SIGNIA INVEST

Signia Invest Insights

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Making America Guess Again

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MARKET SUMMARY AND REVIEW

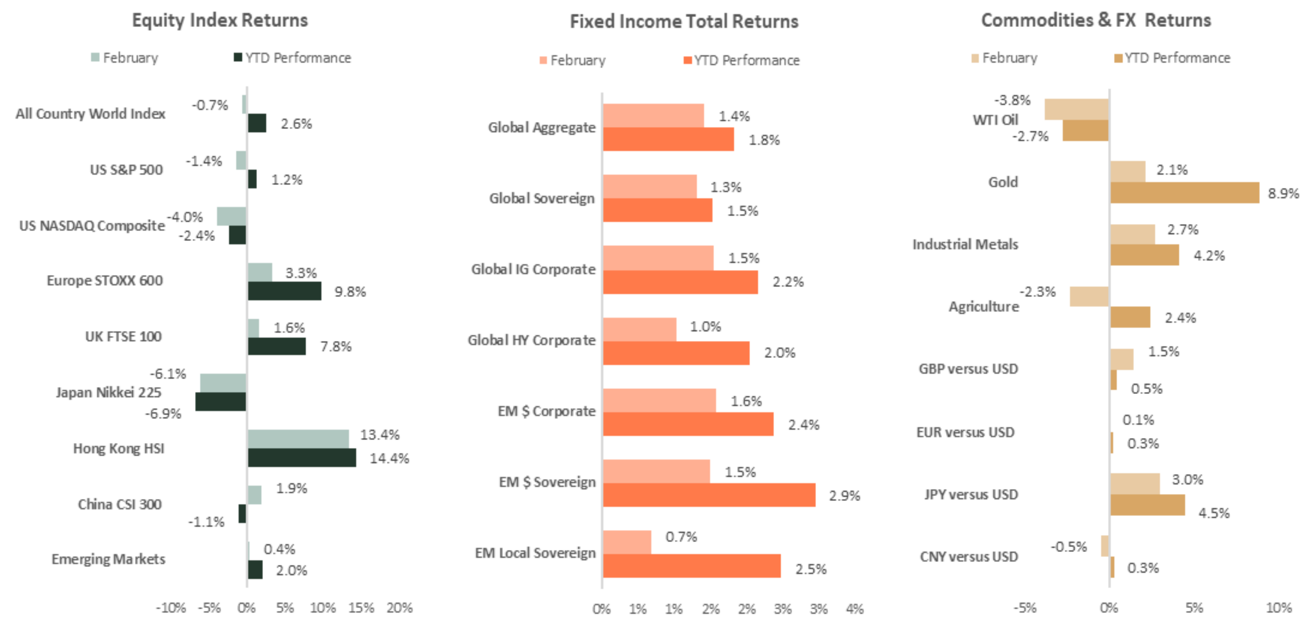
- As we enter the final innings of a remarkable first quarter in global financial markets that can only be described as chaotic, one can only hope that a brief pause for breath is soon around the corner, although somehow the feeling is this could well be wishful thinking! The onslaught of daily social media announcements and executive orders from President Trump, jaw dropping scenes with Ukraine's President Zelenskyy from the Oval Office, and monumental US (and now European) policy shifts, have combined to bamboozle investors and take the steam out of the equity bull market. What started as a growth re-pricing from a high valuation starting point, is now morphing into an economic growth scare driven by tariffs, DOGE, AI ambiguity, and now a growing perceived willingness of the US administration to embrace near-term economic pain and boardroom uncertainty in order to transition the economy for long-term gain. In short, just like he did with his first salvo of tariffs and trade wars in 2018, President Trump is making America guess again with his chaotic approach to policy implementation and brazen use of foghorn diplomacy.

