CARTLIDGE MORLAND
INDIVIDUAL WEALTH MANAGEMENT

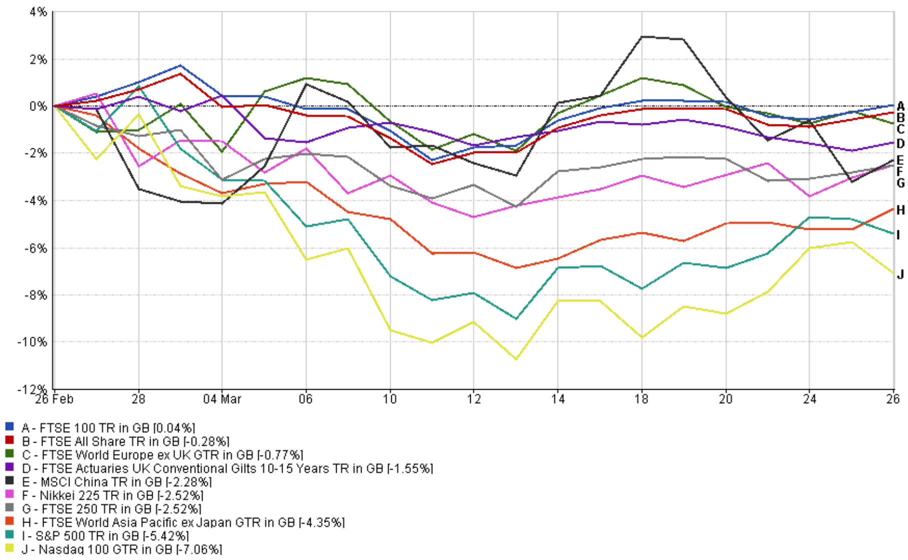
INVESTMENT COMMENTARY

27 MARCH 2025

OVERVIEW

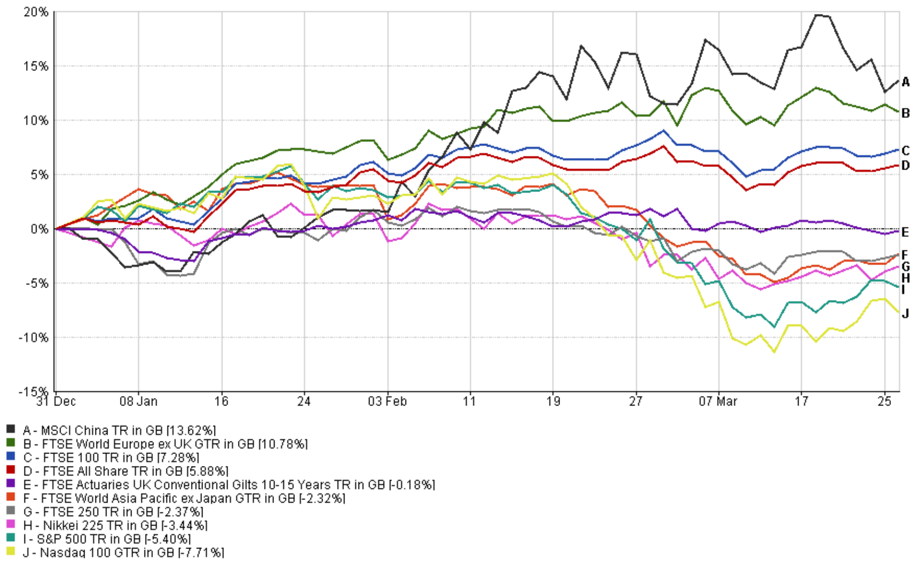
Since our last investment commentary in the middle of February 2025, uncertainty in investment markets has led to weakness particularly in US and Asia Pacific (excluding China) equity markets. President Trump's erratic trade policy which has imposed/lifted/reimposed trade tariffs on key trade partners has led to concern that the US is heading for a period of stagflation – low growth and above target inflation. Inflation in the developed economies has ticked up as energy prices have risen and interest rates are likely to remain higher than originally anticipated. Now faced with President Trump's "Liberation Day", economies and markets are braced for further tariff announcements with the 25% tariff imposed on foreign-made cars and car components a taste of what may be in store. Geo-political developments have also added to more cautious investor sentiment but with European countries looking to bolster their defence spending, the defence companies have seen their values soar in many cases, so adding support to UK and European equity markets. Investors are looking outside the US equity market for attractively valued opportunities.

