JULY 7, 2025

Equity Outlook

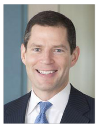
HARTFORDFUNDS

Our benchmark is the investor.®

Beyond US Exceptionalism: Where Now for Equities?

Economic “regime change” has been underway for nearly a decade. Going forward, the global shift presents risks and opportunities for stock investors.

Insight from sub-adviser Wellington Management



Andrew Heiskell
Equity Strategist

Nicolas Wylenzek
Macro Strategist

Is the era of US exceptionalism coming to an end? It’s an unsettling proposition for equity investors, who have long benefited from a seemingly unstoppable wave of US equity market returns and the strength of the US dollar. What could this mean for equity investors in 2025?

What US exceptionalism is depends on who you’re asking. To most people, the term captures a sense of unassailable US leadership across multiple interlinked dimensions, such as geopolitics, military might, economic growth, fiscal spending, rule of law, technology and AI, and equity returns. As equity investors, we see US exceptionalism as the consistent outperformance of US equity markets relative to global counterparts. A shift in any of the dimensions that constitute US exceptionalism is likely to challenge many of the assumptions that have supported the US dollar’s dominance, creating implications for not only currency considerations and Treasuries, but also US equities.

Liberation Day Marked a Turning Point, but Regime Change Was Already Underway

It might feel like this narrative has only been questioned in recent months—particularly in the wake of Liberation Day—but we see Trump’s tariff announcements as the clearest signal yet of a shift that has already been underway for nearly a decade. The prior economic regime of expanding globalization was characterized by synchronized global growth, low dispersion,[1] low inflation, and falling interest rates—an era that began with the fall of the Berlin Wall, accelerated with NAFTA in 1994, and arguably peaked with the formation of the euro in 2000 and China’s entry into the World Trade Organization in 2001. In a highly synchronized environment, investors were incentivized to reduce diversification and concentrate exposure into whichever asset class was delivering the best growth. Throughout this period, and especially since the Global Financial Crisis (GFC), growth leadership was consistently led by the US, particularly its large-cap tech sector—a perception only bolstered by a consistently strengthening US dollar (USD).

But the first cracks in this “Goldilocks” regime began to appear as early as 2015–2016. We saw a growth scare and capital flight out of China in the second half of 2015, Brexit in June 2016, a rise in populism, including the election of US President Donald Trump in November 2016, and the onset of US-China tariffs in 2018.

While the disruption caused by the pandemic obscured this picture, each of these events signaled a shift from globalization as a rising tide that lifted all boats to a more zero-sum, domestically reoriented world. We’ve seen this shift in elections across the US, UK, Germany, France, and Poland, where establishment parties have lost ground to anti-establishment movements representing, or claiming to represent, those that feel left behind by globalization. We’ve also seen the policy response increasingly shift from monetary to fiscal in an attempt to try and address these concerns.

Key Points

- A “Goldilocks” era of synchronized global growth ended in 2015-2016, ushering in a zero-sum world of capital flights, populist movements, and fiscal drama. The Liberation Day tariffs were a symptom of changes already long underway.
- The long-term implications of regime change are yet to be fully understood, but a weaker US dollar could have direct implications for exposures to US equities, especially for non-US investors concerned about net returns and currency hedging.
- European equities, which sharply outperformed in the first half of the year, remain attractively valued in absolute and relative terms. Japanese equities may also benefit from increasing domestic investment, wage growth, and automation.

A US recession was priced in, then out, of markets, leaving investor confidence fragile. In the wake of the Trump adminkstraion's tariffs, the market seems to be gripped by two opposing forces: short-term panic and long-term optimism. A key concern now is that the market overreacts to immediate risks while underplaying the potential for deeper long-term challenges.

> Regime change and the actions of Trump 2.0 start to prompt questions around the durability of aspects of US exceptionalism.

What Does This Mean for US Equities?

Regime change and the actions of Trump 2.0 start to prompt questions around the durability of aspects of US exceptionalism, especially those related to geopolitics, fiscal spending, rule of law, and the treatment of foreign capital. The implications of this are yet to be fully understood, but the most obvious consequence of reduced US exceptionalism is likely to be a weaker USD, with implications for all USD assets, but more significant ones for currency and bond yields than equities. That said, a weaker dollar does have direct implications for exposures to US equities and certainly for how non-US investors think about their net returns and currency hedging.

