BERNSTEIN

Trading Places

The Future of Global Trade

Executive Summary

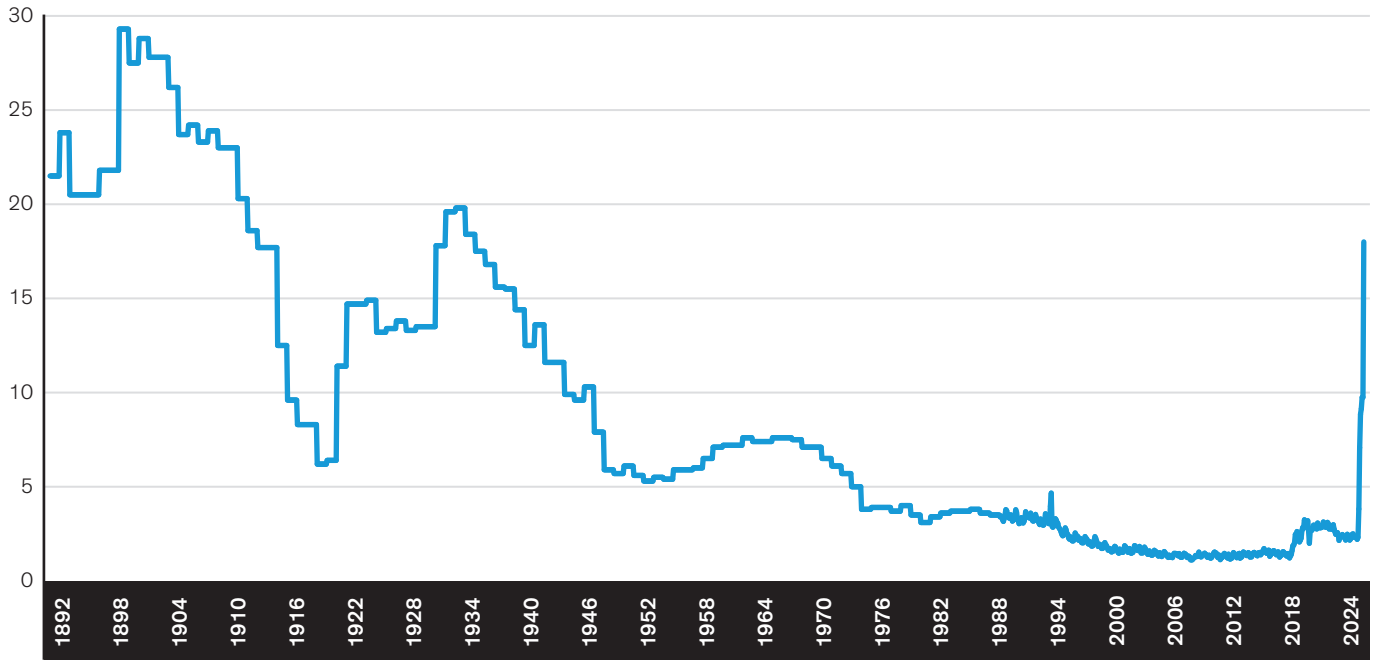
- The term “deglobalization” is often used to describe ongoing global trade trends. But trade plateaued nearly two decades ago and has been roughly flat ever since. While the future remains uncertain, we expect a reshuffling of manufacturing hubs, potentially along geopolitical axes, as countries trade places in the global economy—rather than a full reversal.
- In the coming decades, trade shifts are likely to unfold gradually, not abruptly. Expect continued evolution, not revolution.
- While unlikely, three scenarios could trigger a wholesale disruption in global trade:
  - Large-scale trade war with escalating reciprocal tariffs
  - Global military conflict on the scale of WWI or WWII
  - Unforeseen impacts of AI technology
- Economic and geopolitical forces seem to be aligning around a more multipolar world with relatively less demand for dollars and dollar-denominated assets. Yet no strong alternatives exist, limiting how quickly the dollar could be displaced as the global reserve currency.
- European integration may increase, with European leaders playing a larger role in global events due to geopolitical pressures. This may boost regional economic activity—especially in defense and national/regional security—and enhance the euro or other European currencies’ appeal as an alternative to the dollar.
- When it comes to currencies and markets, trade and geopolitics offer only part of the picture. They hint at a weaker dollar, higher US yields, a larger US bond term premium, and stronger international equities. But these signals are marginal, and investors should avoid aggressive portfolio tilts based solely on this lens.
- The advantage of moving facilities to developing countries is fading as global production costs converge. Automation, industrial AI, and robotics are likely to become become crucial in modern manufacturing, especially for companies reshoring or nearshoring production, providing a long-term tailwind for those aligned with this trend.
- Investors should stay focused on a gradual shift toward a multipolar world and avoid overreacting to global events. Active investment management can play a crucial role in navigating company- and sector-specific impacts.

The Year of Tariffs

Perhaps no topic, except potentially AI, has had more of an impact on the markets in 2025 than tariffs. With striking proposals, sharp reversals, and a heap of trade deals either lined up or on their way, tariffs have dominated both geopolitics and the markets. That's no surprise, as the effective tariff rate in the US is set to reach levels not seen since the 1930s (*Display 1*).

DISPLAY 1: US TARIFFS ARE EXPECTED TO REACH 1930s LEVELS

Effective Tariff Rate



Data history includes USITC historical average effective rate by year prior to 1989 and then uses USITC approximate effective rate from then through August 2025. December 2025 figure comes from Yale Budget Lab estimates as of October 17, 2025.

As of October 29, 2025 | **Source:** USITC, Bloomberg, Yale Budget Lab, and Bernstein analysis

But the real question isn't what investors should do about tariffs in 2025 and 2026.

Far more important are the intertwined questions:

- What will global trade look like in the future?
- Are tariffs a near- to medium-term challenge, or are they here to stay?
- Will countries become less cooperative and more combative? Is trade becoming a long-term tool for global power struggles?
- How can companies intelligently design their supply chains for the coming decades?
- What does all of this imply for the dollar and its role in the world economy?
- How should investors adapt to a potential new era in trade?

While the range of outcomes is wide, our views revolve around a few key premises. First, "deglobalization" has been a misnomer, and we believe that will continue to hold true. Global trade isn't reversing; it's evolving. For nearly 20 years, trade has been migrating, and while current trade tensions are high and we may be at a turning point, calling it a reversal misstates what's been happening and what we expect in the future.

Along those lines, we believe global manufacturing will keep shifting from its current footprint to a more cost-efficient and resilient one over time. This may be along geopolitical lines and might include reshoring or "friendshoring" where it makes economic sense. But there's a reason we don't make iPhones in the United States. As a result, many products will continue to be manufactured outside our borders.

Growing alignment, both within and outside the United States, suggests a future with less demand for dollars, leading to a weaker dollar. While we know better than to make long-term currency forecasts, that backdrop appears notable. Indeed, it's easy to imagine a world where softening demand for dollars and dollar-based assets coincides with increased appetite for their European counterparts. Just because it's imaginable doesn't mean it will happen, but it does indicate the path of least resistance, directionally, for the dollar.

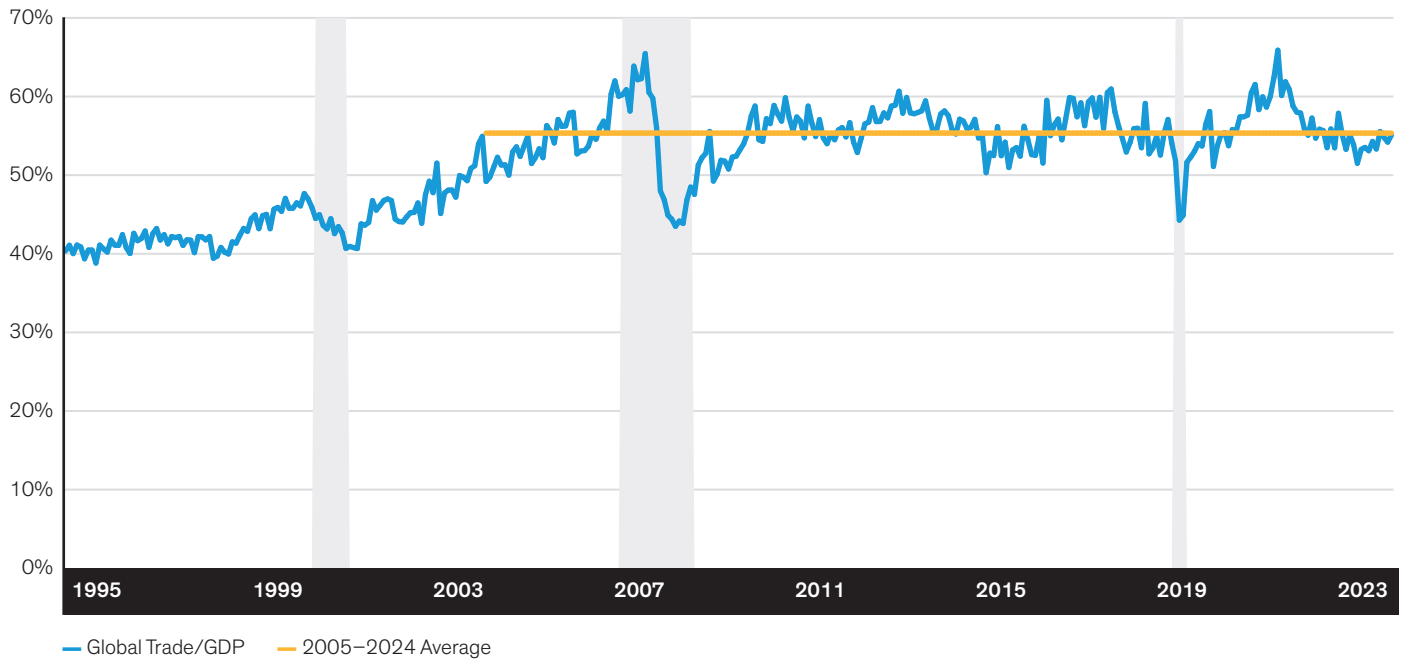
Two major sources of disruption (both beyond the scope of this piece) could substantially alter this base case. First, artificial intelligence has the potential to dramatically shift the balance between labor and capital, upending the economics between local and foreign labor. Second is the risk that a large-scale, multi-country war—which has been rare in the post-WWII order—might become a more acceptable way to decide geopolitical conflicts. Certain types of conflict could materially affect trade flows and the demand for different currencies.