- Despite the threat of US tariffs, many markets made steady gains in February, helped by a last-minute tariff extension for Canada and Mexico and subsequent relief rally. The S&P 500 managed to reach another all-time high on February 19, but towards the end of the month a more risk-off tone developed as tariffs came back on the agenda alongside some weaker economic data out of the US. That hit the Magnificent 7 in particular, which posted their worst month since December 2022, and dragged down US equities more broadly. Nevertheless, it wasn't all bad news, with European equities continuing their outperformance, and the move towards safe haven assets such as sovereign bonds and gold continued to support gains in these asset classes.

- In Europe, a huge political shift was set in motion when Friedrich Merz, who is expected to become Germany's next chancellor, said in response to the US withdrawing military aid and support for Ukraine: "In view of the threats to our freedom and peace on our continent, the rule for our defence now has to be whatever it takes". The new defence proposal recommends that necessary defence spending above 1% of GDP should be exempt from debt brake restrictions, with no upper limit. European equities rallied strongly on the prospect of increased fiscal stimulus and investment, further contributing to the underperformance of US markets over the last three months as the most severe such streak in a decade. The S&P 500 has now trailed the Euro Stoxx 50 by 14% between December and February, but this has so far only put a small dent into the ~150% outperformance of US versus European equity markets over the past 15 years.

- Offshore Chinese equities have enjoyed one of their best starts of the year in history, with the Hang Seng Index gaining 14.4% year-to-date, and outperforming world equities by 11.8%. A few factors have helped lift the market, notably the optimism around the positive AI narrative shift of China technology, the confirmation of a pro-growth policy bias at the ongoing Two Sessions policy meeting, and arguably more benign US-China relations so far under the new US administration than were previously feared by investors.

MARKET PERFORMANCE AS OF 28 FEBRUARY 2025



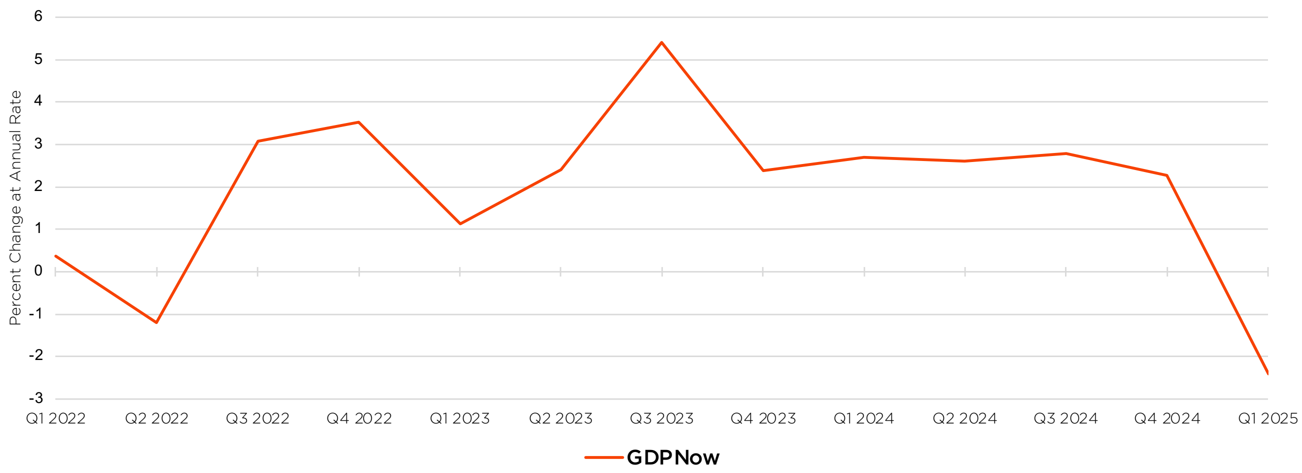
Source: Arbion Ltd.

