What's Hot: The End of US Exceptionalism and Growth of European ETFs

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Key Takeaways

- U.S. exceptionalism—the belief in America's unmatched economic leadership—has driven disproportionate capital inflows, but that narrative is now under pressure.
- Erratic U.S. policy, weakening alliances, and rising global competition are challenging the dominance of U.S. markets and the dollar's "safe haven" status.
- European defence and tech sectors are benefiting from structural rearmament and renewed confidence, reflected in ETF inflows.
- Non-U.S. equity markets, particularly Europe and China, are outperforming the U.S. in 2025, raising questions about a broader shift in investment priorities.
- ETF flows indicate growing investor preference for local European exposure, as confidence in U.S. dominance continues to erode.

For decades, the United States has enjoyed a status of economic exceptionalism, attracting a disproportionate share of global capital relative to the size of its economy. For instance, the U.S. accounts for approximately 72.92% of the MSCI World Index and 66.41% of the MSCI ACWI Index—both market-cap-weighted—despite contributing only 26.3% to global GDP.

What is U.S. exceptionalism?

U.S. exceptionalism refers to the belief that the United States possesses unique economic strengths that make it a standout—or even superior—environment for innovation, growth, and long-term investment compared to other nations. This idea has historically served both as an investment narrative and as a reflection of real structural advantages within the U.S. economy.

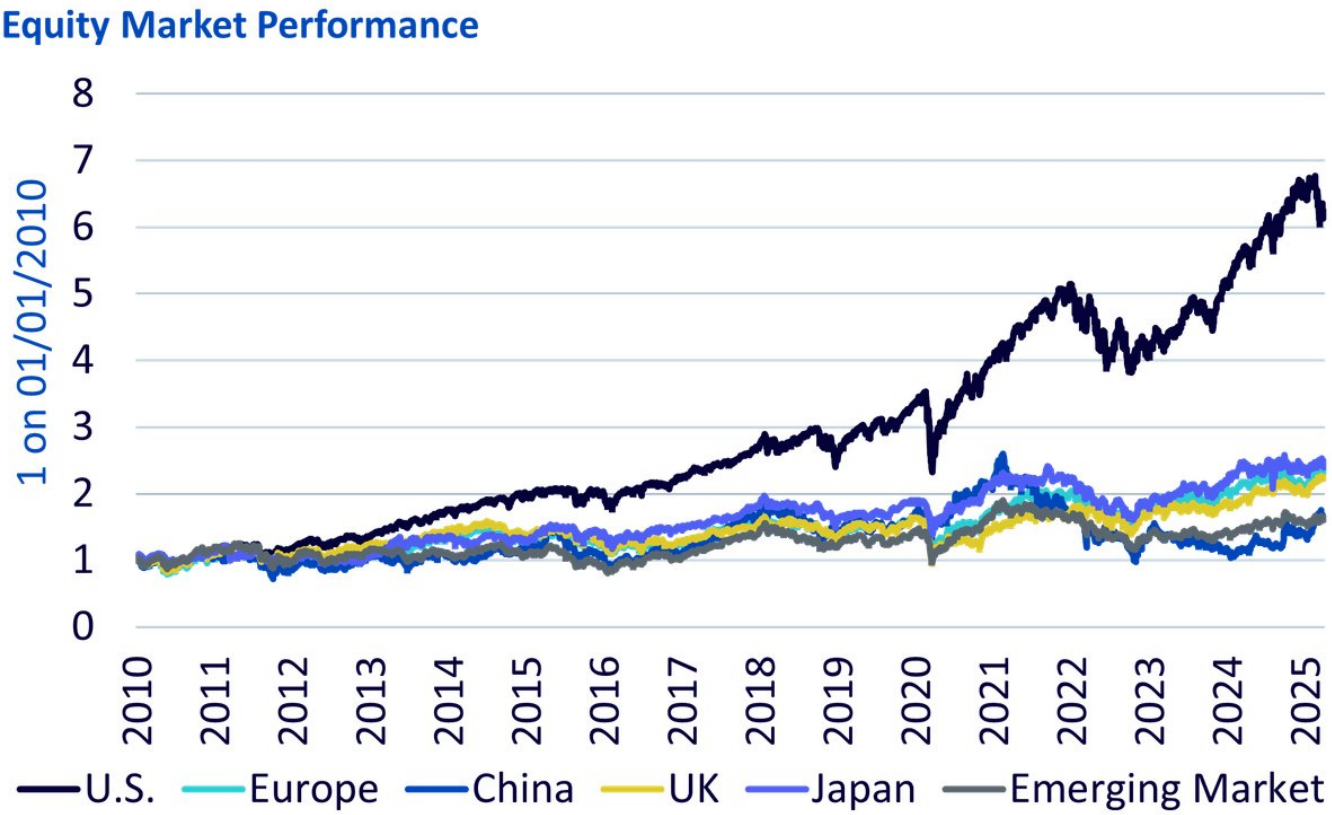
Key Drivers of This Perception:

