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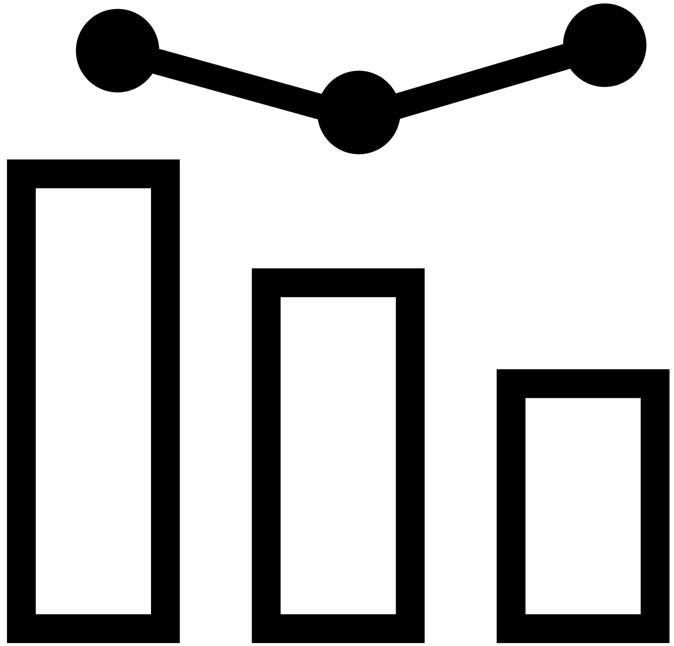

Market update

March 2025

March 2025 Trump continues to set the tone, not in a positive way

Global equity markets declined substantially in March, with US stocks once again posting the biggest losses. Meanwhile, yields on European government bonds rose.

Financial markets remained focused on the dynamic duo of Trump and Musk in March, but not in a positive sense. Uncertainty about US economic policy, and more specifically the threat of a trade war, dangled like a sword of Damocles above the global economy and international financial markets. As in February, the worst effects were on US stocks in March, this time with a negative monthly return of no less than 9.6% for the MSCI North America index. Unlike in February, other equity regions failed to escape the slump in March. European and emerging markets stocks still delivered positive monthly returns in February, but both regions posted negative returns of 4% and 3.5% respectively in March. Asian stock markets were already at a slight loss in February, and posted a further 4.3% decline in value in March. Compared to a year ago, the strong US outperformance relative to other equity regions has now almost disappeared. All equity regions have delivered net returns of between 5% and 8% over the past 12 months.

At least in Europe, one side effect of Trump and his entourage's antics is that pressure to invest heavily in its own defence has ramped up rapidly. In particular, the German shift to higher government spending to fund a build-up of its defence capability caused European government bond yields to rise in March, resulting in a negative monthly return of 1.8% on the benchmark for European government bonds. The rise in yields also negatively impacted European corporate bonds, but this was offset by a slight narrowing of credit spreads. On balance, both investment grade and riskier high yield corporate bonds delivered a monthly return of -1.0%.

Finally, European listed real estate performed in line with the broad equity market in March, with a negative return of 4.2%.

The returns on the various asset classes were as follows:

Return (total return, in euro's)	March	Q1	2025	12 mths
Bloomberg Barclays Eurozone Staatsobligaties	-1,8%	-1,3%	-1,3%	1,2%
Bloomberg Barclays Euro Bedrijfsobligaties	-1,0%	0,0%	0,0%	4,2%
Bloomberg Barclays Euro High Yield Bedrijfsobligaties	-1,0%	0,6%	0,6%	7,2%
FTSE/EPRA Europe Onroerend Goed	-4,2%	-1,9%	-1,9%	-4,9%
MSCI Europe Aandelen	-4,0%	5,9%	5,9%	6,8%
MSCI North America Aandelen	-9,6%	-8,0%	-8,0%	7,5%
MSCI Asia Pacific Aandelen	-4,3%	-2,9%	-2,9%	4,9%
MSCI World Developed Markets Aandelen	-8,5%	-5,8%	-5,8%	5,3%
MSCI Emerging Markets Aandelen	-3,5%	-0,9%	-0,9%	7,8%
EUR/USD	4,3%	3,9%	3,9%	0,3%

