US Credit: The Case for American Exceptionalism

Why a combination of government policy, innovation and macro tailwinds make us optimistic for the asset class.

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Historically, the US economy has reacted to higher interest rates in predictable ways, and has been generally correlated with other developed economies – especially Europe and Japan. However, post-pandemic, these patterns have generally broken down and it has charted its own path.

Between 2010 and 2023, US GDP grew 34%, much faster than the European Union's 21% and the eurozone's 18%.[1] The US is expected to meaningfully outperform other nations in terms of GDP, according to the OECD, and we expect it to continue its run of outperforming the world at the asset price level for the foreseeable future . While many factors have been in play, one primary contributor has been labor productivity – during the same 13-year period, this went up in the US by 22%, but only increased by 5% in the eurozone.[2]

LGIM America

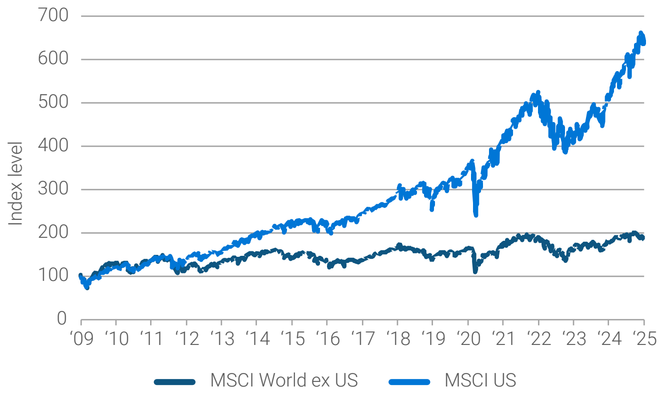
1. Source: Bloomberg as of January 14, 2025.
2. Source: [Organisation for Economic Cooperation and Development, December 2024.]

Figure 1: GDP expectations

	2025	2026
Germany	0.7	1.2
France	0.9	1.0
Italy	0.9	1.2
Japan	1.5	0.6
UK	1.7	1.3
Canada	2.0	2.0
US	2.4	2.1

Source: Organisation for Economic Cooperation and Development. Data as of December 2024.
Assumptions, opinions, and estimates are provided for illustrative purposes only. There is no guarantee that any forecasts made will come to pass.

Figure 2: US equity performance vs. the world



Source: Bloomberg. Data as of January 8, 2025 .
Past performance is not a guide to the future.

The US technology sector, especially firms associated with the new wave of artificial intelligence (AI) solutions, has been the most productivity-enhancing component. American corporate profitability sits at an all-time high as a percentage of GDP as consumers have been largely yield-insensitive (see page four). This has allowed rates to remain higher for longer – thus leading to higher credit yields relative to most other markets. Compounding effects over time have resulted in a larger, more diversified and more liquid market.

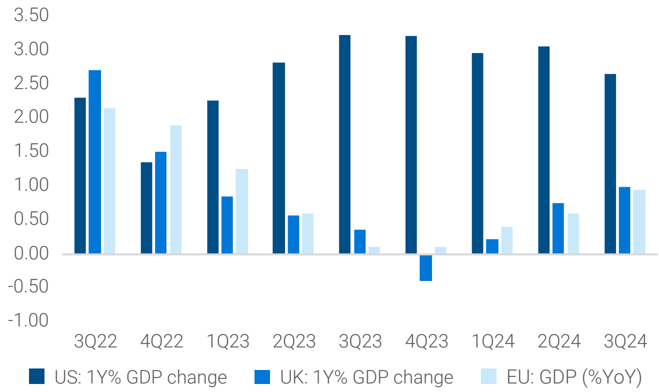
This note outlines the case for further US exceptionalism – and the investment rationale for allocations to US credit over other developed economies.

Favorable macro backdrop

The US economy is showing no signs of a slowdown. November's core CPI ticked up to 2.7%, but sits well below the 9.1% peak seen in 2022. At the end of 2024, wage inflation was near 4% – more in balance, but still relatively strong with low unemployment and jobs continuously being created.[3]

At the same time, US GDP has continued to grow steadily at a pace above the historical average, expanding 2.8% in Q3 2024, well above the Congress Budget Office's (CBO) 2% estimate for long-run growth.[4] This has meaningfully outperformed both the EU and UK economies. This growth and ebullience when looking forward can be explained by two major (and unique) tailwinds: the AI revolution, and stimulative fiscal policy.

