Investment Institute

Ninety One

Investing for a world of change

The great rebalancing

A new cycle reshaping global equity leadership

An Investment Institute series

The end of the one-way trade:
rethinking US exceptionalism for a new cycle

Since the global financial crisis, allocating to US assets has been the consensus trade, justified by technology dominance, deep capital markets, structural economic advantages, and institutional stability. Yet as 2025 unfolds, that consensus is being severely tested. Washington's embrace of tariffs is triggering structural shifts across the US economy and rewriting the rules of global trade. Meanwhile, a deteriorating fiscal position – defined by persistent deficits, rising debt service costs, and policy unpredictability – has begun to weigh on both sentiment and capital flows. The turn to a more transactional style of politics has reconfigured US foreign policy priorities and shaken the traditional alliance system. All this comes at a time when the dollar is overvalued relative to its history, while US equities remain expensive by global standards.

This series explores what happens when allocators start looking elsewhere – not because the US is collapsing, but because right tail risks are increasing in the rest of the world, while left tail risks are rising in the US. Europe is offering a more coordinated fiscal impulse, Japan is emerging from decades of stagnation with newfound corporate momentum, and emerging markets, including China, are demonstrating newfound technology leadership and macro resilience. Understanding the contours of the next cycle, and its implication for portfolios, is now a top priority for investors around the world – and the focus of this series from Ninety One's Investment Institute throughout 2025-2026. If the age of the unquestioned American overweight is behind us, the implications will be profound.

Contents

The fast view

- US equities have outperformed both developed and emerging market peers for over a decade, shaping today's portfolio allocation patterns.
- The US dollar has also been exceptionally strong for many years, and there is a remarkable historical overlap between these long dollar cycles and the relative performance of US versus international equities.
- Current conditions, valuation extremes, divergent policy trajectories, and recent shifts in capital flows suggest markets may be at a critical inflection point.
- The next cycle could broaden equity market leadership significantly, driven by AI innovation and a weaker dollar, creating opportunities across sectors and regions.
- Fundamental indicators suggest a lower allocation to US equities than implied by market-cap benchmarks, with international and emerging markets offering potentially stronger returns.

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Introduction

The sustained outperformance of US equities over 14 years[1] has materially reshaped global allocation decisions. It has attracted significant foreign capital into US markets, contributing to dollar strength, while also raising home bias among US investors, amplified by substantial allocations to US-focused private market investments.

This period of US equity leadership has unfolded alongside a remarkably persistent dollar cycle. Now 23 years since its last major peak, the current cycle is far longer than typical business, credit, or equity cycles. Its duration led us to research the drivers of such prolonged currency cycles and how they eventually reverse. As we outlined in our research paper, 'The unstoppable dollar meets the resolute President Trump', these cycles endure due to four reinforcing forces:

1. **Geopolitical factors**
2. **Relative policy differences and growth trajectories**
3. **Cross-border flow dynamics**
4. **The absence of currency intervention, explicit or tacit**

There have only been six turning points in dollar cycles since 1970. These have only occurred when each of these structural forces flips in a relatively short period.

This paper extends our research by examining US versus non-US equity performance. According to the Macrohistory database[2], from 1870 to 2020, both US and Global ex-US equity markets delivered average nominal returns of 9% per year. However, US equities exhibited higher volatility — 18% annually versus 14% for Global ex-US — implying that comparable long-term returns have historically been achieved with lower risk outside the US.

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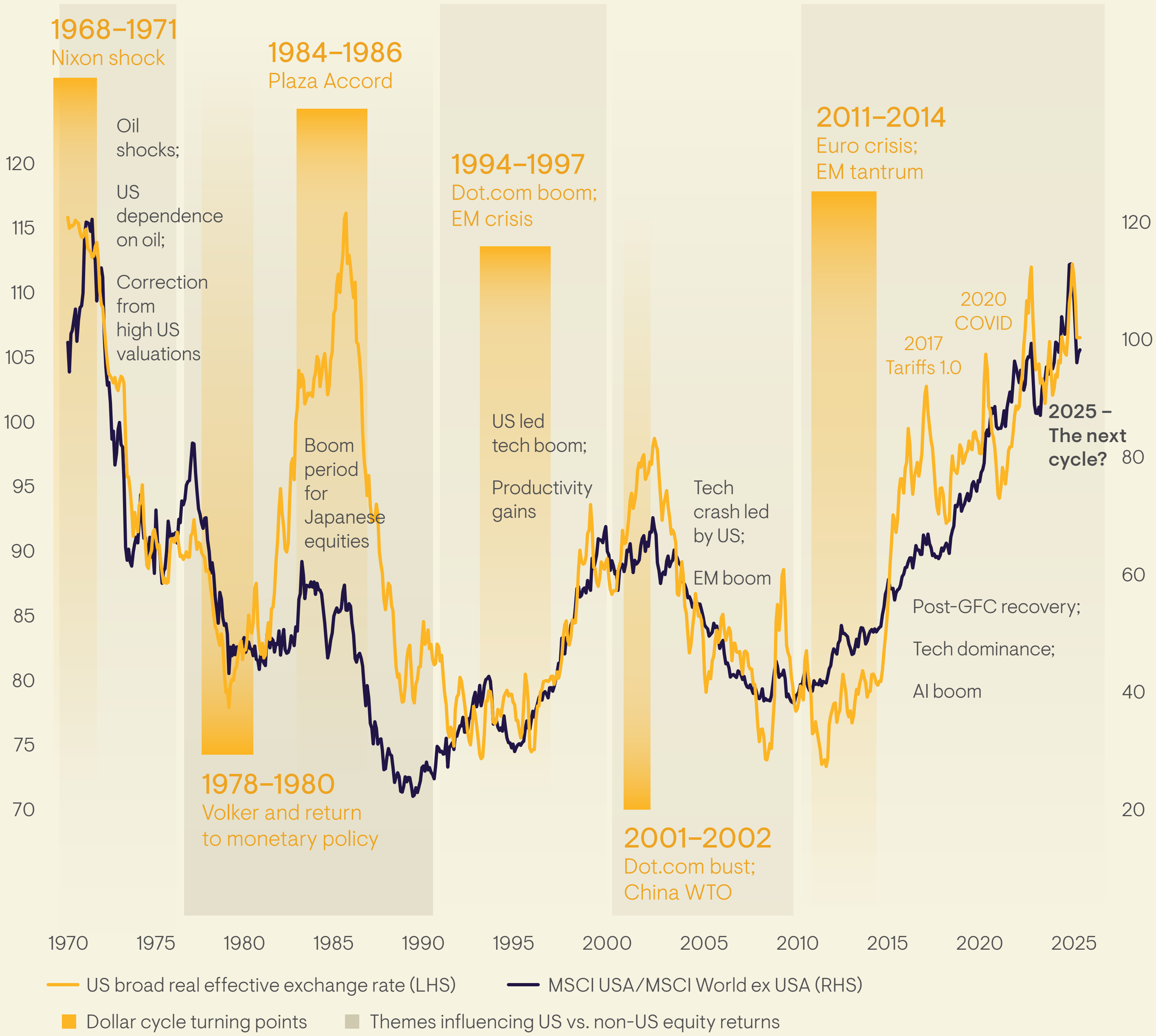
1. Morningstar, Bloomberg, June 30, 2025.
2. macrohistory.net

