

The Way We See It

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How long is “American Exceptionalism” going to last?

A brief update report which serves to review the recent market development and to offer our outlook for the rest of the year and beyond.

Review of Developments

- Global Economies

On growth dynamics, the latest estimate of the U.S. Q4 GDP compiled by the Atlanta Federal Reserve showed a mild deceleration of U.S. growth: from a 3% annualised rate of growth, Q4 is now forecast to grow at 2.4% p.a. While consumer spending growth is estimated to remain relatively robust, real private CAPEX spending is forecast to have declined. Uncertainties relating to the U.S. election, together with the forthcoming domestic and trade policies of the re-elected Trump-led Republican Party, may have slowed CAPEX spending.

Europe is expected to show a stable to mild rise in its Q4 GDP versus both the previous quarter and over a year ago. Japan is projected to see a small positive, albeit decelerating, pace of growth in Q4.

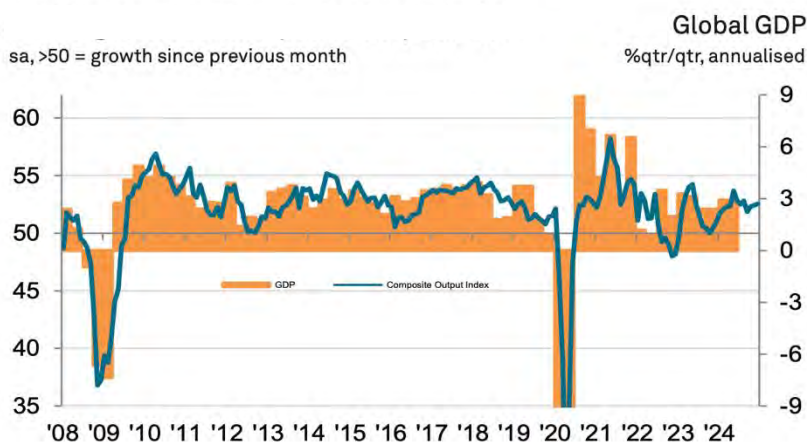
In China, despite the government's attempt to reflate the struggling property and domestic consumption sectors, the latest partial economic data remained mixed. Private economic firms estimated that China's

real GDP could be much lower than the government's re-assurance that the economy is growing at around 5% p.a. in 2024. As a result, domestic and global investors continue to hope that, in 2025, the government will implement bolder and larger fiscal measures to boost the confidence of Chinese households and the private corporate sector.

On the inflation front, in the case of Europe and other OECD countries, headline and core inflation indicators continued to decelerate, thus raising expectations of further rate cuts. In the U.S., the inflationary trend has also been favourable. However, the core rate has not managed to fall below the annual 2.5% level convincingly as yet. In spite of this, the Fed just delivered an additional 25bps rate cut in the December FOMC meeting, based on their desire to reach neutrality, given the balance of downside and upside risks.

Nonetheless, the Fed warned that the need to cut rates further has been reduced substantially. This is based on their assessment that the latest batch of economic data shows that the U.S. core inflation rate remains stubbornly high, and that the U.S. employment sector continues to show signs of strength.

J.P.Morgan Global Composite PMI™



Source: J.P.Morgan, S&P Global Market Intelligence

Finally, while global geopolitical risks have not gone away, they have improved somewhat. The military conflict between Israel versus other warring Arab countries has definitely been cooling down. However, tensions between Russia vs Ukraine remained high. In addition, trade tensions between China and the U.S. remain elevated, particularly as the Republican Party continues to target China as an unfair trading partner.

- Global Markets

Following a strong November month and Q4 quarter, the Santa rally in Equities in the U.S. and globally fizzled out in December. Profit-taking and portfolio rebalancing activities, combined with a worrying rise in long-dated bond yields, pulled the U.S. and other global equity markets down.

Markets' volatility remained high. Positive factors were negated by adverse ones, resulting in a more volatile and thin trading environment.