The simple fact that we're transitioning away from an era of high synchronization and tight correlations[2] has significant implications for investors in terms of both opportunity set and risk management. Keeping all one’s eggs in a US basket seems imprudent given the broader context. Many portfolios remain heavily concentrated in US equities and dollar-denominated assets, a reflection of capital finding its way to wherever it has historically been treated best. However, investors must now ask: How is that capital being treated now, and how might it be treated in the future?

None of this necessarily means that US large-cap tech companies are any less exceptional, but a shift toward lower correlations and heightened volatility means that diversification starts to matter again (diversification does not ensure a profit or protect against a loss in a declining market). Over the past decade, if you were heavily invested in US equities, diversification—and hedging the US dollar—would have been net detractors. That’s no longer likely to be the case, given that country correlations are now at a multi-decade low.[3]

It could also provide greater scope for active managers to add value—a difficult feat when US large-cap equities just went up for 15 years. If the prior regime were all about high beta and low alpha,[4] the future regime could see the reverse: lower correlation and higher dispersion, creating more opportunities for active managers to add value.

Where Else Might Be Worth Looking?

European equities are in the middle of a regime change, which has recently started to accelerate, potentially driving the biggest rotation since the GFC and creating a major opportunity.

While European equities look tactically extended given their sharp outperformance in the first half of the year, they remain attractively valued in absolute and relative terms. This creates appealing potential opportunities for diversification as Europe’s domestic outlook appears to have structurally improved.

This regime change is unlikely to be straightforward, but we believe the key winners will be parts of the value space such as European banks and telecoms, defense stocks, European small caps, and those enablers of the energy transition that are protected by high barriers to entry, such as grid operators. The likely losers are beneficiaries of globalization and lower interest rates.

Japanese equities may also benefit from a number of supportive dynamics, such as increasing domestic investment, shareholder activism, wage growth, and a push toward automation and efficiency. Higher dividends and buybacks, as well as structurally higher inflation, are also contributing to a more positive environment.

This is translating to an increasingly attractive opportunity set for Japanese equities, but it's worth noting that Japanese governance reforms and economic policy measures are most impactful on domestic small- and mid-cap stocks.

The new regime's reorientation toward domestic priorities has been a positive for smaller companies, reflected in the renewed outperformance of small-cap equities in most countries—other than the US. As the disruptive impacts of tariffs on inflation and growth begin to moderate, US small caps could also benefit from these same forces, especially if we see growth broaden out. This is where deep research can come into its own, given the fact that disparity, dispersion, and less sell-side coverage can help drive positive outcomes for active managers.

In a more volatile and slower-growth world, we also believe that quality "stable compounders"—companies that exhibit consistent growth, resilience, and strong balance sheets, whether growth or value—may become increasingly appealing to investors looking for reliable returns.

What Now?

Ultimately, focusing on whether or not we're seeing the end of US exceptionalism could mean investors risk missing the very real regime changes that are already underway, and that already have implications for portfolios. We're moving away from a period characterized by high synchronization and tight correlations, which has important consequences for investors regarding both the range of opportunities and risk management. A weaker USD could impact USD assets, emphasizing the need for diversification. Meanwhile, European and Japanese equities may present attractive opportunities. Above all, investors should assess whether equity allocations are evolving alongside a changing investment landscape.

> "We believe the key winners will be parts of the European value space such as banks and telecoms, defense stocks, European small caps, and those enablers of the energy transition that are protected by high barriers to entry, such as grid operators.

Talk to your financial professional to stay informed about the evolving opportunities within equities.

[1] Dispersion refers to the range of potential outcomes of investments based on historical volatility or returns. Generally speaking, the higher the dispersion, the riskier an investment is, and vice versa.

[2] Correlation is a statistical measure of how two investments move in relation to each other. A correlation of 1.0 indicates the investments have historically moved in the same direction; a correlation of -1.0 means the investments have historically moved in opposite directions; and a correlation of 0 indicates no historical relationship in the movement of the investments.

[3] Based on Wellington's calculations using Bloomberg data.

[4] Beta is a measure of risk that indicates the price sensitivity of a security or a portfolio relative to a specified market index. Alpha is the excess return of a portfolio over its benchmark.