- **Innovation & Tech Leadership:** The U.S. is home to many of the world's most innovative and valuable companies (e.g., Apple, Microsoft, Google), with tech serving as a major engine of market performance.

- **Deep, Liquid Capital Markets:** U.S. financial markets are among the world's most developed and accessible, making capital-raising and investment activity highly efficient.
- **Rule of Law:** A robust legal framework protects property rights and enforces contracts, fostering investor confidence.
- **World Reserve Currency:** The U.S. dollar's status as the global reserve currency provides unique advantages in trade and financing.
- **Favourable Demographics & Immigration:** Compared to peers like Japan and much of Europe, the U.S. benefits from more favourable demographic trends and a steady inflow of skilled immigrants.

Historic Implications of

- **Equity Outperformance:** Over the past few decades, U.S. stocks — particularly large-cap tech and growth companies — have outperformed most global peers (see Chart 1). Investors often overweight U.S. equities in global portfolios.
- **Flight to Safety:** During global crises or uncertainty, investors often flock to U.S. assets (like Treasuries or the dollar), reinforcing the perception of the U.S. as a safe and reliable economic anchor.
- **Higher Productivity Growth:** The U.S. is seen as more dynamic and resilient, with flexible labour markets and a strong entrepreneurial culture that fuels economic recovery and innovation.



Source: Bloomberg, WisdomTree. 01/01/2010 to 03/04/2025. Based on MSCI Net Total Return USD Indices. **Historical performance is not an indication of future performance and any investments may go down in value.**

Mounting Doubts Around U.S. Exceptionalism

Lately, international investors are beginning to challenge this long-held belief. These doubts have been compounded by erratic policy moves from the current U.S. administration. The reduction of U.S. security commitments globally and a pivot toward protectionist or mercantilist trade policies have unsettled traditional allies and investors alike.

In particular, the U.S. drawdown of international security support has led many European nations to abandon prior budgetary constraints and accelerate defence spending in pursuit of military rearmament.

European governments are not making short-term, reactionary purchases—they are redesigning their defence strategies for the long term. Germany's €100 billion special fund is set to be fully allocated by 2027, and France, Poland, and the UK have committed to record military budgets. Europe has historically relied on U.S. defence contractors for high-end military technology, but policy changes are prioritizing domestic suppliers. Reflecting investor confidence in this strategic shift, the WisdomTree Europe Defence UCITS ETF has garnered US$817mn in inflows in the first 16 trading days since its launch on 11 March 2025.

Meanwhile, U.S. tech dominance is also under scrutiny. The emergence of China's DeepSeek—a more cost-efficient AI model—has sparked fresh scepticism over the valuations of high-flying U.S. chipmakers