The Big Picture: View from the Plateau

While many, including us, have used the term "deglobalization" in recent years, it doesn't quite capture what's happening around the world. Deglobalization implies a rollback in trade. But trade as a share of global GDP has not reversed in recent years. In reality, it plateaued almost two decades ago and has stalled at about half of global GDP ever since (*Display 2*).

DISPLAY 2: "DEGLOBALIZATION" IS A MISNOMER

Global Trade Has Hovered Around a Plateau for Two Decades



As of December 31, 2024 | **Source:** World Bank, Macrobond, and Bernstein analysis

The real trend—which we expect to persist barring shocks more severe than the recent round of tariffs—is the ongoing shift in production. Companies are moving away from existing footprints to more cost-effective supply chains. Or, as our title suggests, we are witnessing ***a trading of places***.

> “…we are witnessing ***a trading of places***.”

Could global trade fully reverse? It's certainly possible. We've seen it before in the 20th century, driven by world wars and the spiraling protectionism that led to the Great Depression.

Could history repeat itself in the coming years absent a major physical war? You could make a case. After all, US tariffs are now at their highest level in nearly a century, creating a $250–$300 billion annual barrier to trade. That's already having a noticeable impact on corporate planning and supply chains. We hear it from companies themselves: some, like Pfizer and Lindt, are considering shifting part of their production to the US, while others, like Apple, are looking to diversify assembly outside of China.

If the US continues to ramp up the trade war—especially by targeting specific goods made abroad to make US production costs relatively more cost-effective—we could see more manufacturing return to its shores. More importantly, if other countries retaliate with hefty tariffs on the US, or even against each other, it could spark two major outcomes:

1. Force reshoring not only to the US but also to other developed countries, with potentially redundant facilities in multiple regions, and
2. Pose a headwind to global GDP.

Based on what we've seen so far, we expect global trade as a share of GDP to fall by about 10 percentage points in the coming quarters. This decline is greater than the brief dip seen during the trade war in President Trump's first term—which was partly driven by reversion to the mean—but not as severe as the drops seen during the Global Financial Crisis or the pandemic. While trade quickly rebounded after both those events, there's a chance that the trade environment will continue deteriorating in the coming quarters and years. It might settle at a permanently lower level or even retrench further as developed economies push to reshore production from developing countries, forcing companies to establish local-for-local footprints across developed markets.

Yet despite the United States' revamped trade policy, we don't anticipate such a persistent, large-scale swing for one key reason. Other countries seem attuned to historical lessons and less inclined to take beggar-thy-neighbor approaches. They appear relatively open to negotiating with the US and accepting some shared pain from higher tariffs. At the same time, they still seem committed to reducing frictions and to the ongoing creation of regional trade agreements.

That sentiment could change, and if it does, we'd have to reassess the odds of a severe global recession. For now, we'd note that a resurgence in global protectionism would require ongoing, significant retaliation against US tariffs. That occurred after the disastrous Smoot-Hawley tariffs in 1930, which kicked off the worst trade war in memory and exacerbated the Great Depression. Yet this time around, after some initial retaliatory announcements and a sharp market reaction, both the US and its trading partners quickly scaled back their tariff measures.

For those outside the US, further bilateral or multilateral trade agreements might now seem more appealing. These agreements could serve as a buffer against future trade disruptions from the US or China and help create stronger counterweights to those two behemoths.

While the prevailing shock to global trade is topical, our aim here is to look beyond the current US administration and consider what trade may look like over the next several administrations. In that regard, tariffs implemented in 2025 could be difficult to remove for two reasons:

- Given the US's fiscal situation, tariffs have now become a meaningful source of government revenue. Eliminating them would worsen the debt and deficit situation. That said, in a recession, their removal could be an appealing policy to quickly stimulate the economy in a deflationary way.
- Tariffs also create political winners and losers. Industries and workers that benefit from existing tariffs may fight hard to maintain them.

Looking in the other direction, what might cause an unexpected boost to global trade? Technology has fueled lasting gains in global trade in the past—think of the development of the shipping container and global communications networks. If artificial intelligence has a similar effect, we could see another step change. Yet, AI might also lead to surprising outcomes for the global economy, trade, and politics. Overall, we anticipate trade will keep evolving based on the underlying economics, with production shifting toward its most efficient locations, as it typically does outside of episodic shocks.

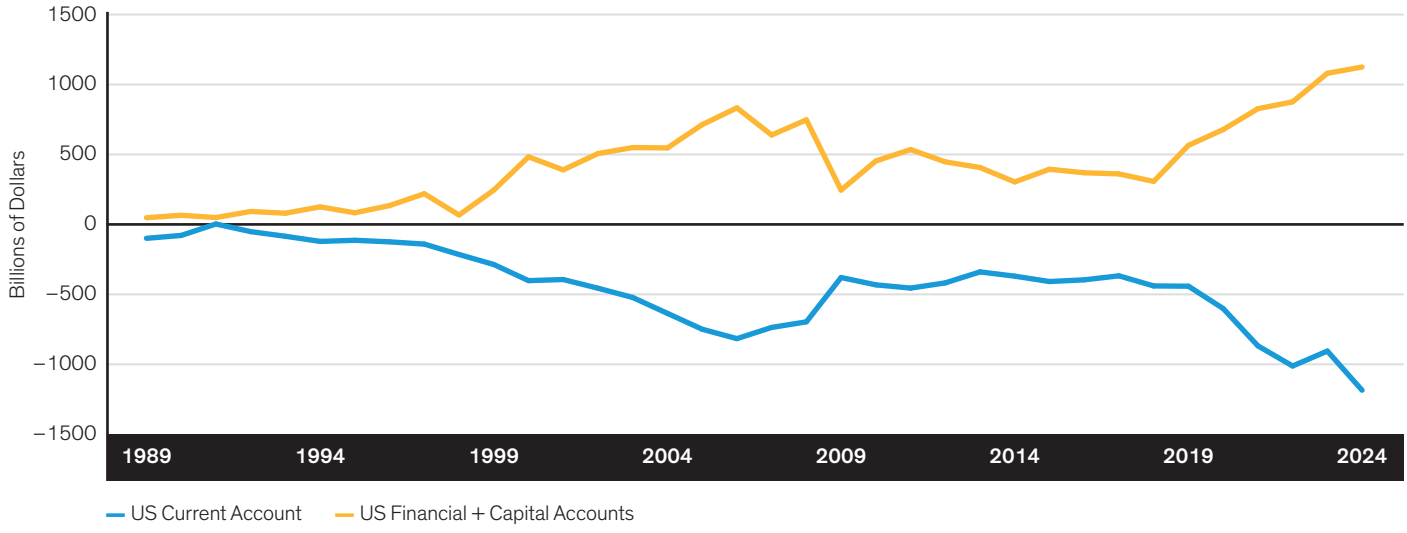
Common Threads and Tangled Yarn

While our aim is to look past the current administration's goals when it comes to trade, we also have to examine policymakers' economic agendas and their likelihood of being adopted by future administrations, regardless of political party.

This analysis is complex because various policy objectives have been expressed by different members of the administration, and multiple reasons have been given for implementing tariffs. So, what's truly guiding the current administration, and what's likely to last in future ones?

