ROCQ CAPITAL

First Quarter 2025

The words and actions of Donald Trump have been the main driver of markets during the first three months of the year as a series of pronouncements drove volatility, particularly in March which ended with a weak tone. The quarter started quietly, with little news of note from the new US administration, and this allowed global equity markets to rise in January. Initial comments about tariffs – a key plank of Trump's economic policy during the campaign – had been relatively benign, though the threat of action against Canada, Mexico and China in particular remained open and in February some strong measures were announced – and then delayed. Such uncertainty is unhelpful for business planning and indeed US data weakened somewhat during the second half of the quarter with business and consumer confidence both lower than expected by economists and existing home sales also below forecasts.

More certainty arrived on 2nd April with a high-profile announcement of tariff levels for the US's trading partners, though these rates seem to have been calculated based on relative trade surpluses or deficits rather than the tariffs levied by other countries. This meant that Asian countries in particular were hit hard, as many are relatively low-income economies, so they tend to import little from America but are a source of cheap exports to the US. There was a strong negative reaction to these announcements across global stock markets, with a continuation of the moves that occurred in March – namely weaker stocks and lower bond yields, as investors scrambled towards safe havens, as well as a sharp weakening of the dollar.

If and when tariffs are enacted there will be an impact on inflation, with a lag, so price data will be closely watched. US inflation has been stable during the quarter, but unable to move to a low enough level to encourage the Federal Reserve to reduce interest rates in the coming months. Inflation has been less of a focus for investors in recent months, having stalled around 3% in many developed economies, meaning that central banks are in wait-and-see mode and expectations for further rate cuts are modest. In the UK, the latest headline inflation figure is 2.8%, although base effects (mainly related to energy prices) and the National Insurance increase are expected to move it towards 4% soon.

This enabled bond yields to decline modestly during the quarter, notably in the US, which made fixed income investments relative outperformers compared to equities, though there was some widening of credit spreads towards the end of the quarter. The MSCI World equity index fell by -7.0% in GBP terms in March, taking it to -5.1% for the quarter, led by large American and other international 'growth' companies such as those in the technology sector. Part of the context for this was a backdrop of rather expensive large-cap US equities which declined during the month to leave the S&P 500 down -7.5% (in GBP terms) in Q1 and the technology-focused NASDAQ 100 even worse at -11.0%. Indeed, the technology sector, particularly high-growth stocks like Nvidia and Tesla, faced significant pressure and led declines over the second half of the quarter and into April.

There has been a significant shift in relations with US allies, notably NATO and the European Union, with less certainty that America will stand with these bodies in Russia/Ukraine and on other matters going forward. This prompted a sudden resolve, particularly in Germany, to increase fiscal spending in general and on defence in particular, something the US is unlikely to be unhappy about given previous complaints about the NATO budget. The new German government, which was elected in late February but had not yet taken office,

pushed through a large spending package which contrasts with the country's decades-long conservative stance on government expenditure. This was bad for German government bonds, which sold off, but it helped European equity markets to outperform other regions, with industrial sectors doing particularly well. It is also helpful that inflation in Europe continued to fall gently to 2.5% with further declines expected; this gives the European Central Bank (ECB) scope to proceed with its rate-cutting cycle which could also be supportive of risk assets. It cut interest rates in January and March and is expected to reduce them by 0.25% another three times this year.

Developments in China continue to be of interest. Recapitalisations of three major banks are mooted as part of the broad stimulus programme that started last September, while there was also a high-profile meeting between government officials and leading technology executives who have previously been out in the cold – indicative of a thawing of relations which boosted returns for companies such as Alibaba in February. In addition, there was news in January that Deepseek, an artificial intelligence tool developed in China, had demonstrated impressive capabilities on a par with US counterparts but at a fraction of the cost. Further developments also came to light, adding to positivity in the technology sector. Question marks remain for those western firms who have committed to vast outlays on AI on the assumption that state-of-the-art technology is essential, though such developments may well increase the use of AI across a wider range of applications which may ultimately be beneficial for chipmakers and others in the US.

Outlook & Portfolio Strategy

Looking ahead, we expect tariffs to dominate headlines. This has been damaging for investor sentiment, and it seems likely that that global growth will be impacted negatively. It is possible that countries will be able to negotiate lower levies, but this will take time and keeps uncertainty high. There may be an impact on inflation, depending on business and consumer behaviour in the US, but the effect on growth is of most concern at present. This is reflected in a fall in US government bond yields, which could be expected to move in the opposite direction if inflation were to become the primary concern (such as in 2022).

Our relatively low allocation to US equities on valuation grounds, which was detrimental to performance in 2024, may be beneficial in the coming months. In portfolios with equity exposure, our 'value' strategies outperformed global indices, benefiting from exposure to more traditional or domestically orientated industries, while emerging market investments were also relatively robust until the end of March – though appear more vulnerable now given the high tariff levels imposed on Asian countries. Our Alternatives allocation provided support to the portfolio, making small gains as the range of strategies held provided useful diversification and protection. We made changes to this part of portfolios during Q1, having identified a new strategy which we felt would add value and diversification alongside the existing set of holdings.

Fixed Income investments remain attractive, on a standalone basis or within balanced portfolios, given they are anchored by falling government bond yields at present. We must be mindful that this could change if inflationary impulses become stronger, though the high coupon levels provide a comforting degree of insulation from this.

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The composition of our multi-asset portfolios, with a diversified spread of equity strategies alongside bond investments and uncorrelated Alternatives, is designed to weather volatility but we remain alert to threats and opportunities as events develop. While the risks of tariffs and volatility are clear, markets can sometime react excessively and provide attractive windows for fresh investment.

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