When viewed through this historical lens, it becomes clear that leadership between US and non-US equity markets tends to shift over multi-year periods. These cycles of relative performance frequently align with broader dollar cycles: periods of dollar strength have often coincided with US equity outperformance, while weaker dollar phases have supported international markets. While the relationship is not perfectly mirrored, the directional alignment is notable and reinforces the importance of understanding underlying macro dynamics.

Figure 1: The performance of US versus non-US equities aligns with dollar cycles



Source: Bloomberg, MSCI and Ninety One, July 2025.

While it might be tempting to attribute currency valuations and relative equity returns primarily to capital flows, doing so would underestimate the complexity of equity markets and the four reinforcing forces that underpin dollar cycles.

We have also seen periods of divergence. In the 1980s, Japan's booming economy muted the relative upward trend in US equities, though the US dollar surged with much higher interest rates than Japan and Europe. More recently, we observed shorter episodes of divergence in 2017 and 2020, when softer US growth expectations pushed the dollar down. Despite this, US equity markets continued to outperform non-US equities as investors focused on the resilience and profitability of US companies, particularly large technology firms, while weak economic conditions elsewhere continued to draw capital into the US. However, history shows these cycles eventually realign.

Therefore, the key question we seek to answer is not whether capital flows drive or reflect dollar cycles; they are one part of the equation. Rather, if we enter a multi-year downcycle in the dollar, as we believe we are, will we see an inflection in equity market leadership and sustained international equity outperformance?

If our analysis is correct, and all four reinforcing forces turn, investors will soon need to navigate a market environment distinctly different from the past decade and a half.

In this new cycle:

- The US dollar would enter a structural bear market, reshaping global capital flows.
- International and emerging-market equities would be buoyed by new tailwinds.
- Equity markets might also see new leadership emerge, potentially shifting away from the dominance of top-down, internet-driven growth towards bottom-up, AI-driven innovation.

The four reinforcing forces

Evidence for a new cycle lies in the decisions taken by policymakers and investors worldwide who act on the four forces and appear to be in the process of reversing them.

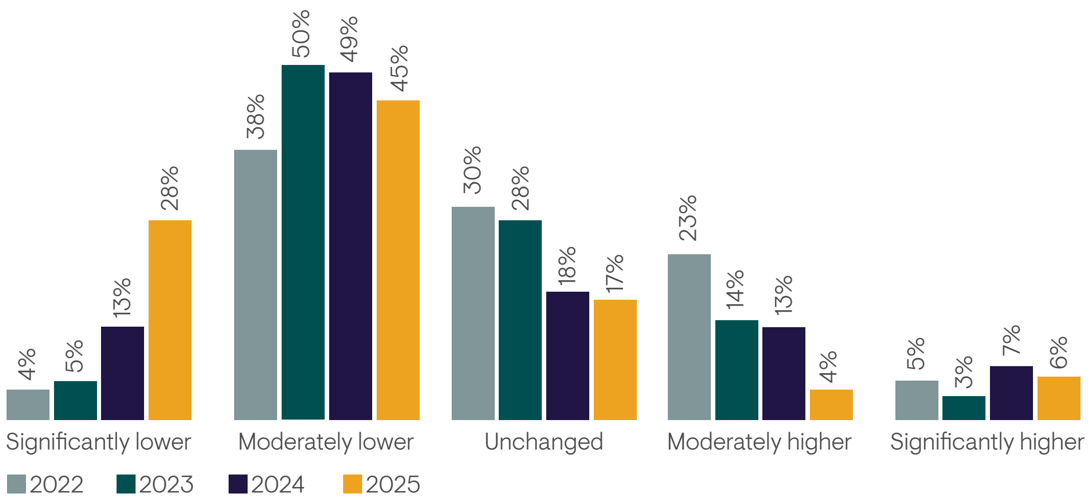
We analyze each in turn.

