World Economic and Market Outlook – April 2025

Introduction

Markets have suffered a turbulent first quarter as Trump's tariff policies posed a challenge to the global economic order and orthodox economics has resulted in significant market volatility. After a strong start to January, US stocks ended the quarter posting their worst returns since 2022 with the S&P 500 sinking almost 5% on rising concerns over the economy. Investors worried that tariffs and the uncertainties around these and US economic policy will result in a pullback in spending by both consumers and businesses with sentiment surveys suggesting heightened levels of caution. Even though Trump has labelled April 2nd as Liberation Day, it is clear announcements have not fully resolved uncertainty, or whether markets will believe that initial statements are an opening position which is negotiable. A high level of uncertainty makes forecasting of corporate earnings highly uncertain, so investors are unsure what valuation levels markets actually trade at. Furthermore, tariffs are likely to increase US inflation and if a full blown trade war results in retaliatory measures announced by other countries inflation everywhere will increase.

Q1

Markets during the quarter moved from risk on to risk off and whilst slower growth favours government bonds, fears of higher inflation and an end to central bank rate cutting has limited gains. China's announcement of an alternative AI tool DeepSeek saw many US technology names sell off, even though to date there have been no downgrades to earnings estimates for these stocks. Some of the hardest hit stocks were the top performers of 2024 with, for example, Nvidia falling almost a fifth in the first quarter. Tesla plummeted 36% and Apple and Microsoft both declined by around 10%. It was a quarter when consumer facing companies and economically sensitive stocks fared worse with, for example, bellwether FedEx falling 13% after guiding analyst numbers lower.

European equities outperformed with the Europe Stoxx 600 gaining about 5% in local currency terms with the election of Merz in Germany and the easing of the German fiscal brake encouraging investors that Europe would now see a significant boost to fiscal spending, both for defence and infrastructure which has the potential to raise GDP by around 1% in 2026 and the same amount in 2027. Over the quarter Asian markets were mixed with Japan's Topix sliding 4.5% in local currency terms with Yen strength a negative for the market despite the continued economic recovery.

In China the market was roughly flat, although Hong Kong recorded strong gains, and in South Korea the rally in Samsung Electronics meant that market ended the quarter higher. Gold performed strongly as a safe haven asset and 10-year US Treasury yields, having started the quarter at 4.57% and rising at one stage to 4.80%, ending the quarter at 4.21% with investors taking the view tariffs would have a greater impact over the medium term on growth than inflation.

History of Tariffs

While tariffs are new to investors today, they have been long part of US economic policy. Between 1820 and 1860 revenue raising was the main motivation. An embryonic country with little ability to tax its population used tariffs to run the country. This changed post the American Civil War when there was restriction of imports to protect new domestic industries at a time when it was European nations such as the UK and Germany which were the economic superpowers. This was the main motivation for tariffs between 1865 – 1933 when the failure of the Smoot Hawley Act and US Great Depression saw a change in policy with trade deals aiming to reduce intra-country trade barriers through reciprocation. Trump has justified tariffs by championing all three motives for his economic policies.

Restructuring Global Trade

Unlike in 2016 Trump has entered office far more prepared. Many commentators have suggested Trump did not really expect to win a first term then, so was ill-prepared, but his economic team of today have all been selected or put themselves forward as loyalists supporting his global philosophy that the US has been cheated by most other countries over many years. Whilst commentators have described a new economic line up as a mix of hawkish and more moderate personalities, they are all believers in tariff policy. The main difference has been the Treasury Secretary Scott Bessent and Miran Chair of the Council of Economic Advisors had been believed as advocates of an escalate to de-escalate policy where reciprocation would eventually lead to much lower levels of tariffs than were initially announced.

Other members of the Trump economic team such as Jamie Greer who is the USTR and highly qualified trade lawyer, Peter Navarro, together with Howard Lutnick Commerce Secretary are more hawkish and anti-China with a belief high tariffs will not harm the US economy. All of the economic team have strong academic economic qualifications which no doubt makes Trump's justification of policy easier. For example, Stephen Moran is a Harvard Economics PhD and Scott Bessent was Hedge Fund Economist for George Soros. His team has from prior roles demonstrated expertise in financial markets, macroeconomic policy, trade policy and national security, although they now all reject the post war economic consensus that Ricardian free trade benefits America. Trump has ensured his new economic team are unified in their support for the introduction of tariffs, even if they do not all agree how the policy should evolve.

