

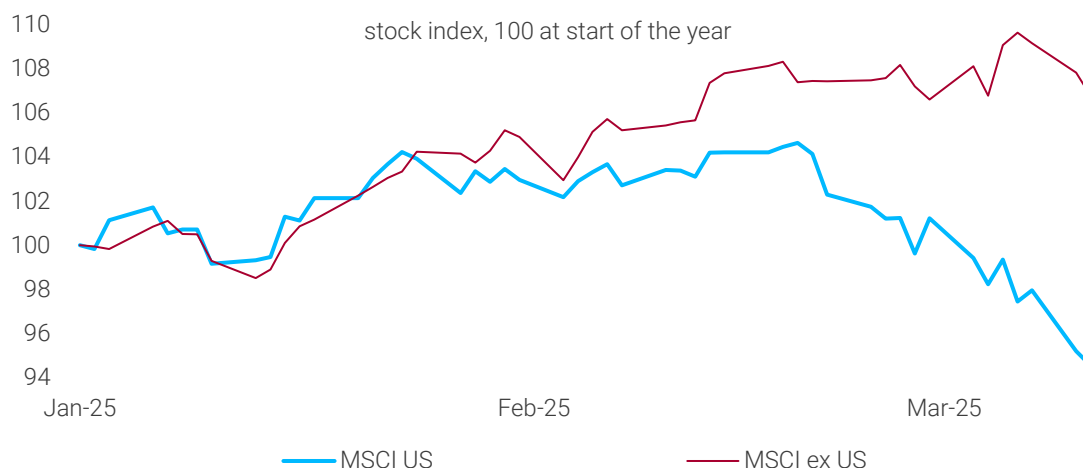
Macro Picture

THE END OF US EXCEPTIONALISM?

Dario Perkins

While it is true that the US economy repeatedly outperforms the rest of the world, that was never a good justification for the US exceptionalism narrative that was so consensus at the start of the year. Either the rest of the world would catch up, or the US would catch down. Right now, we are seeing a bit of both, and there is a chance that realignment continues.

Chart 1: This isn't the US exceptionalism we were promised!



Source: Datastream, TS Lombard

US OUTPERFORMANCE

After Trump's election victory, there was an overwhelming consensus – US exceptionalism. The US economy would continue to beat the rest of the world and US equities would comfortably outperform other stock markets. This is not a new theme: it started a decade ago, reflecting structural forces such as better demographics, faster productivity and a big tech advantage.

A NARRATIVE GONE TOO FAR

There is no real question about whether the US will continue to have an edge over its peers. But we think the consensus is too bearish about growth prospects in the rest of the world. While the post-COVID environment has been particularly challenging for Europe and China, many of the problems have been cyclical rather than structural. The macro situation is not as bad as it seems.

PEAK US DOMINANCE

The US exceptionalism trade has already struggled in 2025, thanks to an increasingly uncertain US policy agenda and hopes that Trump's aggressiveness will force Europe and China to stimulate their economies. We think global stocks can continue to outperform as long as the situation in the US doesn't deteriorate too far. There is no decoupling from a US recession.

THE END OF US EXCEPTIONALISM?

Three months ago, there was a very strong consensus among TS Lombard clients – US exceptionalism. American stocks were the only place you should put your money; and if you tried to make a bullish case for China or Europe, you were dismissed as a “contrarian” who clearly hadn’t understood the seriousness of the crisis facing other parts of the world. (“No tech, incompetent policymakers, ageing demographics, messed-up energy policies, over-regulated, too many bureaucrats and permanent deindustrialization”, as one investor put it, summing up the consensus on Europe as he cut our discussion short.) Of course, this confidence in US economic and market strength is not new. The US has outperformed for more than a decade, and there is every reason to think this will continue. When we break down GDP into its main components – demographics, the capital stock and productivity – it is clear that the US has an advantage in all three areas. Private-sector balance sheets look healthy, and we are starting to see the benefits of a high-pressure labour market. We don’t dispute any of this. While we are sceptical about the macro benefits of AI, this is arguably the healthiest US economy we have seen since the 1990s.

Our issue with the US exceptionalism thesis is that it went too far. It was too optimism about what Trump 2.0 would mean for the US economy, particularly in the short term, and too pessimistic about growth prospects elsewhere. The reason is simple: the consensus was over-extrapolating from the most recent trends, particularly the post-COVID environment, which has been particularly challenging for Europe and China. Various forces have combined to create a distorted view of America’s relative advantage, including: (i) fiscal policy, which was much more expansionary in the US; (ii) the terms-of-trade shock, which had a devastating effect on Europe; (iii) monetary tightening, which has squeezed RoW harder than the US; (iv) the global recession in manufacturing and exports (from which the US was relatively immune); and (v) China’s refusal to stimulate its economy and its bid instead to “derisk” its property sector. The good news is that these recessionary forces are starting to fade. The even better news is that – contrary to the consensus – medium-term growth prospects have improved since COVID-19, particularly when compared with the lacklustre conditions of the 2010s. Add a panicked response to Trump 2.0, which is bringing big fiscal stimulus to China and Europe, and it could be RoW that “outperforms” – at least on a *relative* basis, compared with expectations (which is what matters for markets).

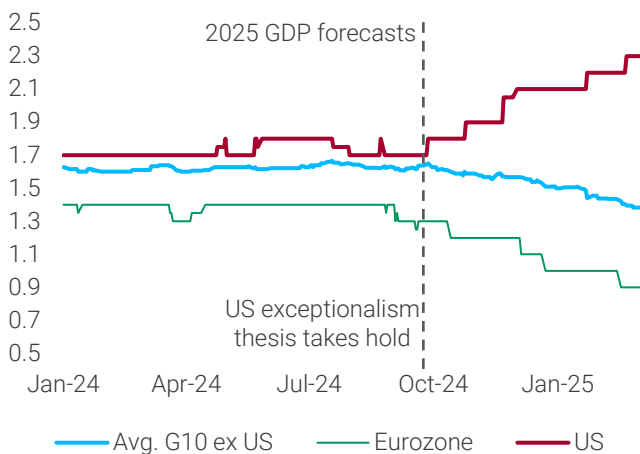
What does this mean for asset prices? It is important to remember that the stock market is not the economy. With that caveat in mind, we see three scenarios for how the US exceptionalism trade unwinds from here, depending on what happens with this highly unpredictable Trump administration. The first scenario is simply a continuation of the recent trend: the policy uncertainty associated with tariffs, deportations and DOGE caps US performance but is not sufficient to trigger a recession. We think non-US stocks would continue to grind higher, narrowing some of their post-COVID differential. The second scenario is where Trump announces various deals, and the policy uncertainty lifts. This would be bullish for all stock markets, and there is no reason why RoW would not participate in the rally. Finally, the third scenario is where Trump’s policies cause more obvious damage to the US economy. Tariffs reduce consumer spending and investment, while DOGE generates material job losses. History suggests this third scenario would be negative for all risk assets and RoW would undoubtedly share in this pain. In previous US bear markets, even those not associated with outright recession, it has been rare to see non-US stocks outperform. Quite the reverse, in fact, because they usually suffer more. China and Europe can outperform only if the US economy continues to grow; otherwise, all bets are off.

1. US OUTPERFORMANCE

When did the US exceptionalism thesis take hold?