INVESTMENT MARKETS STERLING TOTAL RETURNS OVER ONE MONTH



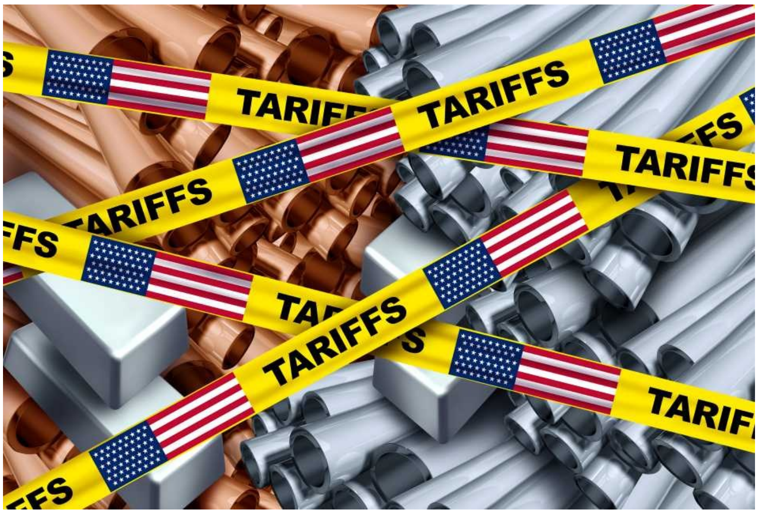
26/02/2025 - 26/03/2025 Data from FE fundinfo2025

INVESTMENT MARKETS STERLING TOTAL RETURNS YEAR TO DATE



31/12/2024 - 26/03/2025 Data from FE fundinfo2025

At its March 2025 meeting, the US Federal Reserve (Fed) kept its benchmark interest rate at a range of 4.25%-4.50%. It cut its economic growth forecast with the Fed now expecting GDP growth of 1.7% in 2025 (down from 2.1% in December) and predicting prices to rise by 2.7% (up from 2.5% in December). Jay Powell, the Chair of the Fed, acknowledged that these revisions were influenced by the imposition of trade tariffs on a number of the US' key trading partners. Mr Powell also commented that the Fed did "not need to be in a hurry" to reduce interest rates due to "unusually elevated" uncertainty. The Fed also announced that it was slowing down the speed of unwinding its quantitative easing programme with the level of US Treasury debt rolling off the Fed's balance sheet reducing from $25bn to $5bn per month from April 2025. There could still be further rate interest cuts this year - perhaps one or two 0.25% reductions – however four Fed officials at the March meeting were expecting no cuts at all.



The uncertainty generated by President Trump's trade policies has unsettled the US equity market and in turn global equity markets. The 'Trump Bump' has developed into the 'Trump Slump' since the inauguration in January. After a sustained period of strong performance, the S&P 500 and Nasdaq 100 have lost value year to date as a result of US trade tariffs, above target inflation with interest rates likely to remain higher for longer than anticipated and economic growth slowing. Worries now persist about the health of the all important US consumer. Consumer optimism appears to be weakening with the latest data from the Conference Board showing US consumer confidence falling to the lowest level in 12 years. The developments announced by the Chinese Artificial Intelligence (AI) developer, DeepSeek, weighed on parts of the technology sector whilst increasing uncertainty has led to investors being less enthusiastic about higher valuation stocks, including those of some of US mega techs.

The Bank of England (BoE) Monetary Policy Committee (MPC) kept Bank Rate at 4.5% at its latest meeting maintaining its plan for a "gradual and careful" approach to more cuts. The MPC faces the challenges of setting monetary policy against a backdrop of flatlining economic growth, a weakening employment market and the possibility of inflation picking up. Global and domestic uncertainty has the potential to weigh on demand. The BoE has cut its GDP growth estimate to 0.75% for 2025 and inflation is expected to increase to 3.75% later in 2025. Against this backdrop the Chancellor gave her Spring Statement outlining spending cuts aimed at meeting the government's fiscal rules. Weaker economic growth than anticipated further depressed by possible US tariffs, coupled with higher spending on debt interest, are likely to strain these fiscal rules again. Further tax rises may be required later in the year. With few measures adopted by the Government to encourage domestic economic growth and higher Employers' National Insurance levels taking effect in April, the medium and smaller cap areas of the UK equity market have continued to suffer. Larger UK companies have seen their share prices perform relatively well. Companies involved in the defence sector, such as BAE and Rolls Royce, have seen strong performance as Europe looks to increase its defence spending. Banks have also benefited from interest rates falling at a slower pace than their net interest margins.