Figure 3: GDP growth



Source: LSEG Datastream. Data as of January 2025.

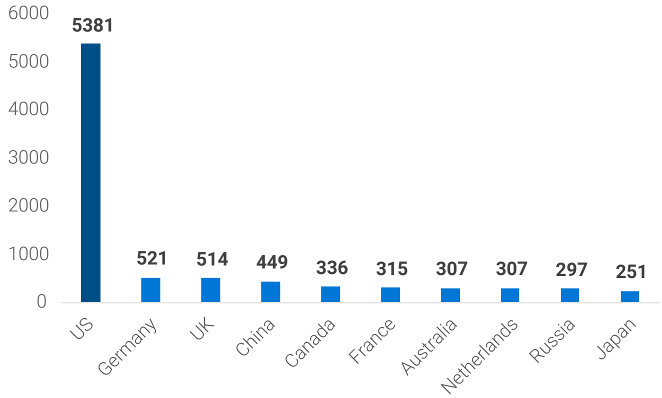
3. Source: Bloomberg. Data as of January 13, 2025.
4. Source: Bloomberg. Data as of January 13, 2025.

The AI revolution

The US is experiencing a surge in corporate and research spending on the back of the AI revolution—a dynamic not seen in other developing nations or even China (see Figure 4). This 'AI boom' is structural, widespread and pervasive, ranging from investments by tech giants in the development of AI itself to the infrastructure supporting it, and from semiconductor design and manufacturing to the building of data centres, increased energy generation needs, and further automation of supply chains.

This surge in AI-driven investment has significantly contributed to the strong performance of US corporations by fostering innovation, enhancing productivity, and creating new revenue streams. Looking ahead, we think the market's continued focus on AI and related technologies is likely to sustain this momentum, positioning US corporations for robust future growth. The ability to rapidly adapt to technological advancements and capitalise on emerging trends adds to our confidence that the US will remain at the forefront of global economic performance.

Figure 4: Number of data centres



Source: LSEG Datastream. Data as of January 2025.

Stimulative fiscal policy

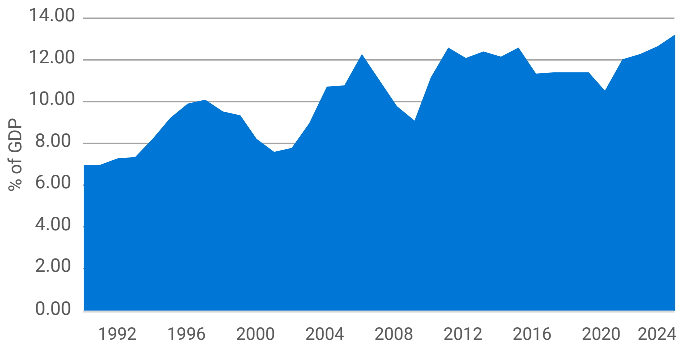
As it moved out of the COVIS period, the US was unique in the degree of fiscal support applied to its economy. It has outspent other developed nations by a large margin, providing strong tailwinds to economic growth through the enactment of key pieces of legislation, such as the CHIPS and Science Act (2022), the Inflation Reduction Act (2022), the Infrastructure Investment and Jobs Act (2021), and others.

These policies are united in reflecting the growing consensus that supply chains had to be taken 'in-house', and they have consequently created a boom in the construction of everything from semiconductors to electric vehicles, batteries, solar panels and windmills. The Federal government's investments in green energy and infrastructure, along with private sector investments in AI, have been crucial to the nation's economic resilience and they are expected to drive economic activity over the coming years.

