



Will the Last Investor to Exit From America Please Turn Out the Lights?

STREETWISE |

By James Mackintosh

When market veterans gather, the talk often turns to memorable crashes: where they were in 2020, 2011, 2008, 1998, or for the older among them, 1987. Last week should join that list. Where were you when investors fled America?

The week was full of thrills that will be more fun to look back on than they were for those trying to trade them.

Stocks had among their biggest- ever two-day drops and one of their largest one-day rises, whipsawing investors. Meanwhile, the dollar plunged and Treasuries flashed warning signs of deeper trouble.

But what really stood out was the combination of moves, the flight from American assets in general. Stocks, bonds and the dollar all sold off at once. ▽

Investors who want to plan for the future need to take a view on three distinct drivers of what happened: trade, debt and de-Americanization.

Trade, or rather President Trump's attack on it, provided the basic reason to sell. His delay of the bizarrely calculated additional tariffs on countries other than China offered midweek relief, and Friday night's exemption for iPhones and other electronics will offer further respite. But investors quickly went back to working out the damage from the tit-for-tat trade war across the Pacific. That is in addition to his baseline tariff of 10%, even on countries with which the U.S. runs a trade surplus.

Stocks naturally fell as Wall Street strategists upped their estimated probability of recession. The S&P 500 ended the week higher than it started but remains well down from the tariff announcement the previous week. Notably, the dollar and Treasuries continued selling off even as stocks rebounded.

The Federal Reserve may be less willing to cut than it usually is in a downturn because of the inflationary effects of tariffs. By the end of the week, futures priced in fewer rate cuts this year than at the start, despite a slower-than-expected inflation report. *

reared its head early

in the week as hedge funds began to liquidate trades deep in the plumbing of the financial system. The unwinding of leveraged positions drove big swings in a usually benign corner of interest rates known as swap spreads. This led to heavy selling of Treasuries that drove up yields and threatened to force more selling. *

The prospect of a self-fulfilling spiral of selling put investors and regulators on edge as a 2020-style panic in the bond market suddenly appeared possible. Trump reversed course in time to prevent the worst. But investors are again aware of the danger of a nearly trillion-dollar hedge-fund unwind. That in itself is a reason to reduce Treasury exposure, at least until hedge-fund positions are cleaned out. !

De-Americanization

kicked in as investors watched the chaotic policymaking from the White House, but it wasn't only about the U.S. losing its aura of economic competence. Far from strengthening as bond yields rose, the dollar has fallen sharply. On Friday, it reached its weakest level since 2022.

E urope and China are expected to stimulate their economies, which will help offset tariff damage. But the U.S.'s giant tariffs amount to a large tax on consumers, slowing growth even before the hit lands from uncertainty about what happens next. A relatively weaker U.S. economy should mean a weaker dollar.

Worries about the independence of the Fed have arisen as the administration asserts its right to fire the heads of independent agencies—an issue that is likely to head to the Supreme Court. A win for the White House would probably give it the power to fire Fed governors. That would call into question their willingness to make politically unpopular decisions.

On top of that, investors were all-in on the idea that the U.S. was exceptionally strong. So there is a lot of foreign money to come out of U.S. assets.

"U.S. assets are losing some of their safe-haven status," said Jack McIntyre, a bond-fund manager at Brandywine Global. "It's another way of saying that U.S. exceptionalism has peaked."

I think most of last week's moves were due to the tariff shock to the economy, combined with the unwind of massive hedge-fund leveraged positions and a starting position of too much foreign money in dollars. But the dollar's fall is at least in part about a loss of faith in America. If that carries on, U.S. markets have a long way to fall.

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