The Trump economic team have outlined a vision of, *"Restructuring the global trading system"*. They argue this will place American industry on fairer ground. Despite the conventional view that owning the reserve currency of the world is an economic benefit, Trump and his team argue American industry has been massively disadvantaged by the status of the US$ as the world's reserve currency, as this results in over-valuation costing American jobs. They argue tariffs will both provide revenues and upward currency adjustments which they believe will occur versus tariffed nations will result in minimal domestic inflationary pressure.

A further development is that Trump believes tariffs can be used to structure international economic and security relations in a manner favourable to the US. Trump and his team have argued that as with the 2018/19 tariffs imposed on China which saw the US currency appreciate by over 15% versus the Rmb demonstrates that American consumers will not bear the cost of tariffs, despite the period of analysis being only two years. Trump believes there should be burden sharing by trading and security partners and the tariff policies will return jobs to the US and create revenue for tax cuts. Trump's team believe that a hollowing out of US manufacturing has led to blighted communities addicted to both government welfare handouts and opioids. They also strongly believe that strength in trade and economic dominance will enhance America's national security. A strong industrial sector with, for example, self-sufficiency in steel is necessary for self-defence. Military conflict cannot be sustained if a country is dependent on others for its raw material imports.

The US has average tariff rates which are amongst the lowest of any in the world, averaging around 3% at the time of the election, whilst the EU was 5% and China 10%. American low tariffs date back to when the US saw its role as assisting with re-building of World War II damaged economies and setting up trading rules which have ultimately benefitted US corporates significantly. Furthermore, Trump and his team argue nations imposed material non-tariff barriers on the States, namely arguing VAT in Europe is a discriminatory measure hitting US exporters but not EU ones. Some of Trump's team have also talked about charging other countries for the global defence shield provided

by the States by forcing them to buy ultra long dated (100 year) Treasury Bonds with a swap facility allowing holders access to short-term Dollar liquidity if needed.

In the week leading up to Liberation Day Trump announced 25% additional tariffs on autos and auto parts, although there were exemptions regarding the USMCA trade agreement. Trump also announced tariffs on countries importing oil from Venezuela and threatened the same on those dealing with Russia if a cease fire deal was not forthcoming. In the run up to the announcements EU officials expected tariff levels to be around 20% despite attempts by Europe to negotiate, with the UK also unable to secure a pre-announcement deal. Prior to Liberation Day US tariffs had already increased from 2/3% to an average of around 10.5%, a level last seen in the 1940s and an average tariff rate of around 15% seemed to be the market consensus view.

The administration also cited non-tariff barriers hurting America which related either to quotas or rules of origin and thirdly some countries imposition of VAT. A breakdown of current additional costs in the US would show tariffs of around 3%, non-tariff barriers of circa 7%, and an average local sales tax of 5% totalling 15%. For other countries tariffs might be on average 7% on US goods, non-tariff barriers a further 7%, whilst an average VAT rate of around 15% meaning the US can argue there is an additional 15% level of barriers on US companies. Countries most exposed on non tariff barriers would be South Korea, Germany, India and Vietnam. Macro fund management house Fulcrum have estimated the pre-Liberation Day level of already increased tariffs of 10.5% would reduce GDP by 1.4% and increase price levels by 1.1%, whilst an average 15% tariff rate would reduce GDP by 2.4% and increase prices by 2.0%.

The Fed's Take on the US Economy – March 2025

The March 19th Fed meeting saw the policy rate left unchanged at 4.25%-4.5%. The Fed reported economic activity had expanded at a solid pace in the fourth Quarter of 2024, with GDP rising 2.3%, but recent indications pointed to a moderation in consumer spending. Surveys of household and businesses point to heightened uncertainty about the economic outlook. This led to the summary of economic projections seeing a reduction in the median projection of GDP growth to rise 1.7% this year, lower than the level projected in December. In the labour market to date conditions have remained solid with payroll job gains averaging 200,000 per month over the past three months, and an unemployment rate of 4.1%, low by historic standards. Unemployment has held relatively steady over the past 12 months, as has the jobs-to-workers gap ratio. Wages continue to grow faster than inflation, but at a relatively sustainable pace looking at the productivity gains seen. The median projection for the unemployment rate in the SEP rose slightly to 4.4% at the end of this year and is forecast to remain at roughly this level over the next two years.

Whilst inflation has eased significantly from peaks, it still remains elevated versus the 2% longer-run goal. To end February PCE prices rose 2.5%, whilst core PCE prices rose 2.8%. The Fed noted some near-term measures of inflation expectations have recently moved up, but longer-term ones had not. Within the SEP the median projection for total PCE inflation is 2.7% this year, slightly higher than previously, and 2.2% for 2026, before falling to the 2% objective in 2027.