1 Geopolitical factors are reducing incentives for global investors to allocate additional capital to US financial assets

Discomfort around the unique role of the dollar and US assets in the global financial system is not new, but recent US policy action has made it more pressing. US policy measures, notably using secondary sanctions and freezing Russia's central bank assets, accelerated efforts toward de-dollarization. The Trump administration has added to this impetus, contemplating additional taxes on US capital account transactions and creating unease around institutional stability, policymaking predictability, and longer-term fiscal credibility.

While these factors are less directly tied to equity market performance, even modest shifts in regional allocations driven by such dynamics could have meaningful impacts over time. Importantly, this does not imply large-scale selling of existing US assets by international investors. Instead, the key issue is how incremental savings and reserve allocations will evolve.

Figure 2: Official sector survey shows 73% of central banks expect to hold fewer dollars over the next five years



Source: World Gold Council, Central Bank Gold Reserves Survey 2025, Perspectives on gold reserves. Available at: gold.org

2 Policy and growth tailwinds are shifting in favor of international and emerging markets

Throughout the last cycle, the US ran an expansionary fiscal policy. It delivered relatively strong growth, supported by interest rates that remained higher than in other regions, even at neutral levels, where they neither expand nor contract the economy. European economies, by contrast, were held back by austerity, delivered very limited growth, and interest rates became stuck at or below zero. With the notable exception of China, emerging economies were much more constrained in their ability to deploy fiscal and monetary stimulus.

The landscape is now shifting:

Europe

In the years following the financial crisis, government austerity and balance sheet repair in the financial sector left Europe constrained but policy has now decisively shifted in a pro-growth direction. The Draghi report on competitiveness laid bare the challenges facing the EU and provided a blueprint for positive supply side reform whilst the Russia-Ukraine war has created a new sense of urgency. Fiscal rules have been substantially relaxed, enabling greater investment in defense and infrastructure, which should deliver substantial growth multipliers.

At the same time, rate cuts by the European Central Bank (ECB) are fuelling credit expansion. Bank balance sheets have been repaired and corporate and household debt are now at the lowest level relative to GDP in at least two decades. This provides strong scope for the private sector to re-lever, providing additional support to domestic demand. This healthier starting point means lower rates and higher public investment can be more effective, allowing fiscal and credit stimulus to translate into renewed momentum within European equities.

Asia and emerging markets

Emerging market governments are on average much less indebted than their developed peers which, with some exceptions, provides significant fiscal headroom. The large Asian economies of India, Korea and Taiwan stand out for solid public finances alongside success in fostering private sector innovation. Taiwan provides a good example of how this matters. The government has maintained broadly balanced public finances in recent years, recording surpluses in both 2018 and 2019 after a period of careful debt and expenditure management. This discipline has allowed Taiwan to retain the ability to provide generous funding of scientific research and education and targeted tax credits and the development of a network of science and tech parks which are a key ingredient in Taiwan's success in the most advanced areas of semiconductor manufacturing.

Across Asia more broadly, the combination of sound fiscal positions and structural competitiveness provides a powerful foundation for growth. With policy space intact, governments can increase investment in areas such as infrastructure, technology and human capital, while maintaining market confidence. These conditions support the region's resilience and underline its importance within emerging market equities as a driver of the next cycle.

China

The focus of public sector investment in China has shifted from infrastructure to advanced manufacturing and household consumption, creating new avenues for growth.

China has built the world's largest and most efficient manufacturing sector[3].For example, CATL's battery manufacturing facility in Ningde spans about 16 million square feet, roughly equivalent to 278 football fields. The plant produces one battery cell every second, operating nearly three times faster than major competitors in Japan and South Korea, with some industry reports suggesting an estimated 1,000 robots operate on the production lines[4]. Initially driven by public investment, China's manufacturing strength is now sustained by world-leading research.

Chinese researchers rank first globally in highly cited academic papers and patent filings[5], while Chinese universities consistently rank among the world's top research institutions[6]. Chinese technological leadership is likely to remain a major factor in global economic dynamics in the coming years and will offer substantial opportunities for investors over the medium term.

