

Investment Views

April 2025

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A Market Disturbance

Fixed Income:

Inflation Reawakens, Uncertainty Rises

Equities:

Trump, Tariffs, and Trying Times for the Equity Markets

A Market Disturbance

- Trump pursuing short-term pain for long-term gain
- But it is a very high-risk strategy
- Markets have moved to reflect higher recession risk

The first quarter saw many of last year's trends reverse in an abrupt manner. The MSCI World Index of global equities fell by a modest 1.8%, but this does not capture the extent of the sector and geographic rotations beneath the surface. Like last year, politics and technology were key drivers of financial markets. In recent decades, politics in developed markets has not been a major driver of market returns. Wealthy countries tend to have many checks and balances on political power, so policy shifts have generally been marginal and often outweighed by other economic factors. That has now changed. We have seen a marked increase in the extent to which politics and geopolitics can influence financial markets.

The victory of President Trump in the November election capped a year of significant outperformance of US equities and appreciation of the US dollar. Market consensus coming into the year was that this



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would be another year of US equity outperformance. However, US equities were down 4.6% in the first quarter, while global (excluding the US) equities returned 6.2%. This was the largest quarterly outperformance since the second quarter of 2002 and the 11th largest since 1970. This was a mirror image of the fourth quarter last year, reversing all of the US outperformance seen in that period.

The market was hoping that Trump would move forward with the parts of his agenda that help growth (tax cuts and deregulation), while using tariffs only sparingly and mostly as a negotiation tool. Instead, Trump has moved quickly on the less market -friendly elements of his agenda, with tax cuts expected later this year. He has imposed additional 20% tariffs on China and 25% on imports of steel and aluminium. Many expected some levels of tariffs to be imposed, especially on China, but the erratic nature of the trade policy and focus on close allies such as Canada has unnerved the market.

There is a general consensus among economists that there are imbalances in global trade, but also that blanket tariffs are not an effective means of countering them. The US runs a substantial trade deficit, and countries, such as China run large corresponding surpluses. Trade in the modern financial system is complex because many supply chains are multinational, and components often cross borders multiple times before becoming finished goods. However, it is clear that the short-term impact of tariffs is to raise the inflation rate. After years of companies struggling to pass price increases onto consumers, that changed during the pandemic, and many companies have already said they will pass on tariff -induced price increases to consumers.

The return of inflation has been a feature of the post-pandemic economy, but the last couple of years have seen inflation rates come down, though still above central banks' targets of around 2%. This is, therefore, an inopportune time for a new inflation shock. The consensus around whether tariffs raise long-term inflation is far

6.2%

The percentage global equities, excluding US, returned in the first quarter.





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less clear, as the dampening effect on growth is likely to weaken inflationary pressures after the initial price adjustment. Still, inflation presents a challenge for central banks and makes it harder for them to lower interest rates.

Policy uncertainty is clearly high regarding trade, but it is also high on the outlook for government spending. The Department of Government Efficiency (DOGE) run by Elon Musk, has promised to slash spending, but it is unclear how much this will move the needle on the budget deficit. This again appears to be a haphazard process, and ultimately, Congress controls government spending. Furthermore, many of these cuts are being challenged in the courts. We have started to see the impact of this in markets, with companies exposed to government contracts selling off, for example, consultancies and software providers.

Our positioning in investment portfolios has a slight defensive tilt. We hold slightly less equity exposure than our benchmarks, while being underweight in the cyclical Consumer Discretionary sector and overweight in the more defensive Health Care and Utilities sectors. Bonds have had a challenging few years but have helped cushion equity volatility in recent months. For portfolios with exposure to Alternative Assets, we own gold, which has had a strong start, returning 19% in US dollar terms. This was the best quarterly performance since 1986. At the beginning of April, President Trump imposed a wide range of tariffs against multiple countries. This will be covered in our next investment commentary.

Inflation Reawakens, Uncertainty Rises

- Tariff tensions reignite global trade uncertainty
- Germany announces major fiscal stimulus, boosting bond yields
- Credit markets show resilience despite volatility

The first quarter of 2025 unfolded against a backdrop of shifting inflation dynamics, divergent monetary policy paths, liquidity injections, and a growing sense of trade, geopolitical, and fiscal uncertainty. Markets entered the year cautiously optimistic about disinflation and easing financial conditions, but by the end of the quarter, it was clear that the road ahead would be more uneven.

In the US, while longer-term inflation measures remained broadly stable, short-term indicators told a different story. Headline and core (excluding food and energy) inflation numbers showed renewed upward momentum, reflecting resilience in the labour market and ongoing services inflation. This reacceleration complicates the policy outlook and challenges the prevailing narrative that rate cuts were imminent. While the Federal Reserve held rates steady, it announced a meaningful slowdown



in its balance sheet runoff starting in April, effectively ending quantitative tightening (contracting the balance sheet) in US Treasuries, signalling a more cautious stance in light of growing macro and financial uncertainty.

In addition, the drawdown in the Treasury General Account and the decline in the Fed’s Reverse Repo balances released significant reserves back into the banking system. Together with the slower pace of quantitative tightening, this created a supportive backdrop for fixed income markets despite elevated volatility in inflation data.