DISPLAY 3: TRADE FLOWS ARE OFFSET BY FINANCIAL FLOWS

The Current Account and the Financial/Capital Accounts Mirror Each Other



The US Current Account is part of the balance of payments, capturing the trade of goods and services, net income from abroad, and net current transfers. It indicates whether the country is a net lender or borrower internationally. The US Financial and Capital Accounts track cross-border financial asset and liability transactions. The financial account covers investments like stocks and bonds, while the capital account includes capital transfers and non-produced asset transactions. Together, they show how the US Current Account is financed.

As of January 1, 2024 | **Source:** CEPII, Macrobond, and Bernstein analysis

Narrowing or Eliminating the Trade Deficit

President Trump's approach to tariffs has always been distinct—even dating back to the 1980s, he espoused them as key policy tools. This worldview also appears to align with a belief that trade deficits are intrinsically harmful, akin to profit losses for a company.[1]

Yet, the desire to eliminate trade deficits, or tackle the deficit overall, has one major snag. When we import more from other countries than we export, there's a flip side. That trade imbalance also means countries import more capital in the form of US dollars than they export to the US in their local currencies as a byproduct.

The US trade deficit largely exists because global investors want to hold dollars and assets like Treasury bonds and US stocks. This demand supports the dollar's status as the world's reserve currency (*Display 3*). **For the dollar to retain its status as the global reserve currency, the US needs to run a trade deficit.** We could reduce the trade deficit if global demand for dollars decreases, but to maintain a trade surplus, the dollar would have to cease being the reserve currency.

The link between trade and capital flows is also directly tied to how savings and investment work in the US and the rest of the world. The capital inflow that the US receives from foreign investors helps fund investments within our borders, beyond what we save nationally. Similarly, other countries save more than they invest domestically, and their excess savings fuel investment in the US. Therefore, to alter the trade deficit via tariffs, those levies would need to be large enough to shift both national and international saving and investment habits.

1 Trump has gone on record saying, "We have deficits with almost every country—not every country, but almost—and we're going to change it." Source: NBC News https://www.nbcnews.com/business/economy/trade-deficit-what-does-it-mean-for-economy-trump-tariffs-rcna199999

Bringing Back Manufacturing Jobs

Focusing solely on the trade deficit runs into another issue as we consider future administrations. When some politicians criticize the trade deficit, they generally highlight other economic indicators, like job creation. However, while jobs and the trade deficit can be linked in discussions and policies, they are fundamentally quite distinct.

The slow disappearance of manufacturing jobs and the growing role of services in the US economy has been a politically sensitive topic for decades. What's more, special interest groups often push for protectionist measures to entrench jobs in certain industries.

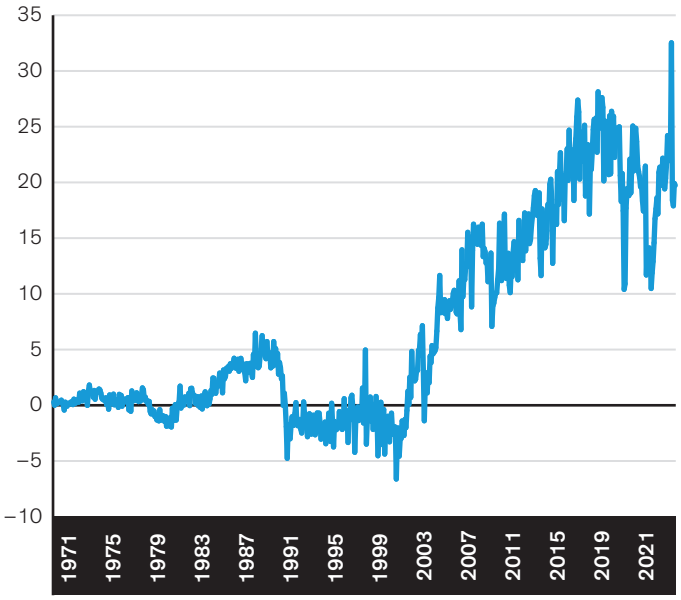
This trend is closely tied to globalization. Numerous domestic factories have been replaced by foreign ones after becoming economically unviable in recent decades. As workers saw their jobs shipped overseas, it's understandable that protectionist instincts flared. Yet the trade deficit itself is not the reason those jobs relocated abroad.

To put things in perspective, let's look at Germany. Known for its strong automakers and manufacturing sector, Germany has enjoyed a two-and-a-half-decade trade surplus (*Display 4*). Yet, since 1991, the proportion of manufacturing jobs in the total workforce has dropped from 27% to 16%, mirroring the trend in the United States.

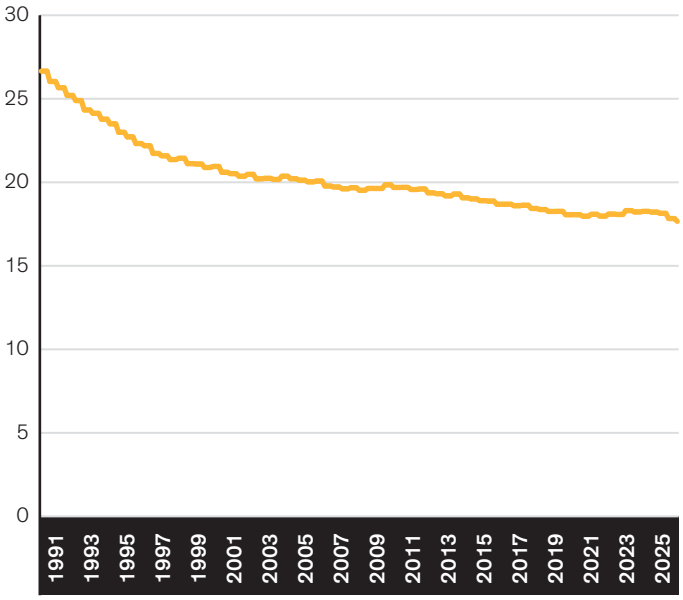
The true issue lies with rising real wages elsewhere in the domestic economy and lower labor costs abroad. As wages increase due to higher productivity in other sectors, it makes sense for workers to move to roles where they can produce more and earn more. Likewise, with cheaper labor available overseas, companies will tend to relocate production to remain competitive globally. While tariffs can slow these trends, that outcome isn't ideal for most people in the economy. Prices will be higher, and both living standards and GDP growth will be lower.

DISPLAY 4: GERMANY RUNS A TRADE SURPLUS, BUT HAS ALSO LOST MANUFACTURING JOBS

German Trade Balance
(Billions of Euros)



Manufacturing Jobs/Total Jobs, Germany
(Percent)



As of September 1, 2024 | **Source:** Deutsche Bundesbank, German Federal Statistical Office, Macrobond, and Bernstein analysis

Weakening the US Dollar

Some members of the administration have proposed another economic goal: to make US trade more competitive by weakening the US dollar. Broadly, this supports the wider aim of helping US businesses and workers.

While this isn't the administration's top priority, it is among the ideas promoted by Stephen Miran, the former chairman of the Council of Economic Advisors and now Federal Reserve governor, in what could become known as the Mar-a-Lago Accord. The notion captured some attention early in this administration, though interest seems to have waned recently and it's unclear if it will be rekindled.

Regardless of which administration is in power, the value of the dollar is always a topic of discussion. It's rare for a Treasury Secretary to openly advocate for a weaker dollar, yet past governments have highlighted how other countries, like China, adjust their currencies to gain trade advantages. Ultimately, we believe the dollar's value will remain a key issue for future administrations as well.

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Tariffs as Geopolitical Leverage

President Trump has taken a unique approach by using tariffs to address non-economic issues. Perhaps the clearest example are the 50% tariffs imposed on Brazil in response to their domestic investigation of former president Jaír Bolsonaro. Whether these will withstand trade court challenges remains to be seen, as the legislative branch has only delegated tariff authority to the executive branch under certain circumstances—namely, national security, national emergencies, or retaliation against unfair trade practices. We expect future administrations to be less aggressive in using tariffs as a tool for more general geopolitical influence.

How Might Other Countries Respond?

While the US is the world's most dominant economic and geopolitical power, the future of global trade will also depend largely on how other countries react.

In foreign affairs, trade is just one of many issues countries must weigh, alongside geopolitical concerns like military responsibilities and political leadership. Both the first and current Trump administrations have encouraged global partners to take on more of the leadership roles traditionally held by the US, believing that these countries have relied too heavily on American support. This perspective also underpins the Mar-a-Lago Accord, which suggests that if the US provides certain services, it should receive direct compensation.

