WEEKLY STRATEGY
Perspectives

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American Exceptionalism – Down Not Out

"The position of the Americans is quite exceptional, and It may be believed that no democratic people will ever be placed in a similar one."
– Alexis de Tocqueville

The Through Line: U.S. economic performance has been the envy of the developed world for much of the post-COVID period, pushing the country's major market indexes to all-time highs as recently as February 19. A mere six weeks later those same yardsticks were down nearly 20%. Oddly, traditional safe havens – including the U.S. dollar and Treasury bonds – declined in tandem. The change in sentiment was dramatic, leaving pundits to question the viability of the American exceptionalism thesis. Using charts, data and a handful of qualitative observations, we put the near-term disruption into a more constructive long-term context.

What a difference a few weeks makes

The U.S. began 2025 on sound economic footing, with most observers putting the odds of a recession at close to nil, given low unemployment, solid GDP growth and moderating inflation. U.S. markets were coming off back-to-back 25% plus growth years – all stats that shone brightly relative to much of the rest of the industrialized world.

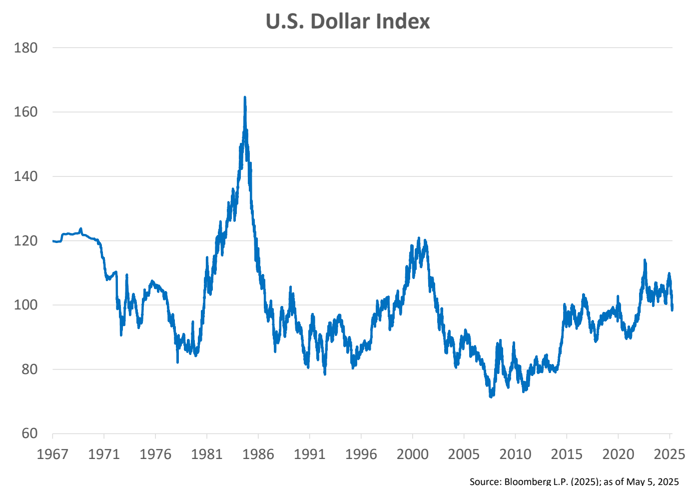
A rapid-fire series of events pivoted the narrative, however, starting with DeepSeek's competitive threat announcement in January; DOGE's disruption of the government workforce; sovereignty threats toward Canada, Greenland and Panama; disparagement of central bank independence; and ending with the initiation of a unilateral trade war against friend and foe alike. As consumer, business and investor sentiment soured, strategists pivoted forecasts to incorporate a substantially increased risk of recession, even though hard data has yet to be broadly dented.

Market volatility has ramped sharply in recent months; intraday moves sometimes shifted trillions of dollars in a matter of minutes following each new headline or social media post. Another trait that has beset recent trading: even assets typically considered defensive havens – like the dollar and U.S. Treasuries – have seen their prices under pressure. It is this latter point that has some observers suggesting the era of American exceptionalism has come to an end – and that the beginnings of a permanent exit of capital from the U.S. may be in process. We respectfully disagree. While the fundamentals on the ground have changed a bit, and opinions toward the U.S. have shifted, we believe the tide of opinion will turn as trade deals are struck and the narrative shifts toward more focus on corporate tax incentives and regulatory reforms.

Widening the aperture

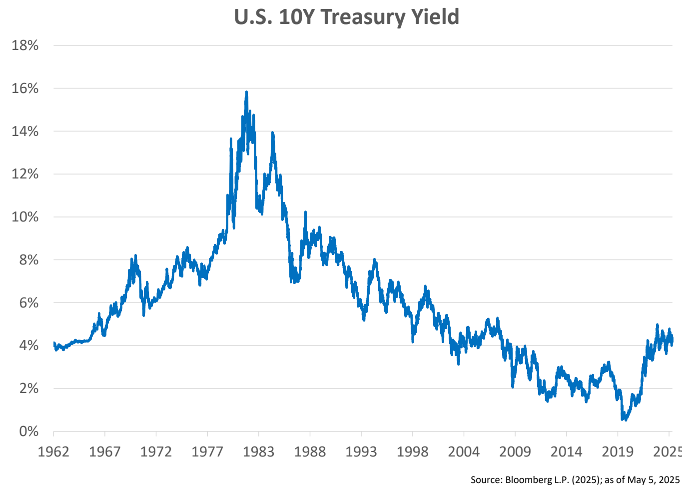
In assessing how unusual the near-term action may be, it is helpful to take a step back and view it in the context of long-term trends. For example:

