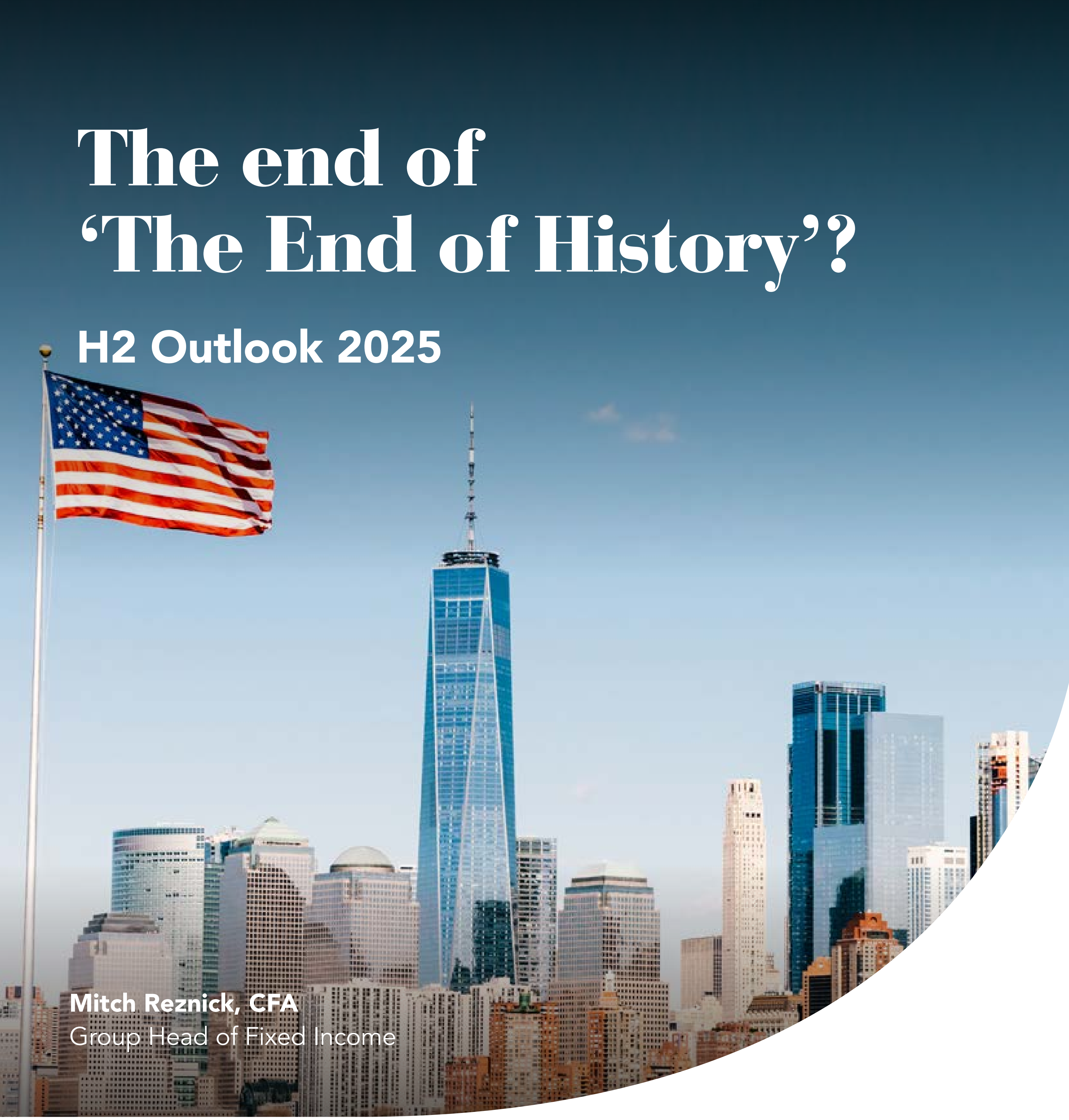
The end of ‘The End of History’?