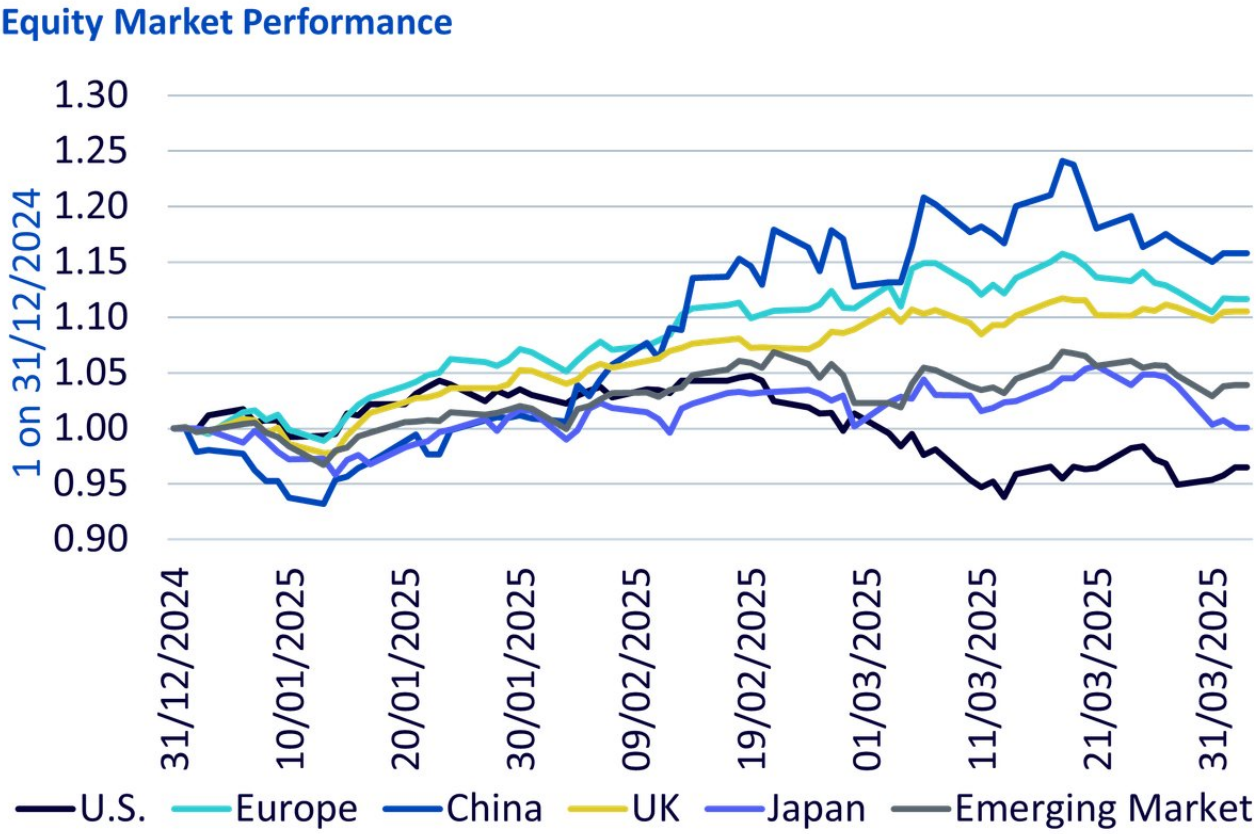
like Nvidia. These valuations have been predicated on the belief that U.S. firms would maintain pricing power for longer than may now seem realistic.

Additionally, the U.S. dollar is losing some of its traditional “flight to safety” appeal. Following the announcement of new tariffs on April 2, 2025, which heightened fears of a slowdown in global growth, the U.S. Dollar Index (DXY) fell 2.5% within just 18 hours.

Non-U.S. Equity Markets Are Leading

U.S. equity benchmarks have significantly underperformed their international counterparts year-to-date. As of the latest data, U.S. indices have lagged Europe by 13.6% and China by 19.3%.

While part of this divergence could be attributed to cyclical factors, there is growing concern among investors about a structural shift—one that may signal a closing of the performance gap between the U.S. and the rest of the world.



Source: Bloomberg, WisdomTree. 31/12/2024 to 03/04/2025. Based on MSCI Net Total Return USD Indices. **Historical performance is not an indication of future performance and any investments may go down in value.**

European investors buying more European funds

Investor behaviour reflects these changing dynamics. European ETF investors, in particular, have been reallocating capital from U.S. to European funds, as shown in the table below:

Source: Bloomberg, as of 03 April 2025, flows in USD. Flows are shown for all ETFs listed in Europe. Figure shown in brackets is negative.

Conclusions

The decades-long narrative of U.S. economic exceptionalism is increasingly being questioned. A combination of policy unpredictability, weakening global alliances, and growing competition—especially in key sectors like technology—has eroded some of the confidence that underpinned U.S. dominance.

As non-U.S. equity markets outperform and global investment flows rebalance, European ETFs are beginning to see renewed attention. The shift may signal not just a short-term rotation, but a broader reassessment of global investment priorities.

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