Unsurprisingly, the Fed noted the new Administration is in the process of implementing "significant policy changes in four distinct area: trade, immigration, fiscal policy and regulation". It is the net effect of these policy changes that will matter for the economy and for the path of monetary policy. *"…uncertainty around the changes and their effects on the economic outlook is high"*. Once again Powell emphasised that the projections in the SEP are from individuals at that moment in time and

not debated as a group. These are projections and not a Committee plan or decision. Powell emphasised that the Fed was ready to move rapidly if necessary if data prompted this either way.

The post meeting Q&A saw Powell emphasise it was difficult to have a precise assessment of how much of inflation is coming from tariffs, and how much from other sources. He added goods inflation had moved up significantly in the first two months of the year, but prices had risen for both tariffed and non-tariffed imports. As to the Fed's response to this, it will depend on whether the Fed believe that this is a one-off adjustment to a price level and not likely to raise inflation expectations. In other words, will it be transitory. The Fed policy path has not changed greatly, and Powell admitted this was partly due to inertia at a time of heightened uncertainty when things could go either way. The projections for slightly weaker growth but higher inflation offset each other to a degree. To date the Fed do not believe that longer term inflation expectations have altered significantly, certainly not market based ones.

Looking at the economy, hard data remains solid, although survey data indicate a rise in uncertainty and concerns about downside risks in the economy. The Fed are waiting to see whether this translates into weakness in real data.

On the labour market, Powell commented that unemployment was pretty close to its natural level and wage growth consistent with 2% inflation. He added the hiring rate was quite low, but so is the lay off rate, and the question was which way this breaks. Powell acknowledged a meaningful increase in layoffs would probably translate fairly quickly into unemployment because it is not a big hiring market.

Powell explained why if the Fed felt an inflationary impulse was transitory and going to go away on its own, it was not the right policy decision to raise rates because by the time they had an effect on the economy you would be lowering economic activity and employment, which then was not necessary.

Powell was questioned on the probability of recession. He answered there was always an unconditional probability or possibility of recession which historically is a one in four chance 12 months out. The Fed do not make forecasts on this basis and Powell added that outside (external) forecasts still show a low possibility of a recession, although not as extremely low as two months ago.

Powell discussed the decline in consumer sentiment, which has occurred when the Fed believe the economy and hard data is still solid. Powell believes consumers concern about grocery bills is about past inflation, that which occurred in 2021, 2022 and 2023 when prices went up. People are unhappy because of the absolute changes to price levels that have occurred in recent years. He added that the Fed through its network of contacts that come in through the reserves banks which go into the Beige Book and contacts at the Board mean they are monitoring to see whether sentiment translates into economic activity but has not done so yet. The Fed believe that some of the negative sentiment is due to uncertainty regarding proposed big changes in policy.

Powell would not be drawn on how much of the increase in inflation forecasts was due to tariffs, except that everybody was incorporating something. Powell was asked about whether he agreed a large share of job growth in recent years has been in government or government adjacent sectors such as Healthcare or Education (with the inference DOGE might affect this), but Powell would not really be drawn on this. Towards the end of the conference Powell emphasised the Fed were well positioned in the sense that they could move quickly in the direction needed to achieve the dual mandate aims of full employment and 2% inflation. Powell stated the Fed did look at overall

financial conditions, but specific levels of the stock market or commodities was not something the Fed discussed. For the Fed to make a move they would have to see soft data affect the hard data. The latest employment numbers released on April 4th far exceeded expectations with the addition of 228,000 jobs in March.

Emerging Markets Update – April 2025

China

After a difficult couple of years Chinese equities sprung to life in September 2024 post the announcement of stimulus and support packages, both for the economy and stock market. Since then, despite fluctuations, a more positive tone has emerged for Chinese equities as market participants realised the leadership of the CCP were serious about underpinning the economy and not allowing significant further depreciation in the property market. The country's annual parliamentary meeting and the CPPCC this year in March known as the Two Sessions saw continued support pledged for the domestic economy and in the post Trump election turmoil China has looked to portray itself as an island of stability in favour of free trade.

