The past month summed up

Yes, changing trade policy by the hour can unsettle markets as much as it upsets your allies.

The rationale

The US came into 2025 in a healthy state and our central view was that this would continue as employment remained solid, inflation stable and interest rates falling, albeit slowly. The new US administration's proposed policies have increased the stakes, but tax cuts and deregulation could offset tariffs and deportation. The approach of US President Donald Trump so far has raised the risks that if something goes wrong, and with US valuations that are already stretched there is little room for shock-absorption in the market

In order to explain this increase in alert on our part it's worth remembering two important perspectives on the economy. First there is its fundamental state of the economy – the objective assessment of prospects for growth and business profitability. But in addition, there is also the market sentiment which is the combined expression of all market participants which at times can diverge from the fundamental state of the economy, becoming overly pessimistic or confident. One of the interesting features in markets over the past 18 months is how strongly this sentiment seemed in our view to run ahead of fundamental data.

Our central view, based on fundamentals, was and still is that the US economy was in pretty good shape and that inflation had been kept under control by higher interest rates but without them sinking the economy – the so-called soft landing. Furthermore, we acknowledged that the US had some particular aspects that made its economy more productive and resilient than others around the world, such as high levels of talent and lower levels of employment regulation, for example. Alongside this we viewed the seismic changes in the technology sector, particularly centred on generative artificial intelligence, as a shift that could, in the medium to long-term, increase productivity and provide companies able to harness the potential of these changes the ability to generate extraordinary profits.

On steroids

The market more recently took this positive fundamental perspective and put it on MAGA-sized steroids creating a narrative of "American exceptionalism". This seemed to coalesce around a view that whatever the US did, it would continue to be the pre-eminent economic superpower with little comparable opportunity elsewhere in the world. And on the technology side there seemed to develop a viewpoint that the largest technology companies could by sheer weight of investment harness almost uniquely the fruits of the AI revolution and were set automatically to benefit from this step change to the exclusion of all others. Not impossible, but absolutely not as inevitable as markets seemed to suggest.

Bringing this to the here and now there have been some challenges to both the fundamental state of the economy and to market sentiment. The actions of the Trump administration are likely partially responsible for issues related to the fundamental economy and almost wholly related to the whipsaw change in market sentiment.

Fundamentally

As regards fundamentals, we had noted previously the potential for Trump's tariff proposals to become an economic headache. Tariffs are essentially taxes ramping up the price of imported goods in the country where they are initiated, possibly stoking inflation and wreaking havoc on supply chains. They also hit the demand for goods of exporting countries and thereby damage the global economic outlook. And that's even before countries respond with their own tariffs, which just double up on all the negatives outlined above. Because people tend to spend less if they see prices increasing, Trump's on-off threats to impose tariffs on his closest trading partners have likely already started to have a damping effect, with consumer confidence dropping to near a two-and-a-half year low in March (the importance of the consumer shouldn't be in doubt – if you recall they represent two-thirds of the US economy and in the recovery from Covid it was the US consumer who kept the economy afloat even while sky-high interest rates were imposed to bring inflation down).

One of the key economic advantages the US has is in the ease with which it takes on and lets go of workers as and when needed. Uncertainty about the economic outlook therefore might have led to the fact that job openings in the US came in at 151,000 last month, lower than analyst predictions (this comes alongside numerous reports that Elon Musk's Department of Government Efficiency (DOGE) has been slashing thousands of posts in the Federal government.) Fewer jobs mean fewer people able to spend money to keep the economy rolling over. To cap it all, the Atlanta Federal Reserve, a reputable source of forecasting, flipped from predicting first quarter growth of 2.3% to a shrinkage of 2.8% (the last decline was just 1% in 2022). The devil as always will be in the detail, the degree of the collapse in this forecast reflecting importers trying to get ahead of tariffs but the scale of the swing cannot be dismissed.

In truth, not all of the economic data has been so negative. There were converse fears that Trump's promise of lower taxes would supercharge an economy already teetering on the edge of overheating and in this instance inflation came in lower than expected at 2.8% last month, softening fears that interest rates would have to be ramped again. Taken in aggregate though, there are signs that Trump's tariff war is beginning to have an effect on the real economy. With little sign of any retreat from protectionism the uncertainty looks set to remain a cloud over confidence.

Getting sentimental

So, it's in sentiment where most of the damage seems to have taken place. We have the leader of the world's largest economy suggesting a philosophical determination to punish other nations for perceived trading slights with tariffs that even he acknowledges could have a detrimental effect on the economy for a period. Whilst tariffs might prove the right medicine to cure what the President thinks ails the US, his approach is both out of the ordinary and clearly would suggest that he is willing to impose self-inflicted damage to get to his end goal.

The stock market has reacted accordingly. The S&P 500 index has declined almost 9% since Trump came to power while the tech heavy NASDAQ has slipped 10% over the same period. All in all, investors are finding the prospect of some of Trump's macroeconomic plans damping previously held excitement based on his promise to slash regulation.

IT support?

It comes as rather an aside then to mention the other key upending of the previous status quo; the appearance of DeepSeek, the Chinese AI upstart that claimed to have made progress similar to US AI models but at a fraction of the investment. As we pointed out, we were not amongst the cheerleaders pumping AI-related equities ever higher, instead running a portfolio designed to take benefits where possible from the then healthy state of the US economy and AI inspired efficiencies but with a tinge of protection to guard against the excesses as we saw it. The market as we have seen has had quite a different experience with investors in some of those tech titans seeing considerable losses – Elon Musk's Tesla for example has shed about half its value since its December high.

Long-term

Such flux may herald some changes in coming months but it's important to note that strategically our view remains unchanged and there are a number of long-term trends where we believe good quality companies can realise their growth potential even amid more difficult economic conditions. Firstly, the ongoing shift in demographics around the world where, particularly in developed markets, populations are ageing rapidly, is an ongoing phenomenon that will not be reversed easily or quickly. Secondly, when travelling around any developed market but particularly in parts of Europe and the US it's clear that infrastructure investment, which mushroomed in the second half of the 20th century, has been sagging for some time and there is a clear need for investment in this area in order to maintain the ability of countries to operate efficiently. Thirdly, the continued digitisation of our economy, exemplified in the AI trends in the US, continues apace and this is unlikely to unwind. And fourth, irrespective of short-term policy changes in the US and even a retreat on some aspects of the Green economy in Europe, the need to find secure sources of reliable energy will mean investment opportunities in energy infrastructure which will continue to including renewables alongside hydrocarbons.

In short, much as King Cnut was unable to control tidal movements, so grand policy gestures may slow or hasten some of these trends, but their existence is not dependent on any political or economic actor. Thus while we can all hope the US avoids a self-induced recession or panic, there remain plenty of investable options on the table.

Conclusion

We are keeping our portfolio in its present state for the moment with a focus on long-term growth prospects in our equity holdings and protection elsewhere through investments in gold, trading strategies and a shorter duration bond portfolio. For our equity portfolio, given the fluid situation in the global economy at present, with a possible (and as yet not certain) German-led European upgrade in defence spending on the cards, there may well appear some opportunities in a relatively underpriced Europe. Likewise the DeepSeek news shows that Asia, again undervalued in relation to its US peers, might demonstrate that this vast region is home to businesses with significant upside potential.