US GDP ESTIMATES REACT TO TRUMP'S TRADE WARS; FIRST QUARTER SLOWDOWN IS NOW NEGATIVE

- Tariff escalation has accelerated the US growth scare, but one thing that investors can partially discount to some degree, is the Atlanta Fed GDPNow tracking estimate below, which has taken a major hit in Q1. US imports have so far surged this year, as firms are rushing imports across the American border ahead of trade war escalation and tariff implementation. The negative impact on GDP measures are somewhat technical, because GDP = C [Consumer spending] + I [Investment] + G [Government spending] + (X [Exports] – M [Imports]), therefore imports have a negative impact. That said, this US import surge would be expected to reverse over time, as quickened shipments build up inventories and merely bring forward future import demand.

- President Trump signed executive orders delaying until April 2 tariffs on goods from Mexico and Canada that meet USMCA requirements, which should exempt about half of the goods affected by the new 25% tariffs. This represents a sizeable but partial rollback, though the share of exempt goods might rise as companies seek to adjust to the new rules. The coverage under USMCA trade agreement, which was renegotiated in President Trump's first term, relates mostly to rules of origin requirements, so the partial exemption could be seen as addressing concerns over re-imports from third countries. Still, with this being a delay rather than a lasting exemption and with reciprocal tariffs also expected to be announced after April 2, this leaves plenty of lingering tariff uncertainty in markets. The trade rhetoric remained tense vis-à-vis Canada in particular, with Canada's outgoing Prime Minister Trudeau saying earlier in the day that we will be "in a trade war that was launched by the United States for the foreseeable future." By contrast, President Trump made more conciliatory comments towards Mexico's President Sheinbaum, who said that her country would "review the tariffs that we have with China" to align itself with US policy.

- In response to the new US tariffs, the Canadian government announced a retaliatory package that includes 25% tariffs on approximately 150 billion Canadian Dollars of US exports. Canada is also considering non-tariff measures, such as pausing electricity and nickel exports to the US. In China, its Commerce department announced countermeasures including tariffs of up to 15% on US goods including chicken, soybeans and cotton, where China is one of America's biggest customers. This is the second round of tariffs the two countries have imposed on each other this year, but this time China is hitting Donald Trump where it has the potential to hurt most by targeting farmers, who are some of his core supporters with almost 78% of farming-dependent counties in the US endorsing Mr Trump in 2024. There are enough corn and soybean supplies in the world for China to simply switch trading partners, so this poses more of an issue for the US where 30% of US soybeans still go to China.



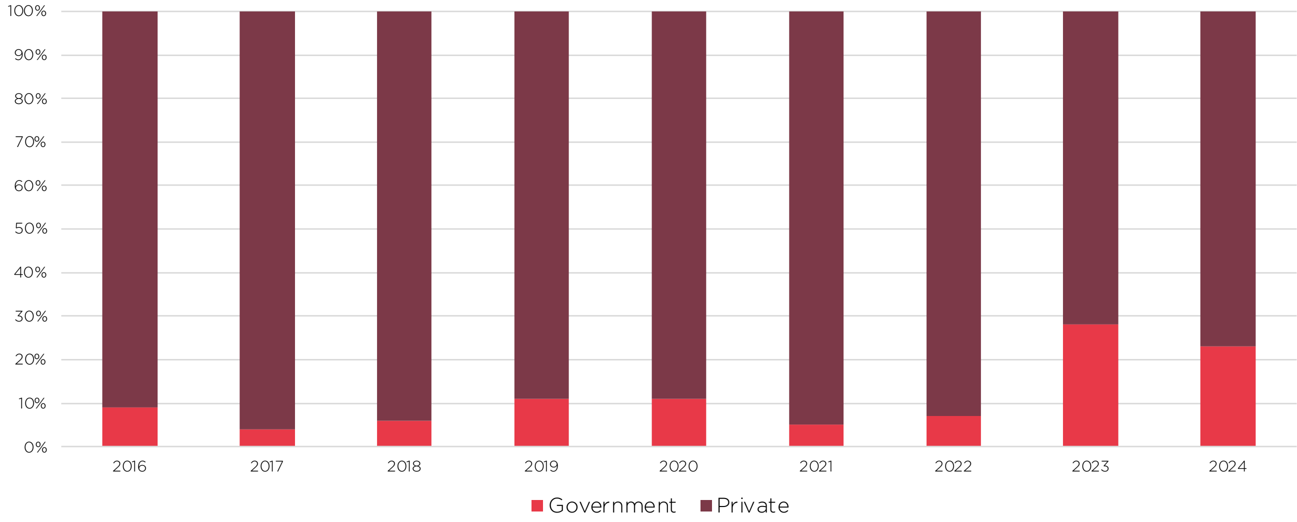
Source: FRED, Arbion Ltd. Data as at 28.02.2025.