Historically, investors have watched the meetings of the NPC or National People's Congress and the advisory Chinese People's Political Consultative Conference for indications of future economic strategy and long-term goals. In recent years these sessions had prioritised national security over development (byword for economic growth) but since last September leaders have switched their emphasis to boosting consumption. As well as monetary and fiscal stimulus measures, there have been meetings with leaders of private sector companies to emphasise the change in attitude to the private sector, which historically has been behind job creation in China. Second ranked leader Premier Li Qiang in March stressed the need to "better ensure both development and security". He also stressed the importance of strengthening domestic demand in the work report, using the word consumption 32x, up from 21x in 2024. He also introduced into the work report the term "embodied AI", meaning AI-powered robots or machines. The central government budget for 2025 announced during the NPC session set out an 8.3% year-on-year increase in spending on the Technology sector, which is twice the rise for general fiscal spending and higher than for social welfare. On property, Premier Li said the government would "stem the downturn and restore stability in the real estate market". A year earlier he had only spoken about diffusing risks in real estate.

While China has rejected the Western model of private wealth driven by property prices, the authorities now want to stabilise the market and in fact are not allowing price falls to clear inventory. The work through from the property bust is likely to take a decade as has been the case in other developed countries seeing similar property downturns, although once again it should be noted that property markets in the four major cities of Shanghai, Beijing, Shenzhen, and Guangzhou have all seen a pickup in transactions, whilst it is in lower tier cities where the worst excess supply remains and prospects for employment driven urbanisation remain challenging.

To help counter the downturn in consumption China is now considering including services in a multi-billion dollar subsidy programme, following on from the existing trade in programme for goods such as mobile phones, cars and household appliances. This could seek to spur purchases of services in sectors such as travel, tourism and sports and be launched in the second half of the year if consumption continues to lag behind expectations. China also pledged to double funding for the consumer goods trade in scheme this year to RMB300bn. China's focus on automation is also likely to continue as the emphasis within manufacturing on 'new quality productive forces', a euphemism

for high tech production and supply chains, continues and Chinese exports remain highly competitive, even against some ostensibly lower cost Asian neighbours.

The last week of March saw a courting of the world's top CEOs with Xi speaking to 40 global business leaders in Beijing's Great Hall of the People. This followed a week in which global business leaders attended the most important China annual business summits, the China Development Forum in Beijing and the Boao Forum for Asia in the tropical resort island of Hainan.

Trump's attraction to strong man leaders means a deal with China is eminently more possibly than when Biden was President. China continues to support its economy and is now managing international relations better. China is also seeing improved activity on the ground in the domestic sector. Together this could lead to a re-thinking of China as 'uninvestible' and this could drive more interest in the GEM universe in its entirety. Valuations in China remain cheap both versus other emerging markets and also developed ones.

India

The stock market in India has seen a setback which began in earnest in September with sentiment souring after the somewhat disappointing IPO of Hyundai Motors Indian subsidiary. The market had reached quite extended levels, looking at short-term valuations and the government which had supported infrastructure spending for a number of years in the run up to last May's election has pulled back on this after their disappointing performance in the polls. Growth in formal employment remains a problem in India, especially as numbers of better qualified younger people look to enter the workforce. The government is clearly concerned about this and has resorted to more populist policies, handing out sops to large parts of the population.

There is now greater concern that the reform programme and corporate capex cycle will not occur certainly to the extent expected and sentiment is now a lot less exuberant than six months ago. Growth in India should still be fine, although the strong outperformance the market has delivered in recent years is unlikely to be repeated until the earnings downgrade cycle ends. Companies in the industrial space which have benefitted from greater infrastructure type spending in the economy are those seeing the biggest level of downward earnings revisions. A market in which everything had gone up may become much more stock specific driven in the next few years. India's market cap to GDP at 110% remains ahead of most emerging markets with, for example, China around the 90% level, so Indian equities whilst having corrected to fair value are not outstandingly cheap yet.

India has yet to resolve the challenge of developing manufacturing significantly as a share of the economy and in fact this peaked in 2010. Its textile industry, despite the problems in Bangladesh, is still 25% more expensive than that country, and in higher end manufacturing, still lacks the quality, productivity, and efficiency of industry in China. Thirty years ago, per capita GDP was 5x lower in India, but over this time period it has grown 30x in China. Thus, despite India's growth per capita GDP is still relatively modest, and the country definitely needs faster growth for a vibrant middle class to emerge. The wealth gap in India has continued to widen. If the electorate follows through with a political backlash opposition party Congress is much less business friendly than the BJP. Even consumer staples such as Colgate have guided revenue forecast down to the mid to high single digits. India's share of world manufacturing is around 3% versus China's 30%, illustrating the gap.

