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The U.S.-China Trade War:
What to Expect in 2026

- Tensions will remain elevated through 2035 but should be less pronounced next year. Any market weakness driven by fear of an escalating trade war represents a buying opportunity.
- Presidents Xi and Trump are set to meet two or three times during 2026. Negotiations will be focused on narrow, technical issues and a formal agreement is likely to be signed. This would be especially positive for Chinese equities which some have viewed as uninvestable.
- The endgame is one of selective decoupling, to eliminate chokepoints in rare earths, batteries, drones, ships, pharmaceuticals, and so on. Bilateral trade is expected to decline by over 50% through 2030, as anything with national security implications is home-shored. Such reindustrialization, reinventing the U.S. economy, represents 5% to 10% of American GDP.
- China is doubling down on its aims to dominate the industries of the future, accelerate higher valued-added exports, achieve technological independence and robust self-reliance. One of their specific aspirations is to integrate AI into 90% of manufacturing by 2030.
- The U.S. cannot stop China, those days are long gone. However, what America does to improve its own capabilities in 2026 and beyond will matter a lot more than whatever it does with China. Successful reindustrialization necessarily involves three urgent pivots: working more closely with allies, attracting skilled immigration, and enhancing state capacity. Each of these is acutely challenging for Trump and the populist right.
- The consensus is skeptical that America can reindustrialize. We are more optimistic, given the progress already made since 2021 and that there simply is no plan B. But how long will it take to reverse three decades of off-shoring? For most sectors, it requires 3 to 5 years just to demonstrate meaningful

momentum and put a dent in the problem. In almost all cases, the key bottleneck is not capital, capex, infrastructure or regulations, but skilled labor.

- **Improving collaboration with allies represents an opportunity for Canada to reset relations, as there is a long list of bilateral win-wins. A trade agreement with the U.S. would lift the CAD by 5 to 10%. Our non-consensus view is that the two economies will become even more integrated over the next decade.**
- **Implications for investors: Please see the concluding section of the paper.**

The G2 relationship will be less erratic and volatile next year

The scope of negotiations has narrowed dramatically, both countries are working around-the-clock to reduce chokepoints and vulnerabilities, and Presidents Xi and Trump are set to meet several times in 2026. However, inescapable challenges remain, reflecting the complex nature of great power rivalry and the rocky transition to a bi-polar world. Further, mutual suspicion runs deep, so future misunderstandings and miscalculations are guaranteed.

While trade is an integral part of the narrative, it is only one component of the struggle for economic dominance, technological supremacy and defense leadership. Although China's rise has been wonderful in many ways, it has also been extremely disruptive and ripped asunder the old global economic order.

What will the new global order look like?

The last transition, over a century ago, occurred ahistorically smoothly as the UK and U.S. possessed kindred political-economic structures. This time around though, the systems are as different as chalk and cheese.[1] Every president since Clinton has tried to make China's structure more open, liberal and democratic. However, these policies have been dismal failures, resulting in dreams of convergence being shattered and, just recently, decisively discarded. The new order is about divergence rather than convergence.

This finally came to a head last month when Trump was forced to jettison the structural demands that had been core to U.S.-China negotiations for decades. In previous rounds Beijing's strategy focused on delay, obfuscation and making vague promises they never intended to fulfill (such as the Phase One agreement in early 2020). This time, however, Beijing tacked decisively from defense to offense, and successfully weaponized their near monopoly of rare earth elements.

Although the bilateral imbalance is entirely structural in nature, Beijing's masterful pivot forced the U.S. to shelve demands for convergence. As a result, negotiations are now focused on narrow, technical issues such as soybeans, port fees and fentanyl precursors.[2] The October 30 meeting between Presidents Xi and Trump also demonstrated that, despite their profound ideological and strategic differences, they both prefer rapprochement and managed détente.

They've only holstered their trade weapons

We expect periodic trade clashes as the G2 test each other's resolve. The disputes are irresolvable, and the level of mutual distrust is impossible to exaggerate. This means crises can erupt quickly with little warning. However, the U.S. and China face profound domestic challenges, so they both have a strong preference for stability. This means most issues will likely be swiftly resolved, allowing a prompt return to the fragile and delicate truce.

An additional reason to expect relative stability is that both countries have weaponized their economic interdependence. America has administered export controls on advanced semiconductors and invoked sanctions to restrict access to the USD-based global financial system. Beijing has been an excellent student and transformed export controls on critical minerals into a core instrument of economic

[1] There have been sixteen previous examples of a rising power challenging the hegemonic incumbent, with twelve of those transitions proving problematic. See "Can America and China Escape Thucydides's Trap?—A Critical Examination of Historical Patterns Leading to War Between Great Powers," 2018, by Harvard's Graham Allison.