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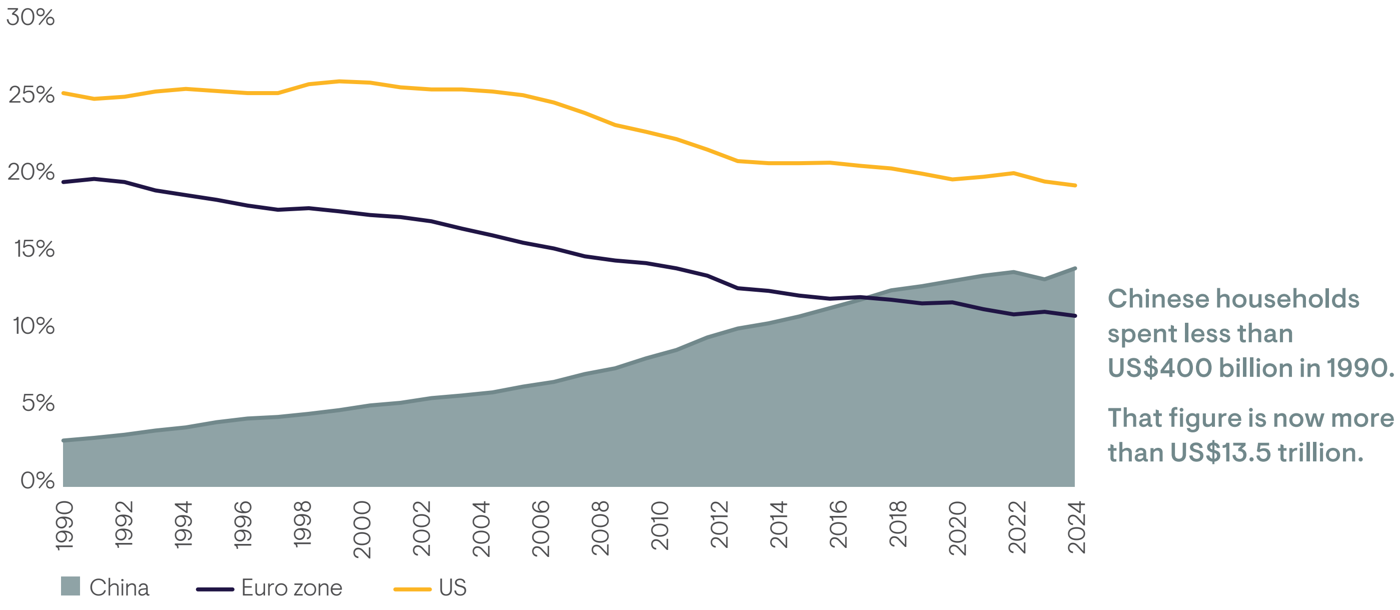
3. The World Bank estimates the value added by the Chinese manufacturing sector was $4.7trn in 2024. The equivalent figures for the US and European Union were below $3trn each.
4. CATL's Ningde (Fuding) facility spans about 1.5 million m^2 (~16 million ft^2, ~278 football fields) [EnergyTrend]. It produces one lithium-ion cell per second [InsideEVs], operates at around 95% automation [PR Newswire], and according to industry reports, uses around 1,000 robots on its lines [World Economic Forum, Global Lighthouse Network]
5. https://nistep.repo.nii.ac.jp/record/2000116/files/NISTEP-RM341-SummaryE.pdf, IP Facts and Figures.
6. https://www.nature.com/nature-index/.

Despite recent setbacks, such as the property market downturn, the Chinese consumer has been the largest single source of aggregate-demand growth in the world economy this century[7] (Figure 3). Even as the structural rate of growth slows, the size and ongoing dynamism of this market make it impossible to ignore. Moreover, Chinese demand is of outsized importance in luxury goods, consumer electronics, and ecommerce, including emerging areas such as autonomous vehicles. With policy now stabilizing the housing market and incentivizing consumption through targeted support and short-term stimulus, China has the potential to meaningfully influence the outcomes for international and emerging equities over the next cycle.

Figure 3: The Chinese consumer has been the single largest source of aggregate-demand growth this century



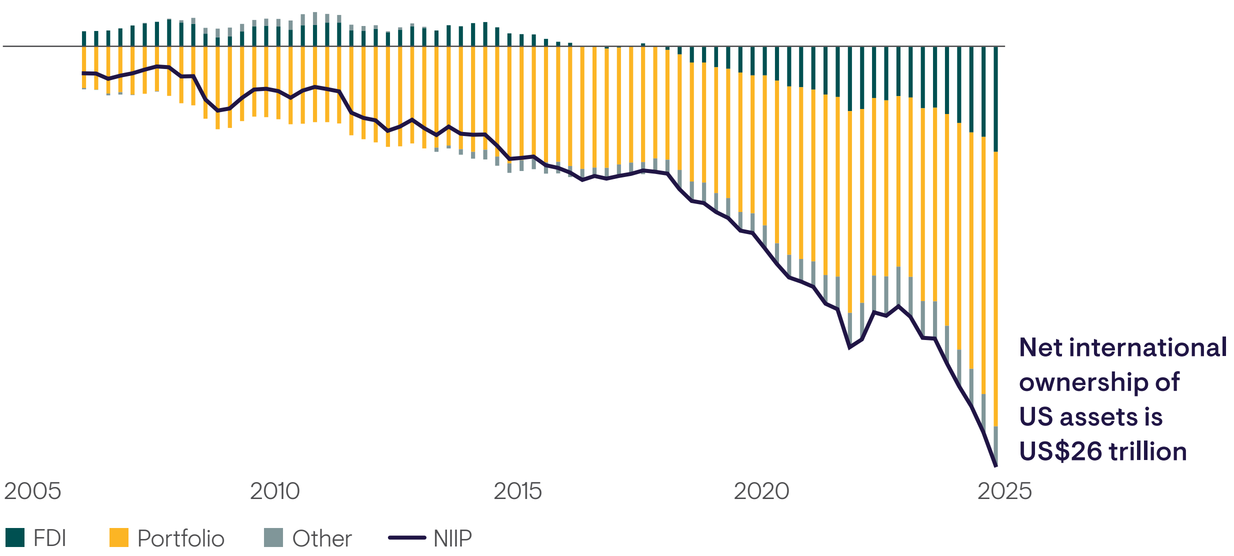
Source: IMF, June 2025 (data as at end 2023).

