of their information technology and primarily due to differences in people management practices.

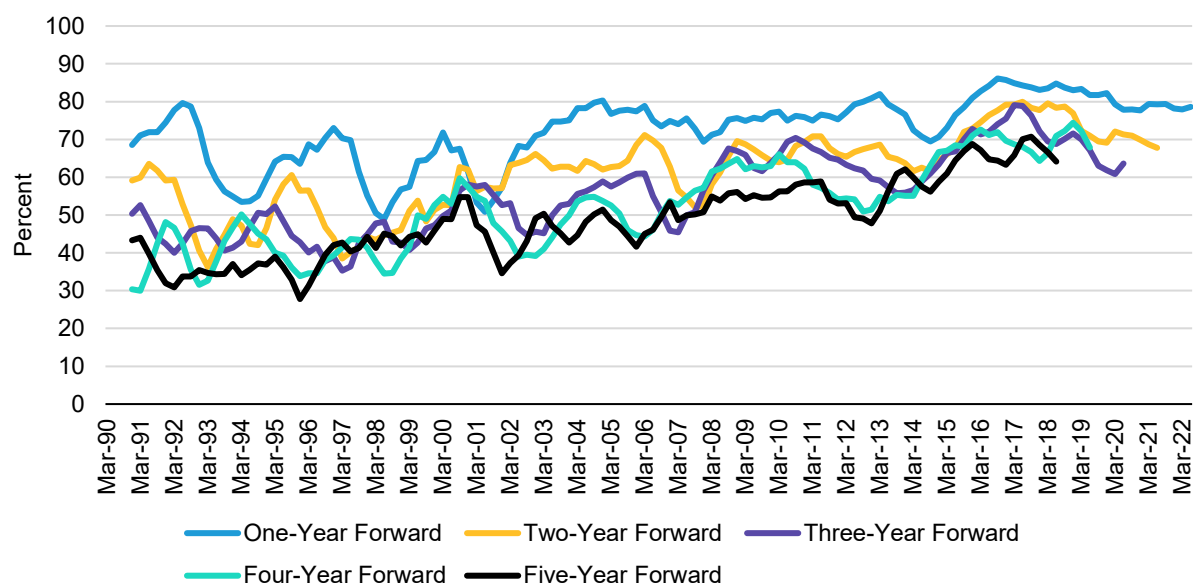
This lead is evident not just in a gap in the level of productivity between US companies and those in other regions, but also in the persistence of that productivity at the underlying firm level. We can show (*Display 5*) that the probability of a high return on equity (ROE) company in the US remaining a high ROE company five years later has been gradually increasing over time. This relationship is not the same in other regions. Note that this analysis is on an equal-weighted analysis, so it is not due to the platform benefits of the mega caps. When it comes to justifying valuation differences, the persistence of ROE is a critical factor.

<sup>3</sup> Bloom et al (2012): Americans Do IT Better: US Multinationals and the Productivity Miracle

It is true that corporate governance changes in Japan might bring about an improvement in ROE there. But this author remembers writing a note on the case for convergence of Japanese ROE while he worked for Lehman Brothers 20 years ago. So, directionally this might happen, but let's not hold our breath to see actual convergence.

# **DISPLAY 5: THE CASE FOR US GROWTH—HIGH-PROFITABILITY US COMPANIES ARE STAYING THAT WAY FOR LONGER**

PERCENTAGE OF HIGH-RETURN-ON-EQUITY DECILE US STOCKS THAT REMAIN IN THE TOP TWO DECILES 1–5 YEARS LATER



## **Historical analysis and current forecasts do not guarantee future results.**

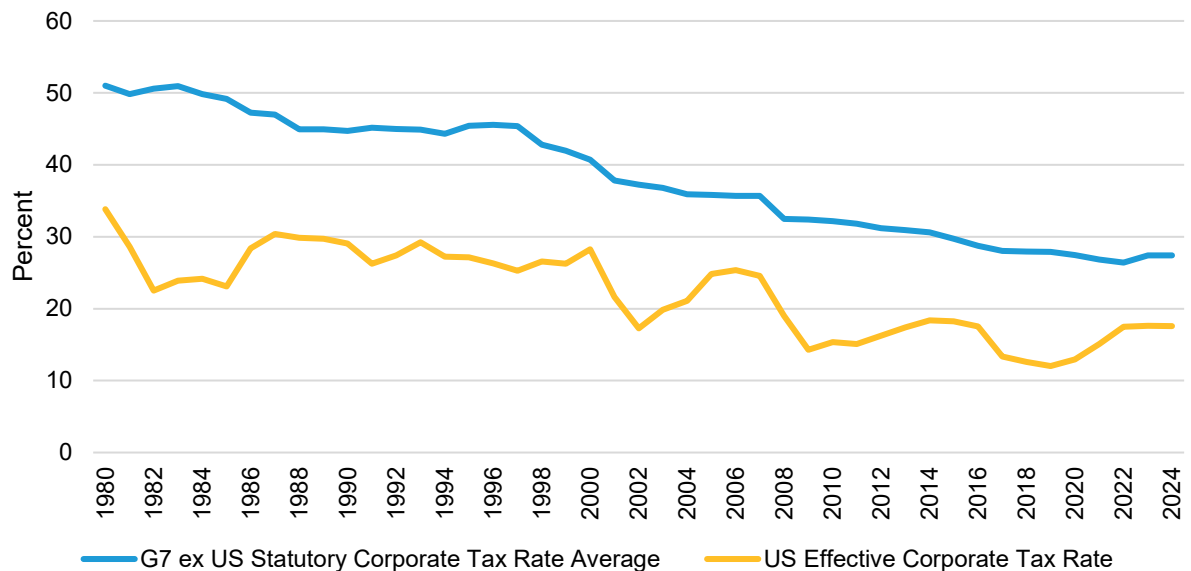
In each quarter since 1990, we split the stocks in the MSCI USA Index into groups by ROE deciles (within sectors) and calculated the percentage of stocks in the high ROE decile at a specific point in time in the highest two deciles over the next 1–5 years. A four-quarter smoothing is applied to the quarterly percentages.