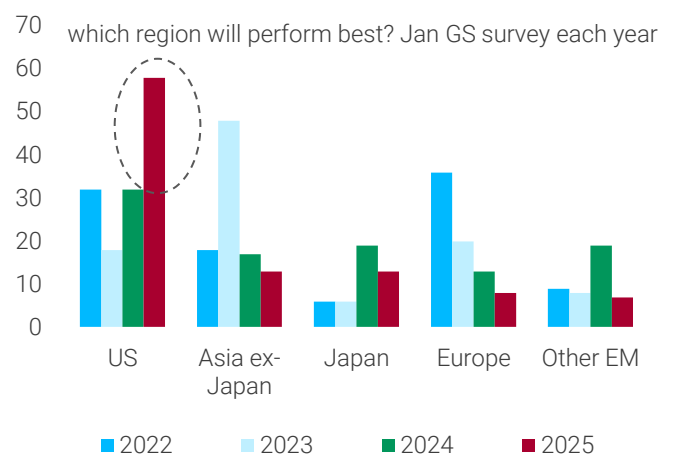
US exceptionalism became a strong consensus theme after the US election. Trump's reflationary policies would boost "animal spirits" and lift economic growth, which would ensure that US stocks would continue to outperform RoW, not least because of their heavy weighting towards AI-related tech. But, in fact, US outperformance started in the mid-2010s and became even more pronounced after COVID-19. Although Americans hated the inflation of the past five years – which is presumably why they voted against Bidenomics – their economy performed well during COVID, at least compared with other developed nations. Since 2023, US-OECD growth differentials have widened to levels rarely seen in the modern era. Usually, this sort of decoupling does not last. Either the RoW catches up or the US catches down.

Chart 2: US forecasters got excited after Trump



Source: Bloomberg, TS Lombard

Chart 3: The US exceptionalism trade

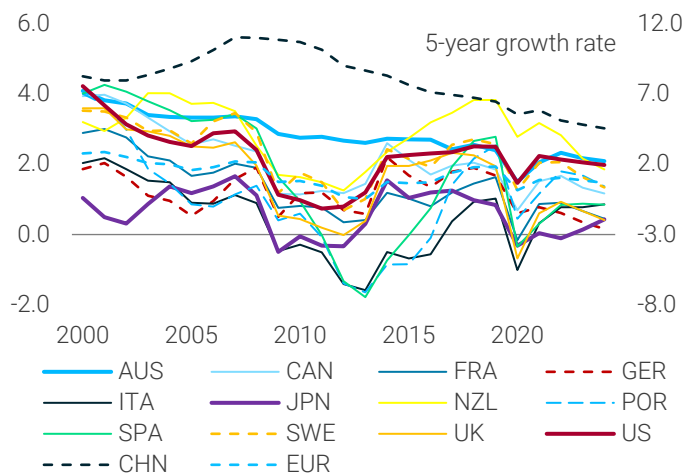


Source: Goldman Sachs via The Macro Tourist

Why does the US economy repeatedly outperform?

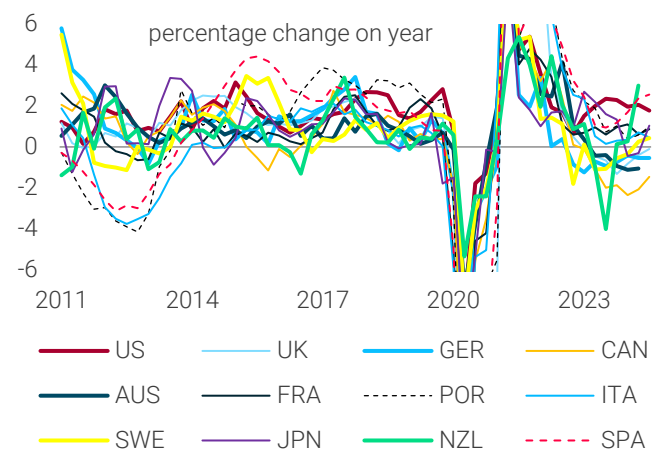
We can use something called "growth accounting" to explain America's economic edge. This decomposes GDP into three components: the labour force, the capital stock and productivity. Since the mid-2010s, the US has had an advantage in all three areas. Demographics have certainly been more favourable, as relatively quick immigration and a younger population have boosted the supply of workers. But the US also has an advantage in *per capita* GDP, which strips out the direct effects of demographics. This advantage is mainly due to productivity, the "secret sauce" of economic growth. Although investment has slowed everywhere (which means the contribution from the capital stock has diminished), the US has continued to enjoy a strong advantage in productivity. According to the [Conference Board's Total Economy Database](#), which provides growth accounting estimates for all the world's major economies, US total factor productivity (TFP) has risen by 0.5%pts per annum, compared with a 0.2%pts decline across the OECD. (Only Germany managed to match the US for TFP growth in the 2010s, but its performance has crumbled since 2020 – something we discuss in more detail below.)

Chart 4: GDP growth



Source: Conference Board, TS Lombard

Chart 5: Uneven per capita GDP growth

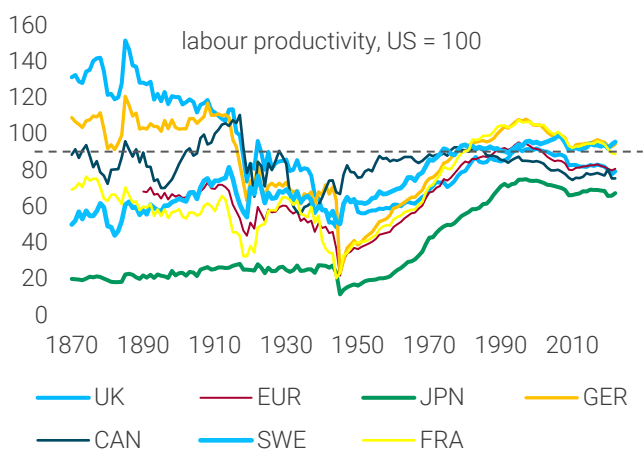


Source: Datastream, TS Lombard

What role does the tech sector play in US outperformance?

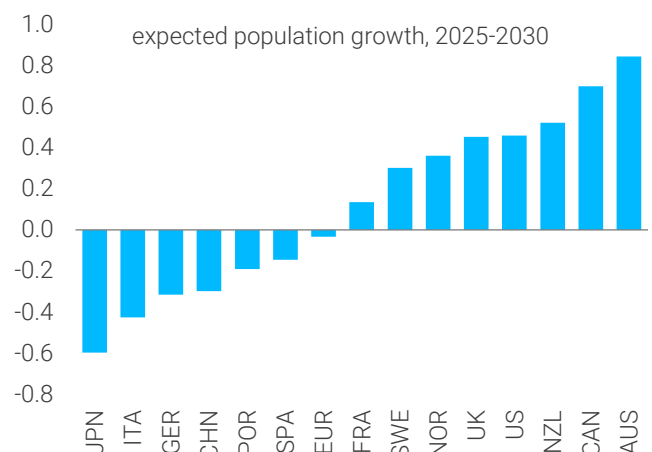
People always cite the US tech sector as the explanation for the country's productivity advantage. Indeed, it features heavily in [the Draghi report](#) as the main reason why the EU has fallen behind. Draghi's analysis argued that once you exclude the tech sector – and its broader economic spillovers – the divergence in per capita GDP between the US and Europe largely disappears (Chart 8). While this is probably an overstatement (the precise “spillovers” are unknowable), there is no doubt the sector is important – and it was certainly a key part of the US exceptionalism trade. But it is hard to know where America's tech advantage comes from. One theory is that the tech sector flourishes in the US because the economy is “less regulated”. There is not much evidence for that. According to the OECD's measures of regulatory strictness, the US scores well on labour market flexibility – it is easy to hire and fire people – but scores poorly on product-market regulation. An alternative theory is that there is a degree of randomness to America's tech advantage. [Paul Krugman points out that industries tend to cluster around regional hubs](#) and the US got lucky with Silicon Valley – in the same way the UK benefits from being a global financial hub (or used to benefit, when the banking sector was a source of growth).