7. Over the 20 years to end 2023 (the latest data available), the World Bank estimates that Chinese household consumption grew by $11.8trn or 11% per annum, whilst US household consumption increased by $11.1trn or 4.5% per annum in PPP terms. In real USD terms, the aggregate growth in Chinese household consumption in this period was slightly lower than the US ($5.9trn vs $6.5trn).

3 Capital flows are driven by relative growth and yield differentials. US technology underpinned superior growth outcomes, but this is changing with the transition from the internet era to the AI age.

Since the global financial crisis, capital flows have surged into the US economy and have reached levels with no parallel in history. By the end of 2024, international investors held US assets worth US$62 trillion, more than double the size of the US economy. After subtracting international assets held by US investors, the US Net International Investment Position (NIIP) was US$26 trillion, approximately 90% of US GDP. The primary driver has been portfolio investment, with international investors attracted by higher yields and stronger growth prospects in US debt and equities. Given the scale of international holdings, even a modest slowdown or reversal of incremental capital flows into the US could have major ripple effects across global markets.

Figure 4: The scale of international ownership of US assets has no parallel in history



Source: Bloomberg, July 2025.

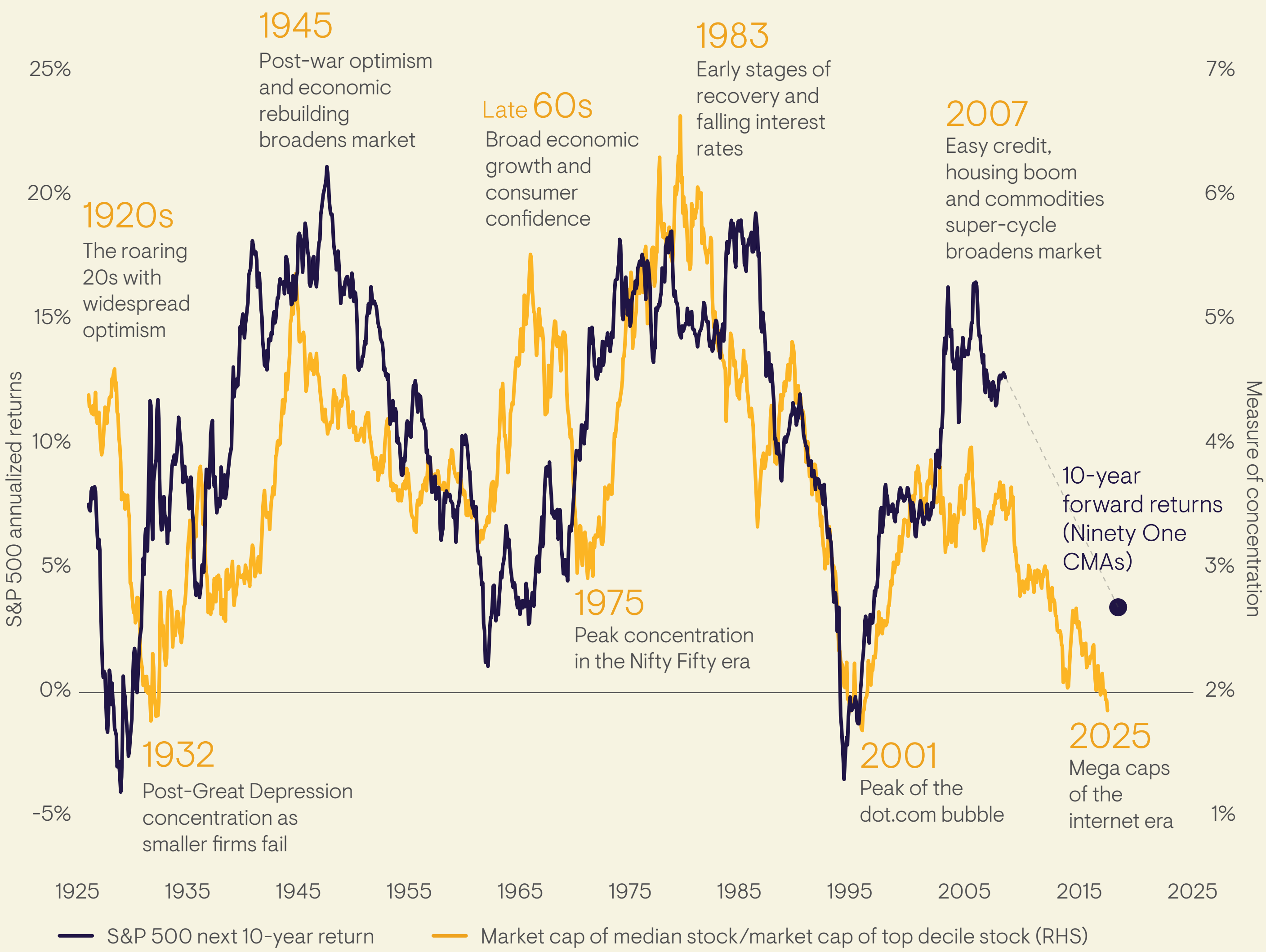
The success of US technology companies during the internet era played a significant part in driving these inflows. Internet platforms benefited from powerful network effects and economies of scale, enabling new digital business models to emerge[8]. Companies specializing in online advertising, software-as-a-service, and infrastructure-as-a-service grew rapidly, delivering exceptional profits. The result has been extreme market concentration, currently at its highest level since 2001, at the peak of the dot-com bubble, and before that, during the aftermath of the Great Depression.