Yet the administration could end up achieving its goals in unintended ways. Instead of fostering cooperation, this stance might prompt other countries to pick up the mantle and bypass the US altogether. For example, Germany's new chancellor, Friedrich Merz, has declared, "My absolute priority will be to strengthen Europe as quickly as possible so that, step by step, we can really achieve independence from the United States." [2]

In terms of trade, other nations may form regional or cross-regional coalitions that exclude or minimize the US's role. A case in point is the Trans-Pacific Partnership. In his first term, after President Trump withdrew from the agreement, which was meant to shore up trade among many of the major trading partners in the Pacific, the remaining countries proceeded without the US. The UK joined in 2023.

Today, the world appears set on a more multilateral course. The US remains dominant, with China the obvious challenger. Meanwhile, European countries are now feeling their oats in ways not seen in decades. Historically aligned with the US, these nations may now find greater common ground with each other and, if they feel the need to balance power, with China. Although the bar for such a shift remains high—it has been falling. Other Asian countries already face a delicate balancing act when it comes to US-China relations. Renewed or weakened faith in US commitments and goodwill could tip the scale either way. Finally, while India is a growing economic power, domestic and regional challenges make them less likely to throw their geopolitical weight around.

When considering the potential for a secular decline in global trade, other countries' actions play a crucial role. If nations pivot from relatively free trade with the US and each other—and engage in retaliatory measures instead—an escalating trade war could lead to a prolonged disruption of global trade flows. Many developed countries face economic and political challenges similar to those of the US, which might encourage their leaders to adopt similar strategies. For instance, just as the US has encouraged European companies to locate manufacturing on its shores, European leaders could require US companies to establish facilities on the continent. This approach could realistically intensify the current trade dynamics in the coming years. The key question would then be which industries would lend themselves to such policy-driven, local-for-local production, and which would not.

Finally, while geopolitical issues indirectly influence markets and trade issues affect them in various ways, capital flows could also dramatically impact the performance of US financial assets—from Treasuries to stocks. Historically, the US has been a prime destination for central banks and overseas investors looking to deploy their capital. Yet, questions regarding the nation's trustworthiness are already affecting the markets in 2025. Should these concerns mount, the longstanding buying pressure from global investors may fade—at worst, it could turn to selling pressure instead.

> "Today, the world appears more set on a multilateral course."

2 https://www.wilsoncenter.org/article/can-ukraine-crisis-make-europe-less-reliant-united-states

How Will Companies Respond?

From an investor's perspective, two trade-related matters stand out: the impact on various companies and industries around the world and the effect on demand for US assets.

Companies large and small require a certain degree of stability and predictability to formulate and execute long-range plans. As the initial burst of uncertainty gives way to a more defined trade environment, we expect companies to adjust their supply chains accordingly to adapt to the new landscape.

Yet we don't see any indication of a stark break in corporate behavior based on recent actions or statements. Remember, it can take anywhere from two years to the better part of a decade to build an automotive or pharmaceutical plant. Plus, companies must ensure that once the facility is operational, there is a skilled local workforce available and that production remains price-competitive in either regional or global markets.

China currently accounts for around one-third of global manufacturing value added, and its extensive manufacturing infrastructure and scaled logistics network can be challenging to escape. Yet, companies have been doing so.

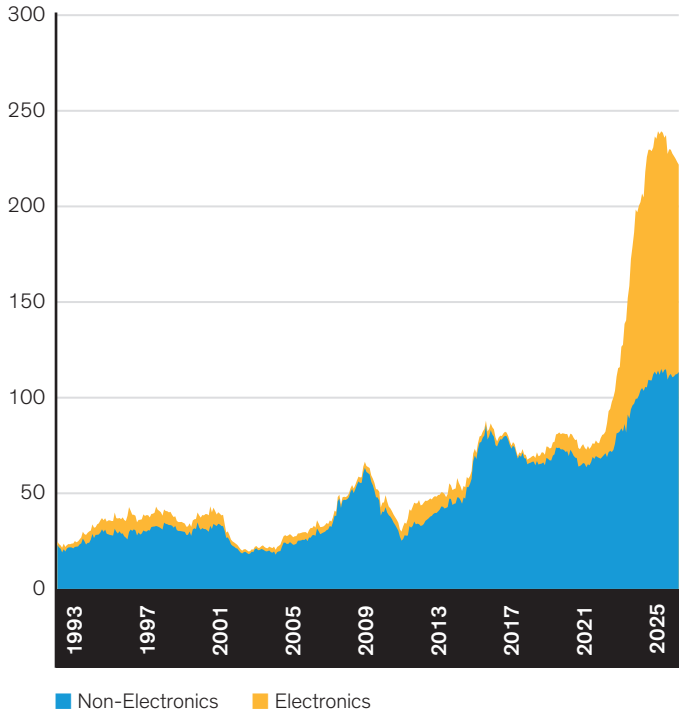
Where is manufacturing headed?

We'd highlight three main destinations:

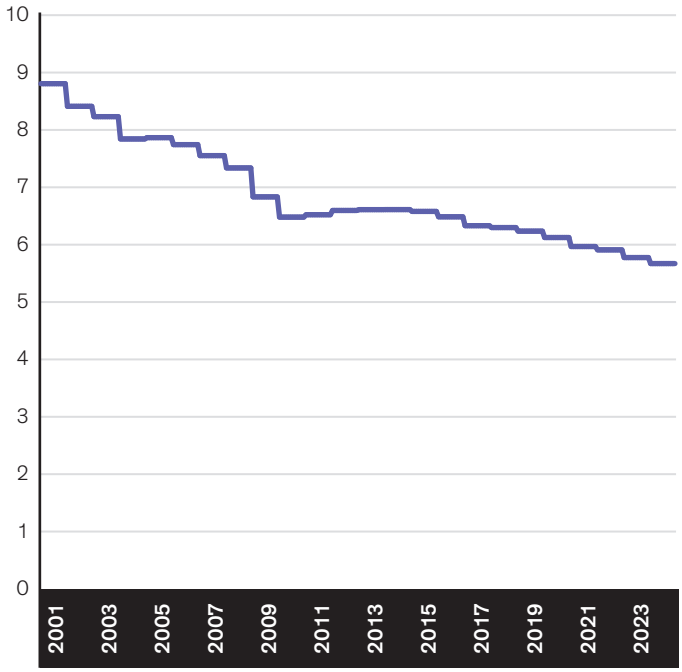
1. **The United States:** Some companies are relocating back to the US to be closer to their end markets and to mitigate risks associated with long supply chains.
2. **Nearshoring:** This involves moving production to nearby countries such as Mexico or Canada, or locations close to other developed markets that offer lower production costs than the end markets themselves.
3. **Emerging Markets, Particularly Southeast Asia:** This either entails a complete relocation or part of a "China + 1" strategy, with some operations kept in China while expanding into another country.

DISPLAY 5: INCREASING CAPEX IN THE US HAS NOT LED TO INCREASING MANUFACTURING JOBS

Private Non-Residential Construction Spending
(Billions)



Production Employment/Total Employment
(Percent)



Source: US Census Bureau, BLS, Macrobond, and Bernstein analysis

Increasing production in the United States, let alone shifting operations from other parts of the world, can be onerous. The numbers are difficult given the high real wages prevalent in the US economy. To be economically viable requires either (i) substantial automation, inherently limiting the jobs created by such moves, or (ii) subsidies, tariffs, or other government interventions that create sufficient incentives or barriers to make domestic production feasible. Incentivizing some movement, the pandemic exposed the vulnerabilities of geographically dispersed supply chains, prompting a shift toward more robust, and often more localized production.

Recent US economic data reflects the impact of government actions on manufacturing:

- **Subsidies and Tax Incentives:** In the post-pandemic years, these measures have had a massive impact on manufacturing capex, while tax- and tariff-driven policies had little effect in prior years.
- **Role of Automation:** Despite large buildouts of manufacturing facilities in the past several years, production employment has remained in a (flatter) downward trend for 15 years (*Display 5*).

The timing of those policies and the pandemic may have influenced outcomes to some extent, but the differences in magnitude and the clear catalysts allow us to draw several conclusions.

The directness of policy matters. When businesses are effectively provided with financial incentives to build manufacturing capacity, they will do so. In contrast, creating economic barriers tends to have a less direct impact.