H2 Outlook 2025



Mitch Reznick, CFA
Group Head of Fixed Income

Federated Hermes
Limited

www.hermes-investment.com
For professional investors only

Elevated uncertainty related to trade and industrial strategy in the US has led to a loss of confidence, which has had an impact on business activity. However, there remain pockets of opportunity in credit markets.

Expectations for US consumer spending, private investment and GDP growth are in decline, while inflation is forecast to rise and the risk of a recession is increasing. How is this shift in macroeconomic conditions in the world's largest economy affecting global credit markets and where do we see potential opportunities?

As a history student at university, I was seduced by Francis Fukuyama's 1989 essay *The End of History?*[1] It was a compelling argument: the Cold War had ended, and peace was breaking out in regions across the world. The great ideological battle between absolutism – through Bolshevism and fascism – and liberal democracy was over. Economic models predicated on protecting individual rights and the freedom of choice had triumphed as a superior system for generating growth and prosperity.

In the view of Fukuyama, and his many acolytes (including myself), humanity had reached the end of its search for the most effective form of government.

[1] Fukuyama, Francis. "The End of History?" The National Interest, no. 16, 1989, pp. 3–18. JSTOR, http://www.jstor.org/stable/24027184. Accessed 27 Apr. 2025.

At the time, it was inconceivable that the most pernicious threat to liberal democracy might come from within the political ideology itself. It was not apparent to Fukuyama that the 'final' form of human government – which was behind so much economic and societal development – might actually undo itself. Yet, here we are.

Professors Steven Levitsky and Lucan Way have coined the term "competitive authoritarianism"[2] to describe the potential unwinding of constitutional liberal democracy in the US following the Republican electoral victories last year.

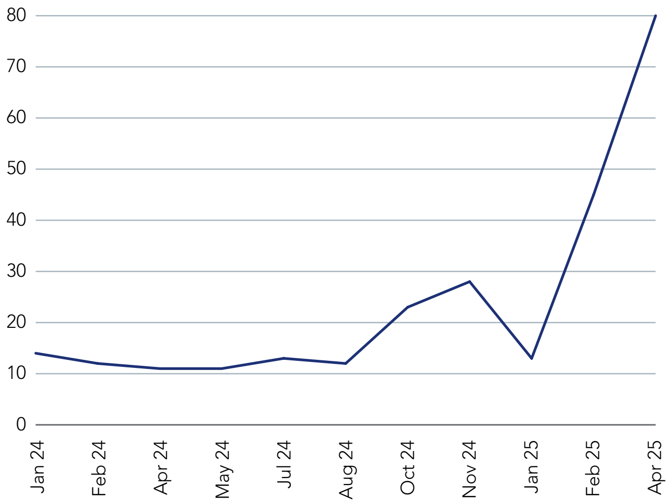
Many supporters of the current administration believe that the flood of executive orders from the White House will help put the US back on a path to greatness and that 'demolition' is a key phase of any renovation.[3]

It is premature to predict whether that 'renovation' will succeed – just as it was premature to predict we had reached "the end of history" at end of the Cold War.

It is, however, undeniable that as the world's largest and most interconnected economy, the situation in the US has generated a significant amount of global uncertainty. It is this uncertainty – from trade policy to US rule of law – that has undermined confidence in capital markets, which explains some of the trends reflected in expectations data.

We counted the number of times the word "uncertainty" occurs in the Federal Reserve's 'Beige Book'[4]. The use of the term is in the low teens until the US elections in November 2024, at which point it increases. Following the Republican victories in both Houses of Congress – as well as the presidency – the use of the word spikes[5].

Figure 1: Mentions of "uncertainty" in the Fed's 'Beige Book'



Source: US Federal Reserve, Federated Hermes.

Many supporters of the current administration believe that the flood of executive orders from the White House will help put the US back on a path to greatness

[2] The Path to American Authoritarianism: What Comes After Democratic Breakdown.