Chart 6: US productivity outperformance



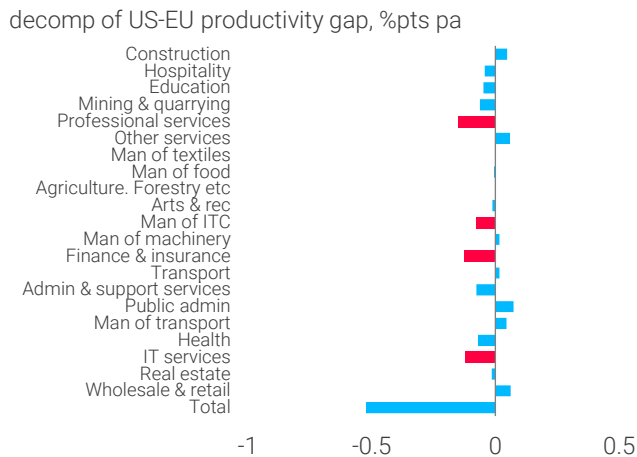
Source: Bergeaud, Cetté and Lecat

Chart 7: The US has a demographic advantage



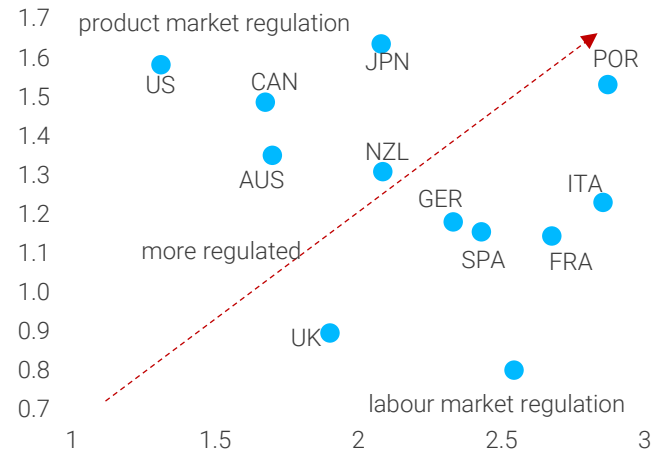
Source: UN projections

Chart 8: Europe's productivity gap



Source: The Draghi Report on European competitiveness

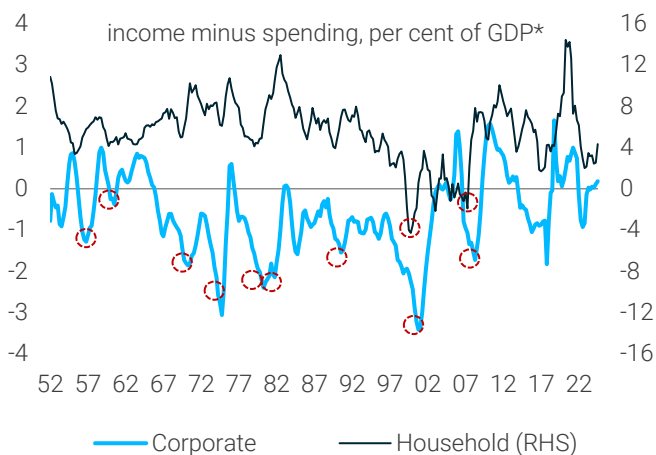
Chart 9: The US labour market is less regulated



Source: OECD, TS Lombard

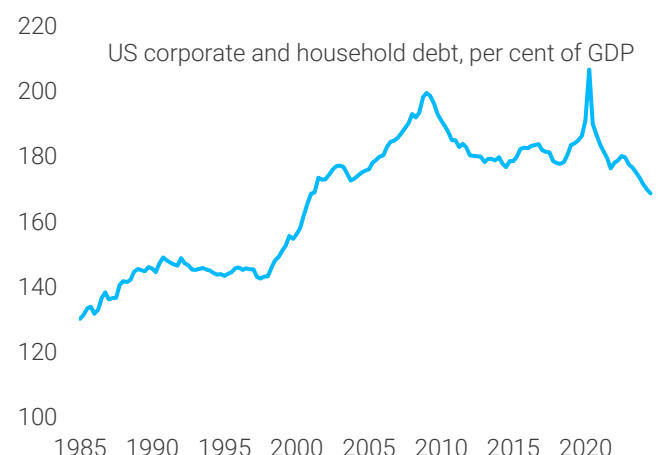
In any case, we are sceptical that the current wave of tech will drive an ever-increasing wedge between the US and other developed economies. While there is evidence that AI can increase the efficiency of specific tasks, there are big question marks about whether it can transform the economy in the way its enthusiasts claim ([as we examined in a previous Macro Picture](#)). And if AI does prove transformative, there is no reason to think the US will be the sole beneficiary, at least in terms of the macroeconomic impact of that technology. (The US may not even be able to retain its industrial edge if the recent success of DeepSeek is anything to go by.) We do not rule out the possibility that what we have been seeing is just a bubble in the US tech sector, fuelled by the Mag7 companies channelling a huge amount of AI investment into NVIDIA.

Chart 10: Private deficits precede recessions



Source: BEA, TS Lombard

Chart 11: Lowest private-debt ratios in 25 years



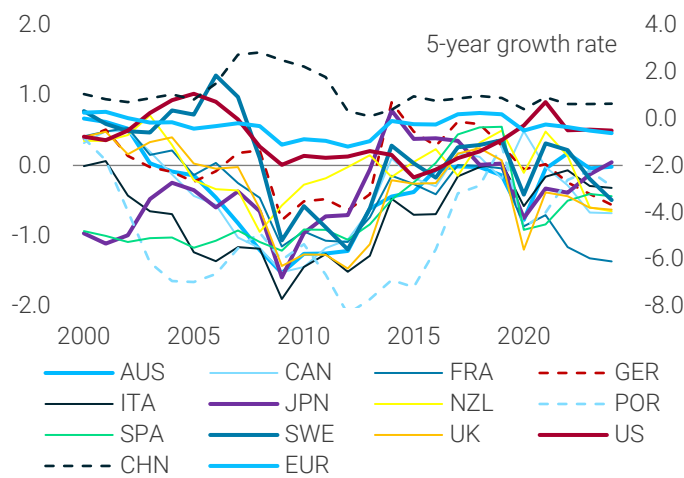
Source: Federal Reserve, TS Lombard

Why are we bullish about long-term growth prospects in the US?

