April 2025
Issue No. 35

GLOBAL INSIGHT

Overview

- In our Global Outlook, we provide an analysis of the most significant events in the 1st quarter through a macroeconomic lens, assessing the key trends and underlying forces that shaped global capital markets.
- We look into the tactics of the Trump Administration regarding tariffs as a negotiating tool and try to assess the impact of policies he has proposed so far.
- Due to the timing of "Liberation Day" we have refrained from making any medium term forecasts while the level of uncertainty is so high.
- We assess financial conditions, indicators and forecasts in the light of the first 10 days of April.
- We present our house view, although we are currently underweight risk assets (equity and credit) relative to our benchmark and further reduced exposure during the first week of April, we are reviewing the extent of this exposure, balanced with defensive assets.
- We retain our positions in liquid alternative trading strategies – although we continue to scrutinise our allocation to this asset class, amidst higher prevailing risk-free rates.

Global Markets (MSCI World) vs Volatility (VIX) Index (Year-to-Date)

Source: *LSEG Datastream*

Inside this issue

The Highlights

- "Liberation Day" has severely clouded the outlook.
- Releasing the debt brake in Germany ,is a significant tailwind for Europe.
- Stress in the US Treasury market affected Trump decision-making.
- Global earnings have been downwardly revised.
- A weak dollar policy may threaten the reserve currency status.

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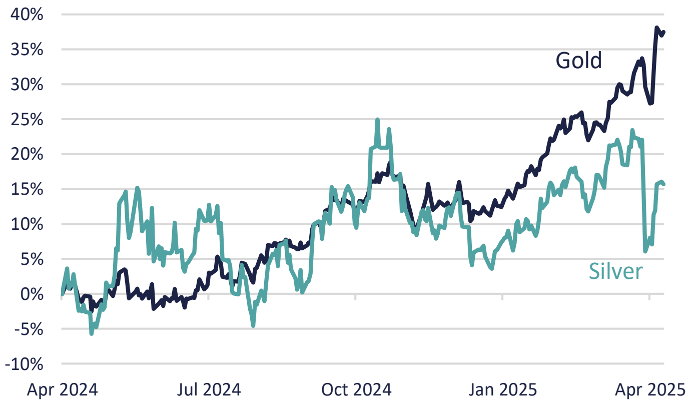
Based upon information available up to and including:

16th April 2025

Key Issues in Charts

Golden age for precious metals



Source: *LSEG DataStream*

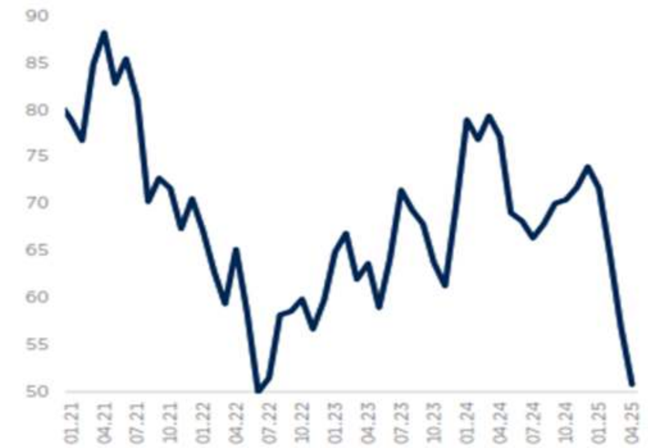
- The Gold price has been a standout feature for the last 12 months reaching new highs as mixture of Central Bank buying and safe haven demand provide for solid gains.
- Historically, Gold and Silver have moved in tandem, although in recent history we have seen a decoupling of this relationship. The industrial uses of Silver may have exacerbated this with the recent recession fears. However, there may be an opportunity in Silver if the discount by historical standards narrows.
- The geopolitical environment and pessimism around government debt levels has seen new found optimism for precious metals.

Resurgence of the Euro

- The Euro has gained approximately 9% vs. the USD Dollar so far this year pointing to a potential rotation out of US asset. The differential between US Treasuries and Bunds yields is also widening.
- The Euro recently hit a three year high vs. the US Dollar of nearly 1.14 amid the tariff turmoil, further underlining the continuing investor interest in European assets.
- Eurozone Industrial Production expanded by 1.1% in February vs. market expectations of 0.2% although sentiment as with elsewhere remains weak.