[3] Dans, P. (2025, May 3). The Economist. P.15.

[4] The Beige Book is a Federal Reserve System publication about current economic conditions across the 12 Federal Reserve Districts. It characterizes regional economic conditions and prospects based on a variety of mostly qualitative information, gathered directly from each District's sources.

[5] https://www.federalreserve.gov/monetarypolicy/publications/beige-book-default.htm

The relationship between uncertainty and a loss of confidence in economic activity is pretty clear. At the same time that uncertainty is rising, consensus estimates for economic data are deteriorating. According to 2025 consensus estimates, in decline are:[6]

- Household spending
- Private investment
- 2025 and 2026 GDP growth expectations
- Industrial production

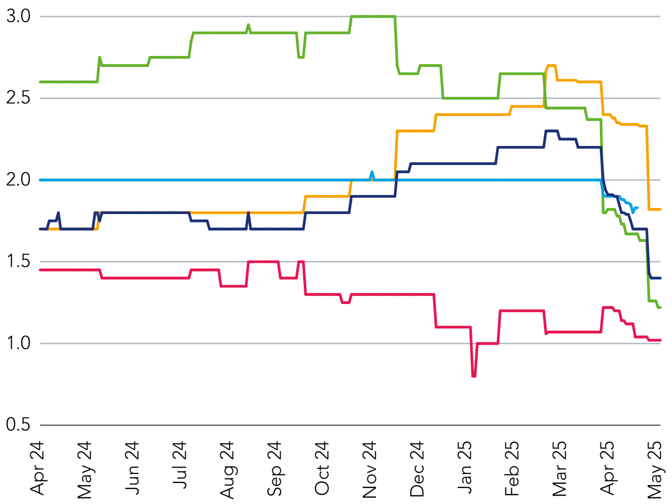
According to 2025 data and consensus estimates, on the rise are:[7]

- Inflation expectations
- Unemployment expectations
- Recession probabilities

Figure 2: University of Michigan Consumer Sentiment Index

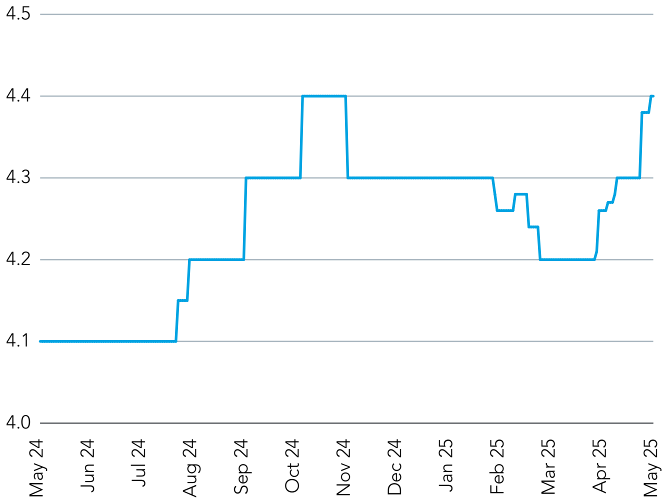
Source: University of Michigan, Bloomberg.

Figure 3: Economic indicators in decline



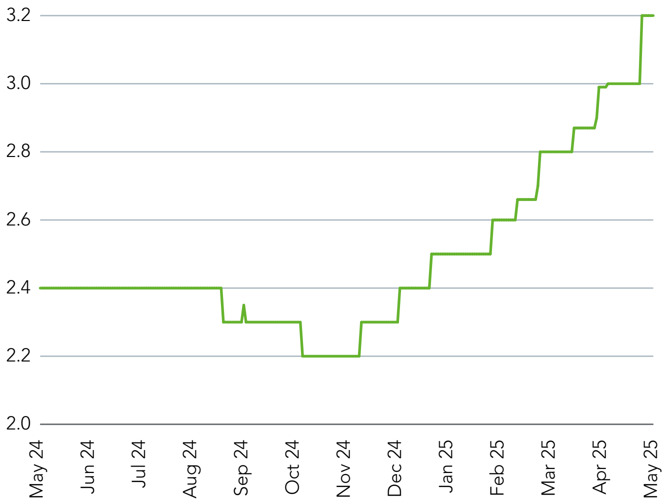
Source: Bloomberg, Federated Hermes.