Data from January 1, 1990, through June 30, 2023

Source: FactSet, MSCI and AB

The US advantage is not just from great people management. US companies enjoy an incredibly favorable regulatory environment. This is most clear when it comes to tax treatment. As *Display 6* shows, the US effective corporate tax rate has been trending down since the 1980s; at less than 18%, it is significantly below the 27% average of other major developed countries. While this is not a secret and so, in theory, easy to emulate, it is not likely to be a change that other countries enact. Indeed, pre-Trump, the international consensus was clearly moving the other way. Under Trump 2.0, it seems clear that favorable corporate tax treatment will continue.

**DISPLAY 6: A SIZABLE GAP BETWEEN US AND G7 EX-US CORPORATE TAX RATES**



**Current analysis does not guarantee future results.**

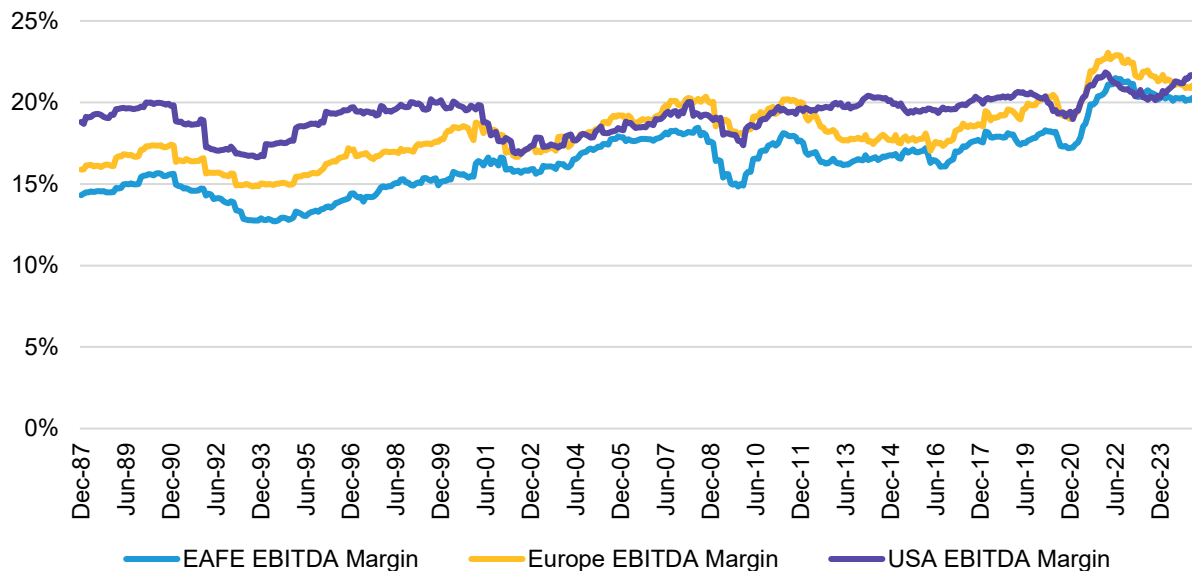
US Effective tax rate is calculated from aggregate US corporate profits before and after tax

As of April 11, 2025

Source: Tax Foundation ([www.taxfoundation.org](http://www.taxfoundation.org)), FRED, LSEG Data & Analytics and AB

The net result of this structural environment is that the US has a profit share of gross domestic product (GDP) that is exceptional compared with the rest of the world (*Display 7*). This advantage has been growing in recent decades, and in part explains the excess earning growth of the US over the rest of the world. While this is an unmitigated positive for shareholders, it does raise more fundamental questions. Are there social limits on the profit share of GDP? We think that there are. Our instinctive view is that profit share of GDP in the US “should” decline over time, which could erase some of the excess earnings growth of US corporations. However, despite that long-term view, for the foreseeable future we think that profit share will remain high. First, the development of AI is firmly in corporate hands. This is a choice that the US is making socially and politically; the decisions on what AI is developed and released will be determined in a way to maximize corporate profitability. Second, the Trump administration has so far focused on tariffs; any potential pivot to deregulation could grow corporate profit share even further.

#### DISPLAY 7: US, EAFE AND EU EBITDA MARGINS



**Current analysis does not guarantee future results.**

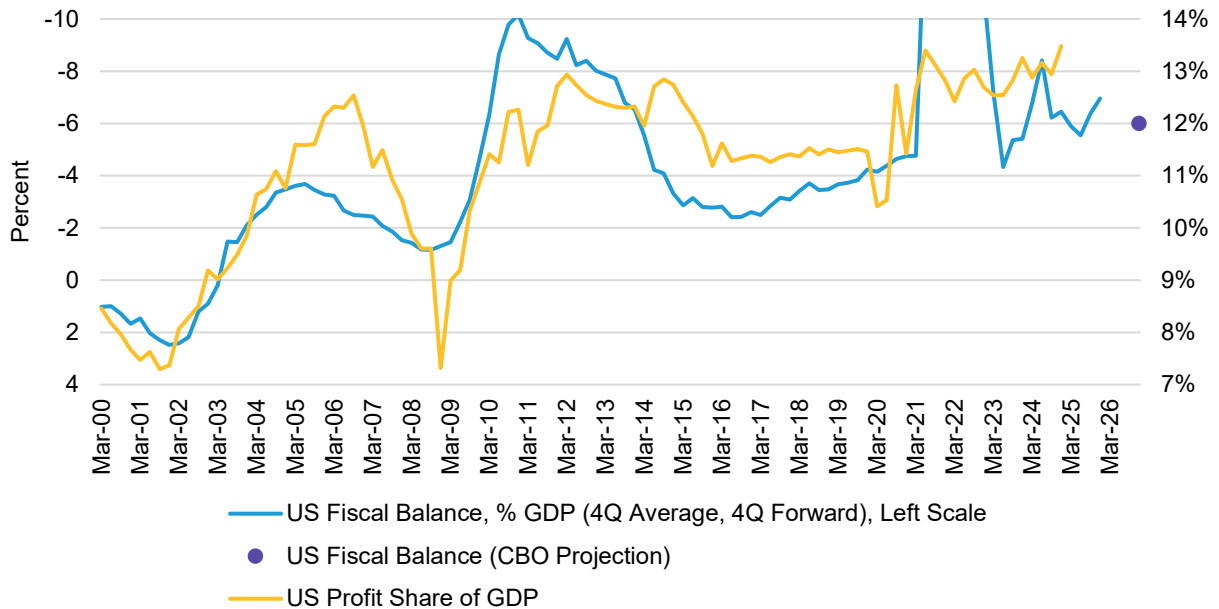
As of May 9, 2025

Source: Factset and AB

We note in passing that there is a persistently positive relationship between corporate profit share and budget deficits, so some of the “profit share exceptionalism” has less-positive connotations from a debt perspective. Nevertheless, it seems set to continue for the foreseeable future.