[2] Fentanyl has killed more than 300,000 Americans since 2020 and is the leading cause of death for 18–44-year-olds. Beijing has the ability to dramatically reduce exports but often loosens controls to exert pressure on DC. See, "Calibrating co-operation. America and China share a dangerous addiction. Fentanyl is hard to kick. Particularly as a source of leverage," The Economist, November 2025.

statecraft. Both countries possess powerful weapons which, somewhat counterintuitively, ensures a degree of stability (in a Cold War, Mutually Assured Destruction, kind of way).

It would be extremely destabilizing if the U.S. had all the cards and possessed escalation dominance. In that case, the U.S. would be tempted to impose a massive permanent tariff, force a whopping USD/CNY devaluation, and revoke China's Most Favored Nations status. This would comprise an enormous shock to the global economy but is unlikely to occur because (a) China has forged its own robust and coercive chokepoints to counterbalance the U.S., and (b) there is a huge asymmetry in pain tolerance. The Trump Always Cickens Out (TACO) trade is a real feature of negotiations, and it strongly favors China.

The endgame is one of selective decoupling, featuring the simultaneous pursuit of escalation dominance and the elimination of chokepoints

As both countries emphasize self-reliance, with China decoupling from America much faster than the other way around, we believe bilateral trade is set to shrink to less than half the pre-2017 level. That is, from 2030, trade will only occur in sectors without national security implications (such as soybeans, textiles, footwear, toys, appliances and mature node semiconductors). While such a partial decoupling reduces economic efficiency and results in higher prices, it could also makes the two economies less vulnerable and impels a more stable U.S.-China relationship.

A final reason to expect fewer fireworks next year is that Presidents Xi and Trump are likely to have two or three face-to-face meetings (recall that their sit-down last month was their first in over six years). Trump has agreed to visit China in April, and Xi has committed to a reciprocal visit "at an appropriate time." At minimum, he is expected to attend the G20 summit in Miami on December 14–15.[3] Additionally, there is the 2026 APEC summit next November in Shenzhen, China, although Trump has not yet confirmed attendance. Such a busy calendar, with all the accompanying pomp and circumstance, provides both leaders with incentives to patch over disagreements and announce diplomatic breakthroughs.

Regardless of all the bilateral meetings, what America does to improve its own capabilities in 2026 will matter a lot more than whatever it does with China. Trump's top economic objectives are to reindustrialize and rebalance the U.S. economy, and this necessarily involves three urgent pivots: working more closely with allies (e.g., on semiconductors, rare earths, shipbuilding, defense), attracting skilled immigration (even temporary visas are anathema to Make America Great Again (MAGA), but experienced talent is the key roadblock every sector faces when reshoring and could be coupled with training programs), and enhancing state capacity (the populist right is deeply mistrustful of elite bureaucrats, but industrial policy can't be effective without a deep bench). Most commentators are extremely skeptical that Trump could manage such a volte face, but he is already playing more nicely with Asian allies and has become a huge proponent of active industrial policy.

In the remainder of this note, we briefly discuss the key takeaways from the meeting last month in South Korea and then define chokepoints and weaponized interdependence. Next, we explain the critical structural differences between the two countries and why China's export surge is a much greater threat to global stability than Trump's tariffs. Following this, we demonstrate that what America does to improve its own capabilities in 2026 will matter a lot more than what it does with China. In particular, we examine what the U.S. must do to successfully reindustrialize and reinvent its economic structure. This includes asking whether America, which has thrived through openness and innovation, can now succeed through tariffs and central planning? Finally, we conclude with implications for investors.

> **Time and momentum are on China's side.**
>
> **– President Xi, January 2021**