DOGE REDUNDANCIES HAVE ADDED TO US LABOUR MARKET AND ECONOMIC CONCERNS

- Government hiring has been a key driver of the strong US labour market over recent years. About 25% of jobs added in the economy since 2022 were government jobs, up from 5% in 2021 and 7% in 2022, so understandably investors are becoming concerned that a partial reversal of this through DOGE, combined with general boardroom uncertainty on the US economic outlook, could be a trigger point for a cyclical labour market downturn.

- Consensus expects total DOGE-related job cuts to be approximately 300,000. Total employment in the United States is 160 million workers, with 7 million currently unemployed and about 5 million people changing jobs every month. In this context, 300,000 federal jobs lost is not much. However, studies show that for every federal employee, there are two contractors, and as a result, layoffs could potentially be closer to a more substantial 1 million. Therefore, any increase in layoffs will push jobless claims notably higher over this cycle.

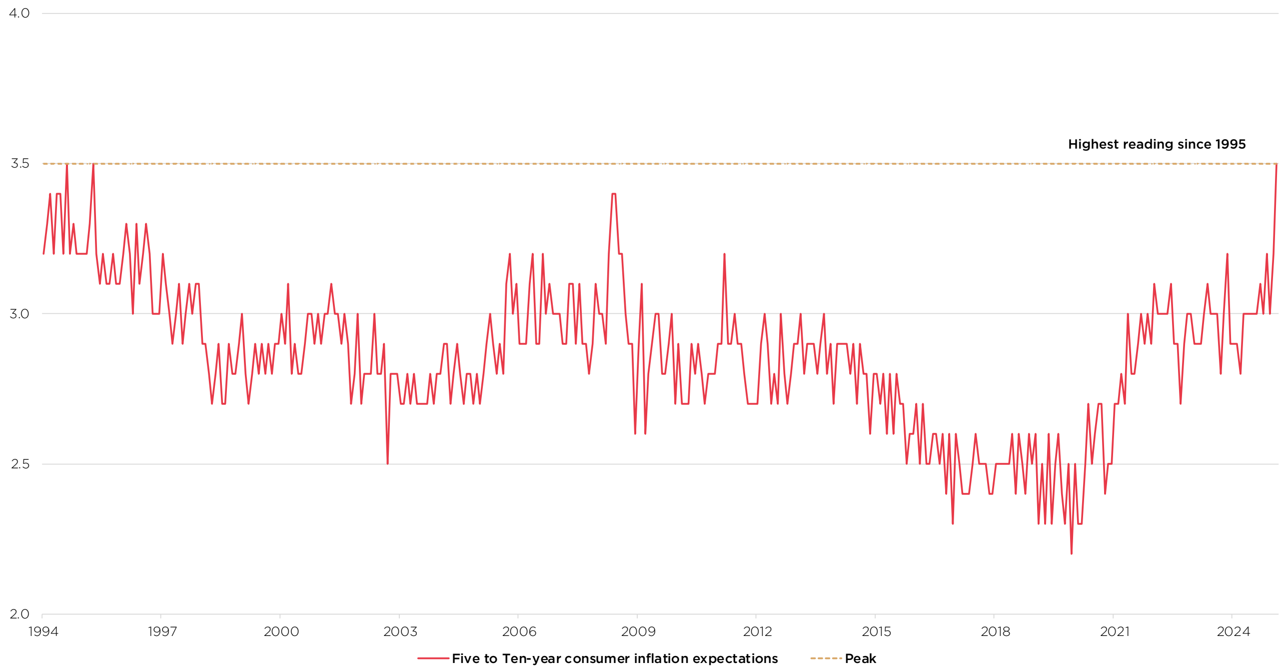
US SHARE OF JOBS ADDED



Source: BLS, Haver Analytics, Apollo.

