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PHILEQUITY CORNER

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US exceptionalism falters as markets tumble

US equities tumbled last week as recession fears and tariff tensions triggered a broad market sell-off. The S&P 500 plunged by 10 percent from its highs, officially entering correction territory, while the Nasdaq Composite suffered its worst single-day decline since September 2022, dropping by four percent last Monday. The Magnificent Seven plummeted by 19 percent from its peak, while the Nasdaq 100 index shed 14 percent during the worst of the sell-off. Meanwhile, the US dollar index (DXY) has weakened by six percent from this year's high as investors sold US assets.

The emergence of DeepSeek AI, which we extensively covered last month (see DeepSeek sparks global tech selloff, Feb. 3, 2025), signaled a shift in market consensus trades with US stocks and the dollar underperforming – a sign that US exceptionalism may be cracking.

Defining US exceptionalism

US exceptionalism is the notion that the US is distinctive or exemplary, marked by standout economic and financial market outperformance compared to others. In recent years, the US-led AI revolution sparked innovation and market gains that outpaced global competitors. Bolstering this was countercyclical government spending – pumping stimulus in times of economic weakness – unlike other developed countries. This combination of tech leadership and proactive policy has set the US apart, amplifying its edge, until now.

Optimism is fading

The US sell off marked a stark contrast to 2023 and 2024, when US equities outshone global peers. JPMorgan had pegged 2025 US GDP growth at 2.4 percent, following a 2.8 percent expansion last year and real spending up by 14 percent since 2019 – far exceeding Europe and Japan. But the optimism is fading fast. JPMorgan now sees a 40 percent chance of recession in 2025, up from 30 percent earlier this year, as Trump's tariff-heavy Make America Great Again agenda stokes inflation fears, trade war risks and the possibility of a US recession.

DeepSeek's Sputnik moment

The Chinese artificial intelligence company, DeepSeek, released a large language model that operates at a fraction of the cost of dominant US counterparts. Dubbed as a "Sputnik moment" by some, its emergence signals that another nation can rival the US in AI – rattling valuations in the US tech sector that has driven exceptionalism the last two years.

DeepSeek's breakthrough has underscored China's resurgence, with the Hong Kong Technology Index up by 34 percent since the start of the year, the Hang Seng by 19 percent and the MSCI China by 22 percent, with Chinese tech giant Alibaba surging 66 percent year-to-date.

Policy uncertainty under Trump

President Trump's push for tax cuts and deregulation is aimed to fuel growth, but his tariff plans of slapping steep duties on imports are backfiring. Investors fear higher costs will squeeze margins and weaken demand. What's worse is Trump's baffling and erratic announcements, which add to the uncertainty.

Mohammed El-Erian, president of Queen's College, Cambridge and former CEO of PIMCO, notes: "One of the US's edges is predictability and rule of law. The more these two things are questioned, the more people are going to start questioning US exceptionalism."

Sputnik moment in Germany

El-Erian also flags a potential "Sputnik moment" in Germany, where massive investments in defense and infrastructure are luring capital away from the US. Volatility in US assets has spiked as old bets unwind. The iShares MSCI Germany is now up by 21 percent year-to-date, while the Euro STOXX 50 index is up by 12 percent.

Flight to Treasuries

US investors are pivoting hard to safety. A Bloomberg survey of 504 market participants shows 77 percent favoring US Treasuries over stocks. This is the most bullish stance on Treasuries since 2022 as bonds promise better volatility-adjusted returns over the next month than equities. Half of the respondents also plan to reduce exposure to the S&P 500 over the next month.

Peso strength signals possible rotation

As US markets struggle, emerging markets are showing signs of a rebound. The Philippine peso has rallied and broken key technical levels (see BSP surprise bolsters peso, Feb. 17, 2025). As noted in the article, "Trump fatigue" combined with the overcrowded dollar positioning and BSP's surprise rate pause has pushed USD/PHP below the critical 58 threshold. It closed at 57.25 as of Friday.

The strengthening peso has historically correlated with Philippine equity outperformance. True to form, the PSE index has climbed 7.3 percent from February lows of 5,862, while the iShares MSCI Philippines is up by 12 percent from year lows. As China's stock market continues to improve, other Asian emerging markets may follow, further boosting Philippine stocks and the peso.

Exceptionalism narrative in doubt

US exceptionalism now faces its most serious challenge. Growth once set the US apart, but now recession odds, tariff turmoil and DeepSeek's rise cast long shadows. Is this just a temporary setback or a structural realignment of global market leadership?

For now, capital flows tell the story. The market landscape is broadening beyond the US and the Magnificent Seven as investment opportunities emerge in other regions. Stretched US valuations, built on US exceptionalism, appear increasingly vulnerable as capital seeks alternatives.

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