Globally, central banks charted different courses. Policymakers in Europe, Canada, Australia, Switzerland, and the UK moved to ease, citing weak domestic activity. Japan, in contrast, raised rates again, reflecting persistent inflation momentum and improving consumption dynamics.

One of the most impactful developments of the quarter came from Germany, where policymakers unveiled a sweeping fiscal stimulus plan, drawing comparisons to a “whatever-it-takes” moment for the eurozone. The package includes large-scale investments in infrastructure, energy transition, and defence. While this initiative aims to revive growth and address long-term competitiveness, it also carries the risk of keeping inflation elevated for longer—particularly in an environment of already tight labour markets and supply-side constraints. Investors began pricing in the likelihood that this stimulus could complicate the European Central Bank’s easing cycle, putting upward pressure on European bond yields and raising the risk of stickier inflation in the euro area.

Bond yields adjusted accordingly. US Treasury yields declined across the curve, supported by rising economic uncertainty, volatility in risk assets, and efforts by DOGE to reduce the 7% fiscal deficit— with savings of US\$140bn now realised. European and Japanese yields moved higher, responding to firmer inflation trends and, in Europe’s case, the significant fiscal expansion.

Currency markets reflected these shifting expectations. The US dollar weakened modestly, while currencies such as the euro and pound sterling performed well. Our portfolio positioning in multi-currency accounts remained overweight in those currencies, supported by stronger growth momentum, favourable policy settings, and resilient capital flows.

Duration positioning also reflected a disciplined, factor-based process. We maintained overweight exposures to Australia and New Zealand, where macro conditions and monetary policy actions remain supportive. Conversely, we hold underweight positions in Japan, the UK, and the euro area, where inflation pressures are more entrenched and policy risk more pronounced—particularly given the implications of Germany’s fiscal shift.

Credit markets remained resilient overall, with modest spread widening offset by strong demand and supportive liquidity conditions. While inflation volatility and global policy uncertainty created pockets of concern, corporate fundamentals and cash flow profiles remained robust, particularly in high-quality names. We continue to favour credit where spreads offer adequate compensation for risk and where liquidity conditions remain constructive.

Heading into the second quarter, markets are facing a renewed layer of complexity. Tariff-related uncertainty is intensifying, and recent moves have reignited global trade tensions at a delicate moment for the economic cycle. For fixed income investors, the implications are material—potential disruptions to supply chains, further volatility in commodity markets, and a possible delay in disinflation progress. We are closely monitoring developments across both headline policy announcements and their secondary effects on inflation expectations and cross-border capital flows.

Meanwhile, the Federal Reserve’s latest projections suggest only a gradual easing path, with interest rates expected to remain above neutral for an extended period. Growth is projected to slow modestly, and unemployment to rise only slightly, reinforcing the narrative of a soft landing—but one that still leaves little room for policy missteps.

In this context, our portfolios remain anchored in flexibility, regional diversification, and factor-based discipline. With liquidity still ample but inflation risk unresolved and geopolitical uncertainty rising, the coming months will require careful allocation of capital, considering both risk and return.

Trump, Tariffs, and Trying Times for the Equity Markets

- Equities succumb to erratic policy backdrop
- US Exceptionalism comes to an end
- The AI narrative has shifted

The news flow in the first quarter was relentless. Analysts and economists have been frantically publishing research notes based on announcements that were sometimes reversed just days later. Despite all the noise and uncertainty, the MSCI World Index dropped only 1.8% this quarter, the worst performance since the third quarter of 2023. However, this only tells part of the story, as the index is down 7.0% from its peak in February. In March, the index fell 4.5%, the worst performance since September 2022.

Most of the pain this quarter was felt in the US equity markets, with “US exceptionalism” being questioned. Money poured into



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European equities as they benefitted from a change in fiscal stance focused on defense and infrastructure spending, but also saw a valuation driven rebound after lagging materially in the fourth quarter of last year. US equities fell 4.6% in the first quarter, while Europe excluding UK equities were up 10.7%. In fact, the US market had the worst quarter compared to the rest of the world in 23 years, which is when the WorldCom and Tyco accounting scandals shook the US equity markets.

The wobble started with the DeepSeek announcement at the end of January. DeepSeek, a Chinese Artificial Intelligence (AI) company, released a new open-source AI model that took the markets by storm. Those who tested it compared it to OpenAI. The developers claimed to have built it in two months and for \$5 million. Reactions ranged from “this is a Sputnik moment” to “DeepSeek did not build OpenAI for \$5 million.” The S&P 500 Semiconductor and Semiconductor Equipment Index fell 16%, a six-sigma event, and a JPM AI Datacentre & Electrification Basket fell 14%. Several other AI models have been released since, and this, coupled with news that Microsoft is cancelling some data centre contracts, created more anxiety.

