GLOBAL CREDIT

The Algebris Bullet: The Myth of Exceptionalism

"It was wonderful to find America,
but it would have been more
wonderful to miss it"
- Mark Twain

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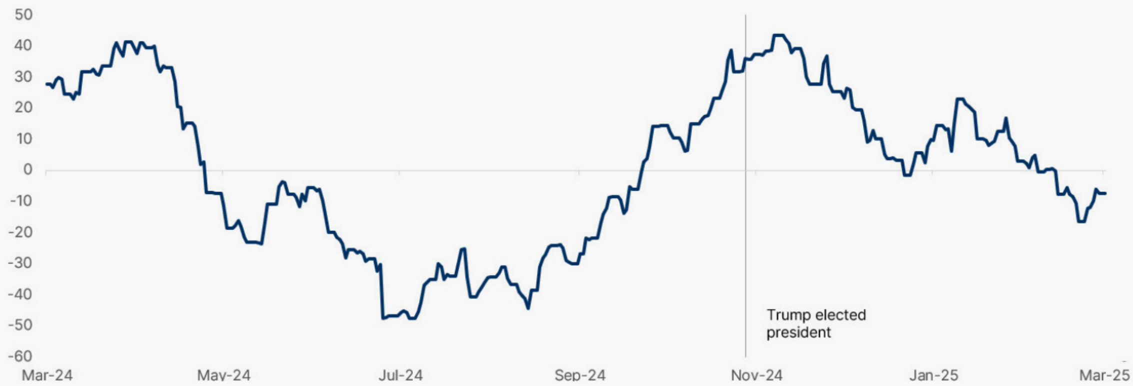
The sweeping Republican victory in US elections revived the American dream. President Trump would be a positive disruptive force for America. Active fiscal policy and tariffs would boost internal demand, and supply-side economics would provide funding and expand capacity. US macro would undoubtedly benefit, although perhaps at the cost of temporary higher inflation and interest rates. The rest of the world would bear the cost via weaker currency and US onshoring. America would be exceptional again.

The first two months of the new administration tell a different story. US macro policy is more focused on appeasing the electoral base than on generating growth. The lack of predictability generates uncertainty. The combination of the two subtracts from growth. Furthermore, midterm elections are still far away, and policy flexibility is limited. The bar for policy to support the economy is higher than the market thinks. We suspect an imminent growth scare is about to come, that risk assets are not priced for.

US economic data are deteriorating meaningfully. Jobless claims are on the rise, pushing non-farm payrolls to six-months low, and the unemployment rate above 4%. Economic surprises have been trending down steadily since November (Chart 1).

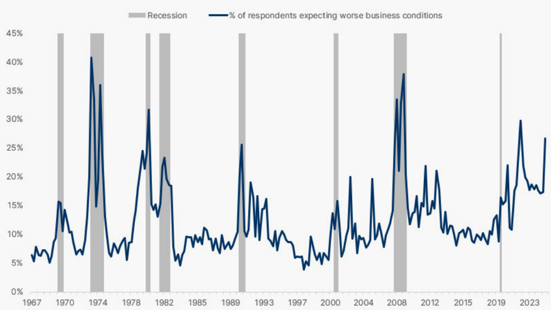
Chart 1: US economic surprises turn negative again



Source: Citi Bank, Bloomberg Finance LP, Algebris Investments. Data as of 07.03.2025
Note: Citi US Economic Surprise Index.

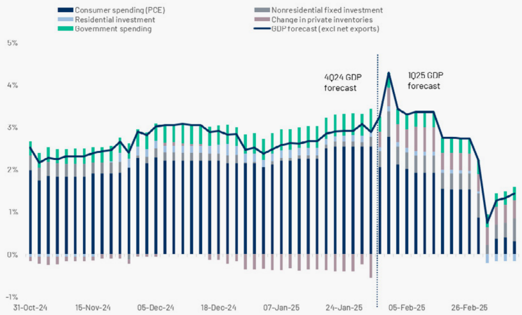
Consumer confidence, the key driver of the 2023-24 expansion, has deteriorated in 2025-to-date (Chart 2), driven by the perceived impact on business and labour market conditions. Real time gauges of US GDP are dropping sharply (Chart 3), driven by import surges but also by more tepid consumer spending.

Chart 2: US consumer - pessimism on the rise



Source: Conference Board. Data as of 07.03.2025.
Note: Consumer Confidence Next 6 Months.
Pessimistic Expectations: Business Conditions.