- Positive factors include the continuing AI revolution in the U.S., global upgrades of economic and corporate earnings, hopes for the continuation of the implementation of an easy monetary policy in the U.S. and OECD bloc, and that the big-spending fiscal trend in the U.S. will continue.
- Negative factors firstly include the desire to lock in profits following a strong quarter and year in equities. In addition, portfolios which are managed based on a fixed asset allocation principle, had to rebalance their portfolios by reducing their exposure to winners (equities) and adding to losers (bonds). Moreover, an increasingly expensive valuation of U.S. equities against rising bond yields and overseas equity peers forced some asset allocators to rebalance. Furthermore, a number of experienced investors, who became worried when they saw signs of FOMO buying of hot stocks and the terms "American Exceptionalism" bandied around frenetically in financial papers and social media, also sold.

Equity markets retrieved in December due to profit-taking & portfolio rebalancing.

Near-term performance of various asset classes

Asset Class	US Equities	Global Equities	Global ex US Equities
Index	MSCI USA	MSCI World	MSCI World ex USD
1 month	-2.54%	-2.57%	-2.66%
3 months	2.79%	-0.07%	-7.36%
FY 2024	25.08%	19.19%	5.26%
FY 2023	27.10%	24.42%	18.60%

Asset Class	US Corporate	US Treasury	US Aggregate
Index	Bloomberg US Corporate	Bloomberg US Treasury	Bloomberg US Agg
1 month	-2.08%	-1.59%	-1.70%
3 months	-3.04%	-3.14%	-3.06%
FY 2024	2.13%	0.58%	1.25%
FY 2023	8.52%	4.05%	5.53%

Asset Class	Global Govt Bonds	Global Aggregate	Global Commodities
Index	Bloomberg Global TSY	Bloomberg Global Agg	CBR
1 month	-2.27%	-1.96%	3.41%
3 months	-5.99%	-5.10%	4.13%
FY 2024	-3.58%	-1.69%	12.47%
FY 2023	4.18%	5.71%	-5.01%

Asset Class	GEM Equities	Asia ex Japan Equities	China Offshore
Index	MSCI EM	MSCI AC Axl	MSCI China
1 month	-0.09%	0.19%	2.69%
3 months	-7.84%	-7.41%	-7.66%
FY 2024	8.05%	12.51%	19.67%
FY 2023	10.27%	6.34%	-11.04%

Source: GOJI, MSCI, Bloomberg; data as of 31/12/2024

The global equity universe, in USD terms, declined in December by 2.57%. The U.S. saw a fall of 2.54%, while the global ex-U.S. equity universe fell by 2.66%. Against the trend, Chinese equities rose (offshore China: +2.69%, China A: -0.92%). For the full year, equity returns in the U.S. were spectacularly strong, following a robust 2023 year.

U.S. Treasuries and other domestic and global fixed income markets also recorded negative returns in December, as bond investors fret over a potential return of inflationary and strong growth conditions under Trump's second term. For the full year, bond investors did not do well, as Cash beat Bonds.

The USD rose against many currencies against the world, as "American Exceptionalism" rules the airwaves, U.S. bond yields rose strongly and the Fed signaled a pause in its monetary policy.

The Commodities complex rose, helped by a rise in energy prices.

Market Outlook

First, the latest data on the equity positioning of Discretionary/Fundamental and Systematic investors during the month showed that both Discretionary and Systematic investors have been taking profit and reducing their equity exposure modestly.

Discretionary vs Systematic Equity Positioning



Source: Deutsche Bank Asset Allocation

In the month, traders and investors' sentiment fell modestly, oscillating between Fear and Neutral.

