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Signal over noise #7: In defense of US exceptionalism—five reasons US equities are Attractive

Global equity strategy

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- President Trump's pause on the implementation of "reciprocal" tariffs and the (at least) temporary exemption of electronic goods has opened the door to constructive bilateral tariff negotiations.
- While volatility is likely to remain elevated until the final agreements are reached, we see five reasons US equities are Attractive for investors with a 6-12 month view.
- The more favorable economic environment under selective rather than universal tariffs, the prospect of an eventual initiation of trade negotiations with China, a shift in focus toward fiscal policy, the potential trigger of a Fed put (including quantitative easing) in the event of further market dislocations, and the historically strong performance following momentum sell-offs, all contribute to a positive medium-term outlook for US equities.

The fog is lifting: while we anticipate volatility and signs of economic weakness on the road to tariff agreements, especially with China, the path from here seems clearer. We outline below five reasons we find US equities Attractive.

1. A road to selective tariffs

Selective tariffs are about leverage, universal tariffs are about cost—especially to the country wielding them. The pivot towards exempting almost $390bn of electronic imports (smartphones, laptop computers, hard drives, chips and other electronics) provides at least a temporary reprieve to US consumers. With the level of "reciprocal tariffs" for most nations reduced to a 10% "baseline tariff" over the 90-day pause period, this could pave the way for further reductions in tariff levels thereafter. In a move to turn the tariff stand-off into a win-win outcome, Germany's chancellor Merz called for a zero-tariff trade zone.

We see a signal in these pivots, which establish release valves for companies that are critically reliant on imports. With universal tariffs there is no way out: imports—no matter their origin—will see higher costs, potentially resulting in broad inflationary pressures and economic malaise. With even just one other sourcing option available at low or no tariffs, the negative economic impact is mitigated. Universal tariffs are more economically harmful for the country imposing them than for the recipient countries, as the latter have more freedom to re-calibrate. The only option for companies in the country imposing tariffs is to relocate production domestically, which may not always be an immediate option.

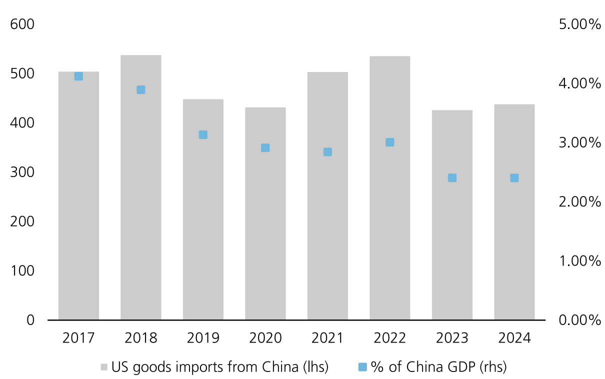
In the wake of first trade negotiations under President Trump in 2018/2019, many companies established a "China +1" strategy, reducing their dependency on China by sourcing from at least one other country such as Vietnam, India, Mexico, or other Asian countries. So, while these countries may not be as economically significant as China, any progress in trade negotiations with these partners will be an important signpost for the wider economic trajectory.

2. A potential initiation of US-China negotiations

We anticipate that the US and China will eventually agree to commence negotiations. With tariff rates hiked to over 100% by both countries, we think that the dispute has reached peak uncertainty, making further escalation unlikely. We do not expect a final trade deal similar to the resolution reached in December 2019, when China agreed to purchase USD 200 billion worth of US goods and services over two years in exchange for a reduction in US tariffs. Given the Chinese economy's reduced reliance on US exports, we expect fewer concessions from China this time. Nonetheless, a temporary relief and partial rollback of existing "reciprocal" tariffs is possible as both parties agree to negotiate.

Figure 1 - The Chinese economy is less reliant on US exports compared to 2018

US goods imports from China. In USD bn (lhs) and relative to China GDP (rhs)



Source: US Census Bureau, IMF, UBS

3. April tariff showers, May fiscal flowers?

Over the coming weeks we anticipate a shift in focus towards US fiscal policy initiatives. On 10 April, the House of Representatives approved the Senate-amended Fiscal Year 2025 budget resolution. The resolution has four key provisions:

1. Up to USD 1.5tr in new tax cuts aiming to expand the 2017 Trump tax cuts.
2. Increased spend on defense and border security.
3. Spending cuts of at least USD 1.5tr.
4. Federal debt limit increased by USD 5tr.