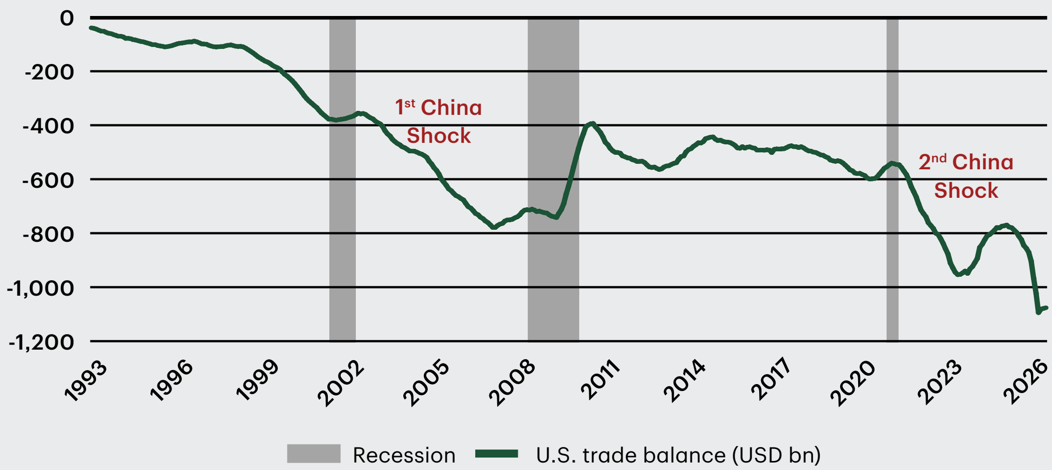
The October 30 meeting: Xi played the player, not the cards

The meeting last month was their first since June 2019's G20 Summit in Osaka. The consensus view is that Xi triumphed, while Trump folded,

[3] Negotiations are in play for this to be President Xi's second official state visit to the U.S. (the first took place over a decade ago, in September 2015).

Figure 1: America's trade deficit is over $1 tn, a massive and unsustainable imbalance

Sleight of hand: China's key victory last month was forcefully shifting the focus of negotiations from catastrophic structural imbalances to narrower, bureaucratic issues like port fees and rare earth export controls



Source: Bloomberg Finance L.P.

demonstrating China's confident ascendance and America's shallow bluster. This seems a fair assessment as China is now more assertive, well-prepared, and less U.S. dependent than it was during Trump 1.0.

They key play was Beijing cleverly weaponizing their near monopoly of rare earth elements. This forced Trump to toss the type of structural demands that had been core to bilateral negotiations for five presidencies **(Figure 1)**. The win for China is that negotiations from now on will be focused on narrow, technical issues. America has finally admitted that expecting China to change its economic and political model is manifestly unrealistic.

Structural change and at least partial convergence have been viewed as critical because America's external imbalance is structural in nature: China invests too much, consumes too little and exports the excess, wind-assisted by massive state subsidies and USD/CNY's 35% over-valuation.[4] As Brad Setser from the Council on Foreign Relations notes, open trade has not liberalized China's political system. Further, China's policy depends even more on external demand, its economy is more export oriented and leadership is more wed to industrial policy than when the trade war started.

Last month America learned, rather painfully and belatedly, that it just doesn't have the cards to force changes in the structure of China's economy and its industrial policies. Rather than the cards themselves (that is, economic chokepoints to squeeze), the biggest factor was an asymmetry in pain tolerance. Xi believes Chinese society has enormous tolerance for pain, that suffering builds strength, and that "The party's interests always comes first." Trump's perspective couldn't be more different.

Chokepoints and weaponized interdependence: Both countries have lots of arrows in their quiver, the real asymmetry lies in their pain tolerance

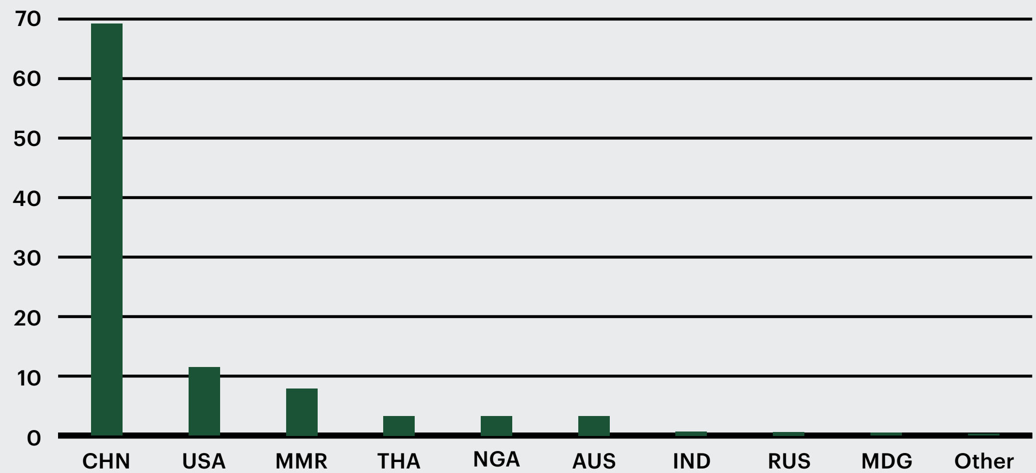
What are the best weapons in an age of economic warfare, and who holds escalation dominance?[5] Both countries hold some powerful weapons, but neither is dominant. However, while the U.S. views them as forms of economic leverage, China correctly

[4] Please see our paper "The Dollar is Our Currency, but It's Your Problem: Rebalancing Requires a Much Weaker USD," August 2025

[5] See "Chokepoints: American Power in the Age of Economic Warfare," 2025, by E. Fishman (Columbia), "Underground Empire: How America Weaponized the World Economy," 2023, by H. Farrell (JHU) et al, "The Economic Weapon: The Rise of Sanctions as a Tool of Modern War," 2022, by N. Mulder (Cornell) and "Paper Soldiers: How the Weaponization of the Dollar Changed the World Order," 2024, by S. Mohsin.