The U.S. dollar – One of the most common measures of the US dollar is the DXY Index, a measure of the dollar's value relative to six other currencies. The chart below shows it remains well above where it has traded since the early 2000s although the index has declined sharply in the current year. **It is also worth noting that over half of all global transactions are denominated in U.S. dollars. No other currency has the depth or liquidity to take over this position in the near term or perhaps even the intermediate term.**

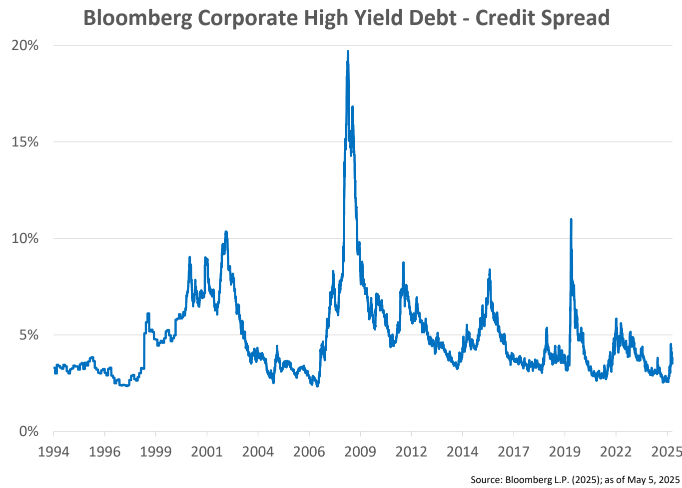


10-year U.S. Government yields – During the days of most intense equity market drawdowns, U.S. Government yields – particularly those at the much-watched 10-year level – swung noticeably, leading some to fear the exodus of foreign holders. As mentioned in our Weekly Strategy Perspectives: Guest Feature – Fixed Income in Focus - BMO Private Wealth we do not believe this withdrawal is likely, given the breadth, depth, oversight and liquidity offered by U.S. fixed income markets. The U.S. sovereign debt market is over $28 trillion – the largest and deepest debt pool in the world – with foreign holders owning over 35% of the outstanding securities.[i, ii]

While yields have been volatile, the 10-year yield in particular remains within our projected fair value range of 4.25 to 4.75%. We have expected rates to normalize to pre-GFC (Global Financial Crisis) levels versus the abnormally low rates prevalent during most of the post-GFC period.



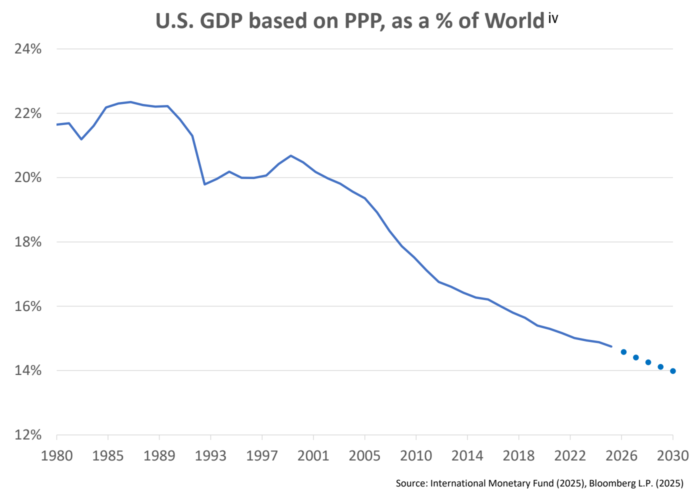
Spreads – It has been noted that corporate credit spreads widened during this year's market volatility. True. But again, when looking long term, the widening remains in an orderly range.



An imbalanced world

Global equity markets totaled $115 trillion in 2023 according to the most recent Capital Markets Fact Book published by the Securities Industry and Financial Markets Association trade group (SIFMA).[iii] The U.S. was 42.6% of the total, nearly four times larger than the next largest component – the EU at 11.0%. China was 9.5% and Canada 2.7%. A decade prior, the U.S. was 36% of a $66-trillion pie, while the EU was 13%, China 6.0% and Canada 3.2%.