Source: *LSEG DataStream*

Expectations matter



Source: *Edmond de Rothschild, Bloomberg*

- As the chart shows, in April the University of Michigan Consumer Sentiment index hit 50.8 vs. 53.8 expected, the lowest level since 2022.
- Current economic conditions, as well as expectations have deteriorated sharply in the wake of tariff uncertainty.
- Inflation expectations are also rising sharply.
- When sentiment deteriorates this quickly, there is a concern that it will translate into actual spending.
- The real risk is that a recession becomes a self-fulfilling prophecy as deteriorating business and consumer sentiment leads to a slump in actual economic activity.

Global Outlook

Global Insights has more recently consisted of two articles, one reviewing the macro developments and market movements that have just occurred in the prior quarter, and a strategy outlook article concerned with prospects for, and interaction between growth, inflation, and monetary policy. The timing of the Trump Administration's "Liberation Day" and the announcements made on April 2, 2025, have severely clouded the outlook with uncertainty over whether the tariffs as outlined will be implemented or moderated leading to several potential outcomes for the global economy, and financial markets. We feel we lack clarity to make any meaningful forecasts for the medium term, which to an extent explains the severe levels of volatility witnessed in all asset classes so far this month. We will, therefore, outline the major items of note from the quarter and then attempt to understand the possible implications of the market movements witnessed over the first 10 days of April.

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There is a temptation to think that tariff turmoil started last week when their implementation or delay has been a theme of the first quarter so much so that although market volatility had increased, many participants were treating the Trump tactics as using tariff announcements as a forerunner to negotiation. Many tariff announcements have been rolled back, postponed or delayed prior to Liberation Day and this has not come without cost: US consumer confidence has significantly deteriorated, the University of Michigan Survey shows that consumer worries over potential job loss has reached levels normally only seen during recessions, household income expectations are declining, the share of consumers that believe business conditions are worsening are at record levels, and inflation expectations are rising rapidly. This is important because the US consumer is responsible for about three-quarters of US total consumption and personal spending has been weak.

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Coming into the year, the narrowness of market leadership in 2024 had seen US AI exposure through mega-cap Technology companies dominate equity returns, investor focus to the point where the valuation differential between US and European valuations had reached historical proportions. Many investors, including us, believed that the higher earnings expected from US companies were more than priced in to valuations and it would appear that many global investors were materially underweight European equities where valuations were less stretched than in the US. Political uncertainty benefited from clarification in both French and German elections and the increased chances of a Russia – Ukraine ceasefire also acted as tailwinds for European equities. Arguably the strongest tailwind for Europe was a creation of the Trump Administration delivered by Vice President J.D. Vance to European leaders in Munich at the Security Conference on February 14. In his speech he criticised the European Union for "backsliding" on freedom of speech and democracy and in doing so potentially changed the framework that had existed in NATO since the Cold War. The European Union seems to have seen this as a warning that US allies can no longer rely on US military support, and it seems to have triggered

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a movement for increased defence spending in Europe. Incoming German Chancellor Merz tabled a bill provisionally approved by the Bundestag to release the debt break in Germany and use increased debt to finance defence and infrastructure spending up to EUR1trn. The significance of the re-arming of Germany for the first time since the end of WWII is not lost on us but it probably provided the strongest tailwind for European equities over the quarter particularly German industrials and the wider European Defense Sector. By the end of the quarter European equities had returned 7% in stark contrast to the US S&P 500 that had fallen -4.6%.