Figure 2: 2024 rare earths production (global share, %).
China's share is even higher for refined products (90%) and magnets (93%).

China's dominance over rare earths was not built overnight, it required over three decades. Meaningful progress with mining and, particularly, processing, will take the U.S. 3 to 5 years.



Source: U.S. Geological Survey

views them as political rather than economic tools. This allows them to exploit the huge asymmetry in pain tolerance, as the TACO trade is a real feature of negotiations, and it strongly favors China.

What chokepoints does China hold over the U.S.? Beijing's ace is its near monopoly in rare earth elements, developed over the last three decades **(Figure 2)**. However, that is only the tip of the iceberg. Regarding industries of the future, general consensus is that China dominates global production of electric vehicles (EVs) (with an 80% share), drones (also 80%) and industrial robots (55%). Similarly for what powers them, with batteries (80%) and solar panels (85%), as well as upstream industries such as aluminum (60%) and steel (55%), and additionally, what transports everything, including high-speed rail (65%) and ships (60%). Further, China controls roughly 80% of the global generic active pharmaceutical ingredient (API) market and dominates the global supply of antibiotics. As the sole manufacturing superpower, with the world unduly dependent on its exports, China has cleverly constructed a surfeit of chokepoints it can trigger at will.

> **The Middle East has oil, China has rare earths.**
>
> **– Deng Xiaoping, 1992**

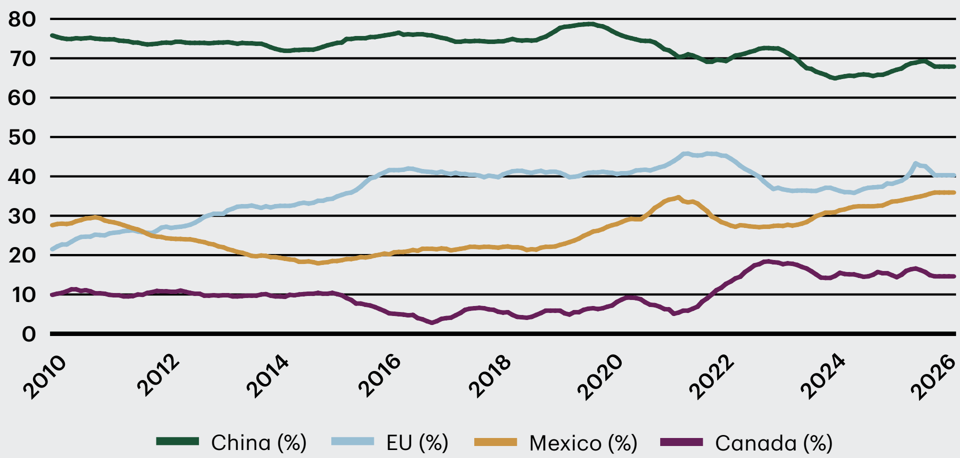
While China possesses an impressive inventory of chokepoints, the U.S. is equally equipped. The most high-profile weapons are leading edge semiconductors and semiconductor equipment, as well as the USD-based global financial system and access to the U.S. consumer. America has at times weaponized access to visas for Chinese students and officials, and is also well ahead in aerospace and aircraft engines. China has managed to eliminate chokepoints in many sectors but has struggled for decades to indigenize aerospace and semiconductors. They won't achieve self-sufficiency next year but almost certainly will by 2035.

What structural remedies could America impose if it had all the cards?

China outplayed the U.S. last month, but what if Beijing had shown up without any cards and highly exposed to chokepoints? In such a counter-factual, the U.S. could have foisted painful measures, and China would have been unable to reciprocate. The U.S. might have been tempted to impose a permanent tariff of 68% **(Figure 3)**, force a USD/CNY devaluation of 35% **(Figure 4)**, or revoke China's Most Favored Nations status, among other structural remedies.