Source: Bloomberg

Tariff man Trump sows uncertainty, damaging global economy

Based on economists' consensus expectations, the outlook for the global economy has not changed materially in recent times. Global growth of around 3% is still expected for 2025 (and 2026 and 2027). What has changed, however, is the uncertainty surrounding this forecast, especially the risk of a scenario of lower economic growth. This is mainly due to the (returning) new President of the United States, Donald Trump. In the first months of his second administration, he announced many new policies, including on the economy. Ahead of his inauguration in January, many economists (and investors) had hoped that Trump would focus on his campaign promises of tax cuts and deregulation. In practice, things have so far worked out differently. Self-proclaimed 'tariff man' Trump has focused on announcing trade tariffs against both enemies and (maybe former) allies of the US, and then postponing them again, scrapping them or doubling down on them.

Actual damage from this incoherent trade policy has so far been limited, but the uncertainty created by Trump is now clearly having a negative impact on the confidence of American consumers and entrepreneurs. This could easily translate into weaker growth in the coming months than the current forecasts from economists. The consequences may already be reflected in economic growth figures in the shorter term as well. Indeed, it seems that many companies have not waited for Trump's trade tariffs, and prioritised imports of their products to the US as much as possible in the first months of 2025. If the Atlanta Fed's GDP Now indicator is correct, this could even translate into an economic contraction over the first quarter, or the beginning of a US recession.

Trade tariffs will hit US consumers in particular

It would be premature to see a US recession as a base scenario at this point. While trade tariffs are expected to be a negative shock to the economy, their effect may be short-lived if they do not mark the start of a protracted trade war. Trade tariffs could also lead to an increase in foreign business investment in the US, which would benefit economic growth. This, of course, is Trump's hope, although he is probably being overoptimistic. The costs of import tariffs will ultimately be borne by American consumers, who may be forced to spend less. With consumer spending accounting for more than two-thirds of US economic growth, this negative effect is likely to outweigh any increase in business investment, which accounts for only about 20% of US GDP growth.

A third potential source of economic growth for the US, a more accommodative government fiscal policy, also does not look to be in good hands with the new people in charge in the White House. While Trump appears to have succeeded in extending the tax cuts from his first term in office, which in principle is conducive to growth, the unfocused way in which the newly created Department of Government Efficiency led by Elon Musk is simultaneously targeting US government agencies seems to be not only making haphazard cuts, but above all creating a lot of chaos and opportunities for corruption and tax evasion. In any case, the scope for fiscal stimulus in the US is limited, with a budget deficit already at around 7% of GDP. An even larger budget deficit is more likely to heighten the risk of ever higher interest costs and ultimately an unmanageable increase in government debt.

'Make Europe Great Again' instead of 'Make America Great Again'?

All in all, it does not look as though Trump will actually succeed with his most important campaign promise of 'Making America Great Again'. Rather, his geopolitical policy, particularly his pro-Russia/anti-Ukraine and EU statements, seem to have woken Europe up, with the potential outcome being to 'Make Europe Great Again'. In particular, the move by the prospective German Chancellor Merz to contribute more to European defence, including an easing of the overly strict 'Schuldenbremse', has led to a shift in sentiment among business owners and consumers (and investors) regarding the outlook for the European economy.

The question is whether this will translate into actual higher economic growth. Economists are not as yet taking this fully on board, forecasting economic growth for the eurozone of around 1% in 2025. An increase in government spending and business investment, particularly in the defence industry, could contribute to higher growth, but on the other hand, continuing geopolitical turmoil could lead to a decline in consumer spending. In addition, the question is whether all the plans, for example in the context of the European Commission's 'Re-Arm Europe' proposal and possibly also Mario Draghi's report aiming to boost European productivity, will actually be implemented. Regardless of other factors, the current tightness in the European labour market, with unemployment still historically low by European standards at 6.2%, could pose a problem. Nonetheless, the overall outlook for the European economy is now better than was considered possible a few months ago, thanks mainly to Trump.

Mixed picture for emerging markets, partly due to the weaker dollar

US trade tariffs are likely to end up being a bigger threat to emerging markets, in particular China, than to Europe. On the other hand, anti-US sentiment could, for example, bring China and Europe closer together. Furthermore, not all emerging markets will be equally harmed by a possible trade war. An important positive for emerging markets, particularly for countries with large sovereign debt and/or loans in US dollars, is that bond yields have fallen since Trump's inauguration and the dollar has weakened. This makes debt more affordable. This does not apply to countries such as Turkey, which borrows a relatively large amount in US dollars but will not benefit because the Turkish lira has depreciated against the US dollar this year.