INVESTORS SHOULD BE EQUALLY CONCERNED ABOUT RISING INFLATION EXPECTATIONS

- Whilst the risk of stagnating US growth has garnered much of the headlines of late, it's the other half of the stagflation equation – inflation – that has continued to grind quietly higher recently. In particular, US long-term inflation expectations, which has reached a near 30-year high amidst the tariff chaos as evidenced by the University of Michigan consumer survey for 5-10 year inflation expectations.



Source: University of Michigan, Arbion Ltd. Data as at 28.02.2025.

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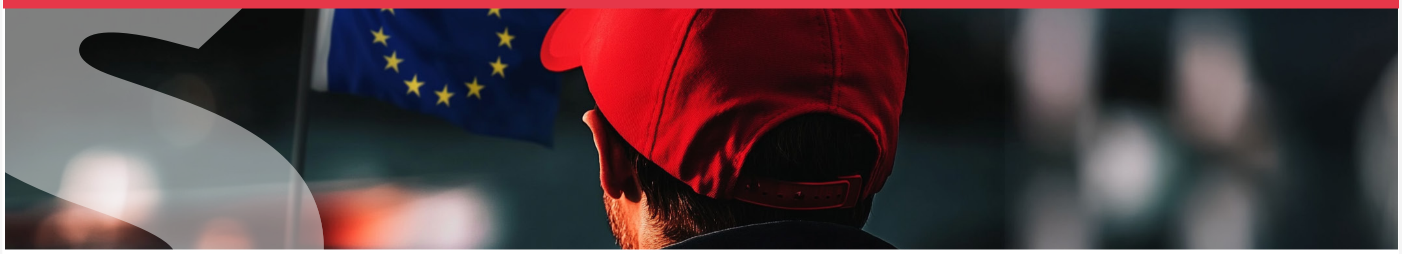
WEAKER US DOLLAR IS POSITIVE FOR GLOBAL LIQUIDITY AND, FURTHER OUT, ALSO FOR EQUITIES AND EARNINGS MOMENTUM

- In a way, the dollar slump is not coming as a surprise, as the greenback rallied 10% from its October lows last year in anticipation of a Trump victory as the consensus expectation for significant tariff announcements was bullish for the US Dollar, i.e. investors were already positioned for it and, therefore, making a move in the opposite direction more likely. Where we are now, the dollar has retraced over 50% of that move and one can expect some stabilisation around current levels unless the trade wars escalate further. A lower dollar is a positive for global liquidity as foreigners have borrowed around $13 trillion in USD-denominated debt and lower US yields corroborate that perspective. This environment of easier conditions should also support US equities at some stage going forward, provided it does not lead to substantial downward earnings revisions. So far, there are no signs of earnings momentum abating globally where forecast 2025 index earnings for the major regions remain at or near record levels and in many cases are still trending higher.

- This is most apparent in the fourth quarter earnings season for S&P 500 companies where earnings growth reached a staggering 17%, the highest year-over-year earnings growth rate since the post covid earnings rebound in Q4 2021. Earnings were led by Financials and Communications, with Energy the only sector that saw earnings decline during the quarter amidst lower oil prices. From a revenue growth standpoint, sales growth of 5% was also quite strong but the combination of the two suggests meaningful margin expansion. Indeed, the earnings bar appears to be set quite high now and the natural progression from here would be a deceleration, and thus a lowering of the bar for 2025 expectations was probably necessary even before tariffs became an issue.

COULD MAGA BE MAKING EUROPE GREAT AGAIN?