Even though we don't buy all the hype surrounding AI, we are long-term bulls on the US economy, for two reasons. First, private-sector balance sheets look healthy – their healthiest, in fact, since the 1990s. Both households and corporates are in financial surplus – which is unusual, certainly ahead of any downturn – and a decade of deleveraging has reduced private debt levels. (Public debt has gone up, because the government's deficit is the private sector's surplus, but we do not

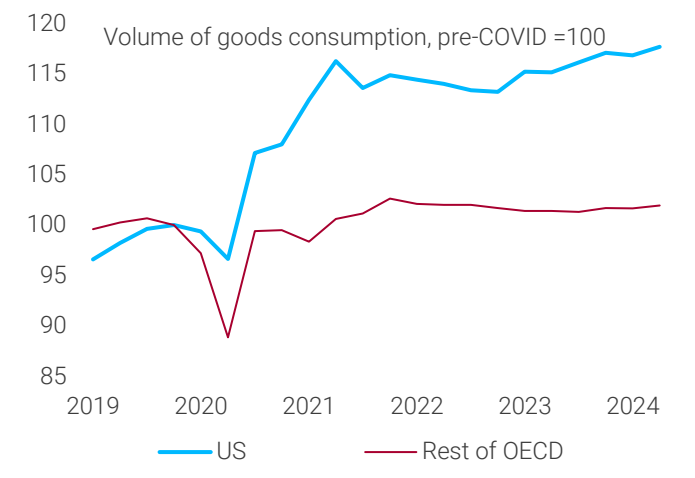
think the US is on the brink of a “fiscal crisis” – [see here](#)). Outside the tech capex, it is hard to identify any underlying macro-financial imbalances (and the economic footprint of tech sector is not huge, especially by the standards of the Dotcom bubble). This means there is room for an acceleration in credit growth, particularly if anxiety about growth blows over, the tariff threat is removed and the new administration is serious about deregulation. Second, the US economy is operating at full employment, creating a [high-pressure environment that is good for investment, productivity and wages](#). Combined with the strength of private-sector balance sheets, this points to faster growth and a more reflationary environment than that of the decade after the global financial crisis (GFC). As long as Trump’s weaponization of uncertainty does not derail anything, there are good reasons to think the US economy has emerged stronger since the pandemic.

Chart 12: Living standards diverged after COVID



Source: Conference Board, TS Lombard

Chart 13: US consumer goods boom



Source: OECD, TS Lombard

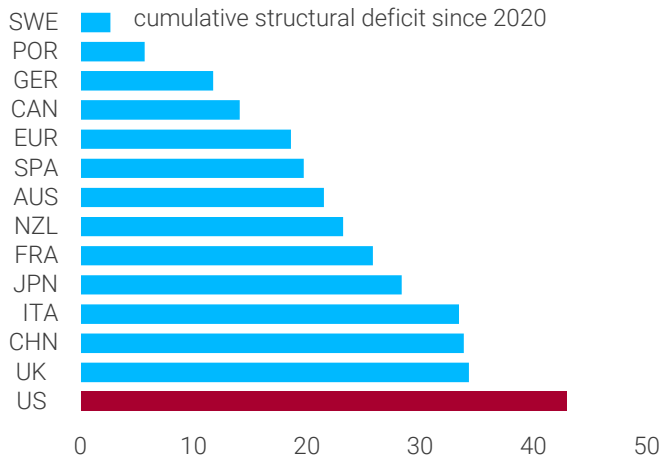
2. A NARRATIVE GONE TOO FAR

Why has the gap between the US and other economies widened since 2019?

While the US economy has emerged stronger from the pandemic, RoW has struggled. Several factors have combined to widen the gap between the two:

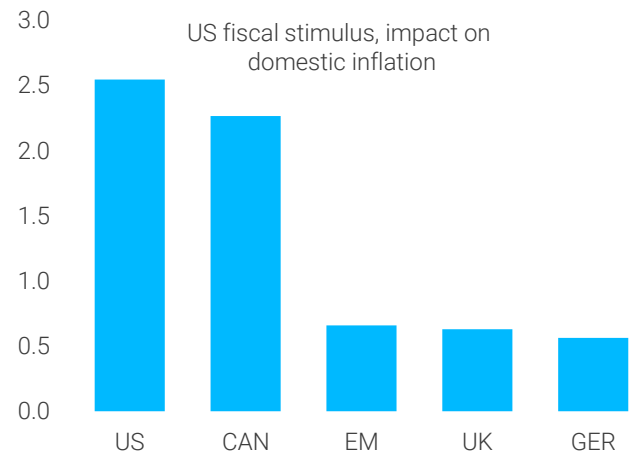
- 1 **Fiscal divergences:** The US government has run large budget deficits since the pandemic, certainly exceeding those of other developed nations and flattering relative US performance. These funds were either spent immediately, providing a direct boost to GDP, or went into “excess savings” and filtered through to the economy over time, providing an important buffer when real incomes were weak and central banks were raising rates. The impact of US fiscal stimulus on the US economy is widely recognized, but there was another, more subtle mechanism whereby big fiscal transfers in the US squeezed consumers in RoW. US demand for consumer goods boomed during the pandemic, causing the prices of those products to surge. But because these goods are traded on international markets, consumers in other parts of the world had to pay “US prices”, too. Amid weaker domestic demand and subdued wages, this was a big squeeze on living standards in other countries.

Chart 14: US has had a bigger fiscal boost



Source: IMF, TS Lombard

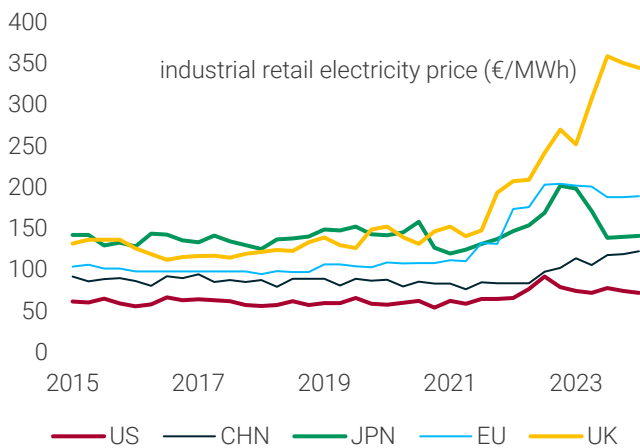
Chart 15: US boom squeezed RoW real incomes



Source: St Louis Fed

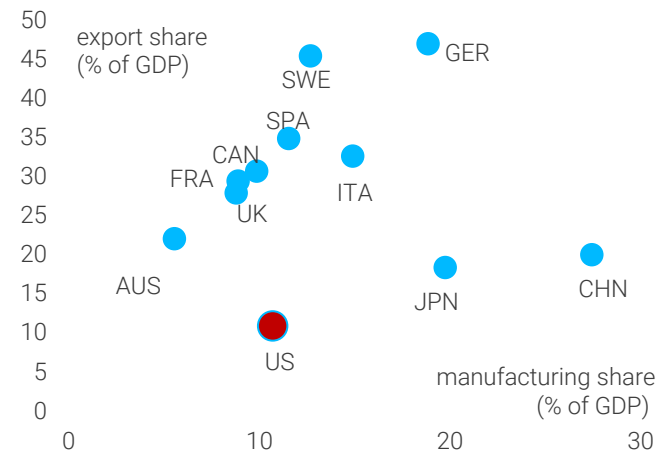
- 2 **Massive terms of trade shocks:** It wasn't just consumer goods prices that surged after the pandemic. Food and energy prices skyrocketed, too, particularly after the war in Ukraine. While the US was relatively immune to these pressures – because it is a net energy exporter – net energy importers in Asia and Europe were hit much harder (especially the likes of Germany, which lost access to Russian gas). Chart 16 shows a big divergence in energy prices after 2022. This was a negative supply shock, which has caused living standards outside the US to decline. (While it is a shock to the level of real incomes, the effect on growth should fade over time.)

