Market comment: recession or concessions?

8th April 2025

In light of recent market volatility following Trump's sweeping tariff announcements last week, aimed at reshaping trade relationships between the US and its global partners, we wanted to share our perspective.

The wider context

We entered 2025 with expectations of moderate growth and few concerns of a recession. With Trump's tariffs taking markets by surprise, investors have dialled up the probability of a recession as well as higher inflation - also known as stagflation - should the tariffs remain in place. The potential economic impact of renewed trade tensions between China and the US - especially as China announced its own reciprocal tariffs on Friday - further unnerved markets Friday and Monday 7th. As a result, we have seen the S&P 500 in the US come off some 17%, with a further decline of 0.2% on Monday 7th. European, Japanese and Asian markets have all suffered similar declines. Even gold, perceived to be a safe haven, has sold off.

While it has been less than a week since markets commenced their steep decline, there are signs that we are witnessing indiscriminate selling where investors 'sell what they can' - or what we call in the industry 'capitulation'. Some 75% of the S&P companies have hit 28-day lows, the small-cap Russell 2000 reached some four standard deviations from trend, gold is selling off in high volume, there are huge amounts of short ETF interest and some $100 billion of the SPDR (S&P Index) has been sold. These are all signs of investor panic which normally signals we are close to the bottom of the market. Bonds are moving to price in more rate cuts as result of the expected economic hit, resulting in shorter-dated bonds outperforming. Futures markets are pricing in 1.50 percentage points of rate cuts by June next year.

What happens next in the US depends on the eventual balance struck between an ongoing attempt to raise revenue to fund tax cuts and the readiness to negotiate in order to achieve strategic objectives relating to immigration, trade imbalances and defence spending. Treasury Secretary Scott Bessent has already urged other countries to not retaliate, encouraging them to view the rates about to be implemented are a ceiling that can possibly be lowered via effective negotiation. The risk, of course, is that trust (especially between allies), once lost, is often very difficult to rebuild.

The response so far

On Friday, we saw China retaliate with a range of measures, including:

- A 34% tariff on all imports from the US starting 10 April (matching the reciprocal tariffs that Trump placed on Chinese products on Wednesday evening).
- Regulatory moves such as restricting exports of seven rare earths and listing 11 American defence companies as 'unreliable entities'.

This response is of a shape and magnitude which appears designed to make a clear point of strength without compromising the possibility of future agreement.

We recognise it is impossible to know at this stage how this plays out, but our current assumption is that this is the beginning and not the end of the playbook. Market volatility is likely to remain high and reactive to headlines. Furthermore, investors will be closely watching the earnings season that is about to start to get a sense of the outlook and how business spending will evolve.

Potential scenarios

There are possible scenarios where the impact of the announced trade tariffs on markets may lessen or even reverse:

1) De-escalation or policy reversal: We may see markets rebound if Trump (or his campaign) soften the tariff rhetoric, or delay implementation. This may come because of Trump backtracking (a bit) on the back of poor market reaction, or because Congress (Democrats and Republicans) forces him to alter his path.
2) Federal Reserve action: The Fed in the US could come to the market's rescue through announcing aggressive interest rate cuts. This would happen if the Fed ignored the impact of tariffs on inflation and focused on signs pointing to a recession. It is unlikely they will go down this path just yet, as tariffs are expected to push inflation to around 4% (from current 2.5-to-3%) and sharp rate cuts would eliminate any hope of inflation falling back to their 2% target.
3) Congress passes tax cut bill ASAP: another positive for markets would be if Congress offsets the tariff increase by reducing taxes that come into effect immediately (within three months). While this is a credible option, there are several fiscal hardliners that need to be swayed first.
4) Europe and China stimulus: We have seen the first signs of this since Trump made his intentions regarding NATO clear. Fiscal stimulus, tax cuts, selective subsidies are all effective ways of counteracting Trump's tariffs, rather than retaliating with reciprocal tariffs that could further damage sentiment.

What are we doing in portfolios:

The LGT Investment Committee (IC) held an ad-hoc meeting this morning and will have a full IC discussion tomorrow. Members felt (for some of the reasons mentioned above) that the sell off appears to be closer to the end than the beginning, with peak negativity around global trade being priced into markets. While it is impossible to pick the top or bottom of markets, several indicators are pointing to it being the right time for us to bring the equity exposure back to its 'neutral point' (60% for medium risk / balanced mandates). The recent sell off has resulted in our equity exposure for medium risk go from circa 61% to circa 57.5%. The Central IC expressed a preference to 're-balance' and bring equity risk back in line with our neutral weight of 60% equities.

Naturally, following the Central IC, the MPS team also met to discuss implementing the IC views. Given the widespread volatility in markets, the **MPS team believe there is currently too much operational risk to trade on platforms at present**. The reason for this is that when platforms rebalance there is typically a period of time between the sales pricing and the buys pricing. In usual market conditions, a small period between buys /sells is acceptable but with markets moving so much (3-5% daily), even a period of one or two trading windows could result in clients being whipsawed. This could result in clients missing out on a month's worth of return or so. The MPS IC therefore voted to wait for volatility to subside before topping up our equity positions.

Our belief in long-term equity market investing is unwavering. Each moment like this in markets has its own story and defining characteristics that makes it appear worse than the last. External shocks are expected and factored in when we are assessing our clients' willingness and ability to take risk. With a market now starting to look oversold and lots of bad news in the price we are inclined to think opportunistically at this point, searching for dislocations using our framework of studying the fundamentals, valuations and technicals of the market.

Earlier in March, in the light of the anxiety the private sector was feeling towards the president's policy platform, we reduced our allocation to smaller US companies and some of our global funds, replacing them with more resilient larger US companies and European companies better exposed to fiscal stimulus in the region.

How have portfolios held up

The nature of market moves over the past three trading sessions has left nowhere to hide, with all major sectors and regions suffering declines. Our equity allocation has held up relatively well which we know in the context of a drawdown in portfolio value is scant consolation. When investing primarily in funds, such sharp intraday moves make having a precise performance picture difficult, but our focus on being globally diversified and biased towards higher quality equities has certainly helped us smooth out some of the volatility. Our allocation to defensive global funds, such as Evenlode Global Income and Lazard Global Equity Franchise, has been characteristically resilient, in contrast to the more cyclical areas of the market.

One fear with the threat of tariffs, was that fixed income may not protect portfolios, as tariffs may lead to higher interest rate expectations to tame the ensuing inflation. Thankfully, fixed income markets have focussed on the threat to growth and therefore government bonds have done their traditional job of rallying in the face of an external shock. Medium and long-dated US Treasuries and UK gilts are up around 5% since the market started focusing on tariff risk mid-January. The alternatives component of the portfolios including Trojan and CG Absolute Return has been largely unchanged since the start of the month. We would expect this part of the portfolio to make money over the medium term, regardless of how things play out in international relations.

Important information