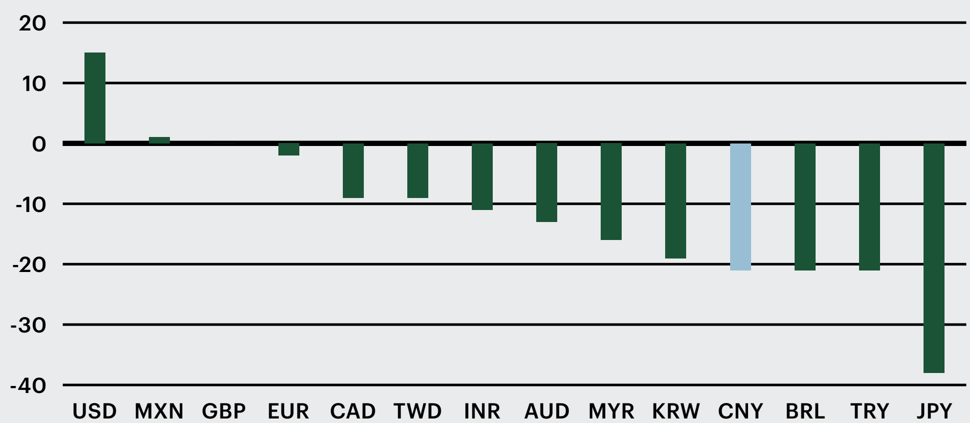
Figure 3: Tariff (%) required to balance bilateral trade

The USTR estimates a tariff of 68% is required to balance trade with China (reflecting enormous structural impediments), roughly 2x that for Mexico and 5x that for Canada



Source: Bloomberg Finance L.P., U.S. Trade Representative (USTR)

Figure 4: CNY is 35% cheap relative to the USD, reflecting Beijing's massive intervention



Source: International Monetary Fund, World Bank, Bloomberg Finance L.P.

Note: The table presents an average of five different valuation measures, including REER (real effective exchange rate) and PPP (purchasing power parity)

Such policies would constitute an enormous shock to China (and the global economy more broadly) and would be extremely destabilizing. This explains why Beijing has worked so hard and so deliberately for decades to achieve technological self-reliance and fashion its own chokepoints. Maybe we should be thankful that neither country currently possesses escalation dominance, as balanced capabilities to inflict harm ensure an appreciable degree of stability. America did have all the cards two decades ago but failed to take advantage because of its mistaken beliefs in convergence and free markets. The unfortunate consequence is that structural imbalances have soared to levels that are undeniably unsustainable and constitute a bona fide economic emergency. This has forced America to fundamentally rethink the economic model that had worked so well for decades.

China's export surge is a much greater threat to global stability than Trump's tariffs: The imbalances are structural in nature, and require structural solutions

President Xi has zero interest in changing China's political economy, reducing bilateral imbalances or any notion of convergence. Actually, he is doubling down on a strategy that is certain to end in tears, as China's structural overcapacity is a much greater threat to the global economy than is Trump 2.0. In fact, China's economy is now even more unbalanced and more reliant on exports than it was when Trump was first elected in 2016 **(Figure 5)**.[6] Countries which engage fall into 'The China trap,' making themselves reliant on China out of convenience and myopia, but soon realize Beijing only believes in one-way trade.[7]

China's version of modern mercantilism involves a massively undervalued currency and enormous industrial subsidies.[8] To encourage exports and discourage imports, it also keeps domestic demand deliberately weak. Consumption represents only 40% of GDP, which is far lower than the Organisation for Economic Co-operation and Development (OECD) average (60%), as well as other large emerging markets, such as India (61%) and Brazil (64%).[9] The flip side of repressed consumption is a massive investment share **(Figure 6)**. This results in over-capacity in multiple sectors with the surplus output, by design, being exported. An inevitable consequence is deindustrialization, and not just of the U.S., but of Germany, Canada and much of the rest of the world.

One way to frame this discussion is that we are witnessing a contest between the Great Producer and the Great Consumer. China is an engineering/production economy, which excels at construction, while America is a lawyerly/consumption economy that excels at obstruction.[10] This is reflecting in the structure of the labour force **(Figure 7)**. China has 780 mn workers, (compared to America's 170 mn), including 137 mn in manufacturing (vs 13 mn in the U.S.), but only 0.5 mn lawyers (vs 1.9 mn stateside).

Figure 5: China's trade surplus ($1.2 tn) is structural not cyclical. To infinity and beyond!

This is unsustainable and represents a huge threat to global financial stability.

Source: Bloomberg Finance L.P.