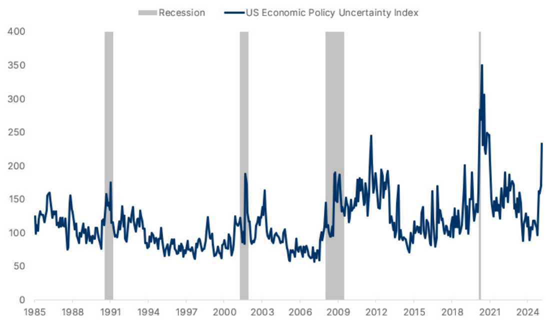
Chart 3: Real time drop in US GDP - trade, but not only



Source: Atlanta Fed. Data as of 07.03.2025.
Note: Subcomponent Contributions to GDPNow 2024 4Q & 2025 Q1 Forecast excluding Net Exports component.

We suspect the US is currently undergoing a deep uncertainty shock. Evidence shows that policy uncertainty can be as bad for the cycle as an adverse exogenous shock. When uncertainty is too high, firms temporarily and suddenly pause investment and hiring. Output and employment tend to fall quickly as a result. US policy uncertainty is at the second highest level of the past forty years (Chart 4). Previous spikes were accompanied by a slowdown. Business surveys in January and February suggest sharp drops in new orders and employment.

Chart 4: Uncertainty means recession



Source: Baker, Scott R.; Bloom, Nick; Davis, Stephen J.
Data as of 07.03.2025.
Note: US Economic Policy Uncertainty Index

The first actual policy steps are not encouraging either. The administration is frontloading growth-unfriendly policies, such as job cuts in the public sector and trade restrictions (Table 1). The US tariff rate rose to 4% this year and may increase to 10-15% if and when fully implemented. Recent IMF research estimates the US growth drag from tariffs at 0.8% over one year. According to the plan, the bulk of growth expansion should be driven by tax cuts. These will take time to materialise as they have to go through Congress and funding remains a challenge.

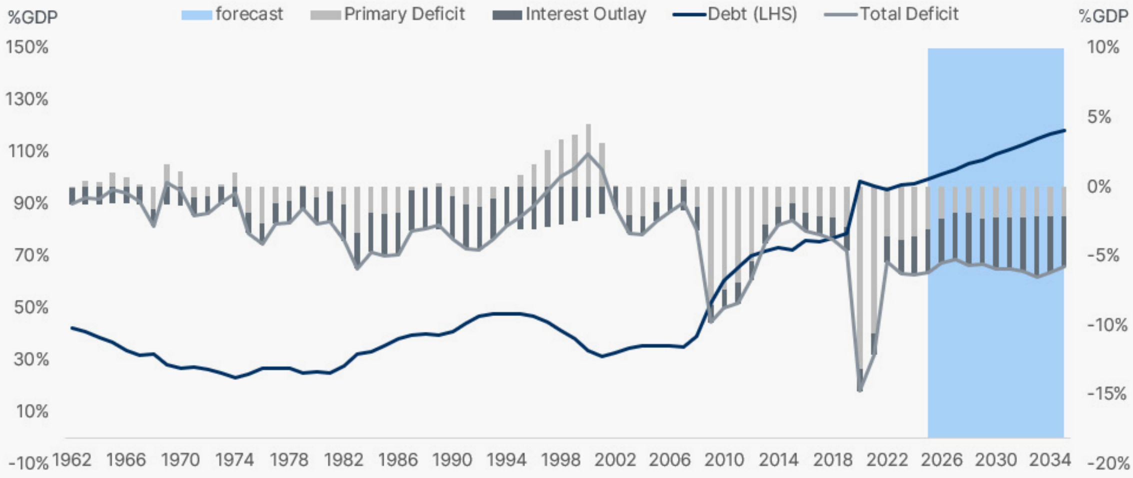
Table 1: Trump policies - contraction now, expansion we shall see