**DISPLAY 8: PROFIT SHARE AND DEFICIT**



**Current analysis does not guarantee future results.**

As of December 31, 2025

Source: CBO, LSEG Data & Analytics and AB

## Counterargument on profitability

There are also counterarguments to this point on the productivity advantage. The first would be that the laxer nature of US anti-trust policy in recent years has enabled the emergence of platform companies that stifle competition. The more extreme version of this counterargument is the one made by Varoufakis<sup>4</sup>, which claims that capitalism has actually died—in the sense that competition and profit are no longer the driving force, and that platform tech companies collect rent rather than profit.

There is then the argument that if tariff barriers are erected they could further erode productivity. It is very hard to collect data that could give a meaningful argument on this point, but if this was indeed a force, then the existence of counter-tariffs could also dent competition elsewhere.

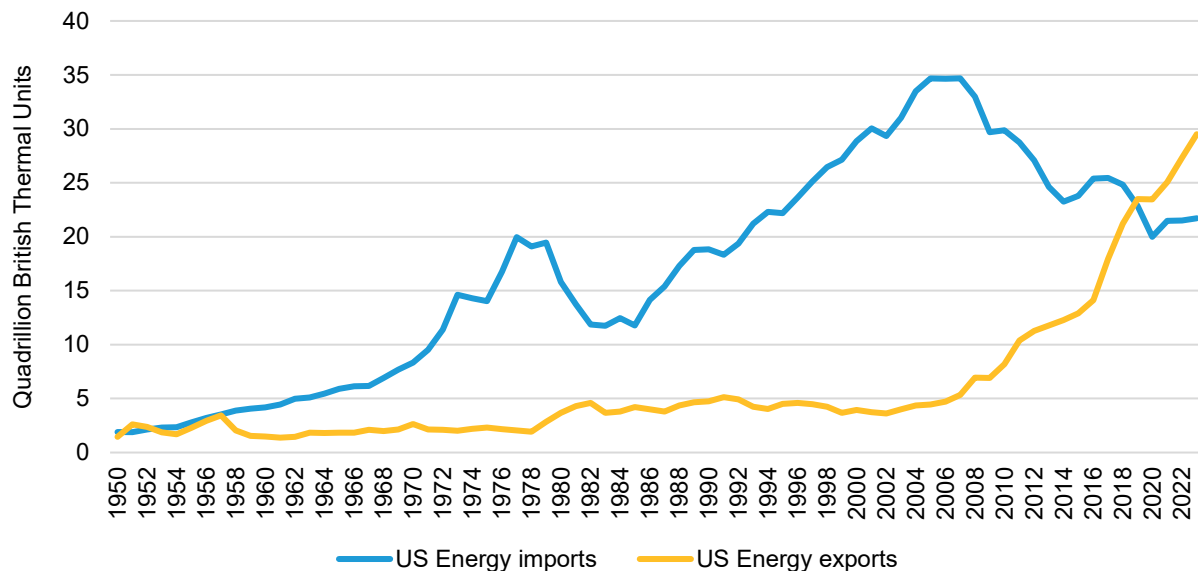
## Geographic security of US energy

The US enjoys a security of energy supply that is unmatched by other major economic regions such as Europe, China and Japan. This gives the US a cost advantage and the ability to ensure continuity of supply in the face of geopolitical pressure, as was clearly not the case for Europe when Russia invaded Ukraine.

On the back of the shale revolution, the US became a net energy exporter by 2019 (*Display 9*). Even under the Biden administration, US oil production continued to surge. In 2024, the country produced a record 13.2 million barrels of oil per day on average according to the Energy Information Administration, cementing its position as the world's largest oil producer.

<sup>4</sup> Yanis Varoufakis, *Technofeudalism: What Killed Capitalism* (Melville House, 2023)