European Equities vs US S&P 500 Index

Source: *LSEG DataStream*

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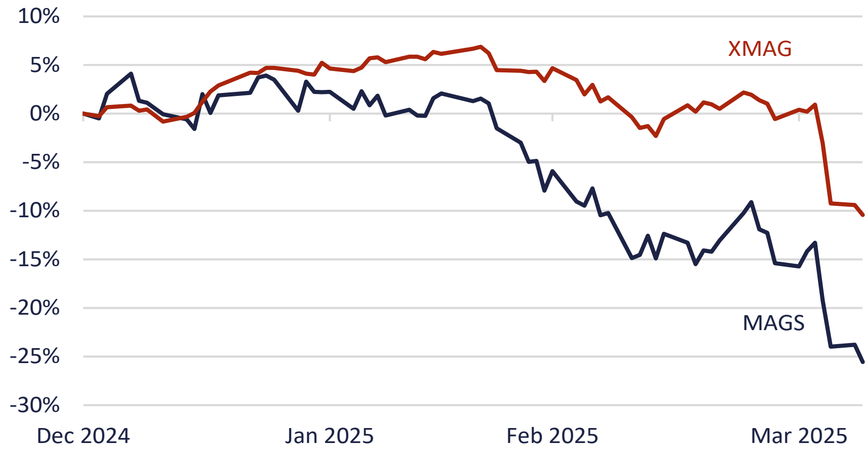
However, this does not really tell the whole story. We believe a major turning point was the Deep Seek announcement in February. Markets were taken by surprise by the Deep Seek announcement that saw a Chinese-based generative AI model achieve comparable results to the latest Western models using a much reduced level of computing power, as well as older chips, and at a fraction of the cost. If verified it would have brought the major AI capex spending forecasts into question, however, shortly after, OpenAI questioned whether the model had infringed their copyright, and the Q4 earnings season saw many “Magnificent 7” companies confirm their forecast AI spend. The US “exceptionalism” story has been based upon a widening productivity gap between the US and other developed nations since the pandemic based largely upon the technological advantages created from the development of AI. Question marks remain on the future demand for datacenters, power usage, and Nvidia dominance, not least the ability to drive productivity growth in the wider economy. Growing market concerns over the monetisation of the AI story saw investors finally question stretched valuations in the light of tariff uncertainty. This triggered a significant sector rotation out of mega-cap Technology into defensive orientated stocks. To illustrate, we note that the Roundhill Mag-7 ETF (MAGS) fell -15.75% over the quarter whereas the Defiance Large-Cap Ex-MAG-7 ETF (XMAG) was up 0.41%.

MAGS ETF vs XMAG ETF Year-to-Date



Source: *LSEG DataStream*

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Against this backdrop, as reflected in the chart below, financial conditions have tightened, and spreads and risk premia expanded (i.e. a risk off status quo, with investors demanding higher compensation from credit and equities relative to the risk-free rate) while gold has performed strongly, as retail investor flow has strengthened and the risk free rate has declined (representing a tailwind for further gold strength, as the opportunity cost of non-yielding gold has lessened).

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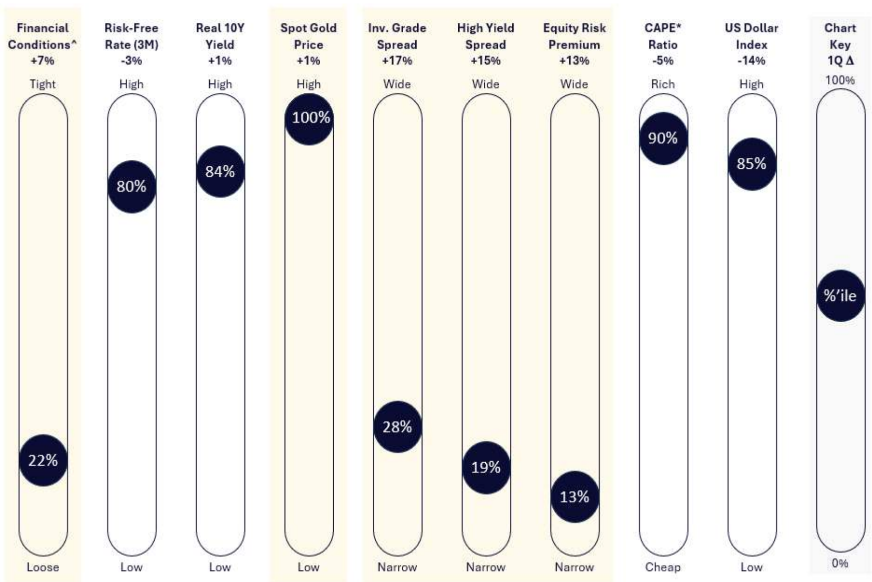
Macro and Markets Barometer



Source: *Federal Reserve Banks of St. Louis and Chicago, LSEG Datastream, Robert Shiller via Yale Department of Economics. *Cyclically-Adjusted Price-to-Earnings. ^The Financial Conditions Index (FCI) considers 105 indicators of risk, credit and leverage. The Adjusted Index presented controls for growth and inflation, to isolate from the economic cycle.*

Gold has performed strongly, as retail investor flow has strengthened and the risk free rate has declined (representing a tailwind for further gold strength, as the opportunity cost of non-yielding gold has lessened).