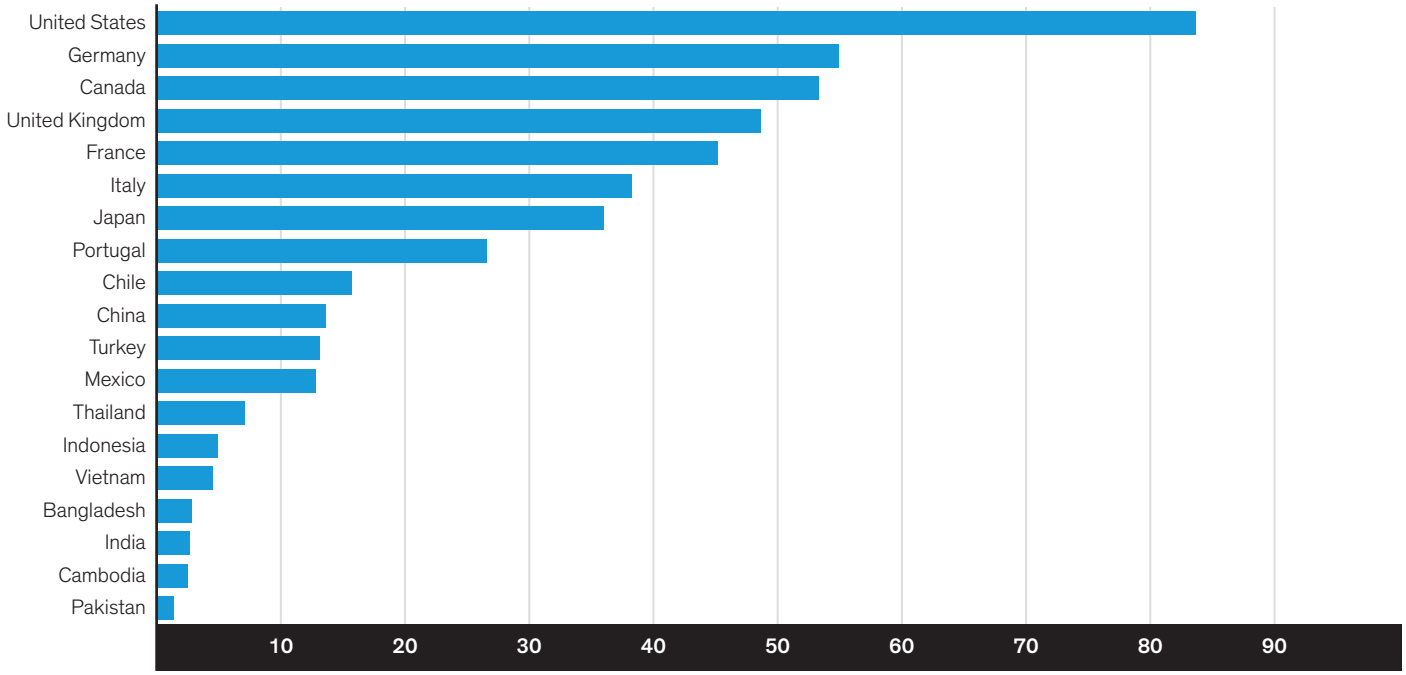
Much of the recent capacity buildout has been tied to datacenter growth, semiconductor manufacturing, and the broader theme of artificial intelligence. Yet post-pandemic policies have also led to a significant increase in capex in non-electronics sectors, with a reported 67% rise over three years. Even with those physical plant expansions, much of the new infrastructure is focused on hardware designed to run software or automated production processes. Ultimately, job gains have been minimal.

Integrating production into near-shored facilities in the US, and just across the border in Canada or Mexico, has been another core strategy. Perhaps no industry has done so more famously than the "Detroit 3" automakers, where legacy production facilities and supply chains often straddled Michigan and Ontario. As the economics have shifted—and Mexico's role in the global economy has evolved—that country has emerged as a leading source of imported vehicles and vehicle parts as well.

Trade policy and international competition aside, over the past four decades, US automakers have grappled with two major issues that have cost them market share: a powerful union and poor product line decisions. Tariffs have hit the industry hard, with profits across the Detroit 3 expected to fall from $29 billion in 2024 to $15 billion in 2025, and recovery not expected until after 2029. Amid these financial pressures, these companies are already juggling a host of competing priorities when it comes to product development to ensure their lineups are competitive—all before looking at overhauling their production footprints. Ford CEO Jim Farley's recent remarks highlight the high standards for technology and quality set by Chinese competitors, underscoring the formidable challenges global automakers face.

DISPLAY 6: LARGE WAGE GAPS REMAIN BETWEEN DEVELOPED AND DEVELOPING COUNTRIES

Gross National Income per Capita (Thousands, USD)



Source: World Bank, Macrobond, and Bernstein analysis

Nearshoring and local-for-local facilities can be attractive for products with both high value-added and onerous shipping costs, justifying production in countries with higher labor costs. For products with lower value-added and/or reduced shipping costs, shifting away from China or diversifying production between China and another country with low per-capita income has generally proven more appealing.

We see this most often in the soft goods and consumer electronics sectors. Even with the desire to move production, companies must also weigh constraints like labor costs, worker skill levels, raw material costs, and shipping/logistics channels. Full reshoring or nearshoring simply does not make economic sense from either a production or jobs standpoint for these sectors. The costs prohibit manufacturing in the US or other developed markets and there are more productive ways for those advanced economies to deploy their human capital.

In apparel, production has increasingly moved to countries like Vietnam, Bangladesh, Indonesia, Pakistan, and Turkey. That has narrowed production costs between China and these competing nations. Gross national incomes per capita still vary substantially but that is only part of the equation (*Display 6, page 12*). Overall, production costs have normalized to a larger degree. Where can manufacturing move from here? Pakistan, Cambodia, and over the very long term, perhaps sub-Saharan Africa. But each comes with its own set of issues and risks—messy political situations, underwhelming infrastructure, and labor that hovers at the low end of the skill curve.

Companies have been migrating production away from China for years. Consider Nike, which made over one-third of its shoes in China in the late 2010s. That figure has since dropped to 18%, with Vietnam and Indonesia picking up the balance. Similarly, Nike manufactured a quarter of its apparel in China as recently as 2019, but Vietnam has whittled that share down to just 16% today.

In consumer electronics, Apple remains highly exposed to Chinese production, with around 80% of their total capacity and 90% of iPhones produced there. Recently, iPhone manufacturing has been migrating to India, with a goal to make around one quarter of iPhones there. To diversify its production footprint, the company has also expanded operations in Vietnam and Malaysia lately.

Over time, we expect the need to balance cheaper manufacturing costs against other risks and issues will continue pushing manufacturing to other regions—with or without tariffs. Of course, tariffs, especially those that differentiate between China and other countries, can accelerate that trend. But even with more protectionist measures in the US or other developed nations, achieving a significant boost in domestic employment—without adverse effects—is challenging. Such policies could result in higher consumer costs while harming global competitiveness. In short, we foresee an ongoing trading of places, as companies seek to optimize their operations in response to evolving economic and geopolitical landscapes.

The US Dollar: Offense and Defense

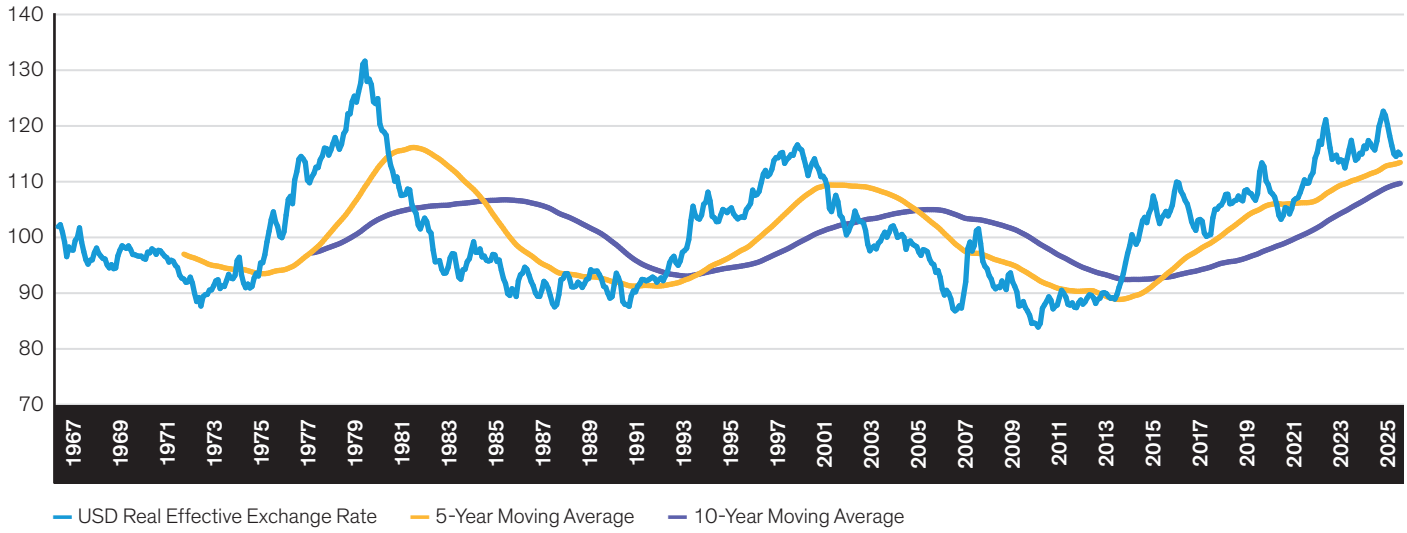
Since currency flows into financial assets are the flip side of trade flows for goods and services, the future of the dollar is closely linked to the course of global trade and the geopolitical order.