Credit fundamentals

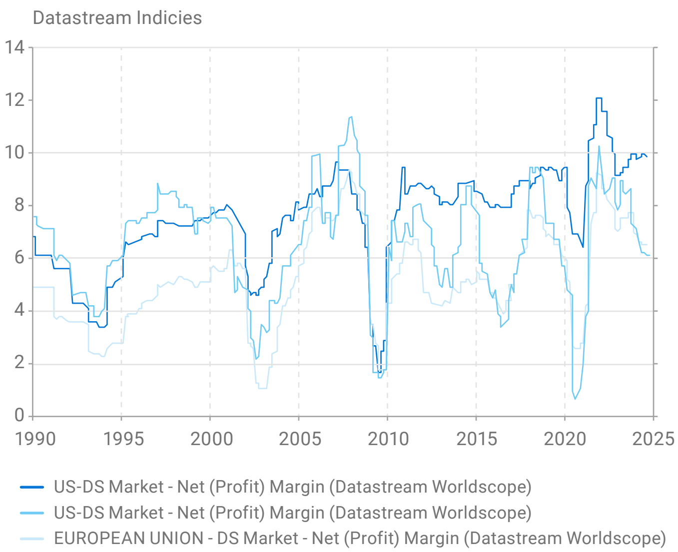
Fuelled by this mixture of stimulus and innovation, US corporations are experiencing profitability levels at all-time highs as a share of GDP, alongside controlled financial leverage metrics.[5] Furthermore, US corporate profitability has shown more resilience over time relative to both the EU and UK, especially during the pandemic. US profitability increased in 2024, while EU and UK data has come under increasing pressure. Also, forward earnings estimates for coming quarters show steady progress in the US with relatively little movement in the UK and deterioration in Europe.[6]

Figure 5: US corporate profits as a share of GDP



Source: BEA and Haver Analytics. Data as of December 2024.

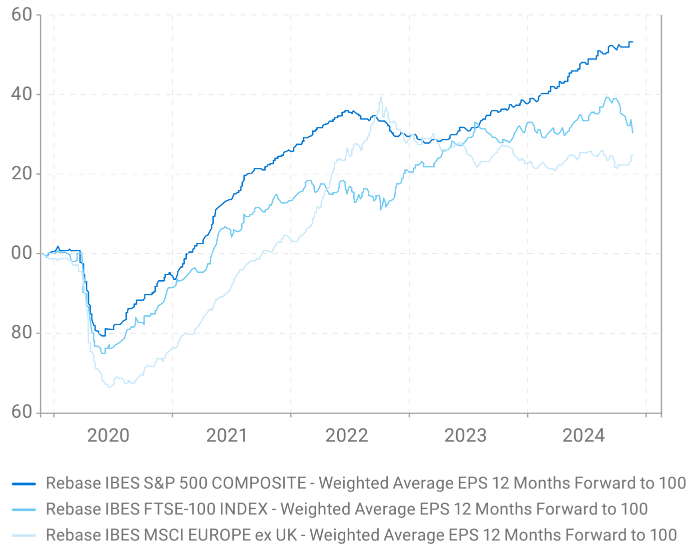
Figure 6: Profit margins: US, EU, UK



Source: LSEG Datastream. Data as of January 15, 2025.

5. Source: BEA, Haver Analytics. Data as of December 2024.
6. Source: LSEG Datastream. Data as of January 15, 2025.

Figure 7: Profit margins: US, EU, UK



Source: LSEG Datastream. Data as January 15, 2025.

In our view, there are a number of factors contributing to the robust outlook for US corporations:

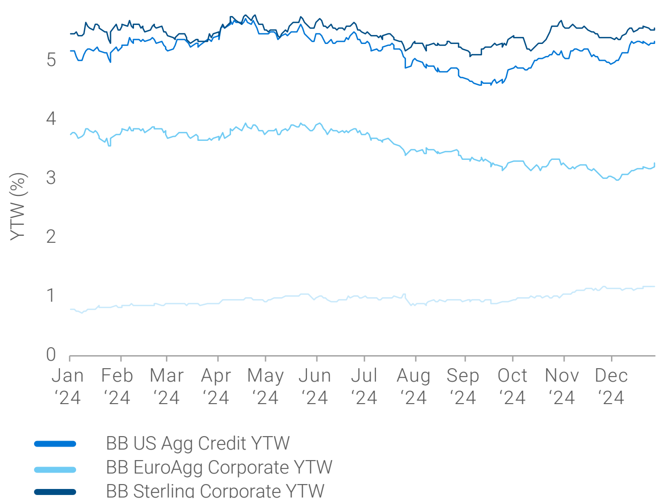
- **US consumer spending**: In 2023 and 2024, US labor market strength led to an acceleration in real disposable incomes, which in turn meant robust household spending. 2024 was a solid year for consumers and they finished the year strong, with December card spending per household up 2.2% year-over-year (YoY), according to Bank of America aggregated credit and debit card data. Seasonally-adjusted card spending per household rose 0.7% month-over-month (MoM).[7] Additionally, US consumers saw immense gains in their aggregate net worth over the past five years -- in excess of $50 trillion USD.[8] As we kick off 2025, the consumer continues to benefit from a supportive labor market with after-tax wage and salary growth up 3% YoY in December.[9]
- **Broad investment in technology**: Businesses stepped up their investments in equipment and intellectual property in Q3 2024, a sign of demand for the chips and software that run AI. Bankruptcies and defaults for levered loans are down. The combination of locked-in low interest rates and strong corporate earnings has meant that net interest payments as a share of operating surpluses have also been declining.
- Expected policy enhancements:
  - **Tax cuts:** At the time of writing, the Trump administration is expected to renew the corporate tax cuts from their first period in government (when it was cut from 35% to 21%), which is expected to benefit corporations' after-tax profits
  - **Deregulation**: The campaign had a strong focus on reducing regulation across various industries, which lowers compliance costs and allows businesses more operational flexibility
  - **Trade policies**: While controversial, some of Trump's trade policies, such as previously renegotiated trade deals like NAFTA (now USMCA), are aimed at creating more favourable conditions for US businesses
  - **Energy sector boost**: The administration's policies favor traditional energy sectors by rolling back environmental regulations, which can benefit oil, gas, and coal industries.