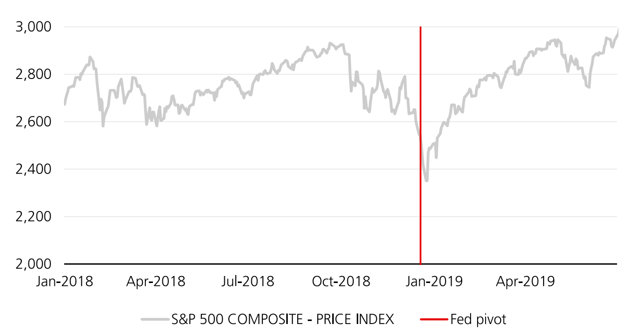
While exact spending cuts and the increased spend on border security and defense have yet to be detailed, we expect a shift in narrative away from tariffs towards pro-growth fiscal policies and see a chance that a comprehensive reconciliation bill will be passed before the Memorial Day recess in May.

4. The Fed put

Comments by New York Federal Reserve President John Williams on 11 April 2025 underscore that the Fed is not a detached party to the tariff negotiations. The fact that he stated that "long-term inflation expectations remain stable" despite a likely short-term rise in inflation from tariffs suggests that the Fed would act should further downside risks to the economy and employment materialize. Similarly, on the same day Boston Federal Reserve President Susan Collins stated that "the Fed would absolutely be prepared to intervene to address challenges of liquidity or market functioning," noting that "the core interest rate tool is certainly not the best way to address those issues." We therefore think it's possible that the Fed will turn to quantitative easing should the bond market show further dislocations.

Figure 2 - In 2018/2019 the Fed's policy pivot occurred after a 15% drawdown in the S&P 500

S&P 500 in 2018/2019



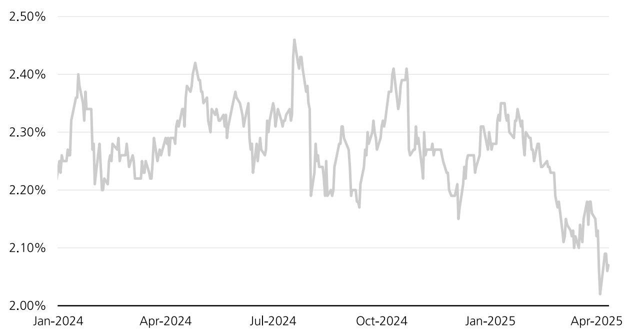
Source: Refinitiv, UBS

This is in line with Fed Chair Powell's policy pivot in 2018/2019 in the wake of market volatility and weakening global growth (see Signal over Noise 6). In his Atlanta speech on 4 January 2019, Powell suggested that the Fed would be "patient" and responsive to market and economic signals after acknowledging "crosscurrents," and in a prior speech on 19 December 2018 had guided toward fewer projected rate hikes. This established Fed Chair Powell's reputation as someone willing to respond to real-time risks rather than follow a rigid policy.

With long-term inflationary expectations trending lower (see Figure 3), we still see the Fed put in play, albeit likely with a lower strike than in 2018. The Fed pivoted its policy stance after the S&P 500's drawdown approached 15% in 2018. This time, we think the Fed is more likely to act when the S&P's decline from the peak is closer to 25% given that current inflationary risks are higher than they were in 2018.

Figure 3 - US long-term inflationary expectations are trending lower in 2025

Average expected inflation over the five-year period that begins five years from today



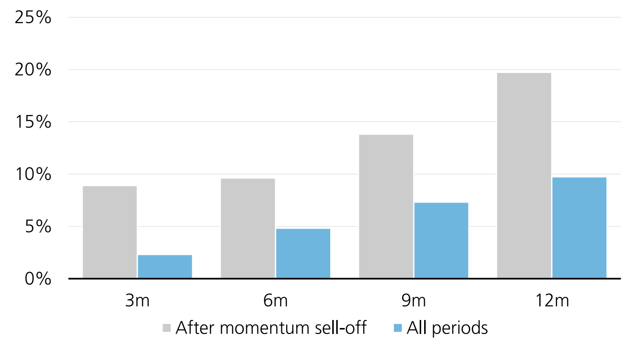
Source: Federal Reserve Bank of St. Louis, UBS

5. The data: Buy US exceptionalism—especially when it's on sale

From a purely empirical perspective, it pays to buy the dip in US equities. On average, buying the dip after drawdowns of 10% has historically resulted in superior absolute and risk-adjusted returns (see Signal over Noise 5). Also, the 3, 6, 9, and 12-month returns after a strong momentum sell-off of 15% (as we experienced on 11 March 2025) have exceeded the average returns over the same windows over the last 25 years.

Figure 4 - The US market usually recovers after momentum sell-offs

Momentum sell-offs and subsequent average returns in the S&P 500



Source: Bloomberg, UBS

Note: Past performance is not indicative of future results.

Appendix

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