Category	Policies		Status	Growth Impact
Tariffs	China	+20%	**In effect.** Raising avg tariffs vs China to 34%	Contractionary
	Mexico	25%	**In effect.** Exception for USMCA compliant trade (~50% of trade historically) for March-2025.	
	Canada (ex energy)	25%	**In effect.** Exception for USMCA compliant trade (38% of trade historically) for March-2025.	
	Canada energy	10%	**In effect.**	
	Steel & aluminum	25%	**To be effective 12-March-2025.**	
	Auto Tariffs	~25%	**To be announced on 02-April-2025.**	
	Drugs & semiconductors	>25%	**Timing uncertain.**	
	Reciprocal tariffs		**To be announced on 02-April-2025** after conclusion of trade review.	
DOGE	Goal of $2trn savings		**Ongoing.** Faces legal and political constraints (Trump leaving ultimate authority with his cabinet members). Claims to have achieved savings of $105bn. Federal govt has cut ~62k headcount in Feb-2025*.	Contractionary
Fiscal	Permanent extension of 2017 tax cuts (cost of $4.5trn)		**Timing uncertain.** Planned extension via reconciliation bill requiring simple majority.	Expansionary
	No taxes on tips, overtime pay & social security benefits		**Timing uncertain.**	
Immigration	Deportation of unlawful migrants, fortifying US-Mexico border, halt of processing undocumented migrants		**Ongoing.** ICE (agency responsible for deportations) is still working with funding from the 2024 budget and hence not yet able to upsize its capacity. Upsizing detention capacity of military bases near Mexican border.	Contractionary
Geopolitics	Negotiations for peace deal in Ukraine		**Ongoing** calls for negotiations with Ukraine and Russia. Suspension of military aid to Ukraine.	Neutral
	Ceasefire Israel/Hamas		**Ongoing** negotiations for stage 2 of ceasefire deal. Currently under 50 day extension of stage 1.	

Source: Veda Partners, Oxford Economics, Signum, The Guardian, Bloomberg LP. Data as of 08.03.2025.
Note: *the federal govt headcount cuts cannot be directly linked to DOGE initiatives.

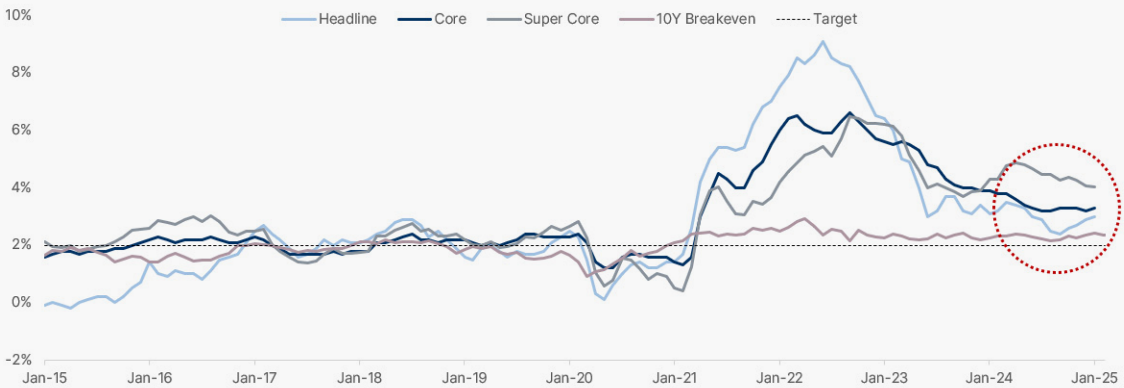
The cost of a US downturn is high as the policy space to respond to it is limited. US debt is high and bound to increase on a growth shock (Chart 5). Interest costs are just shy of 3% of GDP, leaving little space for primary spending. US inflation runs above target and stopped slowing in late 2023 (Chart 6). A trade-induced slowdown is not obviously deflationary, leaving the Fed in a tough spot. Secretary Bessent has stressed that the administration's measure of success is more likely to be the price of ten-year Treasuries than the price of equity. President Trump has strengthened this message. This rhetoric aligns with a lack of urgency regarding supportive policy.

Chart 5: US debt - up and running



Source: CBO, Algebris Investments. Data as of 17.01.2025. Note: All metrics as % of GDP.

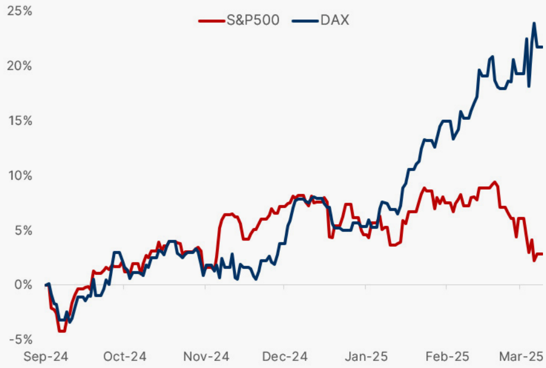
Chart 6: US inflation - fight not over yet



Source: Bloomberg Finance LP, Algebris Investments. Data as of 07.03.2025.
Note: Headline: US CPI Urban Consumers YoY NSA (CPI YOY Index), Core: US CPI Urban Consumers Less Food & Energy YoY NSA (CPI XYOY Index), Supercore: US Bloomberg BLS CPI Core Services Less Housing (Supercore) YoY (CSXHSPCY Index). US Breakeven 10 Year - USGGBE10 Index. Calculated by subtracting the real yield of the inflation linked maturity curve from the yield of the nominal Treasury maturity.