Chart 16: US escaped the global energy shock



Source: Bruegel estimates

Chart 17: US not exposed to manufacturing slump



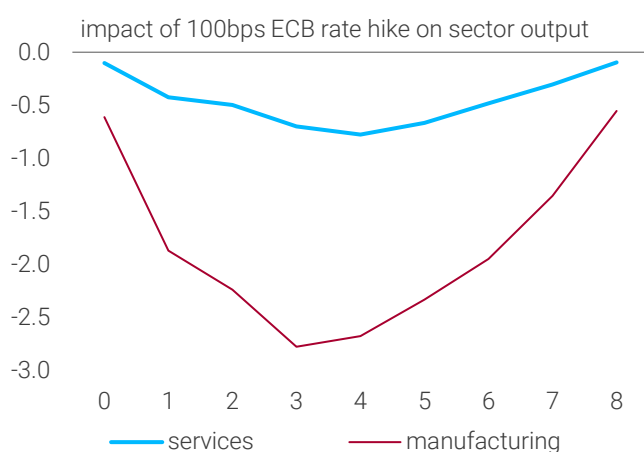
Source: World Bank, TS Lombard

- 3 **Differentiated monetary squeeze:** Central banks raised interest rates in unison, but the impact of that monetary tightening has varied significantly across jurisdictions depending on overall debt levels and the duration/rate-sensitivity of existing loans. This is another area where the US has had an advantage. Remember, the squeeze from higher interest rates comes in two forms: a reduction in the availability of new loans (which means less investment and reduced demand for housing/consumer

durables) and an increase in debt-servicing costs (which means less disposable income for debtors and – if things goes too far – financial distress and a “credit event”). While the first of these effects played out everywhere, debt-servicing costs rose less in the US; that is because US mortgage rates are fixed over very long periods and many US corporates termed out their debt before rates went up.

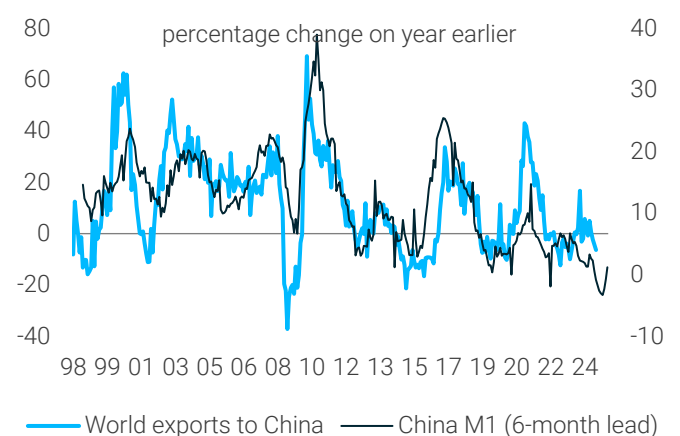
- 4 **The global manufacturing recession:** As the US economy reopened from COVID-19, consumer demand rotated from goods to services. This was good news for the US, because it meant a return to full employment (service-sector demand is basically demand for more workers). But it was terrible news for those economies heavily exposed to manufacturing and international trade. And to make things worse, global manufactures had accumulated significant inventories as a result of all that double ordering when supply chains were snarled up in 2022–23. For big exporters in Europe or Asia, the past few years have, in effect, been a recessionary environment, compounded by the fact that manufacturing activity is particularly sensitive to monetary tightening. (This is another reason why the impact of higher interest rates has not been felt uniformly across countries. A [recent Fed study](#), for example, shows that ECB tightening hit Germany more than other economies in the euro area, in part because of Germany’s outsized manufacturing/trade exposure.)
- 5 **China’s nasty medicine:** As if it weren’t already challenging enough, the international macro environment has been made worse by China’s determination to “de-risk” its property sector and [rebalance growth towards strategically important exports](#). The net result has been an extremely weak domestic economy, which has obviously had knock-on effects for commodity producers, China’s supply chains and those economies that provide capital goods and industrial equipment (another big hit to Germany). Don’t forget that throughout the 2010s, international trade, capital orders and global manufacturing often followed China’s domestic policy cycle, so the authorities’ refusal to stimulate has compounded the weakness of those sectors.

Chart 18: Policy tightening hits manufacturing



Source: Federal Reserve study

Chart 19: China’s slump has hurt global trade



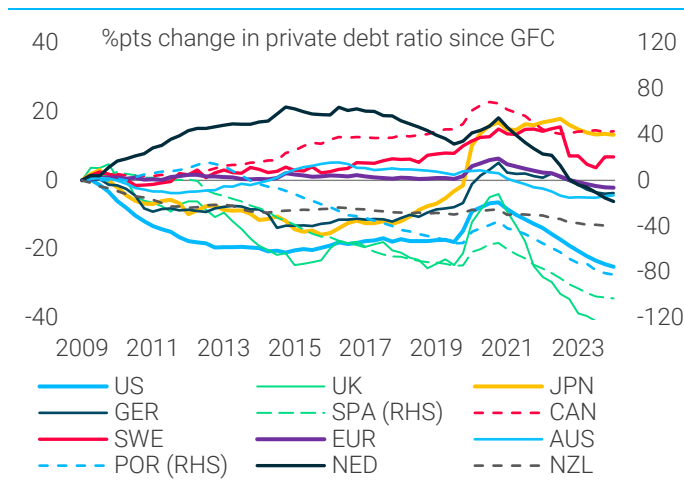
Source: Datastream, TS Lombard

Will these forces unwind and thereby narrow the gap with the US?

Take all the forces mentioned above and it is not surprising that the global economy has struggled over the past few years; in fact, it is remarkable that there has not been a more serious

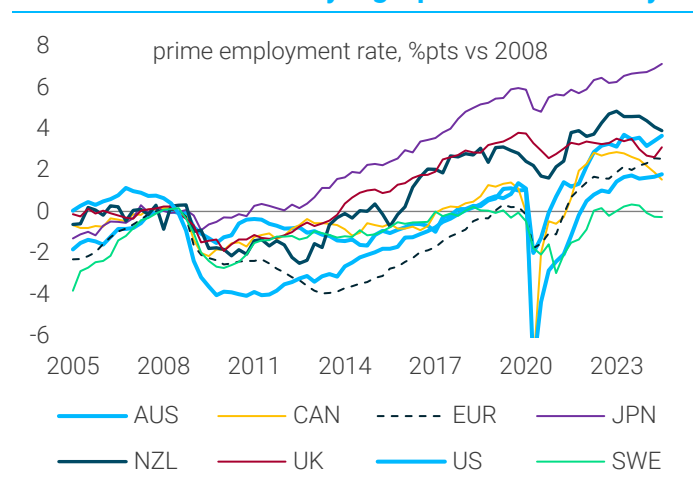
downturn. The good news, however, is that these recessionary forces are beginning to ease. The cost-of-living crisis is over, with wages now outpacing prices in most developed economies. Central banks have been easing monetary policy, which should provide a quick boost to those economies that have struggled most from higher interest rates. Global manufactures have worked off their post-pandemic inventory overhang. China is about to unleash a significant fiscal stimulus, because the weakness in the domestic economy has finally breached the authorities' pain threshold. And the threat of Trump's tariffs (along with reduced US support for NATO) is forcing governments across Europe to significantly increase their defence spending. In fact, after years of the US government comfortably outspending RoW, we could be on the brink of a broad realignment of fiscal policy, particularly if DOGE is successful in cutting government "waste" and trimming the federal workforce. But the basic point is that the post-COVID environment has been particularly difficult for Europe and China and the US exceptionalism thesis was based on the idea that those pressures would remain, perhaps indefinitely. We think that view is wrong, and the consensus has conflated short-term structural pressures with long-term structural decline.