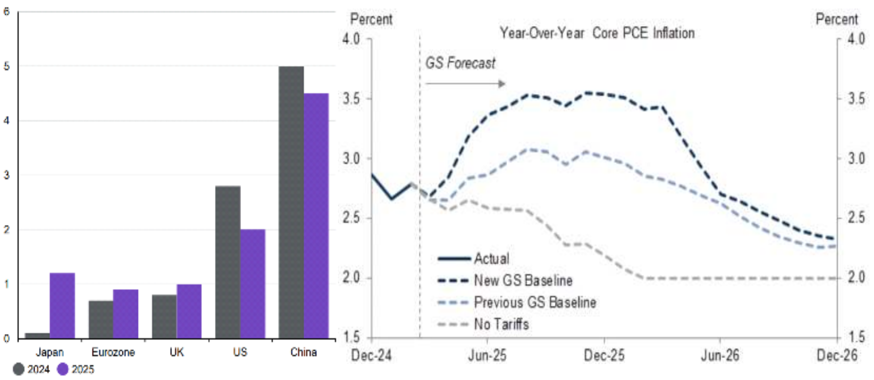
The Budget Lab, a Yale University think tank, has estimated that the annual long run (ten year) global impact on GDP of tariffs announced in 2025 to April 2nd as 17bps globally.

The chart below (L), reflects forecast consensus expectations for annual GDP growth at quarter end. 2025 q/q estimates export continuing to expect US leadership in the developed world, broadly unchanged for Japan and moderately reduced for all other regions. Since quarter end[i], The Budget Lab, a Yale University think tank, has estimated that the annual long run (ten year) global impact on GDP of tariffs announced in 2025 to April 2nd as 0.17% globally, 0.05% excluding the US and 0.56% for the US. Its estimated impact for the US itself sees a trough impact of 1.28% to 2Q26 US GDP, before settling at the 0.56% steady state impact from 2Q28. The Budget Lab's findings highlight the regressive nature of tariffs as a tax on the American consumer: the burden on the 2nd decile is 2.5x that on the top decile (-4% vs. -1.6%).

The chart below right shows the anticipated impact of tariffs on US Core PCE inflation, under revised forecasts as at the end of March, expected to rise more severely, to more than 3.5%.

The chart below (R), shows the anticipated impact of tariffs on US Core PCE inflation, which was expected to decline to near the Federal Reserve's target of 2% under a no tariff scenario. Previously this was expected to rise to above 3% and, under revised forecasts as at the end of March, expected to rise more severely, to more than 3.5% (source: Goldman Sachs). For context, current levels and projections remain below the elevated levels witnessed during 2022, when this measure spiked to 5-6% in February, March and September (a year during which stagflation affected bonds and equities in tandem).

Historical and Forecast Regional GDP Growth (L) and US PCE Inflation (R)



Source: *JPM Asset Management*[i]

Future rate cuts are expected to be deeper than previously estimated for the US and the UK, as both economies stave off slowing growth.

Turning to monetary policy, future rate cuts are expected to be deeper than previously estimated for the US and the UK as both economies stave off slowing growth. The Eurozone is widely expected to cut in April, although further easing may be constrained by recent fiscal stimulus. Japan's rate path has steepened, as the Bank of Japan seeks to combat accelerating inflation. Focusing further on the US, at month end, fed funds futures were pricing in a more-than-70% chance of at least three rate cuts by year end.

Following the early April tariff announcements, JP Morgan has raised its probability estimate of a US recession from 40% at month end to 60%, while S&P Global raised its estimate to between 30-35%, up from 25% in March.

While developments quarter-on-quarter (moderately slowing growth and rising inflation) are in aggregate discouraging for prospective equity and bond returns, and directionally the events since quarter end have exacerbated these pressures, a persistent easing bias in most regions is constructive for these asset classes. On a global basis, following the early April tariff announcements, JP

Morgan has raised its probability estimate of a US recession from 40% at month end to 60%, while S&P Global raised its estimate to between 30-35%, up from 25% in March.