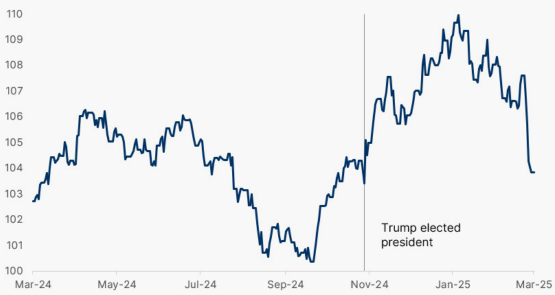
US exceptionalism is fading in the data, but well alive in markets. The S&P 500 trades at 23x, 15% above the ten year average. The US Dollar real exchange rate is at forty year highs, despite the US having grown slower than most of Asia for the past twenty years. Both trends are reverting fast (Charts 7 and 8), but multi-year indigestion of US assets suggests room for further correction.

Chart 7: US equities champion status challenged



Source: Bloomberg Finance LP, Algebris Investments.
Data as of 07.03.2025.
Note: Local currency total returns of S&P 500 & DAX.

Chart 8: US exceptionalims flopping quick

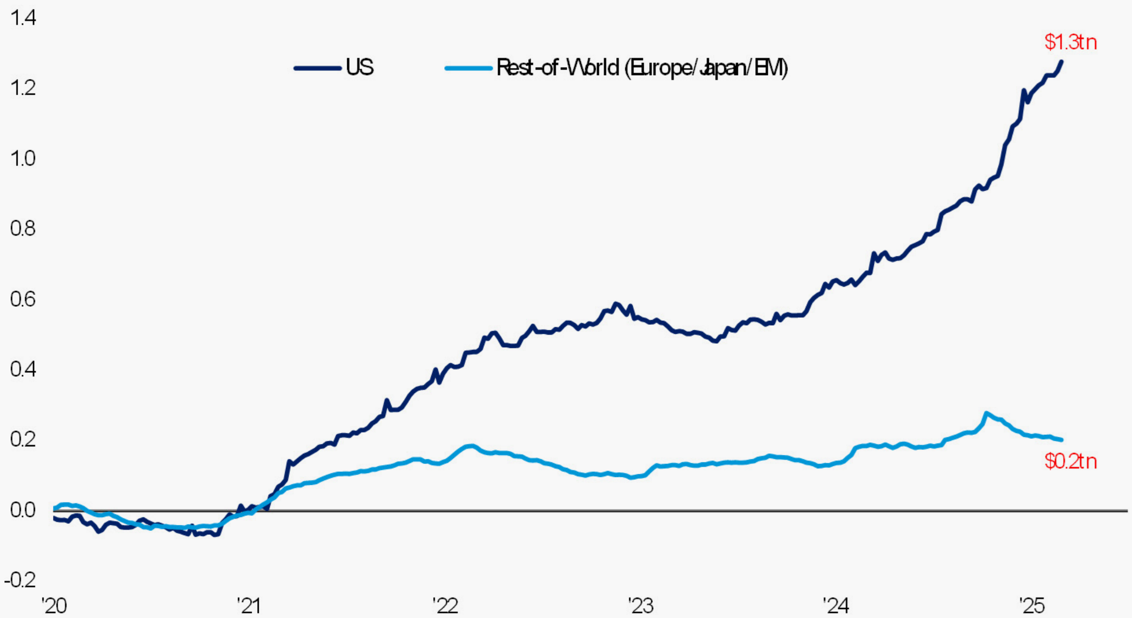


Source: Bloomberg Finance LP, Algebris Investments.
Data as of 07.03.2025.
Note: US Dollar Index (DXY).

Risk assets have flourished recently, but large macro adjustments are in place in the United States. This may lead to a quick re-pricing of the winners of the past two years.
We see US equities and the US Dollar most at risk. European assets are broadly under-owned, although enthusiasm about the new fiscal framework is boosting valuations. Credit is tight overall, but more attractive in selected sectors, particularly in Europe, as dispersion remains high. We see more value in US than European rates. EM credit is tight but value is emerging in local markets.

In the past three years, markets have come to terms with the idea of higher inflation and rates, but slowdowns have been forgotten. We see pre-conditions for one in 2025, with investors broadly unprepared. Volatility is on the rise, and active strategies are set to stand out.

Chart 9: Large positioning in US leaves room for correction



Source: BofA Global Investment Strategy, EPFR, Algebris Investments. Data as of 10.03.2025.
Note: cumulative inflows into equity funds.

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