U.S. market capitalization relative to the rest of the world has steadily grown in recent years. Ironically, this has come while the U.S. share of global GDP has declined. We suspect the market dominance was due to heavier tech weighting of U.S. indexes, plus the size, liquidity and sturdy regulatory framework attracting capital to U.S. shores. Another way to think about it is that the largest companies in the S&P 500 are global businesses that choose to locate inside the U.S.



Building a new narrative

We believe predictions of the death of U.S. exceptionalism are premature, noting that much of the recent action is well within long-term trends. That said, the U.S. position as an attractive place for investment – either for capital or physical goods – is not to be taken for granted. America has benefited from the trade and capital regimes established over the post-WWII decades, with lower financing costs, lower interest rates and lower inflation. The Trump administration is seeking to upend the world order – particularly relative to trade relationships – which could lead to higher costs and/or lower margins as supply chains, processes and cost structures are rearranged. Balance sheets would likely return to being more capital intensive and away from the asset-light, intangibles-heavy nature they have migrated to in recent decades.

The country's debt and deficits are already at peacetime highs, making budget and spending priorities tougher to balance – and putting them under a more intense microscope from potential investors. Then, too, recent zigzagging in treatment of key trading and security partners has other nations and blocs looking to forge alliances that exclude the U.S.

For a long time, the U.S. has been a magnet attracting talent from around the world to innovate, be educated and establish new companies. Many recently announced executive orders seek to change these relationships – a balancing act that must be carefully managed in order to avoid a long-term brain drain.

Implications for investors

U.S. markets remain broad, deep and carefully regulated. That said, given the long period of outperformance, they have also grown to a disproportionate size of global indexes. To the extent that policy remains chaotic in the short run, a flow of incremental investment dollars out of U.S. assets could well continue – pushing global averages back toward longer-term norms. Over time, capital will be allocated where the returns and fundamentals are superior.

In the short run, there may well be damage from the past few months of uncertainty that has yet to show up in the hard data (the bullwhip effect of stop and restart). **However, markets won't care provided that the narrative shifts to a more constructive set of themes (e.g., the outline of trade deals or progress on corporate tax reform and deregulation).**

It is also worth remembering that many companies are reporting solid, even above-expected results, but are pulling guidance nonetheless. This tees up the potential for earnings and revenue beats in the back half of the year and beyond as policy sorts itself out and/or the through line turns constructive.

In focus in North America

Jon Borchardt, Sr. Analyst
George Trapkov, CFA, VP and Portfolio Manager

This week

Bank of Canada deliberations – The BoC's summary of deliberations from its April 16 policy meeting reflected deep uncertainty surrounding the outlook. Policymakers discussed a number of different scenarios and potential outcomes, and where the risks on inflation lie. There were differing views on the BoC governing council, with some preferring a 25 bp cut and others arguing (successfully) for a pause. Those in the pause camp were focused on the extent of the uncertainty around the impact and extent of tariffs. On the rate-cut front, the plunge in economic sentiment, softening data and the lagged effect of policy were noted. Financial turmoil was also cited. According to meeting minutes, council members said that while medium/long-term inflation expectations remain anchored, they have the flexibility to reduce the policy interest rate further to support growth. April job numbers and the newest round of GDP figures (due at the end of May) will be key for the BoC's next rate decision June 4.

FOMC holds rates steady – As expected, the Federal Open Market Committee (FOMC) maintained the federal funds policy rate at 4.25% to 4.5%. Fed Chair Jerome Powell once again eluded efforts by the financial press to draw out tangible clarity on the committee's next steps. The message remained consistent with the committee's March stance: the economy is in a good place, the cost of pausing is low and it is appropriate for the Fed to be patient while awaiting greater clarity. Hard data has yet to crack, despite increasingly negative anecdotal and survey trends. Mr. Powell and the FOMC acknowledge that policy uncertainty has increased the risk of both higher unemployment and persistent inflation, but for now the range of possible outcomes remains "huge." With the Trump administration introducing changes to trade, fiscal, regulatory and immigration policy, the Fed believes it has time to observe how these shifts evolve – and is well positioned to adjust rates quickly if necessary.

Canadian commercial real estate the latest trade-war victim – The trade war marks a sharp setback in what otherwise would have been a better year for Canadian commercial real estate. After rebounding from the pandemic, the industrial segment has returned to more normal activity. The multi-family residential market was recovering on lower mortgage rates, but the trade war has paralyzed buyers. The retail property market was gaining traction prior to the trade war but is now expected to regress as the jobless rate rises. For detailed analysis, Click Here.