Myron Scholes of Janus Henderson writes[ii]:

The benefits of the US Dollar's reserve currency status do not come for free; the costs are paid for with a trade deficit. President Trump's goal of transforming the US trade deficit to a trade surplus similarly is not free, with the long term cost being a weakening of the dollar's reserve currency status.

Despite the 90-day pause in implementation and the possibility of moderation, the original tariff goals were firmly disadvantaging the Asian economies. However, the impact will be primarily felt by the lowest income American households. Importantly, a large contingent of MAGA supporters are included in this demographic. The long-term goal will be to increase the percentage of goods manufactured in the US but in the short term it is likely that the price of many imports will rise, and potentially less goods will be imported meaning less dollars in the global economy. In turn less dollars will mean less demand for US Treasuries from abroad and less Non-Bank Foreign Investment meaning that the productivity advantage shown in US Exceptionalism over the last few years may, in our opinion, be under threat. The weaponisation of the dollar during the Russia – Ukraine conflict has already seen countries moving away from dollar ownership which has been a tailwind for Gold over the past two years. The possibility that the rest of the world will be unable to turn its back on the US consumer may well be true but future supply chains are likely to be constructed around minimising the tariff effect.

The safe haven status of the dollar exists largely due to its strength in adversity. Creating a framework that delivers a weaker dollar will, we believe, undermine demand for the currency in the long term. Myron Scholes further predicts that in the extreme case that the cost of tariffs is fully borne by companies not consumers, their discounted cashflow analysis sees the S&P500 falling to 4,650 – at the time of writing it was 5,250.

There is much uncertainty regarding policy and its consequences as many investors try to weigh up the downside risk of tariffs to the upside risk of falling taxes and deregulation which were other goals of the Trump administration. Market volatility in anticipation of further event risk from tariff policy will be on the agenda for at least another 90 days but most likely considerably longer. The most significant reaction during the last week was the sudden back up in yields for long-dated US Treasuries when equities were falling, a rather extreme example of the positive correlation between asset classes in times of adversity. During the COVID-19 related market volatility both equities and bonds fell in unison, however, this is not the historical norm seen in 1987, 1997, 2001, and 2008 when the traditional relationship saw bond prices rise as stock markets fell. So, it may be less surprising that President Trump referred to the pressures in the Treasury market during his announcement of the 90-day pause in reciprocal tariffs except for China particularly with Treasury Secretary

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One answer may be the unwinding of the “basis trade” by Hedge Funds who look to profit from the differential between bond futures and bond prices.

Furthermore, as stocks fall, and volatility increases, it is also likely that alternative strategies would see an increase in margin calls, and for funds caught in this position to sell their most liquid assets.

Global earnings expectations have been downwardly revised, with the Citi Earnings Revision Index reflecting negative prints every week year to date.

At quarter end, 2025 YoY earnings growth estimates for the US continue to outpace other developed market regions and global markets.

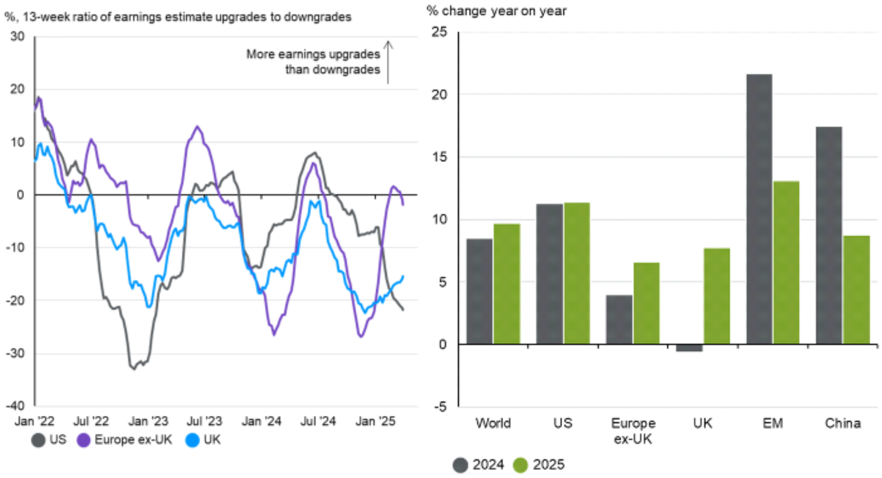
Although earnings momentum has been weak year to date, a more positive development has been the broadening out of earnings growth across countries and sectors.