7. Source: Bank of America. Data as January 12, 2025.
8. Source: Goldman Sachs. Data as of January 2025.
9. Source: Bloomberg. Data as of January 12, 2025.

Yield dynamics

Yields on US investment grade credit are at historic highs, and are meaningfully higher than both EU and Japan corporate indexes.[6] The policies followed by the US Federal Reserve (Fed) were slower to take effect than in past cycles, especially relative to Europe, Canada, Australia, China.

Figure 8: US credit yields near historic highs

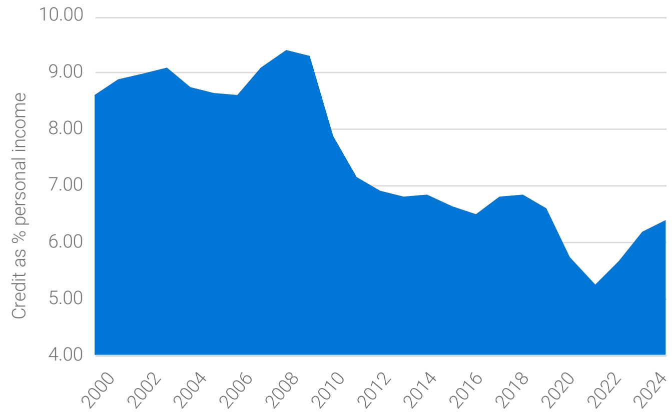


Source: Bloomberg. Data as of January 12, 2024.
Past performance is not a guide to the future.

One primary reason for elevated yields is the US insensitivity to interest rate changes. Due to the broad use of fixed rate financing, both US consumers and US firms were less impacted by the recent high-rate regime relative to their international peers. The US economy has proven to be much less sensitive to the Fed's interest rate hikes than in years past due to key idiosyncrasies (i.e. large, liquid, and long-duration fixed-rate markets for mortgages and corporate bonds), which have allowed both individuals and corporations to 'lock in' rock-bottom interest rates for periods of up to 30 years.

As seen in Figure 9, consumer credit as a share of personal income appears to be quite contained suggesting the consumer can still support the growth of corporations in the credit universe.

Figure 9: Consumer credit as share of disposable personal income



Source: Bloomberg. Data as of January 12, 2024.
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10. Source: Bloomberg as at January 12, 2024.

The US is the largest and most diversified market

In our view, the vast American market provides a wide array of investment opportunities across various sectors, industries and credit qualities, allowing investors to build well-diversified portfolios that can mitigate risk. The high liquidity in the US credit market means that investors can easily buy and sell securities, enhancing their ability to respond to market changes and capitalize on emerging opportunities. Additionally, the depth and breadth of the market enable more accurate pricing and better access to information, which can lead to more informed investment decisions. Overall, we think these factors contribute to a more stable and potentially higher-yielding investment environment for credit investors.

An economically challenging year for much of the world has seen the notion of 'There is no alternative' (TINA) to the US gain significant traction. Investors have flocked to US assets not only because of attractive fundamentals, but because global alternatives appear unappealing. No narrative lasts forever, and TINA is no exception – what could change?