When we think about the value of the dollar, a unique alignment seems to be emerging. Historically, the US embraced a strong dollar while also avoiding an overly high value and discouraging other countries from artificially devaluing their currencies to gain trade advantages. However, the current administration has been advocating for a weaker dollar more openly than any administration since the 1980s.

When we look overseas, many countries are also weighing the pros and cons of a weaker currency. A lower currency value can boost export competitiveness, but if it drops too much, it can lead to higher living costs. Recent US trade and foreign policy actions have prompted investors and governments worldwide to explore alternatives to the dollar or to investments in Treasuries and US equities—a shift not seen in modern American history.

As a result, a rare alignment between domestic and international interests has emerged, with both considering a future with a weaker dollar (*Display 7*).

DISPLAY 7: THE DOLLAR WEAKENED TOWARD ITS LONGER-TERM AVERAGES IN EARLY 2025



Source: Federal Reserve Board, Macrobond, and Bernstein analysis

That does not mean the dollar will weaken from here, though we lean toward that possibility. Offsetting this is the fact that the dollar has already seen a large move, and the currency markets are among the most liquid and efficient in the world.

What else complicates the picture? While beneficial to some, a declining dollar would come at the expense of many others. Exporters become more competitive, as do companies with large foreign earnings bases, as their profits rise in dollar terms. At the same time, the US is a net-importing country. That means American companies and consumers would see higher import prices for goods and services as the dollar falls. Could we reach the point where the US becomes a net exporter? It's possible, though unlikely. As we've noted, that would require sacrificing the dollar's supremacy as the world's reserve currency.

Much has been made of that reserve currency status. For better or worse, it's likely to remain intact. The dollar comprises 58% of global foreign exchange reserves, 54% of export invoices, and 88% of foreign exchange transactions.

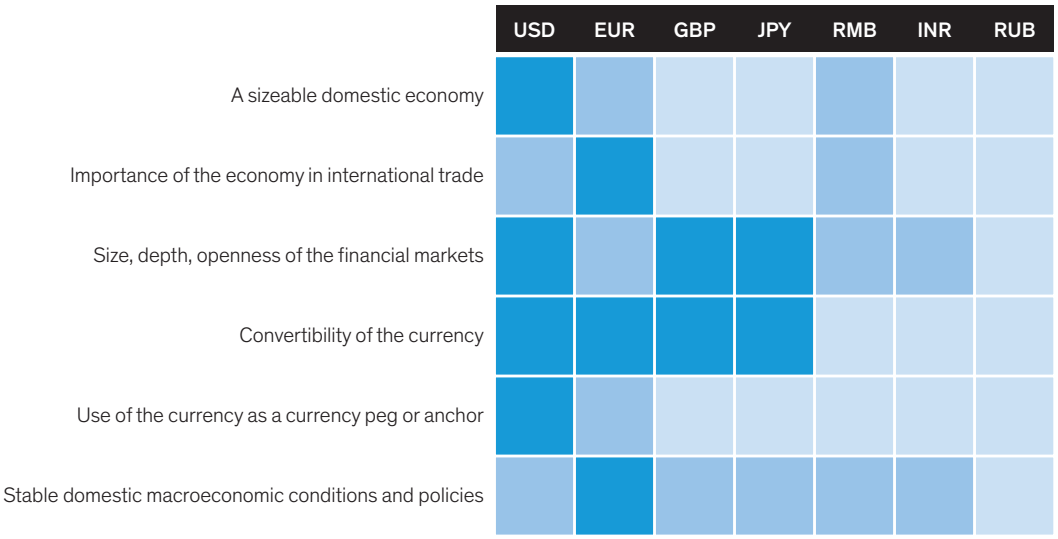
Several characteristics are essential for a reserve currency.

The Atlantic Council[3] provides a helpful list:

- A sizeable domestic economy
- Importance of the economy in international trade
- Size, depth, and openness of financial markets
- Convertibility of the currency
- Use of the currency as a currency peg or anchor
- Stable domestic macroeconomic conditions and policies

DISPLAY 8: WHAT MAKES A STRONG RESERVE CURRENCY?

The Dollar Leads, Followed by the Euro, Then a Wide Gap



Source: The Atlantic Council and Bernstein analysis

3 https://www.atlanticcouncil.org/programs/geoeconomics-center/dollar-dominance-monitor/

For all its flaws, the dollar stands head and shoulders above other currencies based on these criteria. The euro is a reasonable runner-up, with the pound and yen trailing across most traits (*Display 8, page 15*). The Chinese yuan is mainly relevant due to the size of the Chinese economy, but falters on other measures. Other currencies simply pale in comparison.

Both American and European leaders in the current era seem to favor a more geopolitically independent Europe, or at least one that is less reliant on the United States. If achieved, a material shift in demand for dollars could benefit the euro. Beyond that, we could see strengthening in the yen, pound sterling, Swiss franc, and Singapore dollar—while the latter two are much smaller, they are considered strong currencies, and any inflows could be sizeable relative to their economies.

That said, the euro has its own issues. EU countries face problems similar to those in the United States, compounded by a fledgling political structure. Flaws in the currency union—highlighted by economist Joe Stiglitz, investor Jim Rogers, and others—remain. Yet those could be addressed through policy enhancements. While the euro isn't a perfect panacea for those looking to diversify away from the dollar, it has proven resilient since its inception, despite its risks.

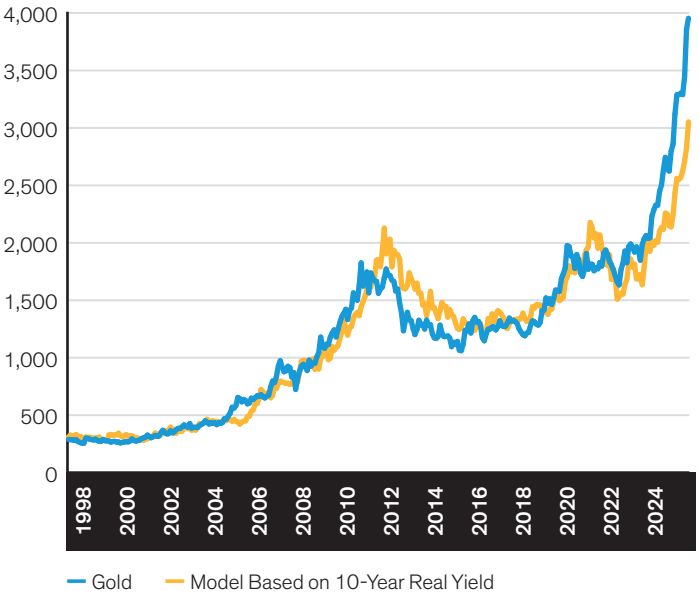
Beyond currencies and productive assets, gold and bitcoin have emerged as alternatives in today's investment backdrop. Gold has a long history as a currency and is often viewed as a risk-off asset. In recent years, its value has surged, driven by Chinese central bank purchases and increased demand for a disaster hedge amid rapid upheaval in the post-WW2 order (*Display 9*).

We continue to view bitcoin as akin to a venture capital bet, with its investor base anticipating that it will be treated like gold—as a disaster hedge and risk-off asset. For now, bitcoin remains a risk-on asset, with its correlation to equities rising in recent years. However, during the tariff-induced market sell-off in April 2025, bitcoin held up better than expected, suggesting investors may be starting to see it as a geopolitical hedge.

DISPLAY 9: GOLD APPEARS TO BE IN SEARCH OF A NEW FUNDAMENTAL ANCHOR

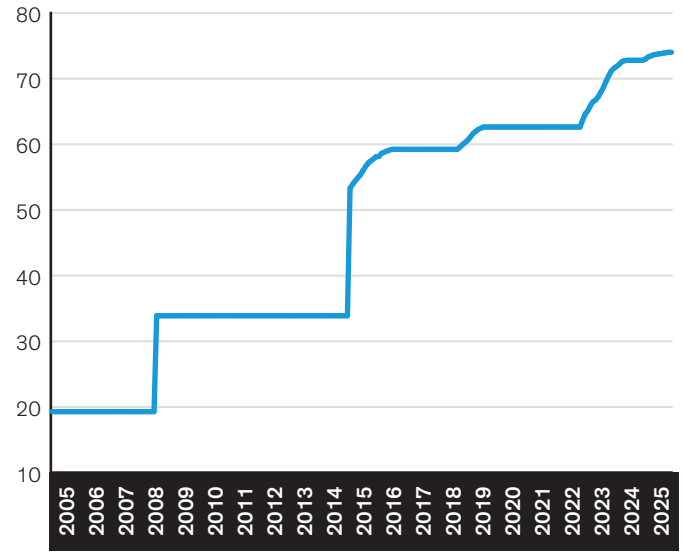
Causes Include Chinese Buying, Momentum, and Growing Geopolitical Concerns

Gold Price vs. Model Based on 10-Year TIPS Yield



China Monthly Gold Reserves

(Millions of Troy Ounces)



Source: Bloomberg and Bernstein analysis

How Will Trade and AI Intersect?

