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ASSET MANAGEMENT

THE STATUS QUO IS GONE

Investment managers everywhere are trying to recalibrate the direction of travel for the world's economies and for risk. With all prior bets off, we must become more conservative in the short term but remain constructive enough to keep in mind we could see a negotiated settlement to all this.

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The world has completely changed in the last few days. Tariffs were a known entity, with 10% being the expected blanket rate, maybe even 20%. What was unexpected was the incremental tariffs Trump has levied on top of these rates.

Bangladesh, Cambodia, Laos and Vietnam have been heavily targeted as they are all countries that became manufacturing hubs for global corporations to allow them to continue supplying the US when tariffs were levied on China by Trump during his first term. These countries' trade surpluses with the US are purely because they are supply hubs – they are poor economies structured around subsistence living; they can't afford to start buying US goods and tariffs won't change this.

In implementing tariffs 'round two', Trump has completely upended the global supply chain. The ramifications of this should not be underestimated. Mexico and Canada were excluded from the list only because they already had 25% tariffs in place on certain items. US consumers now face huge supply chain impacts and the US retail sector looks like it will be destroyed.

Markets were expecting a negotiation; the reality has been reciprocal tariff responses from China and Canada so far, but with the Eurozone preparing if negotiation fails. The escalation we all feared is starting to come through, rapidly pulling the US from a state of exceptionalism to facing stagflation and a 50/50 chance of recession. The 'flation' part of stagflation is perhaps the most pressing concern as we wait for countries around the world to mount their responses.

For fixed income markets, it means more uncertainty. We were waiting on the tariff news in hope of a watershed moment, but the reality has been the opposite – more uncertainty and volatility.

Markets are currently pricing in at least four US interest rate cuts in 2025, flat-to-negative growth and inflation at 4%[1]. If growth does tank, then Powell will have to cut rapidly and deal with the inflation consequences later. For the time being, we'd expect him to remain neutral and walk a very fine line to support financial markets without losing the Federal Reserve's discipline and mandate on growth and inflation. In Europe, three or four cuts also look likely this year. Although a possibility, a cut later this month from either the Federal Reserve or European Central Bank seems pre-emptive, as we still don't know what the permanence of these tariffs might be or how the negotiations will go. Escalation from here is a real concern.

Another worry is liquidity. We have now seen a step-change in risk and high-yield/cash has sold off. The danger is that ETFs could begin to sell assets, which would have the knock-on effect of yield beginning to move wider.

We are derisking our portfolios and transitioning to more conservative positioning. Our short-term view is things could get worse before they get better. Investment managers everywhere are trying to recalibrate the direction of travel for the world's economies and for risk. With all prior bets off, we must become more conservative in the short term but remain constructive enough to keep in mind we could see a negotiated settlement to all this, albeit in several months. The result of this would be the economic cycle is brought to an abrupt end much earlier than anticipated and the subsequent flush-out should create investment opportunities. But for now, we must hold on tight and adopt caution as this wild ride plays out.

1 Bloomberg, 7 April 2025.

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