QUILTER CHEVIOT

# Market commentary May 2025

A strong recovery in the second half of April meant global stock markets recouped the majority of their tariff-induced losses, with the MSCI All Country World index ending the month down 2.4% (all returns for April and in sterling, unless otherwise stated). The monthly decline can largely be explained by adverse currency movements, as sterling appreciated 3.2% against the US dollar — in no small part due to the US tariff announcements. Gilts provided a solid 1.9% return, demonstrating their ability to cushion diversified, multi-asset portfolios during times of equity market weakness.

### Tariff turmoil

2 April, so-called "liberation day" for the US, proved to be dramatic for financial markets as the announcement of far-reaching and more stringent than expected trade tariffs sent stock markets sharply lower. In the days that followed China, which had been singled out for higher tariff rates, retaliated with its own higher tariffs on US imports, escalating the situation in a tit-for-tat manner.

US stocks slid close to bear market territory (defined by a 20% drop from a previous peak) and global stock benchmarks also declined, albeit to a lesser extent. The MSCI North America index (-3.6%) bore the brunt of the adverse impact from the trade tariffs announcement, as European equities fared relatively better with the MSCI Europe ex UK (1.4%) ending April higher and the MSCI UK (-0.8%) posting a minor decline.

### Walking it back

Part of the decline in the days that followed the initial tariff announcement appeared to be due to investors gradually realising that the negative stock market reaction was seemingly not influencing US President Donald Trump into a change of course. However, around a week later a reversal in US Treasuries, whereby yields spiked higher after initial declines on safe-haven flows sparked concerns that markets were potentially losing confidence in the US and led to a rowing back of most tariffs.

Trump announced that all countries, bar China, would receive a 90-day pause from the US reciprocal tariffs, meaning they would face just the baseline 10% import levy. The news was met with a sizable relief rally in stocks, with US benchmarks posting their largest one-day gains in several years — demonstrating once again that the largest moves to the upside often occur after substantial declines. There was further good news when the White House announced temporary exemptions for electrical products and the president softened his stance on Fed chair Jay Powell, after pointed attacks had raised concerns that Trump would interfere with central bank independence, a cornerstone of financial market confidence.



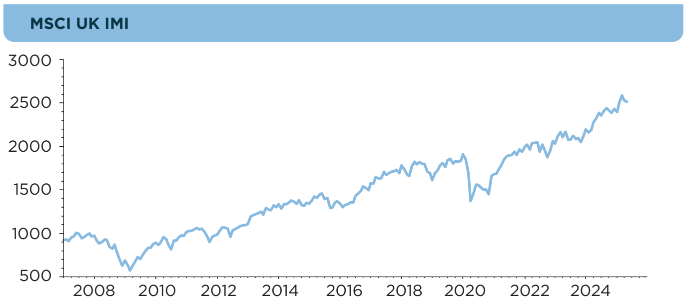
Past performance is no guarantee of future returns.

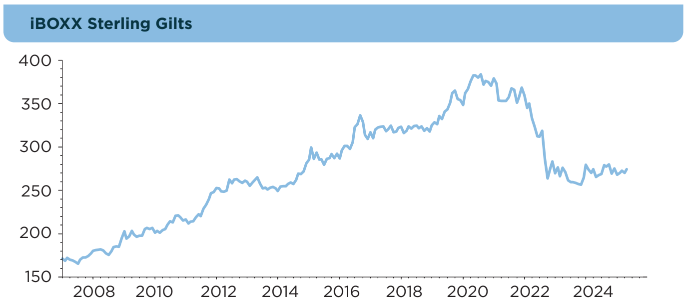
## Bonds have the president's eye

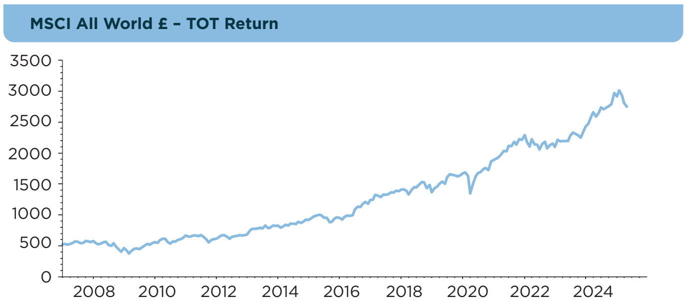
This is welcome in the sense that it reveals that while the US president may not be as sensitive to negative market movements as during his first term, he does still have a watchful eye in this regard and that the bond market seemingly still represents something of a guardrail against more destructive policies. Gilt benchmarks (1.9%) gained on the month alongside Eurozone government bonds (1.9%), dampening the decline in stocks, as they outperformed US Treasuries (0.6%).