Artificial intelligence is set to influence the next era of trade in unpredictable ways. Already, the semiconductors essential for AI software sit at the center of geopolitical positioning, with the United States restricting access to high-end chips based on trade and other policy considerations.

Looking ahead, AI has the potential to dramatically reshape the balance between labor and capital, as well as between local and international workers in the services industry. This will matter significantly to the US, where services account for two-thirds of consumer expenditures and contribute to a $120 billion trade surplus.

Like many predecessor technologies, AI will find greater application in the services sector—at least at first. As advanced robotics become more prevalent, it may also disrupt the goods sector. Yet unlike most other technologies, which tend to benefit highly skilled workers most, the current iteration of AI quickly closes the gap between less-skilled workers and their more-skilled peers. As a result, AI's impact on global trade may differ from previous technological advancements.

Of course, in its most extreme form, artificial general intelligence could blur the distinction between labor and capital. This could force a significant reset in local and global politics, as the social compact between human capital and physical capital—and between governments and society—are rapidly reevaluated.

A Broad Path

While a wide range of outcomes could unfold, we think of it as a stream of water running down a groove in a rock and slowly wearing it into a fissure over time. The companies calculating how to optimally manufacture and market their products are playing the role of gravity. Capital and trade flows, like water, will find the cracks.

Put simply, the story is one of evolution, not revolution. Barring a major disruption, like a sizeable war, those forces should persist. Could policymakers use tariffs or other barriers to change its course like a dam? Yes, to some degree. But certain outcomes may be more entrenched and self-reinforcing than others. It's one thing to support a nascent industry, such as AI, to allow it to scale and find its footing. But protecting a mature industry whose economics are no longer viable is quite another. The line between a subsidy and a handout may be in the eye of the beholder, but it exists. Addressing economic slack is different from reorienting resources in an economy near full employment. And of course, maintaining independence in key industries for national security, even if not economically efficient, might be necessary for societal and economic stability. But how do we determine what is truly essential?

As these forces play out, how does the groove in the rock take shape? Most likely, we'll see some reduced demand for dollar-denominated assets, and a shift toward Western Europe and other markets. Such redirection would pose a headwind to the dollar, which could either fall further or remain resilient. Think about riding a bike into a strong gust of wind. You can still pedal your bike forward, just more slowly than you would otherwise.

The coming decades will likely see enhanced geopolitical coalitions outside the US—not just for trade and economics, but also defense alignment. America may still be dominant, but the era of Pax Americana may give way to a more counterbalanced world order.

Implications for Investors

What does the emerging global trade regime spell for investors? At a high level, the dollar is the common denominator.

From an asset allocator's perspective, this focus on the dollar is less than ideal, as it boils down to a single factor and one major investment call, leaving much to chance. We prefer opportunities to make a wide range of idiosyncratic calls, rather than one big bet. Accordingly, we recommend caution in heavily tilting portfolios in any one direction.

We're looking at the world through one lens in this paper—trade, and some ancillary geopolitical factors. In reality, the dollar and other assets will be influenced by many unpredictable elements. With so many confounding variables, our degree of confidence in the net impact is low. On balance, while our views lean in one direction, they need to be implemented cautiously.

The combination of tariffs and geopolitical policies will most directly impact the dollar's value against other currencies. Surprisingly, when tariffs were announced in 2025, the dollar dropped by 10%. Typically, economic theory and historical precedents would suggest a modest rise in the dollar. The expectation that foreigners would bear the tariff costs was based on the idea that a stronger dollar would offset some effects. Instead, the dollar's decline has intensified the tariffs' impact domestically.

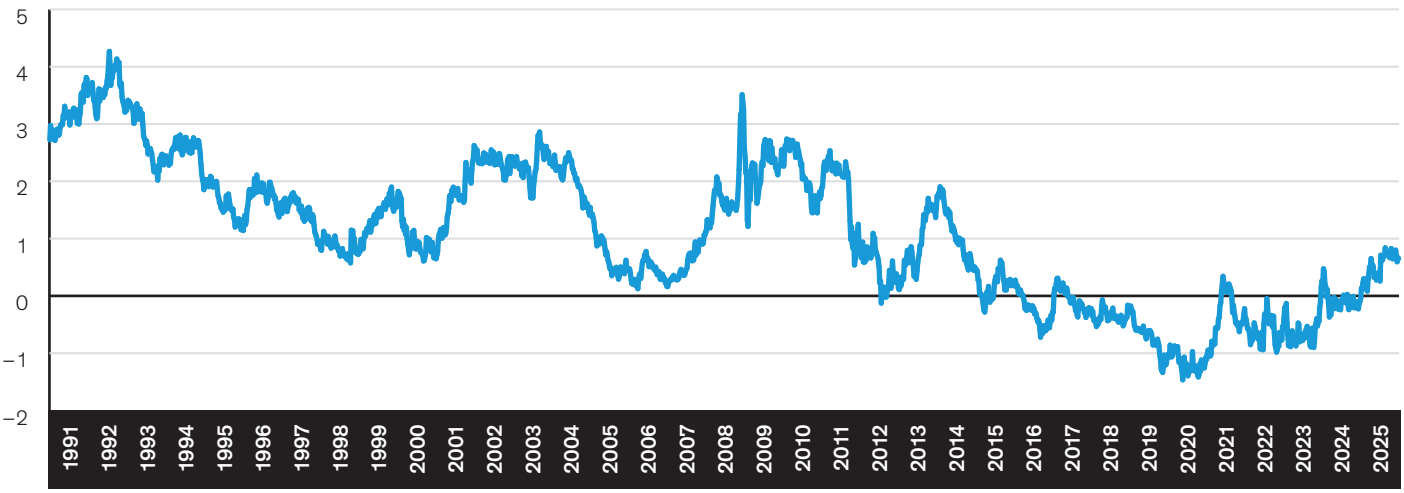
This incident offers two lessons for investors:

1. Reality often looks quite different than traditional economic theory.
2. The dollar not only responds to trade and other policies but also to trust in US institutions.

By extension, US Treasury bonds may also bear the impact as the US's "exorbitant privilege" fades. We'd see this materializing in three key ways. First, overall yields will likely be higher than otherwise, due to less international demand. Second, we'd expect the term premium—which compensates investors for macroeconomic uncertainty—to continue rising if investors are concerned about long-term macroeconomic surprises and the national debt. Third, as a byproduct of the rising term premium, we'd expect a steeper yield curve (*Display 10*).

DISPLAY 10: COMPENSATION FOR MACRO UNCERTAINTY IS BACK ON THE RISE

10-Year Treasury Term Premium (Percent)



Source: Bloomberg and Bernstein analysis

Keep in mind, trade policies don't exist in a vacuum. One important, though extreme, policy to consider is financial repression and yield curve control. As discussed in our national debt white paper, this might be necessary if the government aims to reduce the debt through inflation. We mention it here because, while unlikely, it could swiftly offset the yield impact of trade policy. Alternatively, if a higher yield, higher term premium, and steeper yield curve materialize, policymakers might adopt this drastic measure.

If the trade situation persists or deteriorates more than expected, the implications would be fairly straightforward for the economy and markets. Price hikes would be higher and last longer, corporate margins would shrink, and economic growth around the world—in both developed and developing countries—would fall. On balance, the worse the trade situation, the less constructive the backdrop for global equities.

Yet, the devil will be in the details. Which countries impose tariffs on which nations, on which goods and services, and in what amounts? Individual company footprints and supply chains will also matter—for both US and foreign companies. Take the global auto industry. Based on current consensus earnings estimates, Ford and GM are just as challenged by trade policy as Toyota, and even more challenged than BMW.

At a high level, we often focus on the return gap between US and international stocks. In fact, after a decade and a half of US exceptionalism, early 2025 served as a prime example of international outperformance.

Going forward, an ongoing reduction by global investors in US equity and US dollar exposure would create headwinds for US stocks relative to their international peers over the medium to long term. A declining dollar presents its own issues, and a shift in investor preference toward international stocks can impact relative valuations. Additionally, if Europe shows less fiscal discipline, it might narrow or reverse the economic growth gap with the US, influencing relative earnings growth rates.