Fear & Greed Index

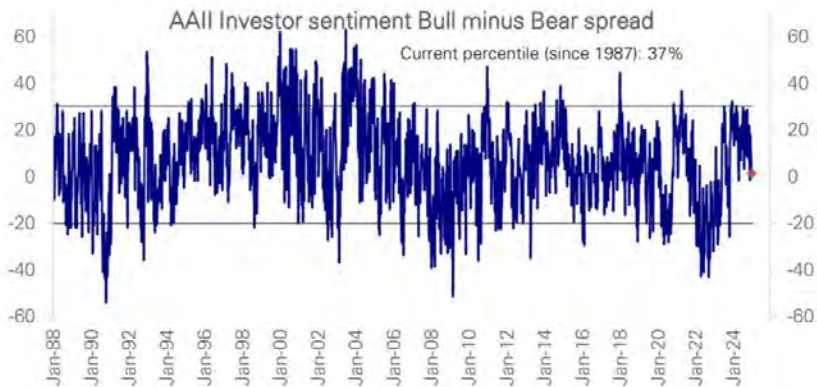
- What emotion is driving the market now?



Source: CNN Business
Last update January 3 at 7:00:00 PM ET

Investors have been reducing equity exposure modestly.

Investor Sentiment
- Investor bull minus bear spread



Data as of January 1 2025
Source: Barron's, Haver Analytics, Deutsche Bank Asset Allocation

Short-term Technical Analysis

Firstly, our technical charts suggest that the world leading equity indices, the Dow Jones and S&P 500, remain in a long-term bull market, supported by the Golden Cross which was formed in October / November 2023.

In the shorter-term, the above indices have become somewhat overbought. Following the profit taking and rebalancing activities, the momentum of major U.S. equity indices has declined towards a more neutral stance.

S&P 500 Stock Price Index



Source: MarketWatch.com

**Long-term bull market
remains; overbought
in shorter-term.**

Consolidated Equity Positioning



Source: Deutsche Bank Asset Allocation

In the month December, following a very strong performance in equities in previous periods, Discretionary/Fundamental investors reduced their exposure to equities.

In the Special Section on Bonds below, since October of last year, we argued that equities have had a great run since the recent lows in August. While there may be some more upside in the short-term, driven by continuing positive newsflow in the U.S. and China, euphoric investors' sentiment, strong equity price momentum which attracts FOMO buying, given the significant rise in bond yields, we caution against joining the ecstatic crowd and chase equities at any price.

We also advocated to use the strength of the equities market to reduce the overweight exposure back to neutral. The rationale of this change is outlined in the Special Section below.

GOJI: use equity market strength to reduce o/w exposure.

The Way We See It

- Global Markets and Investment Thematics

At GOJI, we advocate a two-pronged strategy to invest in risk assets.

While our shorter-term tactical (3-6 months) and long-term strategic (1-2 year) views may differ substantially, since the end of November 2024, we have been advocating a risk-adjusted stance towards equities. In other words, we suggested to reduce any overweight in expensive and popular hot stocks and to adopt an overall Risk-Neutral stance in a multi-asset portfolio.

Long-term Risk-Neutral Strategy Rationale:

As outlined in our Global Investment Outlook for 2025, and our recent monthly reports, it is our belief that both fundamental and quant-driven investors have priced in, positioned for and have been prepared to pay up for a best-case scenario of a pro-growth and pro-equities/-crypto investment scenario under Trump 2.0.

A Goldilocks scenario, but with rather expensive equity valuations in a rising bond yield environment. Hence our hesitation to be overweight equities from a long-term strategic viewpoint.

Thus, our long-term strategy recommendation continues to advocate to hold a neutral exposure to risk assets, with a modest underweight exposure to expensive risky growth assets, and overweight cash and less volatile quality assets.

Risk-Neutral Tactical Rationale:

In early August, we took advantage of the massive fall of risky assets (caused by factors which are well known to all by now - please refer to GOJI's September issue), to recommend to our clients to buy them, and build a moderate overweight exposure in U.S. and global equities.

Our tactical bullish view then changed in our November 2024 report, advocating a Risk-Neutral stance.

GOJI: long-term continues to hold a neutral exposure.