## DISPLAY 9: US ENERGY IMPORTS VERSUS EXPORTS



**Current analysis does not guarantee future results.**

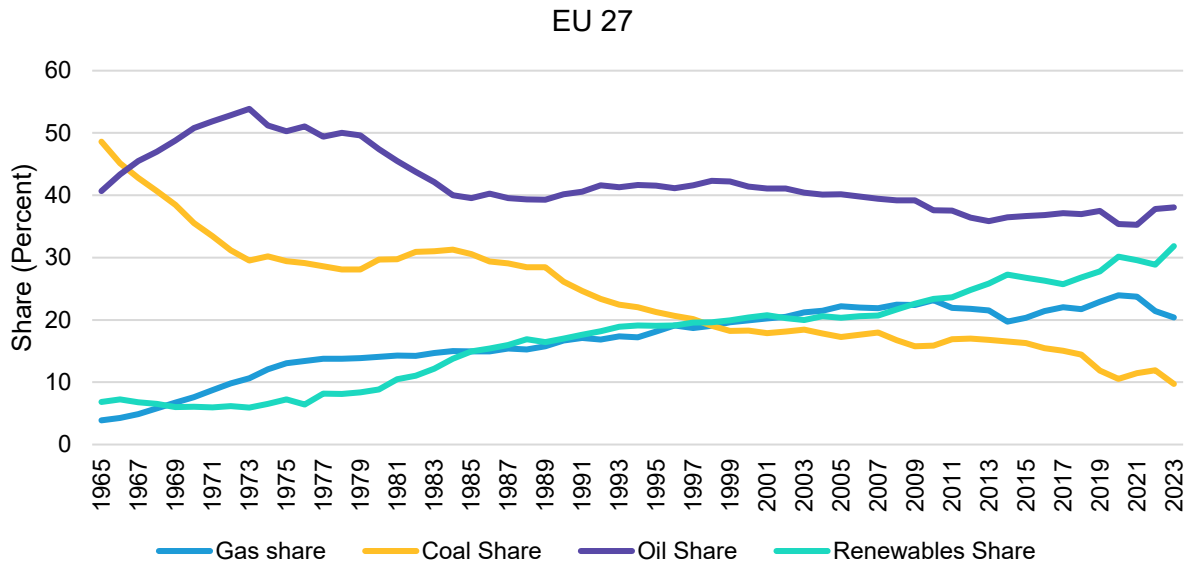
As of December 31, 2023

Source: U.S. Energy Information Administration and AB

## Counterargument on energy security

A counterargument is emerging to US energy security, positing that a rapid transition in other regions could undermine this advantage. This would not be a net negative to the US per se, but it would at least remove an important strategic advantage. We do think that this is eventually likely, but it does not appear to be a near-term prospect. The increase in renewable generation over the last 30 years has really only displaced coal in Europe's energy mix, while the share of oil and gas has barely moved. According to Eurostat, Eurozone energy import share has risen slightly, from 58% in 2003 to 60% by 2023, despite this period seeing the fastest Eurozone adoption of renewables.

## DISPLAY 10: EUROPEAN ENERGY SOURCES: A LONG WAY TO GO UNTIL ENERGY SELF-SUFFICIENCY



**Current analysis does not guarantee future results.**

As of December 31, 2023

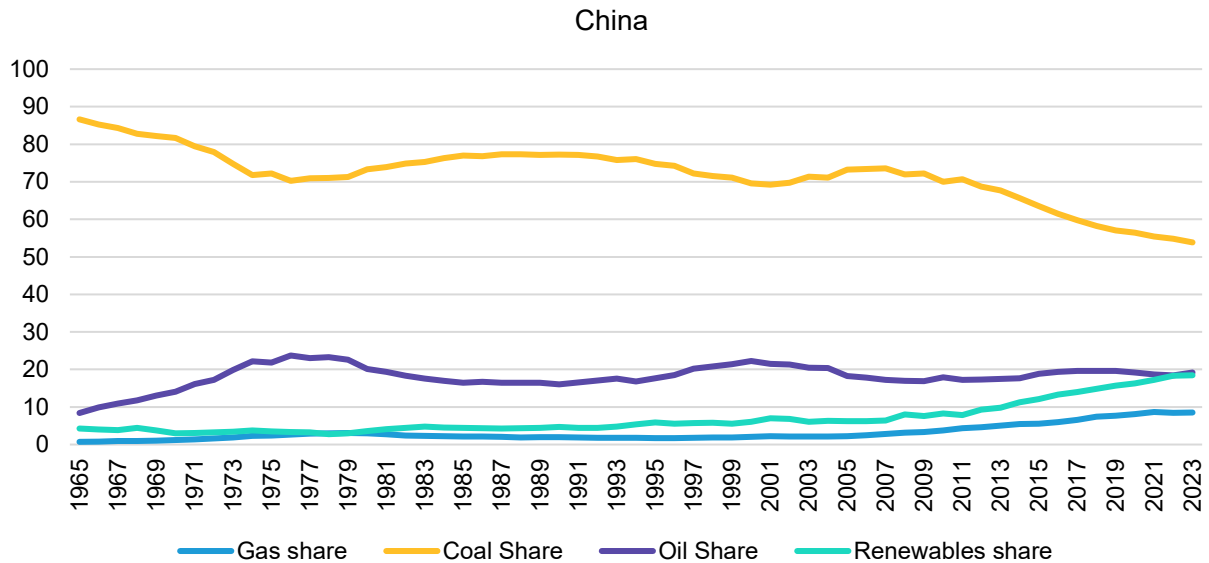
Source: [www.ourworldindata.org](http://www.ourworldindata.org) and AB

There is a case that faster development of renewables would be sufficient to make Europe energy self-sufficient, for example via development of North Sea wind power. In time, this development could bring down inflation in Europe's energy input cost. However, huge investment is needed both in generation and in the development of the grid, so this solution remains some way off. Moreover, there are limits to how large a share of power can be drawn from renewable, intermittent sources. The investigation into the Iberian Peninsula's recent massive power failure is still ongoing, but relying on too high a share of intermittent energy sources seems to be a possible contributing factor at the very least.

China has become the epicenter of the production of key elements for the energy transition, notably solar panels, and the sharp decrease in their price has accelerated forecasts of adoption rates. Nevertheless, coal still dominates Chinese power generation, and 7% of this coal is imported, according to the IEA<sup>5</sup>.

<sup>5</sup> <https://www.iea.org/countries/china/coal>

## DISPLAY 11: COAL REMAINS THE DOMINANT SOURCE OF CHINESE ENERGY



**Current analysis does not guarantee future results.**

As of December 31, 2023

Source: [www.ourworldindata.org](http://www.ourworldindata.org) and AB

## Other aspects of US exceptionalism: market size and climate

Another dimension of US exceptionalism is the size of its home market. Yes, the EU potentially constitutes a larger market than the US, but it still has national distinctions, including banking systems and language.