Figure 4: US Unemployment Rate Forecast (%)



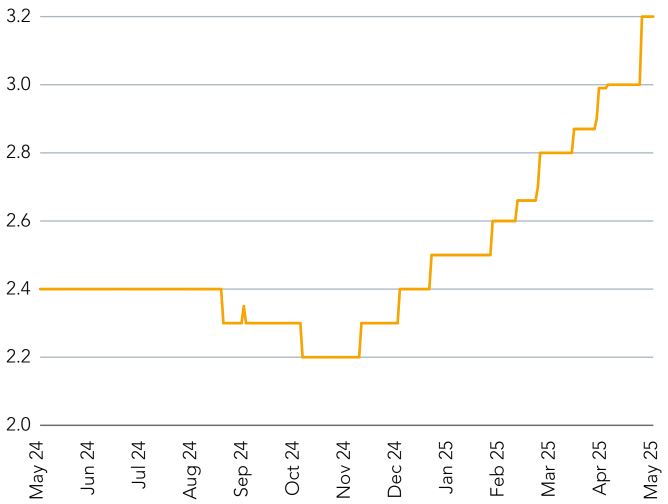
Source: Bloomberg.

Figure 5: US CPI Economic Forecast (year on year %)



Source: Bloomberg.

Figure 6: US recession probability forecast



Source: Bloomberg.

[6] Bloomberg function ECFC from 31 December 2023 to 30 April 2025.

[7] Bloomberg function ECFC from 31 December 2023 to 30 April 2025.

In the meantime, the consumer confidence numbers are also in decline.

The combination of the sentiment data and expectations data paints a clear picture: a reduction of confidence in the US economy. This view was clearly evidenced on 16 May, when credit ratings agency Moody's downgraded US sovereign debt to Aa1 from Aaa[8]. The US' fiscal performance is likely to deteriorate relative to its own past, according to Moody's.

In the most recent set of corporate earnings forecasts, our credit team saw a clear change in the variables that drive total returns in credit – and a pattern has emerged from credit analysts' descriptions of guidance from management teams.

The lack of confidence in the US economy – driven by unpredictable industrial and trade policy in the US – has meant that capital expenditure, operating expenditure, and hiring decisions in the US have been put on hold.

We suspect the notable deterioration in expectations for economic data in 2025 is linked to this loss of confidence causing a 'holding pattern' in decision-making.

Meantime, we have seen the US dollar weaken – and rebound – and the US rate curve significantly steepen. The DXY index, a measure of the US dollar on a global scale, dropped below 100 in April, representing the biggest drop since 2022, before recovering some ground.

What does this mean for credit markets?

The US tariffs programme announced on 2 April will go down as the worst tariffs rollout of all time, and despite the back peddling on many of the levies, it remains the worst tariffs scheme of all time.