8. See Author et al - The Fall of the Labor Share and the Rise of Superstar Firms and Emery - Market dominance in the digital age.

Historically, periods of extreme market concentration are associated with weaker subsequent returns.

To measure concentration in the US equity market, we compare the average market cap of the largest 10% of US-listed companies to the market cap of the median US company. As of 30 June 2025, the median company had a market capitalization of US$4.4bn – the size of the Avis Budget Group or the retailer Abercrombie & Fitch – and the largest decile had an average market capitalization of US$240bn – the size of Goldman Sachs or McDonald's. The median company was therefore valued at less than 2% of the average large company, in line with the lowest that this metric has been over the last 100 years.

Figure 5: Periods of intense concentration have typically led to weaker 10-year returns



Source: Ninety One, Bloomberg, July 2025.

Rethinking concentration in the age of AI

A broadening of market leadership in the next innovation cycle appears increasingly likely, driven by rapid AI advances and widespread adoption. In contrast to the internet era, the benefits of AI are expected to be distributed more broadly. Internet innovation in recent decades led to the growth of new platform business models and saw online revenue growth concentrating among a few winners. AI appears to be a general-purpose technology with the capability of automating a wide range of tasks currently undertaken by humans, leading to higher productivity growth and possibly profound changes to labor markets[9]. If this is right, then AI should deliver returns across many industries through cost savings and greater operational efficiency with smaller companies able to benefit from these advances in a similar fashion to the largest businesses.

Major US technology companies currently lead in AI model development and have significant resources to maintain their advantage. However, examples like DeepSeek or Z.ai show that other companies can quickly compete with much smaller budgets. Moreover, the AI-as-a-service model differs from the internet business models of the last cycle, with higher upfront costs and different scalability dynamics.

Successfully navigating this environment will require careful selection. The winners are unlikely to be simply the earliest adopters or those with the deepest pockets. Instead, investors should adopt a selective, bottom-up approach, focusing on companies that are intentional and strategic in their use of AI, able to convert incremental technological advances into meaningful, lasting performance.

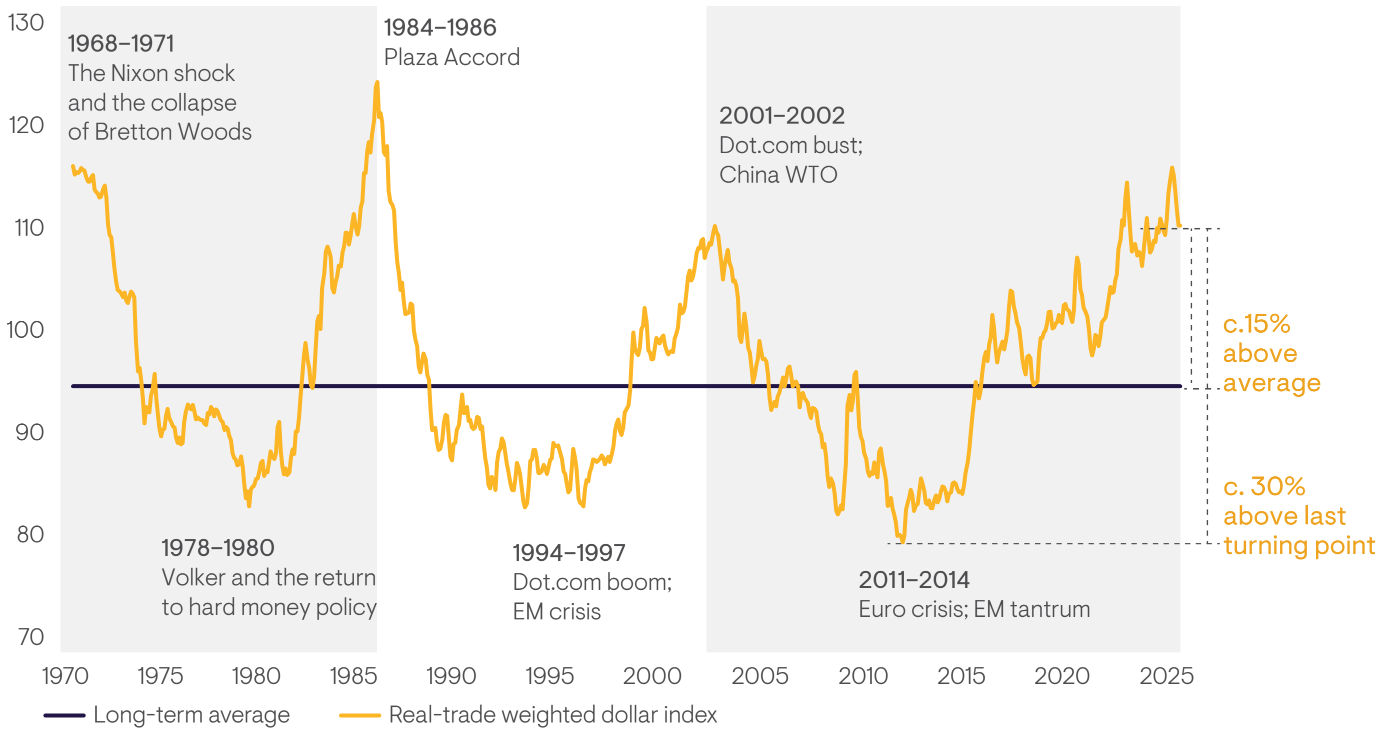
9. Significant uncertainty remains on the size of the productivity impacts of generative AI. For a range of different views see work by Goldman Sachs, McKinsey and Daron Acemoglu.