Canada trade and tariff update – U.S. President Donald Trump met with Canadian Prime Minister Mark Carney this week at the White House, but there was no breakthrough in tariff negotiations. During the press conference, a range of topics were discussed, including a clear message from Prime Minister Carney that Canada is not for sale and not interested in becoming the 51st state. The Globe & Mail's recap of the closed-door lunch noted that President Trump didn't have any specific demands about a trade deal and the conversation also evolved into a discussion on foreign policy.

U.S. trade, China and the ongoing standoff – The U.S. trade deficit rose 14% in March to a record $140.5 billion as retailers and manufacturers rushed to build inventory buffers ahead of new tariffs. This week brought some positive news: China and the U.S. are set to begin talks over the weekend aimed at de-escalating trade tensions. However, the timing of any eventual trade deals with China and other major trading partners remains unclear – along with the rate at which tariffs might ultimately settle. U.S. retailers and manufacturers have shifted into wait-and-see mode. According to FreightWaves, ocean shipping traffic from China to the U.S. has declined by 60%. FreightWaves also estimates that 450,000 U.S. transportation and logistics jobs are at risk due to the import slowdown. Port of L.A. Executive Director Gene Soroka noted that retailers are currently holding five-to-seven weeks of inventory, which should insulate consumers from the full effects of the tariffs near term. FreightWaves CEO Craig Fuller warned that unless tariffs are resolved soon, consumers should expect stockouts and empty shelves by the holiday season. Ryan Peterson, CEO of logistics software company Flexport, cautioned that the U.S. could see a wave of small business bankruptcies if tariff de-escalation with China does not happen soon. The specter of these economic outcomes continues to weigh on investor sentiment and underscores why any positive trade news has been so well received.

Next Week

Datapalooza of a week – CPI, PPI, a variety of manufacturing and industrial production measures.

- **Tuesday 5/13** – U.S. NFIB optimism index, CPI
- **Thursday 5/15** – U.S. initial jobless claims, Retail sales, PPI, Empire State manufacturing index, Philly Fed, Capacity utilization, Industrial production, business inventories | Canada CFIB Business Barometer, Housing starts, Manufacturing and Wholesale Sales
- **Friday 5/16** – U.S. Consumer sentiment

Data scorecard as of May 7, 2025

Equity Market Total Returns						
	5/7/2025 Level	WTD	YTD	2024	2023	2022
S&P 500	5,631	-1.0%	-3.9%	25.0%	26.3%	-18.1%
NASDAQ	17,738	-1.3%	-7.9%	29.6%	44.7%	-32.5%
DOW	41,114	-0.5%	-2.9%	15.0%	16.2%	-6.9%
Russell 2000	1,990	-1.5%	-10.4%	11.5%	16.9%	-20.5%
S&P/TSX	25,161	0.5%	2.7%	21.7%	11.8%	-5.8%
MSCI EAFE	9,152	-0.1%	13.2%	3.8%	18.2%	-14.5%
MSCI EM	612	0.4%	6.6%	7.5%	9.8%	-20.1%
Bond Market Total Returns						
		WTD	YTD	2024	2023	2022
Bloomberg U.S. Aggregate		0.3%	2.7%	1.3%	5.5%	-13.0%
Bloomberg U.S. Treasury		0.2%	2.9%	0.6%	4.1%	-12.5%
Bloomberg U.S. Corporate		0.2%	1.8%	2.1%	8.5%	-15.8%
Bloomberg U.S. High Yield		0.0%	1.4%	8.2%	13.4%	-11.2%
Bloomberg 1-10 Year Munis		0.1%	0.4%	0.9%	4.5%	-4.7%
Bloomberg Canada Aggregate		0.6%	1.3%	4.0%	6.5%	-11.3%
Bloomberg Canada Treasury		0.5%	1.4%	2.9%	5.0%	-9.9%
Bloomberg Canada Corporate		0.5%	1.6%	6.9%	8.2%	-9.5%
Government Bond Yields						
	5/7/2025	Last Month End	Last Quarter End	2024	2023	2022
U.S. 10-Year Treasury	4.27%	4.16%	4.21%	4.57%	3.88%	3.88%
Canada 10-Year Government	3.10%	3.09%	2.97%	3.23%	3.11%	3.30%
U.K. 10-Year Gilt	4.46%	4.44%	4.67%	4.56%	3.53%	3.66%
German 10-Year Bund	2.47%	2.44%	2.74%	2.36%	2.02%	2.57%
Japan 10-Year Government	1.30%	1.31%	1.49%	1.09%	0.61%	0.41%
Currencies & Real Assets						
	5/7/2025 Level	WTD	YTD	2024	2023	2022
USD Index	99.61	-0.4%	-8.2%	7.1%	-2.1%	8.2%
CAD:USD	$0.72	-0.2%	3.9%	-7.9%	2.3%	-6.7%
Bitcoin	$96,794.09	-0.3%	3.3%	120.5%	157.0%	-64.3%
Gold	$3,364.50	3.8%	28.2%	27.2%	13.1%	-0.3%
Oil (WTI)	$58.07	-0.4%	-19.0%	0.1%	-10.7%	6.7%

**Benchmark data does not reflect actual investment performance but reflects benchmark results of the underlying indices referenced. You cannot invest directly in an index. Index definitions can be found at the end of this publication.*

Index Definitions

Equity indices

S&P 500® Index is an index of large-cap U.S. equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

NASDAQ Composite Index is a market-cap weighted index of the more than 3,000 common equities listed on the Nasdaq stock exchange.

Dow Jones Industrial Average ("DOW") is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the Nasdaq.

Russell 2000® Index (Russell 2000®) is an unmanaged index that measures the performance of the smallest 2000 U.S. companies in the Russell 3000® Index.

S&P/TSX Index is a capitalization-weighted equity index that tracks the performance of the largest companies listed on Canada's primary stock exchange, the Toronto Stock Exchange (TSX).

MSCI EAFE Index (Developed Markets —Europe, Australasia, and Far East Index) is a standard unmanaged foreign securities index representing major non-U.S. stock markets, as monitored by Morgan Stanley Capital International. The index captures large and mid-cap representation across 21 developed markets countries around the world, excluding the U.S. and Canada.

MSCI Emerging Markets Index is a market capitalization weighted index representative of the market structure of the emerging markets countries in Europe, Latin America, Africa, Middle East and Asia. Prior to January 1, 2002, the returns of the MSCI Emerging Markets Index were presented before application of withholding taxes.

Fixed income indices

Bloomberg U.S. Aggregate Bond Index is an unmanaged index that covers the U.S. investment-grade fixed-rate bond market, including government and credit securities, agency mortgage pass-through securities, asset-backed securities and commercial mortgage-based securities.

Bloomberg U.S. Treasury Index is an unmanaged index that includes a broad range of U.S. Treasury obligations and is considered representative of U.S. Treasury bond performance overall.

Bloomberg U.S. Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by U.S. and non-U.S. industrial, utility and financial issuers.

Bloomberg U.S. Corporate High Yield Index is an unmanaged index that covers the USD-denominated, non-investment-grade, fixed-rate, taxable corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+ or below.

Bloomberg 1-10 Year Blend Municipal Bond Index is a market value-weighted index which covers the short and intermediate components of the Bloomberg Capital Municipal Bond Index — an unmanaged, market value-weighted index which covers the U.S. investment-grade tax-exempt bond market.

Bloomberg Canada Aggregate Bond Index measures the investment grade, Canadian dollar-denominated, fixed-rate, taxable bond market. It includes treasuries, government-related, and corporate issuers.

Bloomberg Canada Aggregate Bond Index - Treasury is the treasury sub-component of the Bloomberg Canada Aggregate Bond Index, which measures the investment grade, Canadian dollar-denominated, fixed-rate, taxable bond market.

Bloomberg Canada Aggregate Bond Index - Corporate is the Corporate sub-component of the Bloomberg Canada Aggregate Bond Index, which measures the investment grade, Canadian dollar-denominated, fixed-rate, taxable bond market.

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[i] https://www.sifma.org/explore-issues/treasury-market-structure/
[ii] https://fred.stlouisfed.org/series/FDHBFIN
[iii] Capital Markets Fact Book - SIFMA - Capital Markets Fact Book - SIFMA
[iv] note: PPP is purchasing power parity, or the process of converting differing countries' expenditures into a common unit to facilitate apples-to-apples comparison