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FROM BRIDGEWATER CO-CIOS BOB, GREG, & KAREN

Adapting to a New Reality

APRIL 23, 2025

To state the obvious: we are now facing a radically different economic and market environment that threatens the existing world order and monetary system. We have been transitioning to this world for several years, but now the shift has sharply accelerated and become chaotic. This new macroeconomic and geopolitical paradigm is turning past tailwinds into headwinds and reshaping global flows of capital. If you were to list the defining characteristics of recent decades and compare them to today, you'd struggle to find much overlap. We have been through many big economic shifts over Bridgewater's 50-year history, so we don't speak lightly when we say that this looks like a once-in-a-generation one.

Facing a new reality, everyone must adapt. Those who adapt fast and well will gain at the expense of those who adapt slowly and poorly. Our approach to dealing with new realities has always been to embrace them. This starts with identifying which dynamics will matter the most. We then build a fundamental understanding of those dynamics, mapping the cause-and-effect linkages through which they impact the markets and economic machine, which allows us to reflect them in our investment systems and update our playbook. At the same time, we want to be realistic about what we don't know and deal with that by designing portfolios that are diversified and resilient.

Today, we see three interrelated dynamics at the core of this new reality: 1) a new geopolitical and macroeconomic paradigm, 2) an urgent threat to investment portfolios from this paradigm shift, and 3) a once-in-a-generation technological disruption. Below, we're sharing an excerpt from our recent CIO letter to our clients describing how we're processing each of these forces.

Bob Greg Karen

Bob, Greg, and Karen

Co-Chief Investment Officers, Bridgewater Associates

Three Ways the World Is Changing

1. **We're in a new geopolitical and macroeconomic paradigm:** Globalization, rising trade, and capital liberalization was the dominant geopolitical and economic paradigm for decades. That paradigm is over and is being replaced with modern mercantilism. The Trump administration has chaotically accelerated this shift as it seeks to upend global institutions and rebalance trade and security relationships to pursue its "America First" priorities. Now, a global system of interdependency that has been woven together since the dawn of the US-led post-war era is being undone.

   As we show below, in this new mercantilist paradigm, the role of the state is perceived to be to increase national wealth, strength, and self-sufficiency. The state takes a more active role in orchestrating the economy to pursue these goals using trade policy, transactional or even coercive foreign policy, and industrial policy to support companies and sectors it considers strategic to achieving these goals (e.g., domestic capabilities in AI/ML, manufacturing in key areas such as semiconductors, etc.). How these policies play out, and how global policy makers and the private sector respond, will have major implications for markets and economies.

Modern Mercantilism: The Role of the State Is to Increase National Wealth, Strength, and Self-Sufficiency

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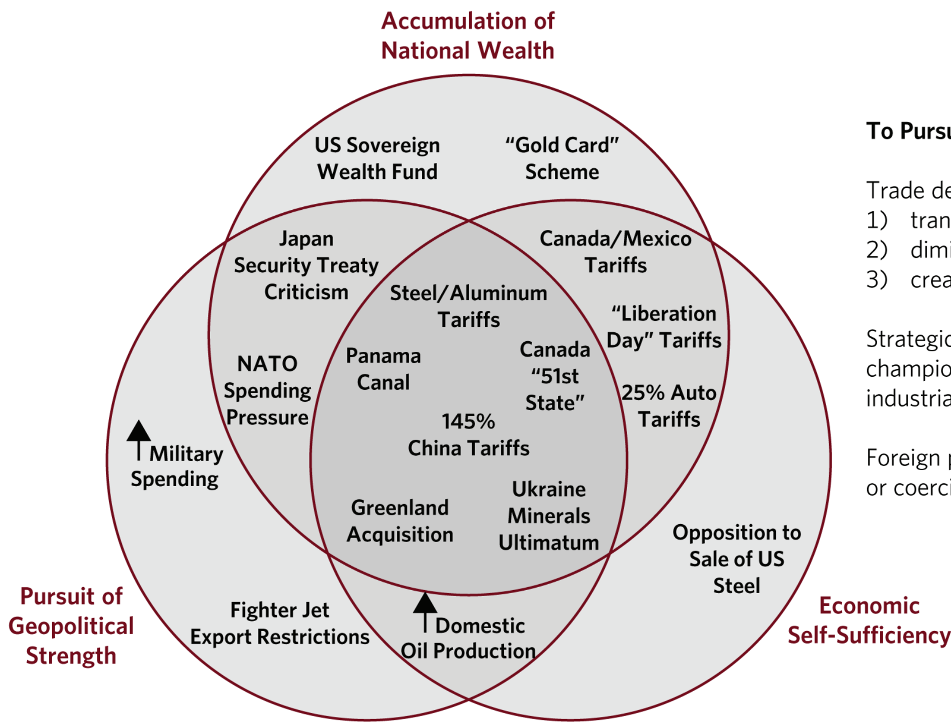

