Winning in the USA

Golf Force One

Key points:

- US stocks hit new highs this week, supported by positive newsflow and perceived trade negotiation victories.
- The end of US exceptionalism has been called into question, aided by robust tech earnings and strong demand in AI driving investment. A resurgent dollar was a clear winner on the week.
- Trade deals and the US Budget passage have eased policy uncertainty, boosting business and consumer confidence.
- With the EU securing a trade deal comparable to most other US trade partners, uncertainty has receded for now. Meanwhile, economic data in the single market is moving in the right direction.
- A strong risk appetite is supporting credit, but spreads are increasingly struggling to tighten on good news, as valuations become stretched.

1 August 2025 (London) – US stocks have continued to make new highs in the past week, with incoming newsflow remaining supportive of risk assets. The capitulation on the part of the EU to US demands on trade was met with a sense of humiliation, resentment and inevitability across the Continent. Yet, from a US perspective, the mood has been ebullient.

There is a feeling that Trump has extracted pretty much every concession he would have hoped for in the trade negotiations conducted to date. Our analysis leads us to conclude that the US has raised the average tariffs rate to approximately 18%, on a global basis. On this assumption, we project annualised US tariff revenues around USD450 billion, versus USD77 billion in 2024; an increase worth 1.25% of GDP. This quantum of revenue should help lower the US fiscal deficit slightly below 7% of GDP, in the year ahead.

In the absence of material retaliatory tariffs, this has been viewed as a great result for the US. It has even meant that a US president has ended up winning plaudits for a tax hiking policy across the political spectrum. This is a rare thing, in itself!

Perhaps more importantly though, the conclusion of trade deals, along with the passage of the US Budget, has helped to reduce the extreme level of policy uncertainty that was weighing on business and consumer confidence a few months ago.

This was making it very difficult to make forward-looking projections with respect to the economy with any confidence whatsoever. With the dust settling, there is a sense that the trajectory of US economic activity remains more upbeat than many had previously feared.

This has seen the narrative surrounding the end of US growth exceptionalism called into question. It has also been compounded by strong tech earnings, with robust demand in AI driving investment in the US.

In the wake of this, a resurgent dollar has been a clear winner on the week. Over the past several months, we have highlighted how many investors and trend-following models have sought to jump on a weak US dollar narrative.

However, in the short term, many of the supporting arguments driving this idea appear to have weakened. The US has emerged as a clear winner in the trade war at this juncture. US stocks have been outperforming and fiscal fears have been mitigated for the time being. Meanwhile, worries that Trump was undermining US policy credibility have been replaced by a grudging sense of respect for the negotiator-in-chief.

In the short term, as positions are unwound, this could suggest that a resurgent dollar has a bit further to run. However, looking forward over the medium term, we think that a weaker dollar trend can resume, as interest rate differentials narrow over the months ahead, looking towards a more dovishly inclined future Chair of the Federal Reserve.

This week's FOMC meeting saw Powell hold the lie on interest rates for the time being. The truth, for now, is that economic data continues to look fine, and we would expect this narrative to continue to be reaffirmed in the monthly jobs report, due later today. Near-term inflation risks on the upside mean that there would normally be limited reason to expect rates to decline any time soon.

However, with Trump bearing down on the Fed to lower rates aggressively, we think that expectations for rate cuts can continue to be supported, on the notion that policy easing is more of a question of 'when' rather than 'if'. From this standpoint, it is also worth reflecting that Trump has largely managed to win every battle he has engaged in over the past several months and so it may be foolhardy betting against him getting his wishes, when it comes to the path of monetary policy.

We would note that the US administration believes that any tick up in prices linked to tariffs will be the temporary result of a one-off price adjustment, akin to a consumption tax. Therefore, it feels that the Fed should be looking through any such noise.

There is also a view in the White House that only around one-third of the tariff hikes will be passed onto US consumers, with the balance absorbed through producer efficiency gains, margins and higher prices passed on in other markets. If this is correct, they conclude that core inflation may only increase around 0.4% over the months ahead.