The European Central Bank (ECB) has cut its main interest rates quicker than the US and UK central banks. At its March 2025 meeting, the ECB cut its deposit rate by 0.25% to 2.5% which was the sixth reduction since June 2024. Christine Lagarde, the President of the ECB, commented that “monetary policy is becoming less meaningfully restrictive” so indicating a possible slowdown or pause in rate cuts at its coming meetings. Eurozone inflation has fallen from 10.6% in October 2022 to 2.4% in February 2025. Economic growth in the region may well now be boosted by Germany’s multibillion euro borrowing to be spent on defence and infrastructure. Together with increased defence spending across Europe, inflation may rise so negating the need for interest rate cuts. The imposition of US tariffs could also add to inflationary pressures.

European equity markets have performed well in recent months following a long period of lacklustre returns. The prospect of improving economic growth stimulated by German federal expenditure, in particular, as well as attractive valuations in comparison to US equities have seen greater investor appetite for European shares. As in the UK, defence companies including Rheinmetall and Thales have seen their share prices soar. Banks have made strong returns with good earnings and share buybacks supporting returns. However, the threat of US tariffs is likely to hold back sentiment to some extent.

As highlighted in previous commentaries, the Bank of Japan (BoJ) is following a vastly different monetary policy to that of the central banks of other developed economies. Japan had been fighting deflation for decades - in recent years a negative interest rate policy was pursued. Inflation has recently returned to the Japanese economy. Japanese households have benefited from wage increases, which this year have been on average about 5.5%, but are now also enduring high prices - in particular food prices. Inflation stood at 3.7% pa in February 2025. The BoJ has been gradually normalising its monetary policy by raising interest rates, although left its main interest rate at 0.5% at its March meeting. The end of the deflationary spiral and the reforms put in place by the Tokyo Stock Exchange have been supporting share prices as companies are allocating capital more efficiently so benefiting shareholders. Domestically focussed businesses are now expanding. The prospect of US tariffs is likely to weigh on the Japanese economy particularly the big exporting companies in the auto and electronics sectors.

The Chinese equity market has been performing well as the policymakers announced various stimulus measures over the last six months to support the ailing property market and domestic demand as well as to combat deflationary pressures. It now seems that the authorities are opening up the IPO market for technology, advanced manufacturing and consumer companies. Chinese equity funds have seen a large spike in overseas investment on the back of the AI developments announced by Chinese AI company, DeepSeek. ASEAN (Association of South East Asian Nations) countries including Thailand, Indonesia, Philippines and Vietnam have seen substantial outflows of foreign capital as investors look to invest in Chinese equities as there are worries about domestic growth. Chinese equities also offer better value together with greater exposure to AI-related companies. However, Asia Pacific equity market sentiment has been impacted by the potential US tariffs with the deadline of 2 April 2025 looming.

UK gilts continue to offer attractive yields and crept higher in recent weeks ahead of the Chancellor’s Spring Statement. There is currently a monthly deficit between government spending and tax receipts of around £10.5bn which is about £4bn more than anticipated in October 2024. This is a result of lower growth and higher government spending. Gilt yields have increased following the Chancellor’s Statement as more government borrowing is expected. The uncertainty over future economic growth and reining in government expenditure continue to weigh on sentiment. Investment grade corporate bonds are likely to be supported by good fundamentals as many companies have reduced debt in recent years and have more robust balance sheets. However, geopolitical tensions and potential tariffs pose a downside risk to 2025 earnings.

OUR VIEW

Compiled by Angela Cooper, MD - Investment Services.

Angela runs Cartlidge Morland's Investment Management team, with over 30 years' experience in investment research working for investment companies, leading UK national IFAs and wealth managers. Angela graduated from the London School of Economics and is a Chartered Insurance Practitioner.