Still, the US equity market has a decided advantage: its sector mix skews toward technology and growth, with many of the largest and most innovative companies still concentrated on our shores. That only goes so far, though. Over the long term, the institutions and pillars critical to fueling innovation and growth must remain intact. Without them, the US's greatest economic and geopolitical advantage could be at risk down the road.

Which industries or companies are likely to benefit? Those with adaptable supply chains, local-for-local production (where it makes sense), or facilities in their end markets or in friendly and adjacent countries. In some cases, superior positioning when it comes to production may reinforce a company's other competitive moats. For instance, Inditex—the company behind Zara—has led the charge on "fast fashion," enabled by production facilities that are relatively closer than those of their competitors.

Tech hardware will be another critical area of focus for both investors and policymakers. This spans semiconductor companies, battery manufacturers, and more. Essential to securing future economic leadership, these leading-edge technologies will serve as potent economic weapons. That poses a two-sided risk: governments will aim to support their national champions but may also exclude or limit customers from countries deemed unyielding, uncooperative, or unfriendly.

In other areas of tech hardware, such as consumer electronics, we foresee an ongoing shift away from relying solely on China, though production will still largely remain in Southeast Asia due to the relatively high cost of moving it to the US or other advanced economies.

Having streamlined their regional and global footprints, Chinese companies dominate production when it comes to white goods like dishwashers and washing machines. Even with punitive tariffs, their dominance is likely to persist, though such measures could make big ticket items much more expensive for consumers.

Steel and aluminum are always a focus of trade policy. These materials are vital in the event of war and labor's bargaining power in those industries tends to be high. The US is relatively self-sufficient when it comes to steel—producing around 80 million tons, consuming around 90 million tons, importing around 26 million tons, and exporting around 16 million tons. Yet, from an investment perspective, not much can be done—the two largest developed market players only enjoy a combined market capitalization of around $40 billion.

The auto industry has also been central to trade policy—both recently and historically—with national automakers playing a key role in economic development around the world. Today, however, trade policy seems more like a headwind or a distraction, siphoning money and attention that major global automakers could use to enhance their long-term competitiveness by producing better vehicles.

US consumers pay the highest prices in the world for pharmaceuticals, effectively subsidizing companies' research and development pipelines. It should come as no surprise, then, that the industry has become the focus of global trade discussions. In fact, its strategic importance has warranted separate negotiations.

Yet addressing trade policy and supply chain management will be a challenge. Companies have optimized production expenses versus tax costs through internal transfer pricing—which tends to inflate internal prices to reduce total taxes paid. Tariffs complicate the picture, since they're levied on the elevated internal prices and disproportionately hike the total taxes paid. What's more, production facilities take over five years to build on average, due to their health and safety regulations, quality control, and scale. As a result, shifting production is a long-term endeavor requiring a high degree of stability for planning purposes.

The geopolitical side will matter, too. High-value pharmaceutical imports overwhelmingly come to the US from Ireland while a substantial portion of generics come from India. Going forward, we think winners will primarily be driven by innovation. Small- or medium-sized players with the chance to establish fresh footprints and transfer pricing—applying existing industry best practices to a new landscape—may possess an added advantage, in our view.

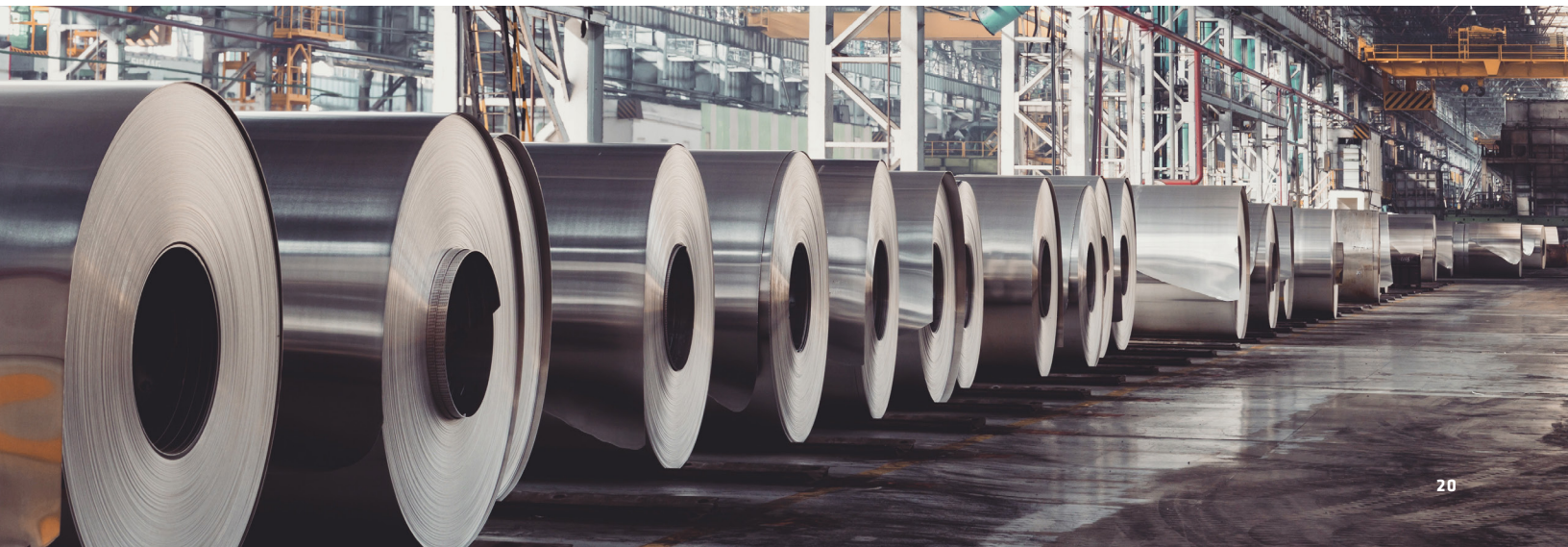
We consider apparel similar to consumer electronics, with an ongoing shift to other low-cost non-China countries. This should help protect margins, but not by a sufficient amount to create a strong tailwind for earnings.

Finally, services companies, like software, should prove relatively resilient. Many of the industries in these sectors lend themselves to global operations and somewhat consolidated competition. As a result, we favor these sectors.

With that said, a large tail risk looms. The US generally dominates services, especially among software and internet companies, which contribute heavily to its economy and stock market profits. This makes services a potential Achilles heel in trade disputes. While the US often has leverage in goods trade negotiations due to its deficit, the situation is reversed in services, where the US exports nearly a trillion dollars annually.

For now, we believe other countries are unlikely to raise the barriers to, or costs of accessing cloud computing, productivity software, online entertainment, and online shopping for their constituents. However, if trade tensions escalate to a degree we don't foresee, these areas could become prime targets.

Technology and growth-oriented sectors stand out for a final reason when it comes to tariffs. Reshoring or nearshoring may be expensive given higher prevailing wages. To make the economics work, companies must automate much of the work. For that reason, we're relatively optimistic about the prospects for companies specializing in technologies such as automation, industrial AI, and robotics. In fact, if we end up overly sanguine about trade—and more conflict and reshoring materialize—automation would become even more important.



A Multilateral World Awaits with Production on the Move

While trade policy has been the epicenter of seismic shocks in the geopolitical landscape in 2025, over the longer term, we expect more of an evolutionary development than a revolutionary one.

The economic laws of gravity remain intact. Even in the face of heightened global trade conflict, production will continue to migrate toward cheaper regions, in our view. As a result, we do not foresee outright deglobalization—barring war or massive technological change. Instead, we expect a world where production continues to trade places. That said, the outlook could deteriorate if trade tensions escalate further in the coming years.

For investors, this emerging world order appears more multilateral than the one that reigned over the past several decades. While the US is likely to remain dominant—with China a key challenger—Europe may have finally found a reason to assert more independence. Additionally, other regional alliances could also gain significance, providing a counterbalance to the US and China.

This could lead to a steady drop in demand for the US dollar and dollar-denominated assets, though the specific impact on asset prices is uncertain. Overall, investors should brace for a more multilateral world, anticipate faster growth in Europe, consider the increased likelihood of military conflicts, and expect changes in global supply chains. The latter should remain disinflationary, but not to the degree seen in the past three decades.

The US dollar will be ground zero for change, though currency moves tend to be limited in magnitude compared to those of stocks or other risk assets. Treasury bonds will remain in focus and investors should prepare for a higher term premium. Reactions in sectors and stocks will vary, offering more chances for active investment management to assess the differing impacts on various companies.

While trade negotiations have been dramatic and unsettling for corporate managers, consumers, and investors, more certainty will likely emerge in the relatively near term. From there, we expect a steadier evolution to unfold, on both trade and other geopolitical matters.

Knee-jerk reactions to global events almost never end well for investors. We believe that preparing for a gradual, if lumpy, progression toward a more multipolar world may benefit investors in the coming decades.

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