Indonesia

Within the Asean region, the country has seen a slowdown in growth and an actual contraction of the number of people classified as middle class. Under former President Jokowi it had separated military involvement from civilian activities and politics. This has created unease about the future environment for business. The most recent announcement was the creation of a sovereign wealth

fund which has had Indonesia's SOEs added into it. Post the Asian Financial Crisis Indonesia capped its fiscal deficit at 3% of GDP and as a result infrastructure spending has lagged other Asian countries. The new President of Indonesia Prabowo now wants to take dividends from SOEs and spend this money developing the country. There is always a risk of corruption and misallocation of funds. Furthermore, while the initial management team of the sovereign wealth fund looks impressive this could be changed at the will of the President, so there are now growing concerns about the longer-term prospects for the country. After the pull back in its currency and valuation, stocks appear cheap in the short term have the potential to rebound. To date Indonesia, despite its favourable demographics and low labour costs, has not developed a credible manufacturing sector which needs to occur for the country to move forward on a sustainable basis. In fact, the whole SME sector in Asia has been hollowed out by Chinese manufacturing efficiency as productivity remains much higher.

Latin America

Mexico has been in the crosshairs of Donald Trump, while the country awaits clarity around Trump's tariff proposals. After the initial market selloff when the election was won by Sheinbaum valuations have adjusted and the currency looks cheap, so on a stock-by-stock basis, there are attractive opportunities. Clearly progress in Mexico will await clarity on the plans of Trump. Furthermore, investors should remember the economy in Mexico is closely tied to that of the US and a significant downturn in its neighbour to the north would impact the country.

In Brazil there is an election due in 2026 and historically incumbents have increased fiscal spending to boost the economy ahead of this in an attempt to get re-election. With Lula at the helm there is clearly a risk of this and Brazil is still suffering as a relatively high inflation economy which is why the central bank has kept rates so high. A deterioration in an already challenging fiscal outlook would mean higher bond yields and a weaker currency which would not be a positive backdrop for the stock market if it occurred. The election in Brazil will need to be watched closely by investors.

Overall, EM valuations now look quite supportive of the region and most currencies have weakened and are therefore cheap versus the US$. A weaker US$ is generally a positive for emerging markets and raises the prospect of a more sustained period of stronger relative performance and a number of countries, now including China, look likely to grow faster than the developed world over the next few years.

Liberation Day

Trump's tariffs are far more substantial than expected, and on many calculations are bigger than the Smoot-Hawley tariffs of the 1930s. If Trump persists with what is currently on the table, then the odds of a US and global recession increase significantly. In the States the tariffs will be equivalent to a tax hike on US consumers, capital investment will be hit with uncertainty, falls in the stock market and in all likelihood housing will create a negative wealth effect and the Fed is likely to be constrained in the near term at least by the rise in inflation numbers.

For the US, considering where the economy was just prior to the election, this is a big own goal. Therefore, there is a likelihood there will be some pull back from what has been announced, although when this happens is hard to say. The tariffs are not due to be implemented before April 9th, so there is a window here, with potentially negotiations being used as justification for a delay. Individual countries affected by tariffs will have to determine whether to bargain or not. Some such as China and potentially Europe may feel boosting their own internal demand may be preferable and let the undermining effect of tariffs on the US economy play out. Other countries may look to

negotiate. The caveat here is whether the stock market forces Trump to blink in the interim. Where Trump's ultimate tolerance for pain lies is unclear and whether his focus is on the stock market which will react in the short-term and also be a predictor of longer-term effects on the real economy. If Trump waits for evidence of pain in the latter his timeframe before looking to course correct would be longer. His statements to date re the stock market reaction, the lack of comments by Treasury Secretary Bessent, and his bigger picture commitment to a mercantilist policy with its focus on trade balances suggest a bigger fall than we have seen in markets to date will be necessary for Trump to contemplate changing course quickly. However, if markets are further hit by algorithmic and quantitative traders, a further setback could occur quickly in stock markets.

Trump is said to thrive on chaos, so in the past it has been unwise to be too definitive or logical about how events will unfold. A sharp fall in equities does mean the US has hit oversold territory once again. On market technicals (charts) there were support levels around the 5200-5300 level on the S&P 500. However, on fundamentals if current policies persist there is more upside to inflation and downside to growth than markets had factored in, even in the week running up to Liberation Day. As has been seen in markets more defensive assets and those where companies are localised in terms of their business mix have fared best in this period of market volatility. Countries with scope for fiscal and monetary flexibility will be better placed to respond to either stock market or economic weakness. Until clarity emerges market participants cannot forecast economic growth, inflation, interest rates or corporate profits so the wild ride will continue as for now it is policy causing the shocks not solving the shocks.

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