4 Global policymakers rethink US capital flow imbalance as coordination gains traction

The Nixon shock (1971), Plaza Accord (1985), and launch of the Euro (2002) were important triggers for the prior downcycles in the US dollar and coinciding periods of international equity outperformance. Recent speculation around a potential 'Mar-a-Lago accord' echoes these historical examples, although formal intervention may not be required as the threat of policy action is already influencing behavior among policymakers and investors. One clear example is the Taiwan dollar's 10% appreciation in the second quarter of 2025, sparked by anticipation of trade negotiations with the US.

Currency market interventions have a greater chance of success when they correct significant imbalances rather than exacerbate them. The US dollar has declined from its peak but remains around 15% overvalued relative to the long-run average real effective exchange rate, or 30% above the last time it reached a low point in 2011.

Figure 6: The US dollar sits 15% above its long-term average

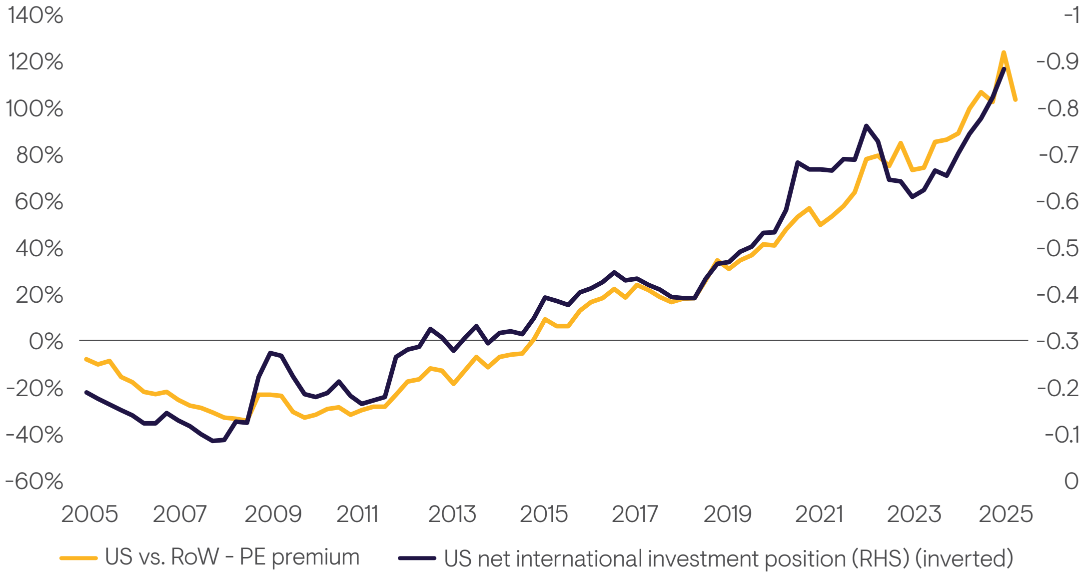


Source: Bloomberg, July 2025.

Furthermore, US equities are trading at 26x trend earnings versus 13x for ACWI ex-US equities. While the US equity market deserves a premium due to its quality and sector composition, this divergence has limits.

The high relative valuation of US equities appears closely linked to disproportionately strong capital inflows into US markets. Although there is some circularity, as rising equity valuations feed into the NIIP calculation, equities constitute less than 20% of the total NIIP, suggesting this is not the primary driver. Instead, it appears the same forces driving broader US capital inflows also support elevated US equity valuations.

Figure 7: The premium investors pay for US equities overlaps with international flows



Source: Bloomberg, July 2025.

A slowdown in the growth of US net liabilities could therefore put downward pressure on the valuation premium US equities currently enjoy.

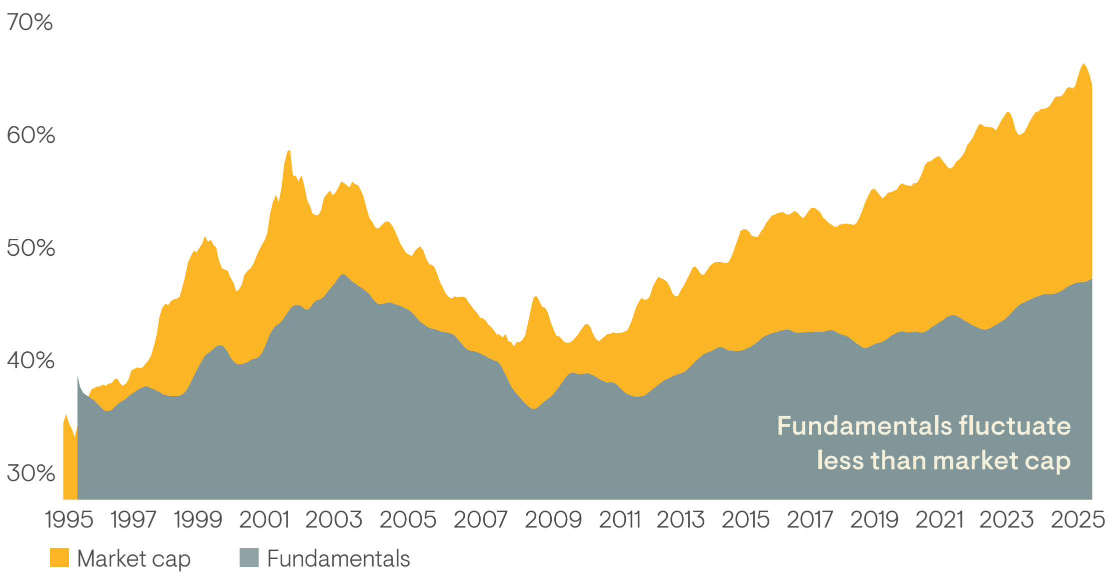
Reframing regional equity allocations for the new cycle