If this proves to be the case, then this would cement a case for rate cuts in September and December this year, with more to follow, given a belief that interest rates at 4.3% remain some way above the long-term neutral rate.

However, the Fed will argue that the lack of slack in the economy could mean that any reacceleration in inflation could be more persistent, leading to secondary impacts on wages. Financial conditions have eased as stocks rally and credit spreads tighten, also mitigating the need for additional monetary accommodation.

Consequently, all eyes are now likely to be back on the data, in order to see how this plays out. Separate to this, there is an interesting narrative emerging from the likes of Kevin Warsh that it will be optimal for the Fed to shrink its balance sheet, but in doing so, allow for materially lower interest rates at the same time.

Given his proximity to Trump's inner circle, this is an idea that may get more airtime in the weeks ahead, as the FOMC seeks to square the circle and reconcile some of the divisions that represent a medium-term risk to the institution.

Treasury yields have largely traded sideways in the past week, staying within a prescribed trading range. However, a more hawkish Fed narrative in the near term has caused the Treasury yield curve to flatten over the past several days. This move has also been mirrored in European markets, though generally speaking, European yields have underperformed moves in the US over the past week, in the wake of Lagarde communicating a neutral policy stance at last week's ECB meeting.

More broadly speaking, the past week has seen plenty of introspection and hand wringing in the EU, with Trump having exposed the lack of power and leadership coming from the bloc. However, there is at least a sense that the worst scenario on trade has been averted.

The EU has a deal comparable to most other US trade partners and so there is not a loss of relative competitiveness, away from US domestic competition. Meanwhile, the economic data in the single market has shown signs of moving in the right direction and it will be good to have the distraction of trade uncertainty and Trump dealt with for the foreseeable future.

A similar mindset seems prevalent in Tokyo. At this week's BoJ meeting, Ueda raised inflation projections, laying the foundations for a resumption in monetary policy normalisation later this year. We expect the BoJ to hike to 0.75% in October, with a further move possible as soon as January, depending on how the economy fares over the next several months.

Yet with Ueda not publicly appearing in much of a hurry, so this has not been enough to stop the yen sliding to 150 versus the US dollar over the past week. Although the yen remains very cheap in our eyes, we continue to think that this is not the time to hold positions in the Japanese currency.

A robust backdrop for risk assets continues to favour credit. However, spreads are increasingly struggling to tighten on good news, as valuations become stretched. Generally speaking, when recession risk is low or falling (which is currently the case), then credit can be expected to continue to outperform.

Should recession risks start to rise, then this could lead to a re-pricing. However, it is difficult to identify a catalyst that would deliver such a reassessment in the near term, unless a new exogenous event leads to a re-pricing of risk.

Meanwhile, dynamics in emerging markets have been less supportive, in contrast. In part, this is a function of renewed US dollar strength. Additionally, tariffs on countries like India and Brazil have demonstrated how the US administration is also seeking to influence domestic policies, by weaponising trade agreements.

Looking ahead

With the focus back on economic data, so we look for today's US payrolls report and next week's ISM numbers to underpin a broadly constructive economic thesis. Markets have not paid too much attention to the noise within quarterly GDP prints and although most commentators think that tariffs should induce some slowing in the second half of 2025, it may appear that risks to a 1.5% forecast for GDP are looking skewed to the upside.

Elsewhere, we see more potential for market volatility with respect to the July inflation print, which will be released on August 12th. Assuming growth remains benign, it may be that the next couple of CPI prints are the key determinants of Federal Reserve decision making and financial market direction over the next couple of months.

We are now in August, and we have another month of summer markets before we enter September and look at the 'back to school' trade, which may define the run towards the end of the year. But for now, it seems that the theme is all about 'USA, USA'. You might wonder whether we will look back at this point as a moment of 'peak Trump'. In that light, it was also amusing to see POTUS entertaining overseas leaders at the second 'White House' on his golf course in Turnberry, Scotland during the past week.

At this rate, with everything going his way, you half wonder whether Trump and his caddies will be planning an assault on the record of Kim Jong Il, who famously scored 38 under par for a round at the Pyongyang golf course, including 11 holes-in-one! What could possibly go wrong….

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