- Turning to the seismic fiscal news out of Germany this month, the leaders of the CSU/CSU and SPD parties announced an agreement to approve three material changes to the debt brake before the end of the outgoing parliament in which the centrist parties still hold a constitutional majority. Specifically, this includes a €500 billion Special Purpose Vehicle for infrastructure investment, an exemption from the debt brake for defence spending above 1% of GDP, and a rise in the net borrowing cap for federal states from 0% to 0.35% of GDP. While recent reporting pointed to increased prospects of a change, the magnitude of the proposal, including the open-ended borrowing room for defence, was well beyond expectations. With party leaders explicitly referring to a "whatever it takes" moment and a determination to "rearm completely", this potentially marks a landmark turning point for higher structural growth rates out of Germany and the EU, which have been stuck in an economic quagmire of secular stagnation for decades. One potential catch is that the Green Party, whose support is needed for the constitutional majority and have not yet confirmed if they will support these changes. However, barring the usual political posturing and negotiating, it is difficult to see the Greens blocking the changes given the large pro-growth nature of the infrastructure fund proposal.

- The concept of Making America Guess Again in order to Make America Great Again is certainly a risky and radical policy transition by the new US administration. Combined with jolting Germany and Europe into their own radical reactions to address emerging military and economic threats from Russia and the US, this has caused a seismic revaluation by investors of the perceived safety of overvalued American stocks and the Mag7 tech giants in particular, and their undervalued European and World ex USA counterparts. Over the last year, the 16% outperformance of the S&P 500 versus the World ex USA equities that prevailed around the US elections in November has all been wiped out.

TOTAL RETURN 28/02/2024 TO 11/03/2025

Source: Arbion Ltd. Data as at 28.02.2025.

WORLD ECONOMIC DASHBOARD

	GDP (YoY)	2024 GDP Forecast*	2025 GDP Forecast*	Headline CPI (YoY)	Core CP (YoY)	Unemploy-ment Rate	Central Bank Policy Rate	1Y Yield (Implied Path)
United States	2.5	2.8	2.3	3.0	3.3	4.1	4.50	4.00
United Kingdom	1.4	0.8	1.0	3.0	3.7	4.4	4.50	4.02
Euro Area	1.2	0.7	0.9	2.4	2.6	6.2	2.50	2.10
China	5.4	5.0	4.5	-0.7	-0.1	4.0	2.00	1.57
Japan	1.2	0.1	1.2	2.9	0.9	2.5	0.50	0.64

*Bloomberg full year economic forecasts

Data as at 10.03.2025. Source: Arbion Ltd. All figures are percentages.

OTHER NOTABLE ECONOMIC AND MARKET DEVELOPMENTS

- **US:** Inflation picked up broadly at the start of the year, with economists warning President Donald Trump's tariffs against China on steel imports, and potentially against main trading partners Canada and Mexico, will only accelerate the trend. The monthly consumer price index rose in January by the most since August 2023, led by a range of household expenses like groceries and gas as well as housing costs. Excluding often-volatile food and energy costs, core CPI climbed 0.4%, more than forecast, fuelled by car insurance, airfares and a record monthly increase in the cost of prescription drugs.

    - Apple announced plans to invest $500 billion in the US over the next four years, hiring 20,000 workers and producing AI servers. President Trump's tariffs on goods imported from China were undoubtedly a major catalyst behind the move. The additional jobs will focus on research and development, silicon engineering and AI. The company is opening up what it calls a manufacturing academy in Detroit, where it will help smaller companies with manufacturing. It already operates an academy for app developers in the city.

- **UK:** The Bank of England delivered its anticipated 25 basis point cut to 4.5% in February but predicted that inflation would rise sharply in the near-term, with the rate of increase in prices shown peaking well above the 2.0% target, at 3.7% in Q3 this year, up from a previous predicted peak of 2.8%. Near-term growth forecasts were lowered and seemed to be a key driver for the rate cut, with GDP growth expected to be just 0.1% in Q1, and down 0.3 percentage points from the Bank's November forecast.