Inflation picture has improved, but a trade war could be problematic here as well

The inflation picture has recently improved significantly in both Europe and the US. Headline inflation is now 'only' 2.8% in the US and 2.2% in the eurozone. Core inflation, excluding volatile food and energy prices, has also declined, but remains above the Fed's and the ECB's 2% inflation targets at 3.1% in the US and 2.4% in the eurozone. The most favourable development for the inflation outlook is that the oil price has recently fallen (to below USD 70 per barrel), which can at least contribute to lower headline inflation.

A less positive point is that the prospect of a trade war could lead to higher inflation, especially in the US. This was also recently a reason for the Fed to adjust its inflation outlook upwards (and its economic growth outlook downwards). US consumers have also noted the increased inflation threat. According to research by the University of Michigan, consumers now expect inflation to be as high as 5% next year and to average nearly 4% over the next five years. Inflation expectations among consumers have not been this high since 1993. Somewhat reassuring, also for the Fed, is that inflation expectations in financial markets have not shown a similar increase, at least not yet. The 5-year inflation forecast currently discounted in the markets is still around 2-2.5%.

Effects of trade war on inflation outside the US are ambiguous

A potential trade war also poses a threat to the inflation outlook in Europe, but to a lesser extent and less directly than in the US. To the extent that a trade war would have a negative impact on economic growth, the net effect could actually be disinflationary. On the other hand, increased geopolitical pressure, also fuelled by the new occupant of the White House, could lead to a wave of new government spending (and business investment), which in time could cause an increase in inflationary pressures. In addition, there are still above-average wage pressures from the tight labour market in the eurozone, although recently these appear to be easing rather than rising further. On balance, the general forecast by economists that eurozone inflation will gradually decline towards 2% in 2025 and beyond seems to us to be the most likely scenario for the time being.

Outside Europe and the US, inflation developments in the opposite direction are notable, especially in Japan and China. In Japan, the textbook example of an economy in deflation for decades, inflation has been hovering around 3% for several months, while China has slipped into deflation for the second time in less than two years, with inflation measured at -0.7% year-on-year in February. This may be due in part to a seasonal effect (due to the celebration of Chinese New Year at the beginning of February), but would appear to be mainly due to weak demand in the Chinese economy.

The ECB's easing cycle appears to be coming to an end

This fluctuating inflation outlook presents a challenge for the central banks. In this respect, the way forward looks to be clearest for the ECB. In the first quarter of 2025, the ECB cut its base rate further in two steps, from 3% to 2.5%. As long as the inflation picture does not change materially, a further movement towards the neutral level of 2% is likely, but at a somewhat slower pace, possibly over the coming six months.

For the Fed, the picture is more complicated. The Fed recently revised its US growth forecast downwards, and upwardly adjusted its forecast for inflation. In other words, the Fed has upwardly revised its assessment of the risk of a stagflation scenario. The Fed now has to focus on what it wishes to prioritise: will it support a possible slump in the economy with more rate cuts, or curb the potential for higher inflation with rate hikes? In any case, the Fed kept its US base rate unchanged at 4.5% in the past quarter. The interest-rate markets are still expecting 3-4 rate cuts in the coming year, but if it looks like inflationary pressures are increasing in the coming period, last December's rate cut could also be the last.

Strong stock market recovery seems unlikely for the time being

From the perspective of tactical asset allocation and with an investment horizon of 3-6 months, we see little room for a strong recovery in equity markets. These markets have been mixed since President Trump's inauguration in January, with expensive US stocks in particular falling out of favour. European stocks on the other hand started 2025 well, but we think it is more likely that deteriorating sentiment on US equity markets will spread to other equity regions, including Europe, than there will be another recovery in the short term. The geopolitical situation and, above all, the bleak economic wind coming from the White House are too unstable for this to happen.

The threat of a trade war and an increase in government spending (e.g. in Germany) could lead to increased inflationary pressures and thus higher interest rates, but we believe it is more likely that deteriorating economic prospects and safe haven behaviour will drive investors towards government bonds. We therefore believe that the risk of (much) higher capital market rates is limited in the short term. In addition, our previous conclusion that the current investment environment does not advocate an overly pronounced tactical positioning continues to apply.

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