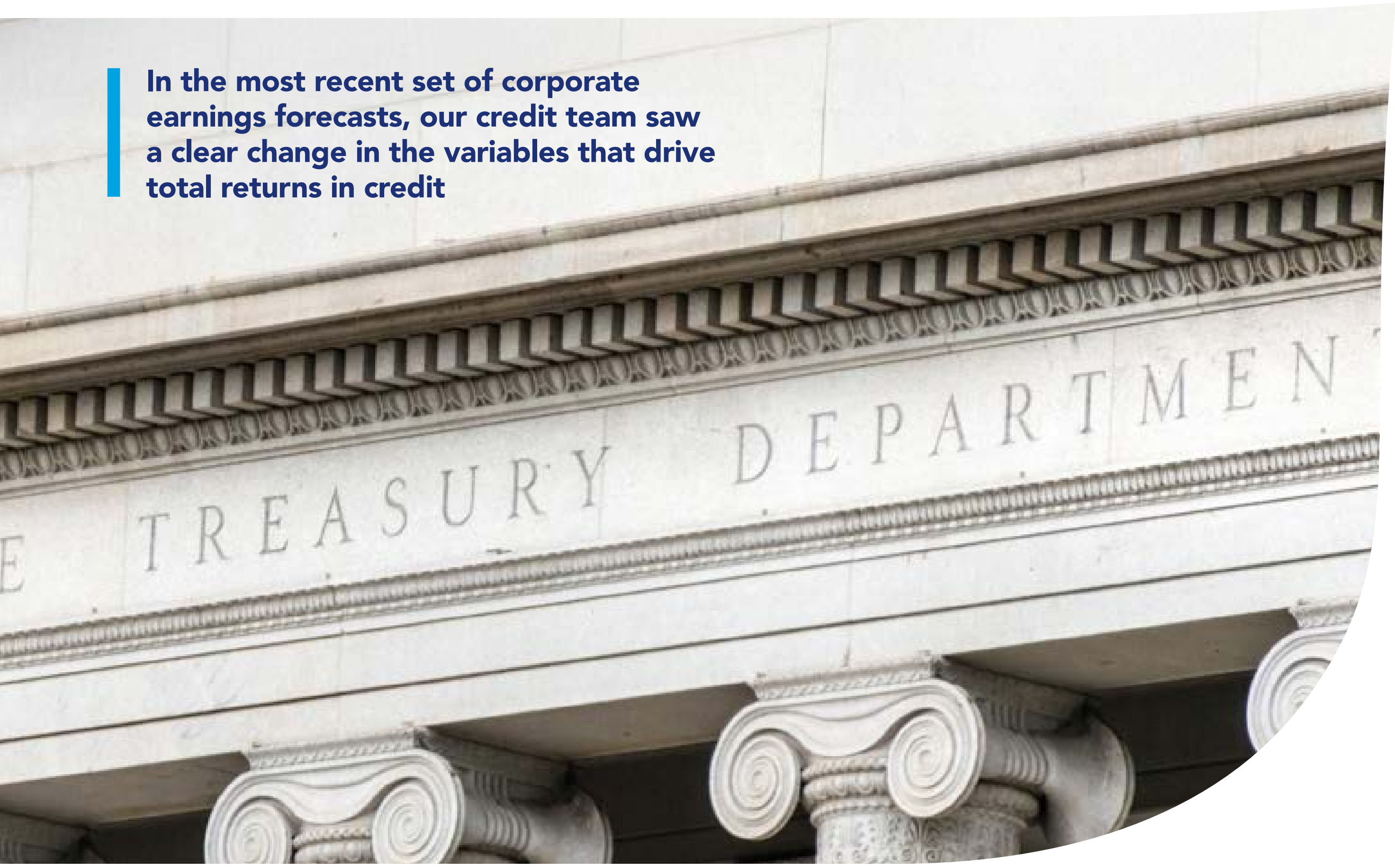
When trade arrangements are used as a foreign policy instrument, much uncertainty rests on whether the various governments find agreements (beyond the 90-day 'pause' periods) and what they will entail. A lot is unknown.

Again, that word: uncertainty. It's not clear to us what the required level of tariffs is to simultaneously keep global trade active and generate economic growth on the one hand, and bring back manufacturing the US (the stated policy of the Trump administration[9]) on the other.

It feels to us that the drivers of capital markets – for lenders, borrowers and investors – will be in a holding pattern until an element of certainty emerges. This scenario can open up investment opportunities for us.