    - Prime Minister Keir Starmer's visit to Washington drew positive rhetoric from President Trump who said he envisaged "a real trade deal" with the UK, which could mean that tariffs were "not necessary". On Ukraine, the UK Prime Minister said that the UK would be ready to put "boots on the ground" to support a peace deal. In the days prior to the meeting, the UK announced that defence spending would increase to 2.5% of GDP from 2027, funded by a cut to overseas aid spending, with an aim to reach 3% in the next parliament (expected 2029-2034).

- **Ukraine:** The US paused all existing military aid to Ukraine (that had been drawn down by the outgoing Biden administration), in a setback for hopes that relations between Kyiv and Washington can recover from the ill-fated Oval Office meeting in February.

- **China:** A meeting between President Xi Jinping and China's top business leaders was seen as a possible end to the years-long crackdown on the private sector with the government working to revive an economy disrupted by a pandemic, regulatory crackdowns, and a real estate crisis. The annual Two Sessions policy-setting meeting has added equity market stability to the People's Bank of China's mandate, a significant step forward for Chinese monetary policy and also a clear signal from China that it intends to support a long-term recovery in its stock market.

- **Japan:** Wages are growing by their fastest pace since 1997 in nominal terms, cementing the view that the Bank of Japan are set to keep hiking interest rates. The headline inflation rate rose to a two-year high of 4% in January, from 3.6% in December, adding to expectations that the Bank will raise interest rates further. Core inflation, excluding fresh food, increased to 3.2% from 3.0%, while the BoJ's closely watched 'core core' rate, excluding fresh food and energy, edged up to 2.5% from 2.4%. Meanwhile, Japan's economy grew 2.8% on an annualised basis in the fourth quarter, beating market expectations and up from 1.7% in the third quarter.

- **Australia:** The Reserve Bank of Australia Board cut its cash rate by 25 basis points to 4.10%, with Governor Michele Bullock framing the reduction as a cautious move that retraced the November 2023 hike as she sought to temper market expectations for further easing.

- **New Zealand:** The Reserve Bank of New Zealand lowered its official cash rate by 50 basis points to 3.75% as expected in its policy meeting, marking its fourth straight cut, as easing inflation provided room for the central bank room to boost the struggling economy.

SUMMARY AND PARTING THOUGHTS

- With the violent moves in American policy spilling over into the US equity markets, it certainly does feel like a warning shot across the bow for the American exceptionalism trade that has dominated markets over recent years. Indeed, political risk is not going away, and this means more market volatility ahead, although potentially with a diminishing effect as investors and trading partners become more accustomed to dealing with President Trump. For the moment, a US recession this year remains an outlier probability, and the ongoing equity market correction can still be framed within the context of an ongoing longer-term bull market, albeit now with added uncertainties and complexities.

- US Treasuries are now outperforming US stocks since Trump was elected in November. Over coming weeks and months this should provide opportunities to take advantage of some extremely oversold situations in the growth and momentum equity sectors, as well as potentially to generate some attractive pockets of income from selling elevated implied volatility via equity options. One thing however is clear, whichever MAGA market you're positioned for this year – 'Great' (risk-on) or 'Guess' (risk-off) – portfolio diversification remains key, as European equities have provided some much-needed ballast and gold prices have continued their steady march higher.

ROBERT LEE

HEAD OF MODEL PORTFOLIO SERVICES; HEAD OF RATES

Robert has been managing the wealth of private clients since 2006 as a portfolio manager and fixed income specialist. He is jointly responsible for the multi-asset investment team, global fixed income strategies, Arbion's MPS business, and is portfolio manager for the Arbion Sovereign Opportunities strategy.

Previously, he worked for Lehman Brothers on the European Capital Markets team, and then Coutts & Co where he was a member of the fixed income and foreign exchange selection committees, responsible for managing the advisory and discretionary portfolios for private clients and institutions.
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