GOJI: tactically also reduced o/w in risky assets in past two months.

Postscripts

Special Section #1: Are the Bond Vigilantes Right?

It is interesting to note that even before Trump won the 2nd term, following the Fed's jumbo cut in the Fed Fund rate in September, bond yields already started to rise. The reason is that bond investors, who usually are more prepared to take a longer-term macro view than their equity counterparts, began to worry that the Fed probably panicked unnecessarily.

This reversal of trend in bond yields worsened following the Trump re-election win. This is particularly caused by Trump's tariffs hikes tweets and his proposed pro-growth economic policies (tax cuts, manufacturing re-shoring, new CAPEX spending, and so on). In other words, investors are concerned that U.S. inflationary pressures could be re-ignited and that the Fed may be forced to tighten rates again.

Currently, a not-small number of bond investors are not convinced that a 4.60% p.a. yield on a 10-year U.S. government bond is sufficiently high to compensate them for the above-mentioned risks.

In brief, should the 10-year benchmark bond yield head towards 5% p.a., and given that the U.S. equity market is trading at a forward P/E of 22.3X (versus a 5-year average of 19.7X) and an 1.3% annual dividend yield, U.S. equities are very expensive against fixed income.

What this means is that corporate earnings growth should rise substantially and beyond what analysts are currently forecasting (revenue growth of +5.8% and EPS growth of +14.8% pa in 2025, versus +5% and +9.5% respectively in 2024, respectively) to compensate equity investors adequately.

Special Section #2: American Exceptionalism - A Secular trend, since 1831

According to Wikipedia, the terms "American Exceptionalism" were rooted deep in the history of America since 1831. See excerpt from Wikipedia (overpage, on the right).

Fast forward two centuries, one cannot but pay attention that the airwaves of the modern financial and social media are saturated with the praise for American Exceptionalism to describe three key aspects of the all-powerful America:

- First, the grand political standing under Trump 2.0;
- Second, the vibrant and productive American economy, and;
- Third, the incredible technological advances in America, and the ensuing boom in American equity and other financial markets.

How do we view this phenomenon?

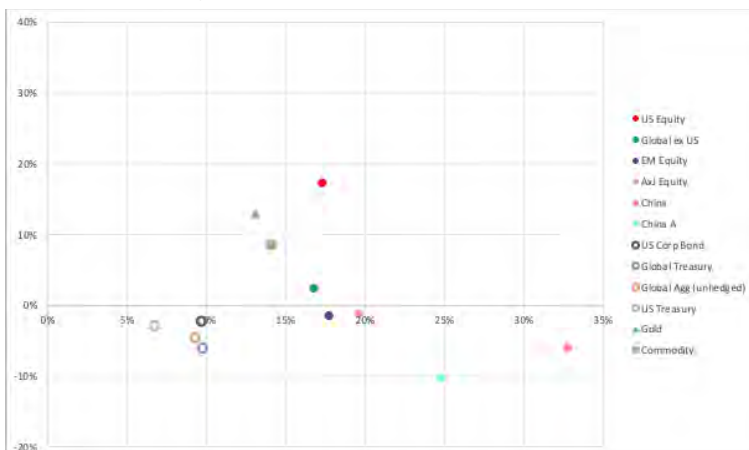
One cannot deny the powerful influence of America in all aspects of the political, military, social, technological and financial domains in the world.

As we will try to limit our observations to the technological and financial universes, we wish to share with you the following historical risk / return quadrants which show the performance of key asset classes, with a special emphasis of the U.S. versus its global counterparts.

We show the relative risk-adjusted returns data over three distinct periods, from the short (3-year) to long (10-year) periods.