## Tariffs are taxes

However, significant issues remain and the macroeconomic backdrop is currently less favourable, and less known, than it was at the end of the first quarter. There are many moving parts in calculating the effective tariff rate but it appears that by the end of April the average level was in the region of 17%-18%, down from around 23%-24% at the peak. This still represents a substantial rise on the previous levels during Trump's first term and the Biden administration when the rate was less than 5%. The sizable increase in tariff level amounts to a substantial tax rise on American businesses and consumers. This is expected to provide a drag on economic growth while also pushing prices higher, increasing the chances of stagflation and providing a dilemma for the Federal Reserve (Fed).

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Source: LSEG Datastream 07/05/2025

An expected slowdown in the world's largest economy will also be felt further afield. European central bankers see the impact as likely being disinflationary, rather than inflationary, as the drop in demand and potential for increased supply due to the rerouting of hitherto US-bound goods suppresses prices. This dynamic could cause a monetary policy divergence should the Bank of England and European Central Bank continue to lower rates while the Fed stay on hold (or even raises rates), as derivatives markets are currently pricing a similar amount of Fed and BoE rate cuts for the remainder of 2025. In our opinion there is greater scope for the Fed to disappoint in this regard.

## Coming from a position of strength

Economic data continues to suggest that the US economy was in rude health before the tariff shock. Although US GDP declined in the first quarter — the first contraction since 2022 — this can be explained entirely by a surge in imports as businesses stockpiled goods ahead of the imposition of tariffs. The 0.3% decline (in annual terms) was due to the biggest quarterly drag from net exports since at least 1947, which subtracted 5 percentage points from headline GDP.

The latest US employment report also looked fairly healthy. 177,000 jobs were added to the economy, which is considerably higher than the 130,000 expected, while the unemployment rate stayed steady at 4.2%. Sentiment-based indicators are flashing warning signs but there is little in the "hard" data to support this yet. We are mindful that "hard" data is inherently lagging in nature and therefore are monitoring developments closely for signs of deterioration.

## Gold gains and oil drops

The commodity space has seen a clear reaction to tariff developments, with Gold (5.3% in US$) hitting new record highs, in US dollar terms, and oil benchmarks experiencing large declines. The rise in gold, commonly denominated in US dollars, can be partly explained by the depreciation in the greenback but is more likely a reflection of safe-haven flows — and possibly a decline in confidence in the US dollar.

Brent crude (-15.6%), an international oil benchmark, has fallen to the low US$60s to trade at its lowest level in four years on growing concerns of a slowdown in the global economy. At the same time OPEC (Organisation of the Petroleum Exporting Countries) has announced an output increase, putting more pressure on falling prices.

## Conclusion

On balance, we see the outlook for US stocks as less favourable due to tariff announcements. Forecasts of earnings growth have been lowered, valuations remain relatively high and we expect increased uncertainty to weigh on capital expenditure decisions for businesses while at the same time tariffs will weaken consumer demand. There is also the risk of a continued depreciation in the US dollar.

At the time of writing, the latest set of corporate results have been largely ok, but future expectations have been revised lower. We expect the 145% tariff on China to be lowered — Trump and his advisers have suggested it is unsustainable at this level — but even a fruitful negotiation giving a large reduction would likely still represent a substantial increase on what was in place at the start of the year. At present a recession is still not being priced in to markets, but the risk of one has increased.

US stocks remain above their 30-year average for valuations, and it is increasingly hard to justify this premium while European stocks trade below their 30-year average. Fiscal stimulus continues to provide an expected tailwind for European economies, but the political situation remains fragile, as was demonstrated by Friedrich Merz requiring a second confirmation vote to become German Chancellor. Geopolitical uncertainty remains uncertain, with the Middle East, Russia/Ukraine war and India/Pakistan clashes all causes for concern. We like fixed income investments in the current environment, due to historically high yields on offer and the potential for cushioning a portfolio should stocks take another leg lower. We also find hedge funds attractive due to the macroeconomic backdrop and also the potential portfolio diversification benefits should stocks and bonds start to move in a similar fashion — like we saw in the US recently when US Treasuries declined alongside stocks.

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