Scott Bessent being a former Hedge Fund manager and potentially understanding the forces being exerted on the market. There is the possibility that investors are worried about rising inflation in the system caused by tariffs and so are re-pricing risk in long-dated bonds, however, it felt a little more systemic to us.

One answer may be the unwinding of the “basis trade”. This is a strategy employed by Hedge Funds who look to profit from the arbitrage opportunity in bond prices and associated derivatives. Whilst this would usually deliver measly returns, this often involves utilisation of leverage, sometimes up to a hundred times. The IMF, as reported in the Financial Times last week, estimates that the total worth of the basis trade may be up to $1trn and as volatility increases it seems likely that some funds may have been forced to unwind some positions. Furthermore, as stocks fall, and volatility increases, it is also likely that alternative strategies would see an increase in margin calls, and it would not be unusual for funds caught in this position to sell their most liquid assets, i.e. US Treasuries. As is often the case, the mechanics of the murkier side of investing are not always visible until something spectacularly fails but when equities reacted positively to the 90-day pause announcement it was noticeable to us that there was little reaction in the bond markets. We would certainly expect volatility to continue to figure over the medium term, which may provide opportunities, but it is worth noting that the weakness we have seen in markets is a product of policy rather than a single economic shock or financial stress that normally signals a pending recession.

Focusing on equities, global earnings expectations have been downwardly revised, with the Citi Earnings Revision Index reflecting negative prints every week year to date. This global measure is heavily influenced by the weight of US companies in global indices. Divergences in regional earnings revision ratios (chart, below, left) between the US (declining YTD, negative) and other regions (improving YTD) have been consistent with the relative performance of their respective stock markets. Nevertheless, at quarter end, 2025 YoY earnings growth estimates for the US continue to outpace other developed market regions and global markets (chart, below, right).

Global Earnings Expectations — Equities



Source: *JPM*[iii]

Although earnings momentum has been weak year to date, a more positive development has been the broadening out of earnings growth across countries and sectors, signifying wider fundamental improvement. The percentage of countries with positive year-on-year (Y-o-Y) forward earnings per share (EPS) growth stood at almost 80% on the 24th March. The share of industries with YoY year rising earnings per share stood at 77% globally and, on a regional basis (chart, below) 68% for the US, 82% for Europe and 81% for Japan. Furthermore, most regional valuations are historically undemanding outside of the US. Based on forward P/E ratios, the UK actually trades at a historical discount. However, the global all countries measure is at an 8% premium, driven by the US (almost 10% premium), rendering US projected earnings growth crucial to drive performance.

Most regional valuations, based on forward P/E ratios, are historically undemanding, standing at moderate premia.

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Our approach, which focuses on active management and broad diversification across regions and sectors.

Although we are currently underweight risk assets (equity and credit) relative to our benchmark and further reduced exposure during the first week of April, we are reviewing the extent of this exposure, balanced with defensive assets.

Regional % of Industries with Positive YoY Forward EPS Growth

Source: MacroMicro[iv]

The ongoing valuation premium in the US market (set against declining forward earnings expectations), as well as relative resilience in earnings momentum outside the US and across industries (tariff negotiation outcome dependent), are conducive to our approach, which focuses on active management and broad diversification across regions and sectors. Going forward, although we are currently underweight risk assets (equity and credit) relative to our benchmark and further reduced exposure during the first week of April, we are reviewing the extent of this exposure, balanced with defensive assets: cash and government bonds (focusing on shorter maturity bonds, that are less sensitive to changes in interest rates, wary of rising inflation pressures) and gold. We retain our positions in liquid alternative trading strategies – although we continue to scrutinise our allocation to this asset class, amidst higher prevailing risk-free rates.

[i] Timiraos, N. (2025) 31 March. Available at https://x.com/NickTimiraos/status/1906495234478838183 (Accessed: 05 April 2025)

[ii] Scholes, M _ Janus Henderson _ Dollars Role as a Reserve Currency _ April 4, 2025

[iii] JPMorgan Asset Management _ Guide to the Markets _ UK Q2 2025 _ March 31, 2025

[iv] MacroMicro website. [Online]. Accessed 05 April 2025. Available from: https://en.macromicro.me/blog/wefc-bulls-in-waiting-or-bears-in-disguise

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