QUILTER CHEVIOT

Market commentary April 2025

There has been a significant regional rotation in financial markets in recent months, driven by political developments on each side of the Atlantic. European stocks have strongly outperformed US counterparts, although a larger weighting to the latter in global indices meant the MSCI All Country World index (-4.2% — **all returns Q1 and in sterling, unless otherwise stated**) finished lower for the first quarter. UK government bonds were somewhat caught in the middle, pulled in opposing directions on either side, with a broad-based gilt index (0.5%) cushioning multi-asset portfolios with a small positive return.

Ramped-up spending plans vs belt tightening:

The MSCI Europe ex UK (+7.8%) posted strong first quarter returns whereas the MSCI North America (-7.2%) declined. There was a notable detrimental currency impact for sterling investors as the pound appreciated 3% to US$1.29. The regional rotation has been caused by continental Europe gearing up for largescale government spending increases while the Trump administration is pushing US policies — such as trade tariffs and unorthodox spending cuts (DOGE) — seen as reducing economic growth. The ongoing war in Ukraine also played a part, as the US walking back its security guarantee has led to European governments to ramp up defence spending plans.

Cautious fiscal approach ends

Germany's election signalled a step change in the country's approach to public spending, as incoming chancellor Friedrich Merz used the outgoing parliament to let off the so-called "debt brake", a constitutional measure capping deficit spending to 0.35% of GDP per year. Alongside an open-ended commitment to increase defence spending, parliament approved a €500bn package (approximately 1% of GDP per year) to improve infrastructure over the next 12 years.

US — slower growth, higher inflation

The substantial US tariff increases announced in early April have led to lower growth and higher inflation forecasts for the world's largest economy. The measures are above and beyond what many had expected but despite the claims of further clarity, uncertainty has increased. This could be the high-water mark for tariffs with duties negotiated down from here, or there could well be an escalatory tit-for-tat. This only adds to the uncertainty, which further weighs on economic activity.

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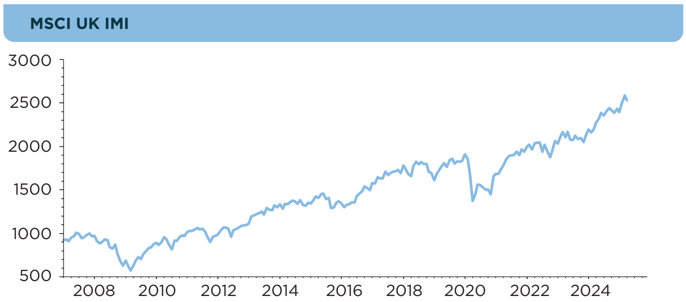
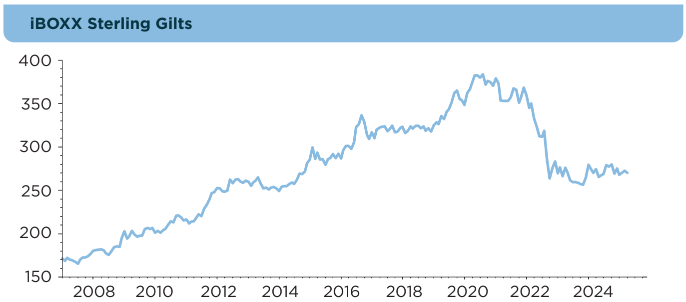
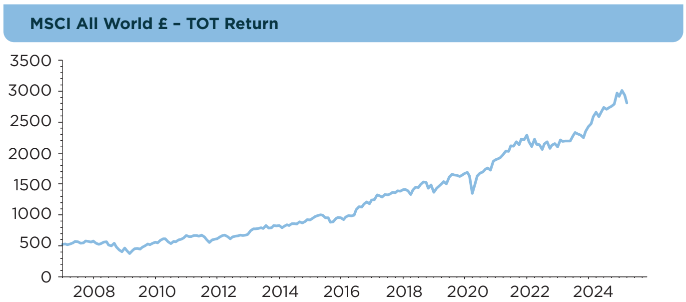
PA WEALTH PARTNERSHIP AWARDS 2023 Fund Selection Team of the Year: Wealth Manager

It appears that Donald Trump is following a markedly different approach from his first term, when it was widely believed that signs of economic or financial market weakness would cause policy U-turns. The heightened level of uncertainty and seemingly increased tolerance for economic pain has caused sharp drops in sentiment data, but "hard" data points such as the labour market remain strong. A closely watched survey of fund managers showed the sharpest shift out of the US and into Europe since 1999. We see this as explanatory of past market moves rather than predictive of future ones, and, if anything, in our experience sharp changes in sentiment often increase the chances of some mean reversion going forwards.







Past performance is no guarantee of future returns.
Source: LSEG Datastream 07/04/2025

Earnings in the spotlight

Forthcoming first quarter corporate results are expected to show downgrades in growth and earnings for US stocks going forward. The MSCI North America 12-month forward price/earnings ratio has dropped to 20.6x from 22.2x at the end of 2024. US tariffs will ultimately hit consumers and consequently result in lower earnings. Any company producing goods outside of America is going to be adversely impacted by tariffs.

UK stocks middle of the road

The MSCI UK posted a strong quarterly return (+6.4%), comfortably outperforming the US although slightly lagging continental Europe. The Bank of England (BoE) is forecasting inflation to rise in the coming months to 3.7% and has halved its 2025 growth forecast to 0.75%. Stagflation — the unwanted combination of low growth and high inflation — is becoming an increasing concern but there are some reasons for optimism, such as the recent pick-up in retail sales figures. UK small- and mid-cap stocks have underperformed large-caps, primarily due to rising bond yields and a greater exposure to the slowing UK economy.

BOE and Fed on hold

The BoE and Federal Reserve (Fed) kept policy rates unchanged at 4.5% at their March meetings. Only one of the BoE's nine-member monetary policy committee voted for a reduction in rates, compared to forecasts for a 7-2 split. Inflationary concerns continue to weigh on policymakers' minds, with strong wage growth in particular signalling that perhaps above target price pressure will persist longer than hoped. Further rate cuts from the BoE and Fed are expected, with derivatives markets pricing a year-end rate of around 3.9% and 3.7% respectively.

Fiscal reset

Rachel Reeves used the Spring Statement to restore the £9.9bn buffer outlined in October's budget through £14bn of spending cuts, as rising bond yields and slower economic growth erased her fiscal headroom. Overall, we believe that bonds are an attractive diversifier in portfolios, with historically high yields compelling to us at a time of heightened geopolitical uncertainty. There is also some cushion as the 10-year gilt yield would need to move up by around 70 basis points (0.7%) from March's closing level, to 5.35%, to generate a negative total return over 12 months.

Summary

Uncertainty surrounding the impact on trade and geopolitics from the implementation of tariffs has undoubtedly increased in recent months and we are monitoring developments closely. The adversarial US tariff approach is a cause for concern, both in the US and globally, but we recognise this is a fluid situation and could quickly change. The risk of a US recession has increased significantly in recent months and we will be monitoring incoming economic data carefully.

After a couple of very good years global equities have above average valuations due to the US market impact. Strong earnings growth and interest rate cuts had supported this at the start of the year, but we remain vigilant for signs that this may no longer be the case. We see bonds as attractive at current levels, offering historically high yields and potential diversification benefits should economic data deteriorate.

Caroline Simmons
Chief Investment Officer,
Quilter Cheviot

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