The ability to allocate credit on a global basis is advantageous. We have seen a risk-capital allocation away from the US and into Europe and other international markets. Non-US credit and equities have outperformed US risk assets. As an example, following the market panic caused by the presentation of tariffs on 2 April, the Bund rallied as investors sought a safe haven from US risk and Treasury markets.

In the most recent set of corporate earnings forecasts, our credit team saw a clear change in the variables that drive total returns in credit



[8] Source: Ratings.Moodys.com/ratings-news/443154

[9] Regulating Imports with a Reciprocal Tariff to Rectify Trade Practices that Contribute to Large and Persistent Annual United States Goods Trade Deficits – The White House.

While the loss of confidence in the US economy has led expectations for global, macro fundamentals lower, we do think there are some relative bright spots.

Europe, for example, recently unveiled plans to provide up to €800bn for defence investment.[10] The ReArm Europe plan enables member states to quickly and significantly increase defence investment. It is not unreasonable to expect such ambitious spending plans on this level to offset some growth problems in the region.

Emerging markets (EMs) have been surprisingly resilient, given their interdependence with the US. We think any expected loss in momentum in the global economy is somewhat mitigated by a weaker dollar, which can lower repayment obligations and the market price of US dollar-denominated debt.

China's economy is expected to grow at a slower pace. Despite fiscal and structural woes of its own, China appears amenable to pumping more fuel into the tank of its economy, as we have already seen.

The outlook for credit fundamentals appears weaker, but the strength of balance sheets is providing some reassurance. While growth-oriented corporate spending may be on hold until there is more visibility or consistency in trade and industrial policy, we actually believe that creditors benefit from measures to protect cash…in the near term. Of course, the longer this goes on, the more challenging it becomes for financially weaker companies in the market who must grow into their balance sheets.

China's economy is expected to grow at a slower pace. Despite fiscal and structural woes of its own, China appears amenable to pumping more fuel into the tank of its economy, as we have already seen.

How are we positioned in credit?

The situation led us to position our strategies to benefit from steeper curves. We have also been favouring Europe over the US; higher quality credit risk; higher rated asset-backed securities (ABS); higher quality CLO managers, and an actively managed book of credit options that seeks to indemnify performance from spread widening.

While we have seen technicals weaken, they did regain some ground after the Republican administration responded to a bond market volatility and walked back its more aggressive approaches to trade policy.

We think the market for higher quality credit remains decent. Many companies and financials have strong fundamentals, despite this loss of momentum. As such, we are hesitant to capitulate on risk altogether, because all-in yields still look attractive.

We remain long on: Europe (vs. the US and EMs), higher quality asset-backed securities (ABS), collateralised loan obligation (CLO) managers, and higher quality credit, in general.

We are also positive on the outlook for financials. The impact of tariffs has been muted, and revenues are supported by a range of factors including falling deposit costs, and higher income streams. Capital strength is driving fresh buybacks and there does not appear to have been any demonstrable deterioration in asset quality.

In general, where we see flare ups in spreads, we will buy higher quality credit as the value proposition becomes very attractive.

[10] Commission unveils the White Paper for European Defence and the ReArm Europe Plan/Readiness 2030.

Federated Hermes
Limited

Federated Hermes

Federated Hermes is a global leader in active, responsible investing.

Guided by our conviction that responsible investing is the best way to create long-term wealth, we provide specialised capabilities across equity, fixed income and private markets, multi-asset and liquidity management strategies, and world-leading stewardship.

Our goals are to help people invest and retire better, to help clients achieve better risk-adjusted returns and, where possible, to contribute to positive outcomes that benefit the wider world.

Our investment and stewardship capabilities:

- **Active equities:** global and regional
- **Fixed income:** across regions, sectors and the yield curve
- **Liquidity:** solutions driven by five decades of experience
- **Private markets:** private equity, private credit, real estate and infrastructure
- **Stewardship:** corporate engagement, proxy voting and policy advocacy

For more information, visit **www.hermes-investment.com** or connect with us on social media: