Issued: June 2025

For investment professionals only

Ashmore

The Inconvenient Truth Behind US Equity Market Exceptionalism (Abridged)

Many global investors were all-in on US stocks at the beginning of the year. Since then, the backdrop has changed. The launch of DeepSeek in China has shaken US hegemony in AI and software. Trump's trade policies bring huge risk to US companies' supply chains and the wider economy.

The average tariff rate rising to around 15% would likely amount to a net tax hike, even if further tax cuts are approved. But most importantly, incremental fiscal stimulus looks increasingly unlikely in the US, given the threat it would pose to financial stability. This is a key signal, as in our view, the expansion of fiscal deficits since 2017 has been the core macro element behind US stock market outperformance.

Quantifying 'US exceptionalism'

- Several factors are widely lauded as underpinning US outperformance: the Dollar hegemony as the world's reserve currency, and US dominance in military, education, and technology (internet; AI).
  - Yet, the US has had these advantages for a century and US stocks did not trade at a wide premium to the Rest of the World over the whole period.

What has changed?

- **The Oil Boom**
  - The shale oil boom increased US oil production by 142.5% between 2010 and 2024. This was a game changer for the US economy. Energy costs fell significantly, demonstrated by negative spread between WTI (US oil) and Brent (Global oil).
  - Growth in US oil production x average WTI price = USD 118bn into US economy each year since 2010.
- **Pro-cyclical fiscal deficits post Tax Cuts and Jobs Act (TCJA)**
  - The historical relationship between the unemployment rate and the fiscal deficit in the US allows us to quantify the size of the 'pro-cyclical' largesse since 2017.
  - After 30 years of tracking, this broke down during Trump 1.0 after TCJA. If the relationship had remained in place, US fiscal deficits would have been, on average, c. 5.7% GDP lower than over past eight years.

A sobering truth (for US exceptionalism)

- Multiplying these excess deficits by nominal GDP leaves USD 12.6trn of excess spending, or USD 1.5trn a year.
- This excess has driven US equity returns exceptionalism. Government deficits were absorbed by companies' bottom line (tax cuts and subsidies), and top line (pay cheques, infrastructure, tech stimulus). They were not absorbed by households or foreign companies as saving rates and net imports to GDP were broadly unchanged.
- Above trend EPS growth since 2017 has added USD 13.0trn to the S&P 500 market capitalisation. This is eerily close to the 12.6bn fiscal deficit largesse we have quantified.

Macro leaves US stocks between a rock and a hard place

- Any fiscal consolidation now would favour a rotation out of US stocks, in our view.
- However, continued fiscal expansion would likely keep inflation higher and raise long-end rates, which would likely be negative for US stocks, particularly growth stocks. Long bond yields already now highest since 2006.

Many opportunities in the Rest of the World

- Germany's bold EUR 1trn infrastructure and energy investments boosting EU GDP growth, EPS, rates, EUR.
- China's stimulus now focused on consumption. Real estate stabilising. Deep Seek a significant driver of re-rating.
- EM ex-China had better macro policies over the last 5-years, leading to many credit upgrades.

Diversification? Think EM

- EM vs DM growth is expected to widen in coming years. A moderation in US fiscal excess will expedite this, in our view.
- Portfolio outflows from the US will likely weaken the dollar, benefitting financial conditions in EM countries.
- A portfolio rebalancing away from US stocks is likely to benefit flows to EM stocks, which are very cheap.
- EM's largest tech companies set to benefit from AI adoption, regardless of whether MAG 7 hegemon is challenged by China.
- EM countries are rich with natural resources critical for all modern industries, including AI, electric vehicles, and renewable energy technologies.
- Aside from Taiwan and South Korea, EM has much lower exposure to the tech sector than the US. EM equities offers diversification to powerful structural growth drivers, including demographics that no longer exist in developed markets.

June 2025

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Emerging View

The inconvenient truth behind US exceptionalism

31 January 2025
By Gustavo Medeiros and Ben Underhill

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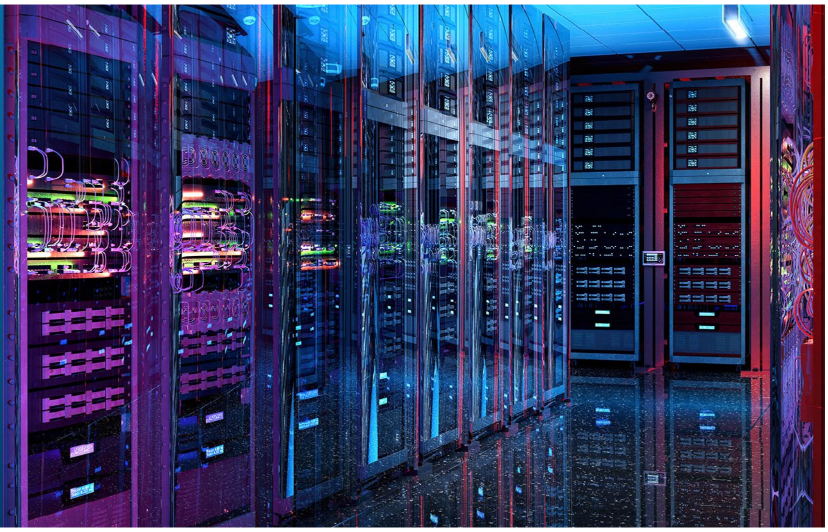

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