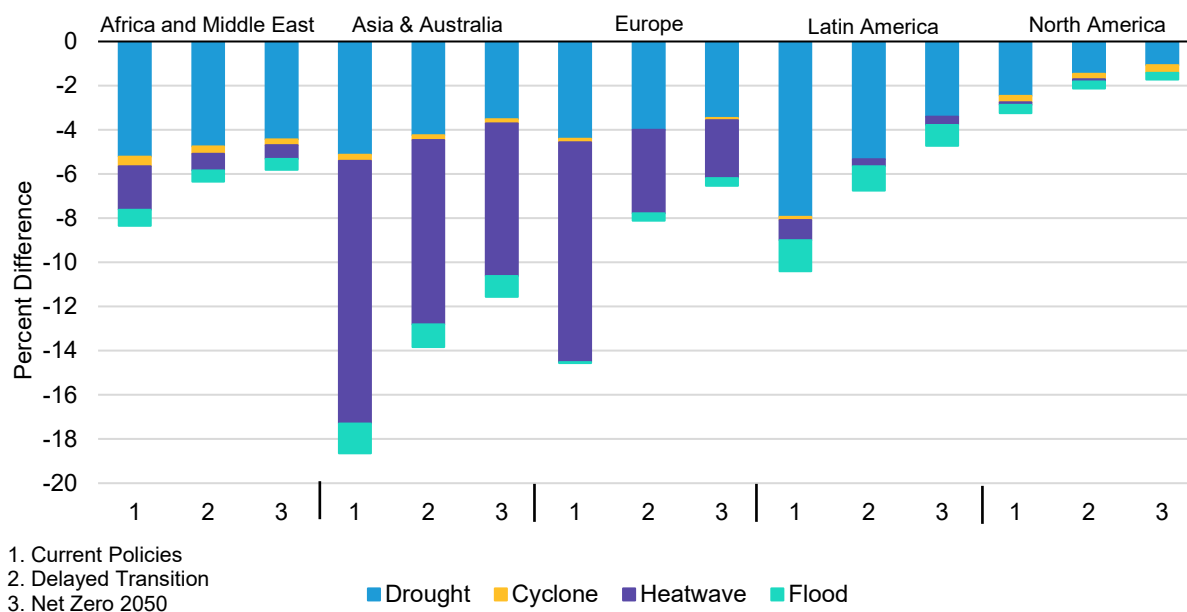
A final point in favor of exceptionalism is that some models for the impact of climate change on the global economy suggest that the US may feel a below-average negative impact. We do not explore this point in detail here—not because it is not significant, but because the scale of the errors in making such forecasts means that one would not wish to pin a whole argument on it.

Our view, as laid out in recent research, is that it is socially and politically [almost impossible to achieve net zero by 2050](#), especially when one adds the power demands of AI. This means it is highly likely that we see global warming of more than two degrees Celsius. The big unknown is what this warming means for growth rates. The consensus is that it will be negative, but with large error bars around the forecasts.

Several forecasts, notably those run by the Network for Greening the Financial System and used by many central banks, assume that the negative impact on the US will be less than the global average. While that global average is important for determining the human impact, what matters through the blinkered lens of making a return forecast for financial markets is the impact of climate change on a GDP-weighted forecast for the world. This somewhat lowers the potential advantage to the US but still points to the possibility of a less unfavorable outcome for the US than for other major economies (*Display 12*).

## DISPLAY 12: TEMPERATURE PATHWAYS AND REGIONAL GDP

### NORTH AMERICA RELATIVELY LESS AFFECTED THAN OTHER REGIONS?



### Current analysis and forecasts do not guarantee future results.

All values are differences from baseline (a hypothetical scenario with no transition nor physical risk). Simple averages are used across countries available for a given region. Latin America is composed of Chile, Mexico and Argentina, except for floods, which is available only for Mexico. North America includes the US and Canada, but only the US for floods. Africa includes Egypt and South Africa (only South Africa for floods).

As of November 2023

Source: NGFS ([NGFS Climate Scenarios for central banks and supervisors phase\\_iv.pdf](#)) and AB

## The case against US exceptionalism

### Erosion of US soft power and standing back from international institutions

We have laid out some of the potential counterarguments to US exceptionalism within the discussion above. However, some of the stronger arguments against continued US exceptionalism are qualitative. One is the impact of the US potentially standing back from some of the multilateral institutions that underpinned the US-led post-WWII order, such as the International Monetary Fund and North Atlantic Treaty Organization as well as other institutions in which the US has historically had significant influence, such as the World Health Organization.

Similar claims can be made more generally about US “soft power.” This power can take many forms, such as cultural, general sentiment of the populace and aid. On this basis, US standing appears to have taken a significant hit. What we do not yet know is the marginal impact above and beyond tariff effects on international trade. The impact is perhaps clearest in defense policy. Aside from a trajectory of higher defense spending, e.g., in Europe, there is a debate about where these additional funds are spent. At the moment, a significant share is spent on US products, but the change in the geopolitical frame of reference makes it clear that a significant shift is afoot, with the likelihood that more of these funds will be spent locally.

Likewise, China has engaged in a new “Scramble for Africa” over the last decade with its “Belt and Road” initiative. There were signs of a negative backlash against this effort, which could give an advantage to the US, but early indications are that the shutdown of US AID has rapidly eroded US soft power on the continent. Studies had indicated that every \$1 spent on foreign aid generates approximately \$1.35 in U.S. exports to recipient countries (Business Roundtable, 2022), but that advantage is now moot.

Humanitarian assistance during natural disasters and conflicts has also historically enhanced US soft power. Countries receiving US humanitarian assistance have displayed a one-third higher likelihood of voting with the US on key UN resolutions, according to Chicago Council on Global Affairs interests [ref Chicago Council on Global Affairs, 2020]

## Friction with US universities and risks to growth

When we have discussed the ongoing case for US exceptionalism in recent client meetings, one line of pushback we have encountered is the long-run impact of the current US administration's more confrontational approach to universities. Could this friction, we are asked, significantly erode the US growth advantage? The twin fears here are around the risk of an exodus of talent from US universities, with highly skilled people moving overseas, and around the impact from any funding cuts.

A recent paper by the Dallas Federal Reserve<sup>6</sup> concluded that in the US, government-funded R&D has accounted for one-fifth of business sector growth in total factor productivity since WWII.

Where the role of US universities and US soft power overlap is on educational exchange and the attraction of US universities as a destination for global students. For example, the Fulbright Program has produced 42 heads of state, 60 Nobel Prize recipients, and thousands of other people in senior roles worldwide<sup>7</sup>. So, the undermining of US universities could in theory dent the US growth advantage. Having said that, given the large pay disparities between US and European universities, at this stage a large exodus looks unlikely—though of course this could change.