[6] Many commentators resent Trump's biting criticisms of international organization. However, in the case of the IMF, it is purely an own goal. It has one job, addressing unsustainable structural imbalances, and it has failed miserably. https://www.cfr.org/blog/chinas-massive-surplus-everywhere-yet-imf-still-has-trouble-seeing-it-clearly

[7] For a case study of the auto sector see https://newsletter.dunneinsights.com/p/the-great-china-joint-venture-boomerang

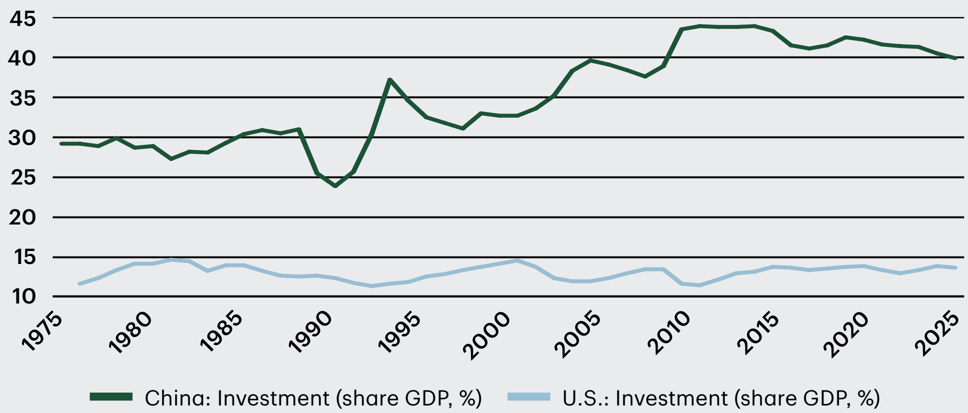
[8] Industrial subsidies represent roughly 5% of GDP. They primarily target the manufacturing sector, which is 25% of GDP. Further, subsidies are focused on select sectors within manufacturing, for which they often represent 20%-40% of value-added. Add on a 35% currency tailwind and we get a sense of how aggressively Beijing has tipped the scales. With such beneficial policy support, even George Castanza could turn a profit.

[9] See https://www.noahpinion.blog/p/chinas-people-are-on-a-treadmill

[10] See "Breakneck: China's Quest to Engineer the Future," 2025, by Dan Wang. He believes both countries need to learn from each other and move toward the middle. China should do less producing and more consuming, and vice versa for the U.S.

Figure 6: Investment share of GDP (%) is far too high in China (40%), forcing it to produce output that vastly exceeds domestic demand.

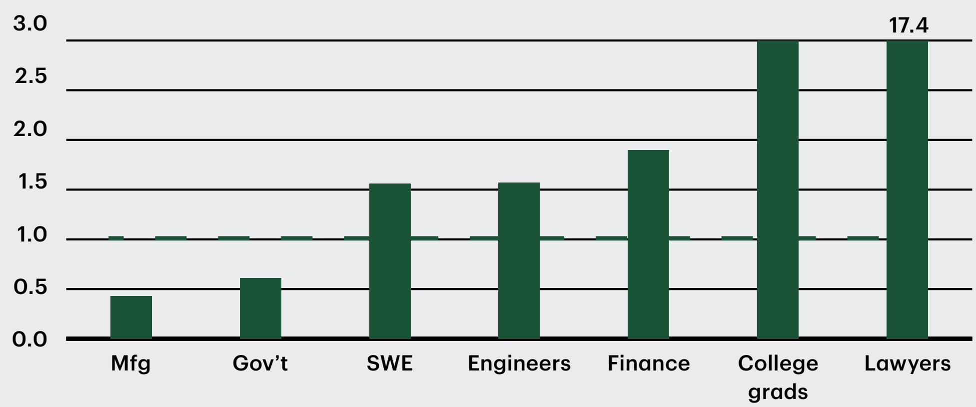
This is unhealthy and unsustainable: Excess production is exported, driving imbalances and deindustrialization in the U.S., EU and, increasingly, other EMs



Source: Bloomberg Finance L.P.

Figure 7: Composition of U.S. labor force relative to that of China

U.S. has proportionately fewer manufacturing and government workers, but more engineers, finance, college graduates, and lawyers (an eye-popping 17x more)



Source: Bloomberg Finance L.P., National Statistics. SWE: Software engineers

China's economic priorities: Industries of the future, export-driven growth, self-sufficiency

China did not develop into the global manufacturing superpower simply because of textbook comparative advantage and benign market forces. Rather it was the result of deliberate industrial policies, designed and implemented over decades. To illustrate, the 13th five-year plan (FYP), commonly referred to as "China 2025," was released in 2015. It aimed for China to dominate the industries of the future (e.g., batteries, solar, EVs, robotics, drones, biotech) and has been spectacularly successful. The 14th FYP, "Dual circulation," was published in 2020 and emphasized technological independence and robust self-reliance, plus a focus on higher valued-added exports. It has also been tremendously effective.