Something breaks globally: The combination of a strong US dollar, persistently elevated real yields and a less accommodative Fed than previously expected could create stress in Asia, Europe, or emerging markets. If the stress becomes severe enough, the ensuing risk-off sentiment could spill back into US markets.

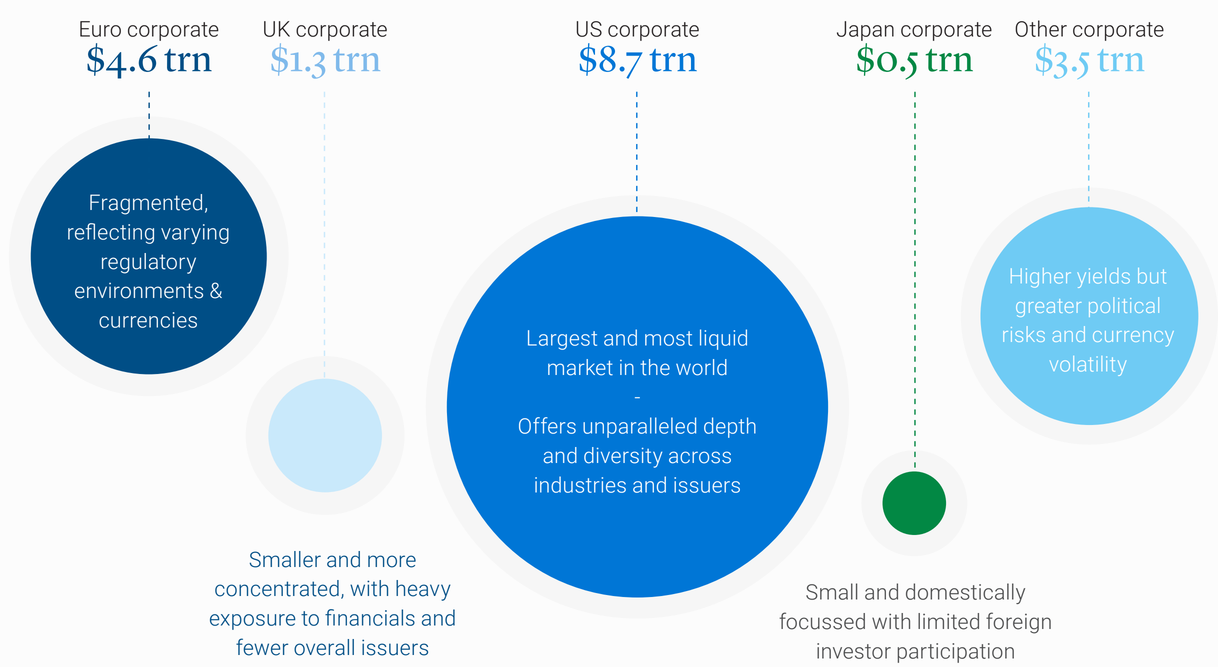
A recovery in China or Europe: A stronger than expected recovery in either region could draw capital away from the US as alternative prospects improve. Should Chinese structural reforms succeed or Europe find a way to reignite growth, investors may look to rebalance their US-heavy allocations.

US growth slows: If the US economy falters, with growth dipping below trend or corporate earnings stagnating, the TINA narrative would likely start to wane. Opinions and commentary asking if US valuations have gotten ahead of reality could quickly manifest into investors taking their chips off the table.

Market disruption from Trump policy surprises: Policies that initially seem manageable could quickly escalate or have unintended consequences. As any good negotiator knows, all threats must be credible. Thus, enlisting tariffs as a negotiation tactic necessitates his willingness to enforce them. With no re-election pressure, President Trump may focus on his legacy rather than maintaining short-term market stability. Trump may be more willing to emphasise his vision of prioritising American interests on trade and immigration than investors currently believe.

The US undoubtedly remains the dominant force in global markets, and for good reason. The economy is strong, and attractive alternatives – for now – seem few. Yet no narrative lasts forever, and it's especially important to question the narrative when a single thesis dominates. TINA has served investors well in recent years, but preparing for shifting landscapes is what separates reactive decision-making from thoughtful long-term strategy.

Figure 10: Breaking down global corporate debt



Source: SP Global. Data as of January 2025.

Large, diversified market that aims to boost stability and liquidity

Contact us

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