Chart 20: US not the only one to deleverage



Source: BIS, TS Lombard

Chart 21: US not the only high-pressure economy



Source: OECD, TS Lombard

Which economies could match the US over the medium term?

As we explained in the first section of this Macro Picture, the US has had advantages in both demographics and productivity. In terms of the former, the latest UN projections suggest there are not many economies that will match the US over the next five years – only the UK, New Zealand, Canada and Australia. But those forecasts assume a continuation of recent immigration trends. With public opinion moving against immigration, medium-term population projections are more uncertain than usual. If, for example, the new US administration sticks to its plan of mass deportations, US GDP growth could be curbed relative to other countries. But since RoW is planning its own crackdown on immigration – for example, much tougher restrictions were recently introduced in Canada – it is best to assume that demographics is becoming less significant for growth differentials, at least over the horizon that is relevant to investors.

The more interesting story is what might happen on the productivity side. There is definitely a case for a short-term narrowing in productivity differentials as the forces that have restrained non-US demand start to wane. Output is likely to recover faster than employment or hours. But we also think the consensus is too pessimistic about the medium term as well, especially because some of the reasons why we are optimistic about the US also apply elsewhere. The US is not the only economy where private-sector balance sheets are in good shape; many other parts of

the world experienced deleveraging in the decade after the GFC. Even if there is not a strong revival in credit growth – and there may well be one – we are not going to see further deleveraging, which means a big deflationary force is gone. Chart 20 shows that the UK and the euro periphery countries reduced their debt levels more than the US, which is a reason to be bullish about their medium-term growth potential. In fact, there are only a few developed economies where private balance sheets look problematic – namely, those countries, like Sweden and Canada, that did not suffer a banking crisis in 2008 and instead leverages themselves up. Those are the economies that could be facing a medium-term struggle.

Strong balance sheets give countries an advantage when it comes to beating their lousy growth performance of the 2010s, but they are not the only reason for optimism. Most economies are also operating at full employment, which is another advantage compared with most of the decade after the GFC, when persistent slack in the labour market depressed wages, discouraged investment and kept productivity low. Consider, for example, the situation in the euro area, which now has its healthiest labour market for several decades. The ECB spent much of the 2010s battling lowflation, continually deploying QE and NIRP in a bid to ward off the threat of Japan-style deflation. If the central bank can deliver a soft landing here, it could lock in a more reflationary labour market and secure a much brighter medium-term outlook. The euro area is not going to beat the US over the medium term, but it can certainly defy current gloomy expectations. And that's before we get into the potential for positive surprises from European fiscal policy.

Can the defence sector become a growth catalyst for Europe?

We have long argued that Trump 2.0 could be a policy catalyst for Europe. Governments will need to spend more – both in direct support for Ukraine and because the US is threatening to cut its involvement in NATO. Our confidence in this view has only strengthened in recent months, with Germany set to dilute its debt brake and countries across Europe planning big increases in defence spending. There is even talk of deploying pan-European investment funds, like the NextGenerationEU scheme introduced during the pandemic. And we could be talking about a sizeable fiscal boost: [Bruegel estimates](#) that Europe would need to spend at least an extra €250bn per year on defence (1.3% of GDP) and recruit another 300,000 troops. That is a doubling of Europe's defence budget. Of course, the impact on the economy will depend on several factors, including how the spending is financed (higher taxes vs more borrowing), how the funds are spent and whether central banks respond by raising interest rates (because higher rates reduce the fiscal multiplier – the additional GDP generated by each extra dollar of government spending).

Most governments in Europe spend 1–1.5% of GDP on defence, around half of which is spent directly on the military and the rest goes to the defence industry (private companies involved in the production of defence goods and services). When people think of governments spending more on defence, they imagine them buying more bombs and recruiting more soldiers. The fiscal multiplier on those sorts of activities is not very high (the consensus is for a multiplier of around 1.0, although academic studies come with wide confidence intervals and a huge range of estimates). And if Europe wants to increase its defence spending rapidly, it is going to have to import defence equipment from RoW – particularly the US – which will also reduce the impact of that fiscal boost to European output and employment. Europe's defence sector – that is, the part of manufacturing involved in the production of defence equipment – is tiny: our estimates suggest it is worth just 0.5% of GDP, 0.75% of employment and perhaps 1–1.5% of exports. But it would not be a bad idea for Europe to channel more resources into this sector over time. Not only are these typically high-productivity/high-wage manufacturing jobs, but they are also good for economy-wide R&D. Since almost half of the people employed in this sector are working in areas like science, technology, engineering and maths, it is not surprising that studies often find

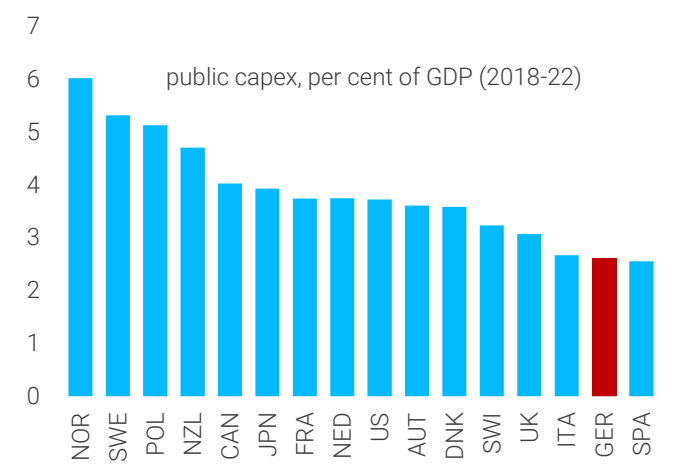
powerful spillovers in terms of innovation and productivity. If increased defence spending is successfully implemented, Europe may have stumbled upon an important growth catalyst.

Chart 22: Decades of German austerity



Source: OECD, TS Lombard

Chart 23: Germany has underinvested



Source: IMF, TS Lombard

3. THE END OF DECOUPLING

What happens next?