A draft of the 15th FYP was released last month, with a final version to be published in March 2026. It doubles down on the previous two FYPs, prioritizing national security and self-reliance (ending "strangleholds"), with the aim of achieving technological independence, especially in semiconductors and physical AI. China has its sights on sectors such as semiconductors, robots, autonomous vehicles (AVs), EVs, drones, and quantum computing.[11] One specific aim is to integrate AI into 90% of manufacturing by 2030 (by contrast, America's AI focus is on foundational models, chatbots and artificial general intelligence).

What America does to improve its own capabilities in 2026 will matter a lot more than what it does with China

The U.S. cannot stop China: Those days are long gone. That means its primary focus needs to be on reinventing itself. Decades of hyper-globalization and free-market orthodoxy, beginning with Reagan's presidency, resulted in massive imbalances, deindustrialization and rising inequality. This interpretation was heretical a decade ago, when the Washington Consensus still ruled the roost, but is now a firmly and durably held, bipartisan belief. And it will continue to drive American economic policy, regardless of who next sits in the White House.

For decades, an exaggerated distrust of government meant passively importing China's industrial policy, an outcome that was great for Beijing. However, the pendulum had clearly swung too far and is now lurching forcefully back. The U.S. is currently implementing the most aggressive industrial policy witnessed in its (almost) 250-year history, outside of WWII. The irony is indisputable, given how relentlessly Trump has campaigned against big government and pursued policies to diminish state capacity.

Trump has been extremely successful at blowing up the old order. Does he have the temperament and facility to build a new one?

In particular, reindustrialization and rebalancing require three urgent pivots. First, partnering with a long list of allies that are essential to sectors such as semiconductors, rare earths, nuclear power, shipbuilding, and defense. Such collaboration is critical to match China's scale and scope, as no single country can do everything on their own. Although skepticism is widespread, especially after having suffered from extensive bullying, Trump is already playing more nicely with a number of allies, particularly those in Asia.

China can draw on a talent pool of 1.3 billion people, but the United States can draw on a talent pool of 7 billion.

– Lee Kuan Yew,
Prime Minister of Singapore,
1959-1990

Second, increasing the number of skilled workers, as that is the key bottleneck for almost every sector that is being reindustrialized (providing the capital, capex, infrastructure and regulatory framework is straightforward by comparison). This has already been a focus of the administration.[12] However, after three decades of offshoring, the skills shortage is extreme, including people to train them and supervise apprenticeship programs. This means experienced labor will need to be attracted from abroad. To soften objections from MAGA supporters, they could be offered limited visas (say, three- or five-years) and be required to train local workers. The U.S. should not squander its most powerful edge over Beijing: access to talent, including talent from China.

The third pivot involves enhancing state capacity. All policy is hard, especially given the scale and scope of Trump's industrial policy ambitions. It will require a significant budget and sizeable bureaucracy. The problem here is that Trump and the populist right are extremely mistrustful of elite, unelected, unaccountable bureaucrats.[13] However, industrial policy simply can't work without a deep and talented bench.

[11] To illustrate, China is set to produce over 15 mn EVs this year, with production up 33% yoy and exports surging 90% yoy. This is proving especially disruptive for Germany.

[12] https://www.whitehouse.gov/fact-sheets/2025/04/fact-sheet-president-donald-j-trump-modernizes-american-workforce-programs-for-the-high-paying-skilled-trade-jobs-of-the-future/ and https://www.dol.gov/sites/dolgov/files/OPA/newsreleases/2025/08/Americas-Talent-Strategy-Building-the-Workforce-for-the-Golden-Age.pdf

[13] For example, Trump plans to reduce the size of the NSA and other intelligence agencies by 8% annually over the next five years. This would slash NSA employment to roughly 21,000, which is less than 30% of its peak in 1989, at the end of the Cold War. This is why Dan Wang wonders if "America is getting authoritarianism without the good stuff." https://www.economist.com/by-invitation/2025/10/21/donald-trump-is-copying-the-wrong-things-from-china-writes-dan-wang

The consensus is deeply skeptical that America can reindustrialize

Much of the dubiousness reflects a view about Trump. His key achievement over the last decade was convincing America that China is an existential adversary and then destroying the old global economic order. While he was certainly the right person to dismantle the old, is he capable of constructing a new and more sustainable economic order? This is a valid concern given that his policy MO is improvisational and transactional, rather than deliberate and strategic. Further, Trump prefers to act unilaterally, rather than pursuing collective action (with allies, or even Congress).