If today's market extremes and the emergence of the AI era mark the beginning of a new investment cycle, investors may need to rethink how they approach regional exposure. Relying on market-cap-weighted benchmarks is, in essence, anchoring to past returns, returns that have repeatedly proven unreliable guides to future outcomes. Despite its unmatched scale and liquidity, the nearly 70% dominance of the US equity market within global benchmarks creates a distorted lens, undermining genuine geographic diversification.

If historical returns are unreliable for determining regional allocations, what other options exist? GDP weighting is not appropriate, as GDP includes economic activities unrelated to listed companies, and multinational firms rarely confine their operations within national boundaries.

A more intuitive approach is to focus on fundamental measures of listed companies. Based on metrics such as revenues, earnings, cash flows, and dividends, the US currently represents between 40% and 50% of the global total. Developed ex-US markets contribute around 35% to 40%, and emerging markets approximately 15% to 20%. A further advantage of fundamental measures is stability. Over the last 30 years, the fundamental share of the US market ranged from 36% to 48%, whereas market-cap weightings have fluctuated widely from 33% to 67%.

Figure 8: US share of company fundamentals has operated in a tighter band



Source: Bloomberg, July 2025.

Achieving a fundamentals-based global allocation would imply rebalancing US equity exposure downward, but not dramatically. Given structural differences in profitability, sector mix, and business models, a full convergence in valuation multiples across regions seems improbable. Instead, fundamental measures can serve as a durable floor, suggesting a sensible lower limit for US exposure between 40% and 50%. A practical upper limit might be around 70%, just above the highest historical weighting. This creates a flexible strategic allocation range anchored in economic reality rather than benchmark inertia.

Figure 9: Regional weights based on a range of different metrics

	US	DM ex US	EM
Market cap	67%	23%	10%
GDP (USD)	26%	32%	41%
GDP (PPP)	15%	25%	60%
Revenue	48%	37%	15%
Earnings	52%	33%	14%
Cash flow	46%	34%	20%
Dividends	46%	40%	14%
Book value	41%	41%	18%
Range	50% - 70%	20% - 40%	10% - 20%

Source: Ninety One as of 31 December 2024.

Many US allocators also hold substantial US-focused private-market exposures, often ranging between 20% and 40% of total assets. Given the illiquid nature and long-term horizons of these investments, diversifying such allocations geographically can take considerable time. As a result, achieving sufficient geographic diversification through private investments alone may be challenging. This places even greater importance on diversification through public equity markets for US-based investors.

Strategic allocation anchored in forecasted fundamentals

Determining an appropriate allocation within these ranges requires more than historical intuition. It calls for a forward-looking view on returns, volatility, and correlations. Our capital market assumptions aim to provide this perspective. Developed independently from the analysis above, they draw on long-run empirical relationships to forecast the primary building blocks of returns: income, growth and valuation. While such forecasts inevitably carry uncertainty, they offer a structured basis for setting strategic allocations.

Our ten-year projections, in annualized nominal US dollar terms, suggest a clear divergence in return potential:

3.7%	6.3%	7.2%
US equities	Developed ex-US equities	Emerging market equities

Higher income yields and anticipated currency appreciation relative to the US dollar are the main drivers of the higher expected returns in international markets.

Using these forecasts, we construct a constrained efficient frontier based on our proposed allocation ranges. Given the lower expected risk-adjusted returns in the US market, the analysis points towards the lower end of the US equity allocation range.

The portfolio offering the highest risk-adjusted return comprises:

50%	30%	20%
US equities	Developed ex-US equities	Emerging market equities

This allocation delivers a projected annual return of 5.2%, above the 4.7% forecast for the MSCI AC World Index. These expected returns could potentially be enhanced further by active management and the pursuit of alpha.

Conclusion

Regional performance cycles have remarkable staying power, but once clear evidence emerges that a cycle is shifting, investors can reposition portfolios for sustained new trends. Today, the convergence of geopolitical realignment, divergent policy paths, shifting capital flows, and coordinated efforts among global policymakers signals the onset of a new multi-year investment cycle.

Market-cap-weighted benchmarks anchor portfolios in the past, reflecting yesterday's winners rather than tomorrow's opportunities. The current dominance of US mega-cap stocks, powered by internet-driven platforms, appears increasingly vulnerable as valuation extremes collide with a weakening dollar and the transformative impact of AI. Investors should look beyond the familiar to identify new growth engines emerging across regions, sectors, and market segments. Successfully navigating this next cycle will require forward-looking diversification and careful, bottom-up selection to capitalize on a broader global opportunity set shaped by fundamental trends rather than index inertia.

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