Risk & Return of Various Asset Classes

3-year Risk-adjusted Returns

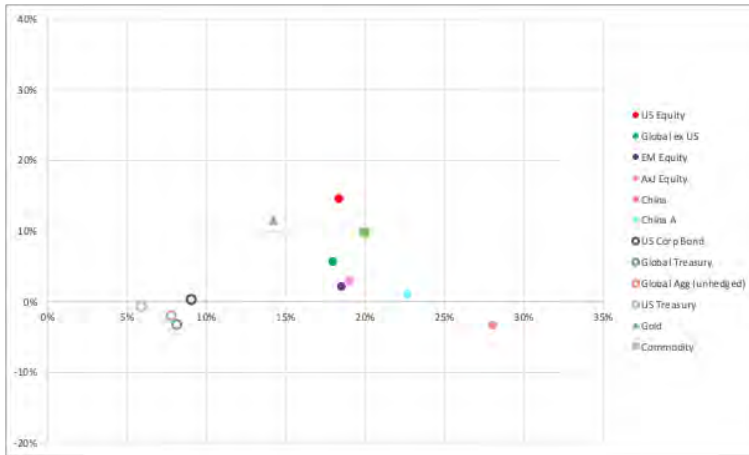


American exceptionalism is the belief that the [United States](#) is either distinctive, unique, or exemplary compared to other [nations](#).^[1]

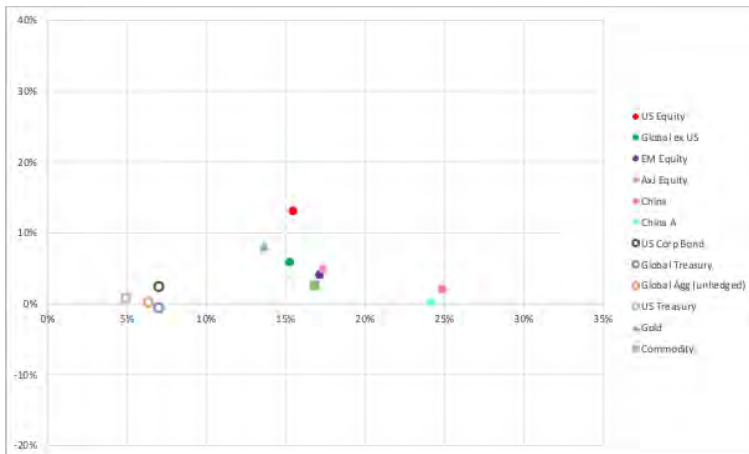
Proponents argue that the [values](#), [political system](#), and [historical development of the U.S.](#) are unique in [human history](#), often with the implication that it is both destined and entitled to play a distinct and positive role on the world stage.^[2]

It originates in the observations and writings of French political scientist and historian [Alexis de Tocqueville](#), most notably in his comparison of the United States with [Great Britain](#) and his native France. Tocqueville was the first writer to describe the country as "exceptional" following his travels there in 1831.^[3] The earliest documented use of the specific term "American exceptionalism" is by American communists in intra-communist disputes in the late 1920s.^[4]

5-year Risk-adjusted Returns



10-year Risk-adjusted Returns



Source: GOJI, MSCI, Bloomberg; data as of 31/12/2024

The relative compound annualised outperformance of U.S. over Global ex-US equities over a period of 3-, 5- and 10-year periods to December 2024 was 6%, 8% and 7% p.a. This demonstrates how powerful the fast-growing Tech mega-caps and the USD currency outperformances have lifted American equities' returns substantially above those of its global peers.

The million-dollar question is if this exceptional trend in favour of the U.S. is likely to continue.

Based on current available information, the answer is almost a sure thing. However, macro policies under Trump 2.0 may reignite inflationary pressures in the U.S. and reverse the Fed's easy to tight monetary policy again.

Expect U.S. favourable trend to continue but Fed may return to tightening.

If this were to occur, and based on crowded positions in expensive U.S. tech mega-caps, it is quite plausible that we may see a mini-2022 market meltdown again.

In brief, GOJI endorses the longevity of the American Exceptionalism thematic. However, we believe that this great theme is so well known and thus fully priced. Hence, we would advocate a neutral, not overweight position in this thematic.

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