Regardless, we are confident America can reindustrialize.[13] But how long will it take to reverse three decades of deindustrialization? For most sectors, it requires 3 to 5 years just to demonstrate meaningful progress and put a dent in the problem. It should also be emphasized that the goal is not full reshoring and complete decoupling. Based on trends in U.S. government data, bilateral trade is set to decline by over 50% by 2030, as anything with national security implications is home-shored. Such reindustrialization, reinventing the U.S. economy, represents 5% to 10% of American GDP.

America has thrived through openness and innovation: Can it now succeed through tariffs and central planning?

In the decades since Reagan's 1980 campaign extolling the virtues of free markets, there have only been two notable examples of industrial policy in the U.S.: Operation Warp Speed (2020), which accelerated the development and deployment of COVID-19 vaccines, and the CHIPS and Science Act (2022), which aimed to revitalize U.S. semiconductor manufacturing. However, during 2025 we have witnessed America's quiet but decisive turn towards state capitalism.

Two examples serve to illustrate DC's growing intervention in corporate America. In July, the Department of Defense invested $400 mn to take a 15% stake (on a fully converted basis) in MP Materials (the largest producer of rare earths in the U.S.). Second, in August the government invested $8.9 bn (mostly from the CHIPS and Science Act) to take a 9.9% stake in Intel. It's been a busy six months and there are many other examples of the profound transformation in the relationship between the U.S. government and corporate America.

DC is abandoning its traditional free-market posture, to reflect the rising importance of national security objectives in chokepoint sectors such as rare earths **(Figure 2)**. The U.S. had been aware of this vulnerability since at least 2010, when China imposed a two-month embargo on rare earth exports to Japan. However, one Trump administration official has been quoted as saying, "We've sat around admiring this problem for decades." Action by previous administrations was stymied by a mixture of environmental concerns, a reluctance to engage in industrial policy and a naive view that the market would sort things out. Everyone now agrees this was a major policy error.

Implications for investors

1. **Short USD:** America can't reindustrialize without a much weaker greenback. We expect the greenback to decline by 15% to 20% over the next three years.[4] Non-U.S. investors should consider hedging their exposure to USD-denominated assets.
2. **Long CAD:** To appreciate by 5 to 10% in 2026, with the key catalyst being a narrow trade deal. The U.S. needs to improve collaboration with allies, and this represents an opportunity for Canada to reset relations. There is a long list of potential win-wins (including rare earths, aluminum, ice breakers, Arctic defense, AI). Our non-consensus view is that the two economies will become even more integrated over the next decade.

[13] To illustrate, U.S. construction spending on manufacturing facilities is up 3x since 2021. The increase for semiconductor fabs is even more impressive, up 12x. Data center spending has also grown rapidly, up 20x over the last decade. So yes, American can definitely reindustrialize, at least for some sectors.

3. **Emphasize quality tech:** AI is the key domain in which the U.S.-China contest for supremacy is to be waged. There are only two AI superpowers, but the supply chain extends to many other countries as well. By quality we mean companies generating sustainable Free Cash Flow (FCF), with solid margins, and a return on invested capital (ROIC) > weighted average cost of capital (WACC).

4. **U.S. industrial supply chain:** Reindustrialization is positive for select companies in industrials and materials, many of which have languished for years and trade at attractive multiples.

5. **Diversify beyond the U.S.:** We remain constructive on U.S. equities, but too many investors hold overly concentrated portfolios. The USD is over-valued, eventually there will be a U.S.-centric AI capex downcycle, and the U.S. valuation premium often doesn't appear justified by fundamentals. Seek global champions outside the U.S. that meet our definition of quality.

6. **China is investable:** Especially global champions like the leading EV and battery companies (but not those companies for which the public mission dominates). Chinese equities will receive a boost if a broader trade deal is signed in 2026. However, China has invested too much in industrial capacity, and much of this will destroy value (ROIC < WAAC), so the overall market is likely to underperform.

7. **U.S. state capitalism = worse capital allocation:** Companies with a dominant public mission exhibit a lower marginal efficiency of capital, meaning reduced margins and ROIC. However, as national champions their credit risk is often minimal, justifying a narrow spread.

8. **Infrastructure is in a secular bull cycle:** Reindustrialization requires massive investment in ports, pipelines, and power, as well as transportation and manufacturing infrastructure. Governments face fiscal challenges so this will primarily be funded by private investors.

9. **TACO trade:** Trump has an infinitesimal pain tolerance, especially as 2026 midterm elections approach. Any market weakness on trade fears represents a buying opportunity.

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