## What about bond exceptionalism?

Where the case for US exceptionalism becomes murkier, we think, is for sovereign bonds and the US dollar. There are two types of worry here: one is related to fiscal sustainability and the other is related to any explicit policy implementation that changes the terms for non-US debt holders.

Fiscal sustainability has long been a concern, and it has become more elevated as an issue in client meetings over the last year. We take the view that there is no explicit level of debt/GDP that presents a problem per se, but as the ratio rises, it creates the risk of an exogenous shock causing a large increase in yields. This risk should be a feature of high-debt governments when the trend of interest rates is no longer endlessly downward. We have seen this in the “Liz Truss” moment in the UK, and also in the run-up to the last French election. As we suggested in a recent note, perhaps rather than debt/GDP, [interest expense as a share of government expenditure poses more of a threat](#). The US servicing cost of debt exceeded the country's defense budget in 2024 for the first time in modern history. The proposed Ferguson limit, discussed in that note, suggests that when this happens to a great power it is at risk of no longer being a great power. However, the focus of this note is US exceptionalism, not an absolute statement about market direction. From this point of view, all of the G7 nations face the same debt problem, really.

The second concern is any change in US policy that would be to the detriment of foreign bond holders specifically, as was mooted in the idea of a putative Mar-a-Lago accord. However, the US administration and Miran, the author of the report proposing this, appears to have stepped back from such notions recently.

Much of this debate ultimately comes down to trust. We think that trust in the US has been eroded, but investors face a dearth of other good options, especially if liquidity is their key concern. There have been flows out of US Treasuries by foreign investors over the last two months, but these do not amount to a strategic re-alignment, despite all the talk. We are often asked what would prompt such a shift. The only plausible mechanism for this to change would be some massive capitulation by global investors in their positions, and that is something that we are not yet ready to call. So, we are left with the view that sovereign risk in the US “should” be priced, but so far the global demand for liquid assets swamps that pricing of risk.

Over strategic horizons, we remain of the opinion that inflating away US debt is more attractive (and frankly more normal for large economies) than a more aggressive action; hence we retain a preference for Treasury Inflation Protected Securities over nominal duration.

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<sup>6</sup> <https://www.dallasfed.org/~media/documents/research/papers/2023/wp2305r2.pdf>

<sup>7</sup> <https://eca.state.gov/fulbright/fulbright-alumni/notable-fulbrighters/heads-stategovernment>

This issue begs more fundamental and theoretical questions. One is the question of what counts as a risk-free asset. We have long held the view<sup>8</sup> that there is no such thing, or that, at least, the existence of a risk-free asset is a contingent concept, predicated on a specific set of geopolitical or economic states that do not always hold.

The other question is more methodological in nature referring to how risk premia “stack.” There is a common notion that there should be a credit risk premium over “safe” government bonds and then an equity risk premium for the extra risk of having a lower level of claim. But does it have to be that way? We are not so sure. There are examples of when corporates are deemed at lower risk than the countries that play host to them, as happened in the Eurozone debt crisis for large corporations in a range of sectors. This also occurred in the US in 2009–2010, when some large corporations such as JP Morgan and Johnson and Johnson traded at negative spreads.<sup>9</sup> That was a brief episode in a time of extreme dislocation, not the situation that we currently face, but it shows that this is possible.

If there were a sudden shock that sent US sovereign yields higher, it is hard to envisage that development not being very negative for equities at the same time. However, over longer horizons, at the very least if the “default” is a soft one via higher longer-term inflation, then maybe equities as real assets (up to a certain level of inflation at least) can still deliver returns. No one really knows the answer to this, so we suspect that it will run and run.

## **US currency exceptionalism and the role of the US dollar**

Where a potentially more negative narrative may now hold is the exceptionalism of the US dollar, i.e., its reserve currency status. Let’s be very clear up front before we go any further with this discussion: There is no plausible near-term replacement for the dollar in its role as a reserve currency and the basis for the vast majority of international trade. There is no other plausible asset to replace it; we do not think that China will be willing to make its currency convertible, as there would be risk of huge capital flight. Nevertheless, the path toward finding other alternatives is set and a lot of participants are going to speed up attempts to de-dollarize.

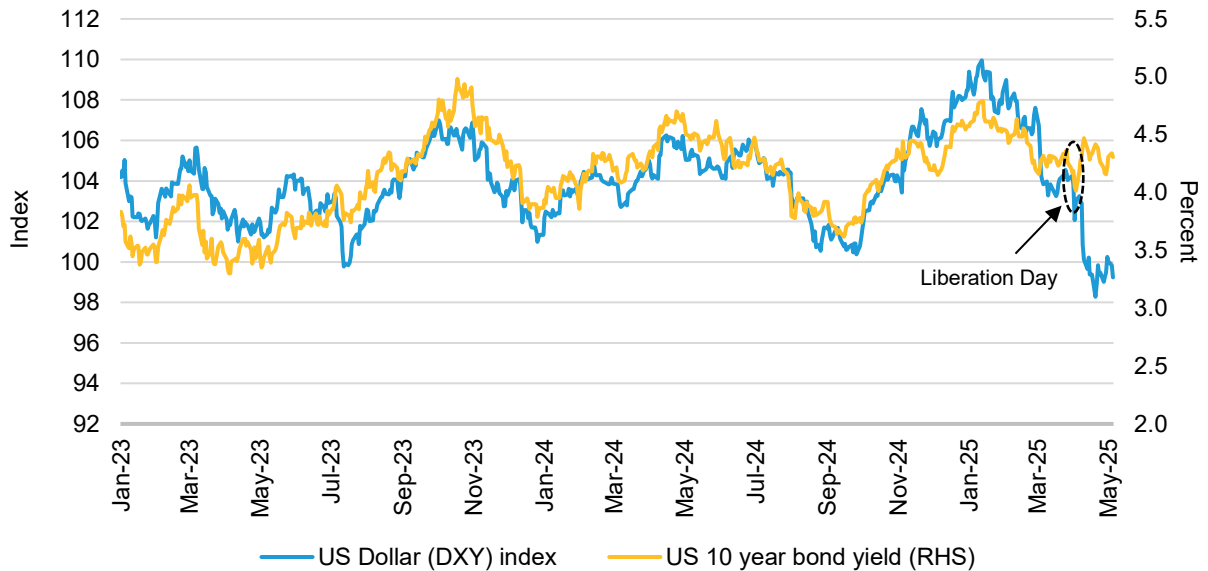
At the very least, the US has lost its veneer of being a safe haven. Through the enormous move down and back up again in markets since so-called “Liberation Day,” the dollar has weakened. More importantly, in the period of extreme risk-off sentiment in early April, bond yields moved up and the dollar sold off, a sign of neither being safe-haven assets (*Display 13*). In our conversations with clients, there is a lot of interest in hedging US dollar exposure. We think that makes sense: 1) the US dollar is pretty clearly a riskier asset than it was before the current administration took office; 2) the risks are skewed to the downside (as the finance expression goes); and 3) the nature of downside risks to global investment assets stem from events (such as abrupt US policy changes) that are likely to weaken the dollar not strengthen it, hence increasing its correlation with other assets in response to such news.