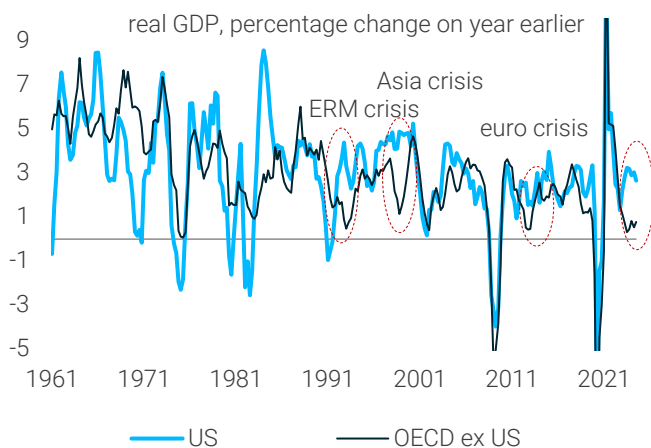
Even if the US economy maintains its medium-term performance edge, the past four years has created a distorted view about the underlying growth differential between the US and RoW. History suggests this sort of gap rarely persists, either because RoW catches up (the bull case) or because the US catches down (the bear case). Since we first heard the US exceptionalism thesis in December, we have been assuming that investors were too bearish about prospects in RoW: we posited that the temporary restraints on activity would fade and Trump's tariff threats would trigger more expansionary policies from China and the US. That is still our base case, but it is true that the risk of the US "catching down" has also increased. Tariff uncertainty is damaging business confidence, DOGE is threatening to undermine the resilience of the US labour market, and the Fed is suddenly a lot less inclined to cut interest rates, which is jeopardizing the soft landing. While we still think the US will avoid a recession, the risk has certainly increased. And that risk is higher than it was two years ago – the last time everyone was obsessed with the "R" word. Labour shortages have gone, and profit margins have narrowed. Faced with a shock to demand, US companies will likely start cutting staff levels, which is what triggers the classic reflexivity of a recession. Job cuts reduce spending and corporate revenues, leading to further jobs cuts.

Why don't we expect a US recession?

There are currently two main threats: tariff uncertainty and DOGE spending cuts. On tariffs, we think the uncertainty will encourage companies to put their spending plans on hold rather than actively shrink the size of the workforce. As in 2018–19, this would create a soft patch in the economy rather than a genuine recession. Tracking estimates of Q1 GDP (such as GDPNow), which are suddenly attracting a lot of attention as a potential recession signal, are certainly exaggerating the extent of the slowdown, particularly this early in the quarter. But the impact of DOGE as a potential recessionary force is more intractable, because it is hard to get a sense of

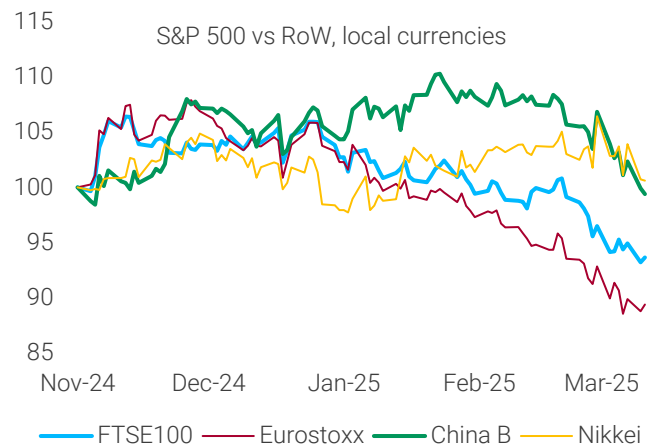
what Elon Musk and his protégés are really up to. They are making bold claims about cutting government “waste” but there is no real transparency about how many federal employees will lose their jobs and we don’t know how many cost savings they will find. What we do know is that the Federal government accounts for just a small fraction of total employment, and it is hard to believe the US is genuinely adopting “austerity” unless Musk and Co. extend their cost-cutting campaign to entitlements. (We shouldn’t forget that the Trump administration is also planning to reduce taxes, and there is even talk of returning DOGE savings to taxpayers in the form of COVID-style stimulus cheques.). We will need to monitor this situation closely, particularly in terms of how it affects the labour market. Our next Macro Picture will look at these risks in detail.

Chart 24: Decoupling is usually fleeting



Source: OECD, TS Lombard

Chart 25: US underperformance in 2025



Source: Datastream, TS Lombard

What does this all mean for stock markets? Can RoW outperform?

US exceptionalism always sounded like hubris; and, so far, the thesis has not played out the way it was supposed to. Since the thesis became popular, US equities have underperformed other major markets, including China and Europe. There are specific reasons for this, with Chinese tech and European defence stocks doing particularly well. (Since the defence sector is a tiny part of the European economy, big increases in government spending will radically transform the long-term revenues of companies like Rheinmetall, BAE systems and Rolls Royce, so it is not surprising that their valuations have rocketed.) Yet we think there is more to the story than just these specific factors; and if we are right about US-RoW growth differentials narrowing, it is possible that the whole US exceptionalism thesis is about to get flipped on its head, especially as the gap in terms of market valuations still looks extreme.

It may sound counterintuitive, but global equities can outperform – or at least match – the US only if US stocks do not fall too quickly or too far. That’s because there is a fine balance between asset managers reallocating capital from the US to other markets and a serious “risk-off” event that triggers a broad-based equity plunger. Table 1 shows what happened during previous bear markets, focusing on those with specific US catalysts. The 1987 crash, LTCM, the Dotcom bubble – in each of these episodes, markets plunged in tandem and there was no advantage to holding non-US stocks. The reasons are obvious. Equities are risky securities and when people panic about the US, they also panic about every other market, dumping stocks and moving to safer assets like government bonds. This is a rational response, particularly given America’s dominant role in the global monetary system and the financial/ trade linkages between the US and other economies. If the US suffered a recession, there are good reasons to think RoW would follow.

Table 1: Global markets never shake off US bear markets

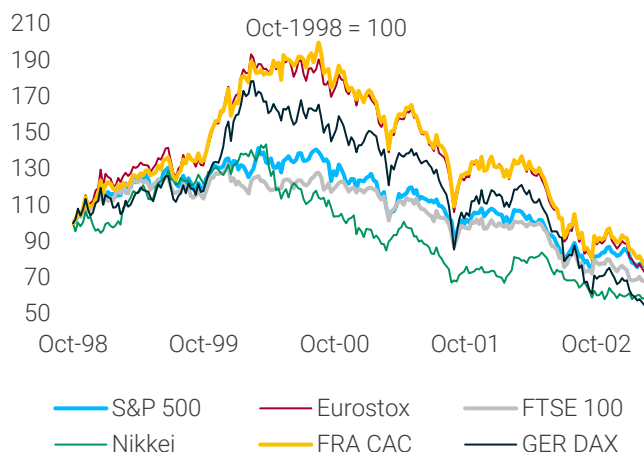
	SPX	Eurostoxx	FTSE 100	Nikkei	Fra CAC	Ger DAX
1987	-32.7	-31.4	-27.3	-10.2	-30.5	-32.8
1998	-19.0	-33.0	-23.2	-22.1	-32.1	-36.1
2001	-46.1	-59.0	-45.9	-49.0	-58.4	-64.6
2018A	-9.1	-7.0	-5.8	-7.5	-6.0	-7.8
2018B	-16.5	-13.2	-9.2	-15.5	-15.4	-15.5
2022	-23.3	-18.9	-6.2	-6.2	-15.1	-19.6

Source: Datastream, TS Lombard, 2018A – Volmageddon, 2018B – US trade war with China

Bearing this in mind, we see three scenarios for how the US exceptionalism theme ends; and each has very different implications for whether investors can remain bullish on RoW:

