

Transcript

Financial Market Commentary – Review of Q1 2025 and Future Outlook

Simon Lewis on 03 April 2025

Hello and thank you for joining our latest financial market commentary. So much has happened already this year, it's hard to believe that we're only a quarter of the way through.

It was confirmed that Donald Trump had won the US presidential election on 5th November and fittingly, since he took office on 20th January it has been non-stop fireworks.

It's hardly surprising that Trump is creating disruption. However, it is the speed and extent of such disruption that is in so many ways, alarming. Trump's first term was heavy on rhetoric but light on fundamental policy reform. This time is different.

Trump has established a hardline team to execute his plans, and in many respects, it feels as if the mafia has taken over the US. International conventions are being ignored in pursuit of leveraging the country's geopolitical and economic muscle. The ferocity of their approach is not going down well, except for their die-hard supporters. The US now wants a bigger slice of the global economic pie. The question is, does Team Trump really know how to get it?

Before I talk about the latest tariff announcements, let's wind back the clock and remind ourselves what has happened so far.

This chart shows the initial euphoria in financial markets, from the perspective of the S&P 500 index, which rose by 5% in the days following 5th November. A volatile period followed but there was nevertheless a general trend of appreciation, with the index starting the year well and reaching its peak on 19th February, over 7.5% higher than before the election.

In recent months volatility in global financial markets has become more acute and this is the cumulative result of an increasingly erratic policy agenda from the Trump administration. The strength of the US economy had previously given confidence to investors in the US. It was thought that the disruption would be relatively short-lived and there was a consensus that Trump's heavy handed economic policies would moderate and ultimately would be good for the US economy and even better for US financial markets.

It was always likely that at least some of this benefit would be at the expense of the rest of the world, and that realisation has already had a big impact on the policies of other nations.

Of note is the seismic shift in the fiscal policy of Germany. Arguably, we've just witnessed the biggest economic change there since the dismantling of the Berlin Wall. After following a path of fiscal austerity since the second World War, Germany is opening the fiscal floodgates as a direct consequence of Trump's policies, particularly those that revolve around NATO.

German Government debt stands at around 60% of the country's gross domestic product, well below the debt levels of western counterparts and constrained by a constitutional debt brake. The Bundestag recently voted to remove that brake from defence spending and infrastructure investment, freeing up an estimated one trillion euros to be spent over the next 10 years. It's important to remember that when governments spend money, a good proportion of it ends

up in the pockets of ordinary people and on the balance sheets of companies. So, this extra spending will be a stimulus for the German economy and the wider Eurozone.

Rolling the clock into March, the initial financial market euphoria has evaporated as investors became increasingly concerned about the needless economic impact of prolonged uncertainty. There's also an increasing danger that in trying to secure a bigger share of the economic pie for the US, Trump's policies will make the overall pie smaller.

The market gain accrued in the aftermath of Trump's election victory has consequently been reversed and as markets lost faith in Trump, the S&P 500 index shed a little over 8.5% from its peak to the end of March.

I know it happened after the end of the first quarter but let's talk about Liberation Day, which sounds like an action movie with Donald Trump selecting himself to play the Arnold Schwarzenegger role. He's evidently enjoying the power and celebrity of his role. To the dismay of many, he presented an extensive range of tariffs, affecting 60 countries, as if he was a TV game show host. For anyone who is serious about macroeconomics, the optics could not have been worse. The US average effective tariff rate was 2.3% in 2024. After the tariffs announced on Liberation Day, it's now closer to 23%, increasing by a factor of 10.

Every country is a loser because there is now a minimum import tariff of 10%. In the UK, we can be relatively relieved that our rate is set at the minimum. It will be painful but it's important to remember that something like 55% of the value of our exports to the US are services, which aren't affected by tariffs. The biggest UK losers will be makers of cars and medical products.

The EU isn't escaping so lightly. Its exports to the US are goods heavy, with only around 35% represented by services. The tariff rate will also be set twice as high, at 20%. If sustained, it will prove a headwind for the EU and offset some of the benefit of that additional German spending.

But the real target of the new tariffs is clearly China, with big increases for exports from the Chinese mainland and significantly, any other country where China has established an economic foothold to manufacture and export its products.

Fans of algebra will enjoy this formula published by the US trade department to validate the new tariffs. Incidentally, it differs from how Trump has described it. In essence, the formula divides the country's trade surplus with the US by its total exports to the US and then that number is divided by two, to produce the supposedly 'discounted' rate.

For example, China had a trade surplus of around \$300 billion with the US in 2024, on total exports of \$440 billion. It's a ratio of around 68% and dividing by two according to the published formula gives a tariff rate of 34%. In the case of China, which was subject to an existing tariff of 20% the new effective rate will be 54%.

If sustained, these new far-reaching tariffs represent a huge increase in tax, even if it isn't yet clear who is going to end up paying it. It might benefit the US fiscal position and help to bring

the US deficit under control, but surely that would be at the expense of economic growth, which would have the opposite effect.

We will have to wait to find out whether Trump wants to change the world in a way that might make the US poorer, or if he is simply trying to make a point during the preliminary round of negotiating a settlement that he can label the deal of the century.

In the meantime, the UK stock market is likely to benefit, in relative terms, from the less onerous impact of new tariffs on the UK. The UK stock market is smaller and shallower than it used to be, but there are some good steady eddies that are useful to own during a period of stagnation.

But it's important not to write off the US economy or US financial markets. The US accounts for only 4.5% of the global population but a staggering 30% of consumer spending. It's where the money is and even Trump's hopefully short-lived policies can't change that.

In summary, we expect global financial markets to continue to be volatile throughout the year but there are always opportunities for investors to make money. We remain confident that the significant diversification we create for our clients will continue to smooth returns and, in the end, generate a positive investment outcome.

I hope that this update is helpful and look forward to catching up with you at the end of the second quarter. In the meantime, thank you for listening.

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