To Pursue These Goals...

Trade deficits are avoided; they:
1) transfer wealth abroad
2) diminish self-sufficiency
3) create security vulnerabilities

Strategic sectors/national champions are protected with industrial policy

Foreign policy is transactional or coercive

2. **This shift presents an urgent threat to markets and investment portfolios:** Today's mix of global assets reflects the winners from the past paradigm, which were largely assets like US equities that benefited from rising growth, a proactive Fed, and US outperformance.

   This shift in asset allocations has created risks if the future is different than the past. Many portfolios are increasingly vulnerable to 1) any weakness in growth, 2) central banks not being able to ease into problems, 3) equity underperformance, and 4) US underperformance relative to the rest of the world.

   The rapid shift to modern mercantilism presents imminent risks across each of these dimensions, which have begun to materialize:

   - We expect a policy-induced slowdown, with rising probability of a recession.
   - The Fed is less able to ease proactively into the slowdown as stagflationary risks rise; other central banks will lead the easing cycle.
   - US corporates are under threat, while strong earnings remain priced in.
   - We see exceptional risks to US assets, which are dependent on foreign inflows.

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	Vulnerabilities	Yesterday's Environment	In The New Mercantilist Paradigm
1	**Growth Weakness**	Strong US Growth	Policy-Induced Growth Slowdown
2	**A Fed that Can't Ease Into Problems**	Flexible, Proactive Fed	Stagflationary Risks, Fading Disflationary Tailwinds
3	**Stock Underperformance**	US Corporates Globally Dominant	US Corporates Highly Exposed to RoW, While Continuing Outperformance Priced In
4	**US Equity Underperformance vs the World**	Global Capital Surplus, Massive US Inflows	Loss of US as Reliable Trade and Security Partner Threatens US Capital Inflows

3. **Simultaneously, we're in a once-in-a-generation technological disruption:** Every several decades, we experience technological evolutions that impact human productivity in such profound ways that they lead to structural and societal change; we are amid one of those. The intelligence is already here—AI/ML can now significantly outperform human experts in a range of fields. The economic, market, and societal consequences have only begun, and they will exponentially grow. The interrelations with geopolitics, policy making, and portfolios will be complex and impactful.

   For markets, it is too soon to say who the winners will be and if they will hold on to their winnings. Being on the leading edge of a technology does not necessarily mean being on the leading edge of its deployment and monetization, and it is not yet clear where in the AI value chain the profits will accrue (e.g., will the models become commoditized?). In many ways, the AI story today is analogous to the internet story of the late 1990s; we believe we are in the early stages of this story, akin to around 1998. Technological progress around the internet eventually achieved almost everything that was promised in the dot-com boom (e.g., today we all have wireless high-speed internet available on devices we carry in our pockets), and yet US equities were among the worst-performing assets of the 15 years after 1998, underperforming Treasuries, emerging market equities, and gold. Bets on the market-leading internet names in the dot-com era broadly underperformed the market (Microsoft was a noticeable exception). Many of the ultimate winners, such as Alphabet and Meta, were small or did not yet exist.

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