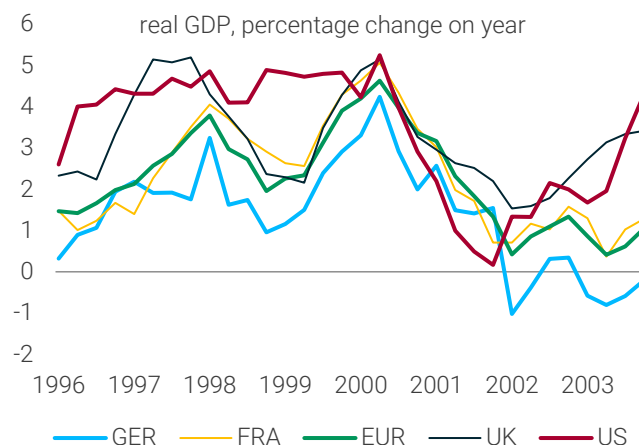
- 1 **US recession/bear market:** All stocks fall in tandem. The US exceptionalism trade is wrong, but there is no advantage to holding other equity markets instead. (Perhaps RoW would fall by less, but that isn't what happened in the past, even though it is rare to see the sort of divergence we have seen recently: there was no divergence in Dotcom, when European equities matched the US during the bubble – Chart 26).
- 2 **Trump uncertainty caps US stocks, but no big bear market:** So far, this has been the story of 2025. The threat of tariffs and DOGE cuts in government spending have stopped US stocks from rising, but there has not yet been any damage to the economy. Meanwhile, global stocks have started to catch up, because a lot of bad news was already priced into foreign markets and because Trump's threats are forcing other governments to stimulate their economies. We think this can continue as long as it is just a US soft patch and not the start of a genuine recession.
- 3 **Uncertainty recedes/US melt-up:** It is possible (still) that Trump is bluffing and that he will strike a series of trade and military deals that end the threat of tariffs. The risk of a US recession would diminish, triggering a relief rally in stocks and perhaps even the return of the bull market. We see no reason why RoW wouldn't participate in this rally, leading to broad based equity gains – especially as the terms of any deal are likely to ensure that governments in China and Europe continue to pursue growth-friendly macroeconomic policies.

Chart 26: Dom crash hit Europe just as hard



Source: Datastream, TS Lombard

Chart 27: Dotcom recession spread to Europe

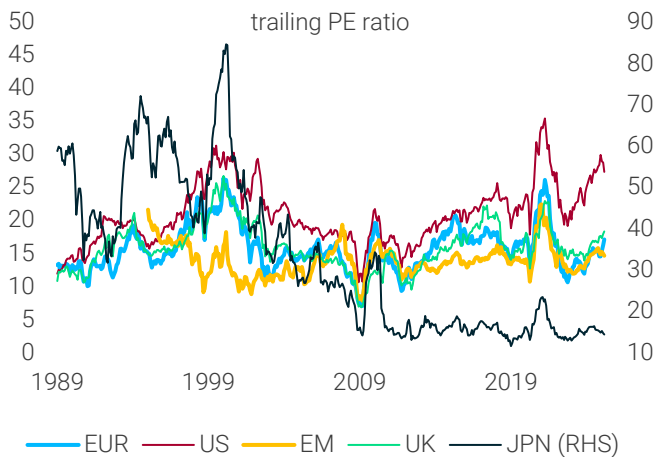


Source: Datastream, TS Lombard

Bottom line

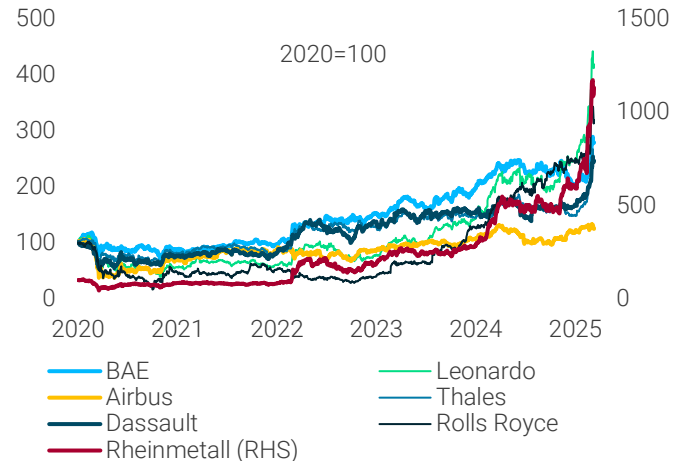
US macro and market outperformance is not a new theme. It emerged in the 2010s and reflects American advantages in terms of demographics, productivity and a vibrant tech sector. But the divergence between the US and RoW has been particularly pronounced since COVID-19; and until very recently, this had fuelled talk of “US exceptionalism” – the idea that the US was the only place to invest. We were never comfortable with this narrative, and it now seems to be unravelling. Either RoW would catch up, or the US would catch down. Right now, we are seeing a bit of both – investors had been too optimistic about the US, and they were too pessimistic about the rest of the world. We think this convergence in economic fortunes can continue, but only if the situation in the US doesn’t become too toxic. There is a fine balance between asset managers reallocating capital away from the US, and a global volatility shock that forces investors to dump all risk assets simultaneously. And the global economy would not be able to decouple from a US recession, even if that recession were self-inflicted or the result of an unforced policy error.

Chart 28: US stocks most exposed to downturn?



Source: Datastream, TS Lombard

Chart 29: The European defence boom



Source: Datastream, TS Lombard

Authors



Dario Perkins
Managing Director,
Global Macro

Disclaimer

This report has been issued by TSL Research Group Limited in conjunction with its subsidiaries Lombard Street Research Limited, Lombard Street Research Financial Services Limited, and Trusted Sources UK Limited (together "TSL Research Group"). This report is intended to be viewed by clients of the TSL Research Group only. The contents of this report, either in whole or in part, shall not be reproduced, stored in a data retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise without written permission of TSL Research Group.

The information and opinions expressed in this report have been compiled from publicly available sources believed to be reliable but are not intended to be treated as advice or relied upon as fact. Neither TSL Research Group, nor any of its directors, employees or agents accepts liability for and, to the maximum extent permitted by applicable law, shall not be responsible for any loss or damage arising from the use of this report including as a result of decisions made or actions taken in reliance upon or in connection with the information contained in this report. TSL Research Group does not warrant or represent that this report is accurate, complete, or reliable and does not provide any assurance whatsoever in relation to the information contained in this report. Any opinions, forecasts or estimates herein constitute a judgement as at the date of this report based on the information available.

There can be no assurance that future results or events will be consistent with any such opinions, forecasts, or estimates. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied is made regarding future performance. This information is subject to change without notice, its accuracy is not guaranteed, it may be incomplete or condensed and it may not contain all material information concerning the company and its subsidiaries. The value of any securities or financial instruments or types of securities or financial instruments mentioned in this report can fall as well as rise. Foreign currency denominated securities and financial instruments are subject to fluctuations in exchange rates that may have a positive or adverse effect on the value, price or income of such securities or financial instruments. This is a generic research report and as such does not have regard to the specific instrument objectives, financial situation, and the particular needs of a client. Clients should seek independent financial advice regarding the appropriateness of investing in any of the types of financial instrument or investment strategies discussed in this report.

By reading this report you accept [TS Lombard's terms and conditions](#).

Registered Office: John Carpenter House, John Carpenter Street, London, England, EC4Y 0AN. Registered in England No. 10232483