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<sup>8</sup> Inigo Fraser Jenkins et al., *Global Quantitative Strategy: The end of Pax Americana and what it means for the market* Bernstein Research, January 2019

<sup>9</sup> Negative Credit Spreads: Liquidity and Limits to Arbitrage | Portfolio Management Research

### DISPLAY 13: NO LONGER A SAFE HAVEN?



### Past performance does not guarantee future results.

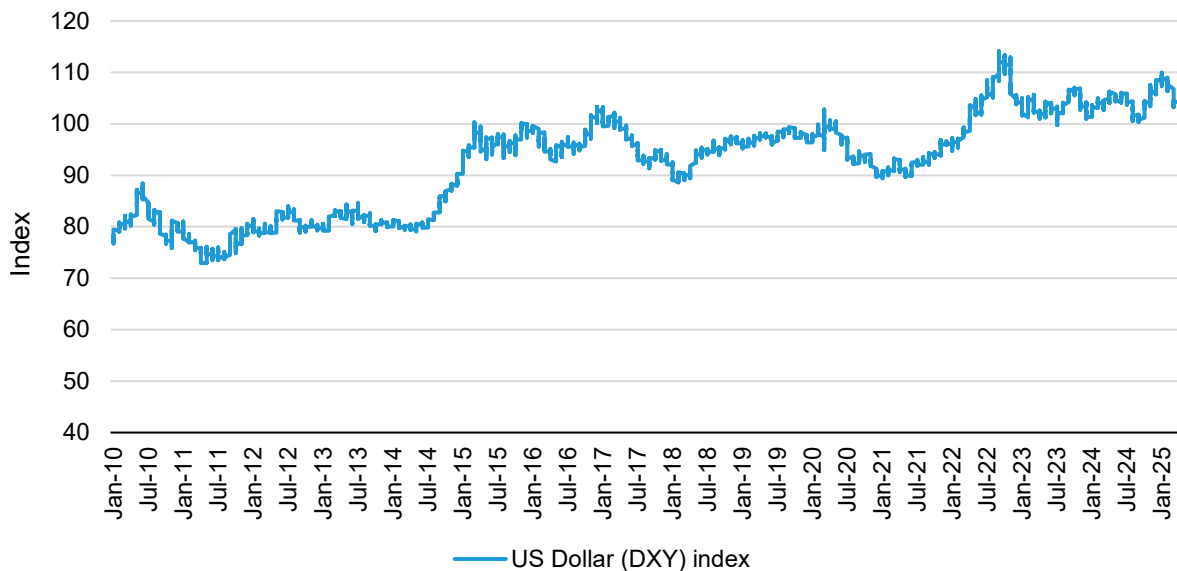
As of May 6, 2025

Source: LSEG Data & Analytics and AB

Generally, overseas investors have been paid to be underhedged when it comes to their dollar exposure. Since 2010, the DXY index has shown a return of 1.9% annualized (although to keep things in perspective, one should note that the dollar has depreciated by 7.7% annualized against gold over the same time). However, that dollar outperformance has been episodic rather than anything approaching monotonic. The reason to hedge more dollar exposure now really rests on the notion that of the list of negative things that could happen, around policy announcements at least, more unfavorable developments seem to chart a path that would be negative for risk assets and the dollar at the same time.



#### DISPLAY 14: IT HAS PAID FOR NON-US INVESTORS TO UNDERHEDGE THEIR DOLLAR EXPOSURE



#### Past performance does not guarantee future results.

As of May 6, 2025

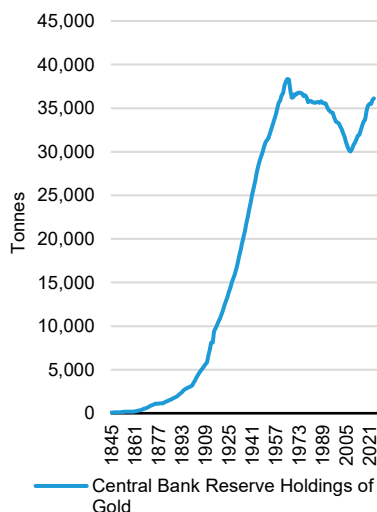
Source: LSEG Data & Analytics and AB

Attempts to de-dollarize received a massive boost after Russia's invasion of Ukraine and Russia being shut out from the dollar system as a result. From an investment perspective, trying to time when central banks might buy more gold and at what size is a fool's errand, but we think that central bank gold demand will remain for geopolitical reasons.

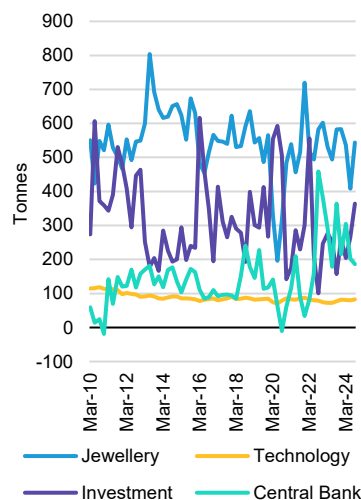
There cannot be a move back to gold as a real alternative, as the problem with all asset-backed currency systems is that they are incompatible with growth. The supply of the material in question cannot keep up with modern expectations of economic growth. Nevertheless, central banks and investors will likely continue to see gold as a useful allocation, not only directionally but also as a hedging asset given its ability to hedge equity risk even at higher levels of inflation (an attribute that does not hold for bonds).

## DISPLAY 15: CENTRAL BANKS HAVE BECOME A LARGER SHARE OF GOLD DEMAND

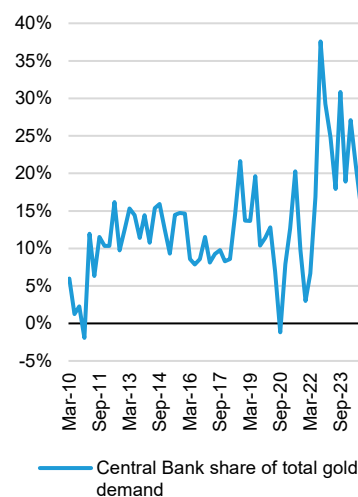
**Central Bank Reserve Holdings of Gold**



**Gold Demand by Category**



**Central Bank Share of Total Demand**



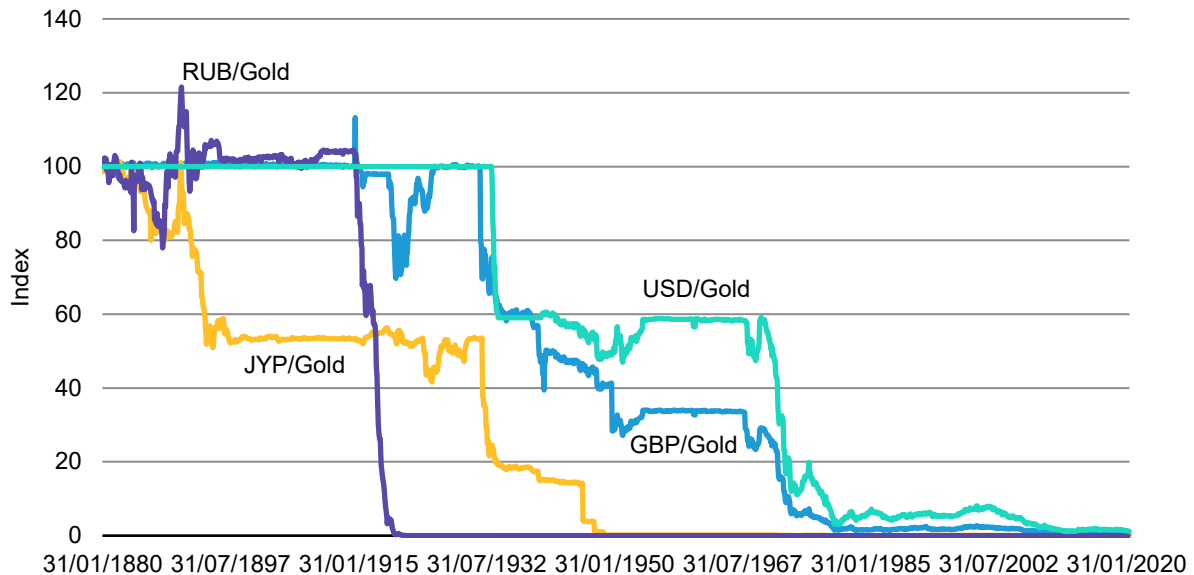
### Current analysis does not guarantee future results.

As of September 30, 2024

Source: Metals Focus, Refinitiv GFMS, ICE Benchmark Administration, World Gold Council, LSEG Data & Analytics and AB

While there is no near-term prospect of any alternative emerging as a true contender to challenge the dollar's role as a reserve currency, we do see the case for a directional move away from it. Trade is predominantly denominated in dollars, so a significant decline in trade creates less demand for global investors to hold dollars. Any decline in trust in the US implies less willingness to hold dollars. This implies that the dollar is directionally more negative and less of a safe-haven hedge. This is not all due to Trump. Far from it. The buildup in debt across G7 countries has raised questions about the path for major currencies; there is a long history of fiat currencies depreciating either by war, revolution or simply leveraging up of economies (*Display 16*). Moreover, the ability to weaponize the dollar is at the same time one of the huge benefits that the US enjoys by having the world's reserve currency, but it also has created a demand for alternatives.

#### DISPLAY 16: SINKING WITHOUT TRACE? MAJOR CURRENCIES AGAINST GOLD SINCE 1880



**Past performance does not guarantee future results.**

As of May 31, 2020

Source: Global Financial Data and AB

Of course, in the case of a really large shock, the dollar presumably does still play a role. It probably depends on the nature of the shock. Leaving aside the recent focus on policy pronouncements from the White House, there are other types of shock where near-term dollar demand may be strengthened by, say, a Chinese move against Taiwan. So, hedging out all dollar exposure might not be optimal. It is still exceptional, but less so than it was.

#### Conclusion and AB portfolios

For equities, strategic US exceptionalism still stands. It has taken a knock for sure, and the scale of consensus in favor of the US before so-called “Liberation Day” makes it susceptible to near-term outflows. But in the longer term, investors who are desperate to eke out a positive real return in a lower-return world need to overweight US equities. Exceptionalism with regard to US bonds is moot. We can see good reasons why sovereign risk “should” be priced and why the curve should be steeper, but the lack of other liquid alternatives makes a strategic realignment hard for investors. Where exceptionalism may have been weakened is the US dollar. For the foreseeable future it has no rival but attempts to de-dollarize will step up, and we think that its role in portfolios has become riskier.

In AB retirement portfolios for non-US dollar investors, we are moving back to a strategic hedge on US assets from what has been a (very) long-term dollar overweight. Likewise, in our multi-asset income portfolios, we have increased hedging for non-US dollar accounts. In neither case have we changed our strategic view on US equities.



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