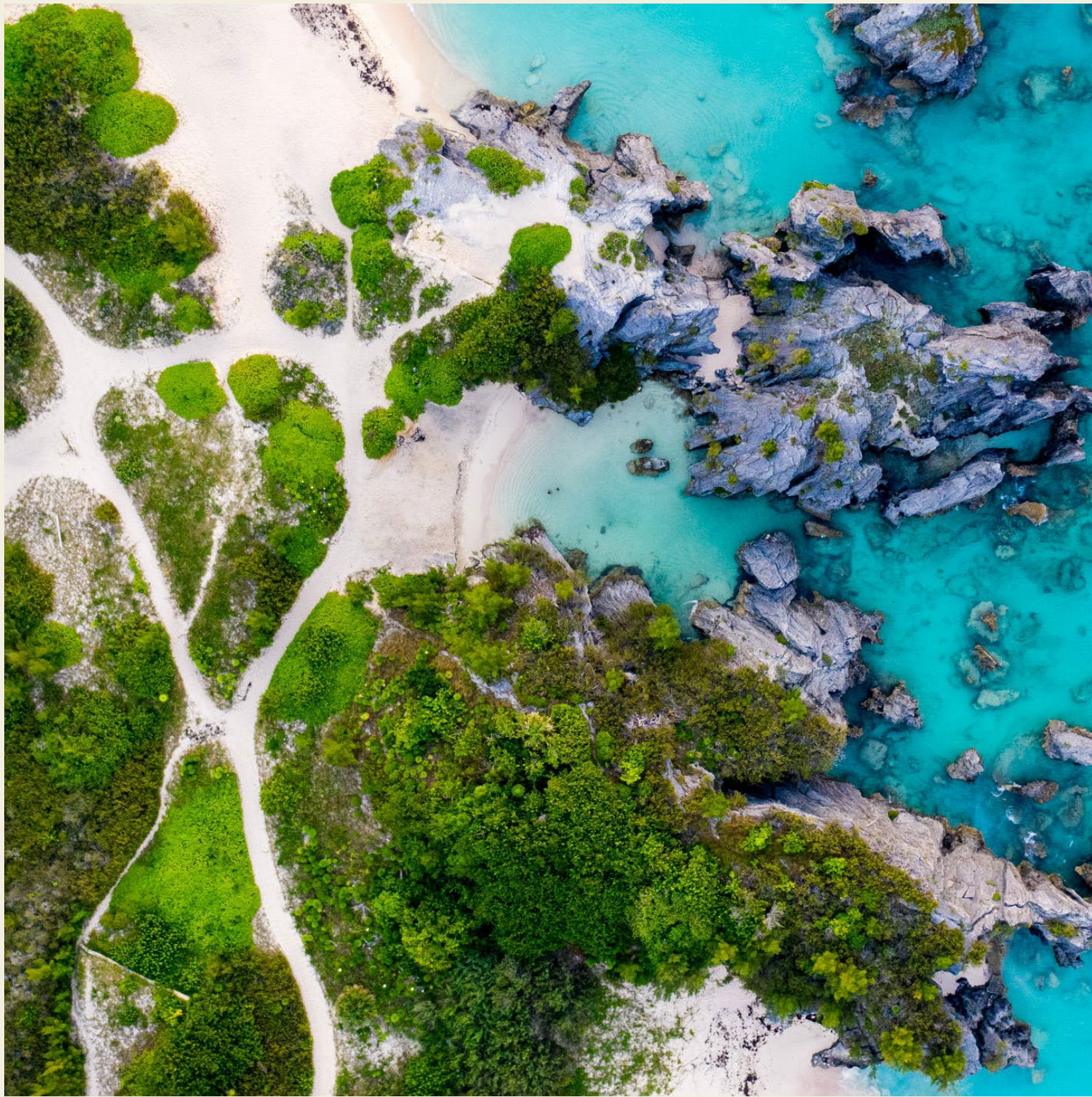
Shortly after, tariffs were announced. This is an ongoing story, and the end goal is unknown. We also had our first taste of how far the Department of Government Efficiency (DOGE) is willing to go to achieve its goals, with the pace and size of cuts larger than expected. What is also worth mentioning is the US’s aim to quickly end the conflict in Ukraine, which has brought into question the US’s relationship with NATO and its long-term allies. These events have created significant uncertainty and are hitting consumer and investor confidence.

Many of the merger and acquisition deals and expected increases in business activity have been put on ice, and on the deregulation front, we have yet to see meaningful progress. Numerous large banks have cut their S&P 500 year-end targets. The growth in

16%

The percentage The S&P 500 Semiconductor and Semiconductor Equipment Index fell.

earnings is weighted to the second half of the year, which is a source of risk if tariffs are here to stay and growth expectations are downgraded. The Bloomberg compiled top-down S&P 500 year-end price target has been reduced to 6,400, a 12% upside from the current level, on fears that we are heading into a US recession. However, we are seeing a different narrative from our bottom-up research providers, who appear to be less concerned by these macroeconomic headwinds. For now, we wait for the first-quarter earnings season to see if there are any signs of this self-inflicted slowdown. We remain modestly underweight equities relative to our benchmarks.



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Global Asset Allocation

The chart below details our 6-12 month tactical investment strategy