Donald Trump made clear what he wanted to do before he was elected – the markets were calm and jerked sharply upwards with the 'Trump Bump'. The problem since has been a series of knee-jerk policy announcements using Presidential 'executive powers' which appear alarmingly unchecked to those more familiar with European political systems. Multinational businesses and those which are part of international supply chains cannot plan whilst US trade policy changes constantly. How can any business even plan its pricing against such an unstable background? This apparently cavalier approach to maintaining global trade volumes will cost the world dearly if it continues – not least the US itself.

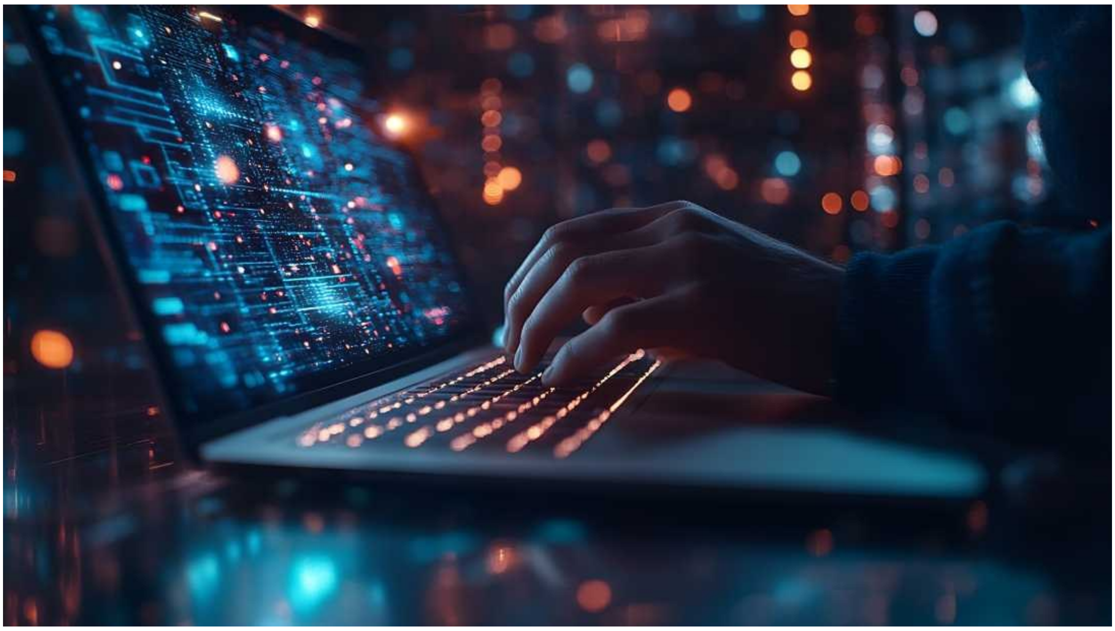
Above all, Mr Trump would like a US economy growing more strongly than any modern President has so far achieved. He wishes to cut taxes and increase Federal spending, whilst watching the dollars roll into Federal coffers from increased Customs revenues. It is not all nonsense – the US probably can extract greater revenues from tariffs without too much self-harm but the ground rules need to be laid very carefully and selectively, and then remain stable so enabling businesses to plan. Presently that is impossible, hence the uncertainty which has undermined previously buoyant markets. Furthermore, the President will have to be very careful as to which goods he applies tariffs because the US consumer will not welcome higher prices for essential imports and the Fed will resist higher inflation by maintaining elevated interest rates – not what the markets wish to hear.

On the brighter side for investors, protected markets will increase pricing power and market share for American corporations and therefore their profits. That will be beneficial for investors for some time although it may lead to under-invested and inefficient corporations eventually. We see this in telecoms which is already a protected sector – US corporations generally eschew investment in Europe, because competition and regulation in Europe has resulted in lower pricing/profitability and market fragmentation.

It is sometimes forgotten that so much of the world is dependent on selling to the US – but that the US is far less dependent upon selling to the world. Around 14% of US GDP was derived from exports in 2023 – whilst the equivalent figure for Germany was over 43%. US factories can certainly churn out millions more cars – but if the American public really prefer German ones - US customs will take a slice for the US Treasury.

Ultimately, Mr Trump will not wish to be responsible for global trade collapsing around his ears. He will use his big stick to improve US terms of trade with China and the EU in particular. The EU tends to be protectionist and the US is a sponsor of free trade, yet not without protectionist tendencies in sectors such as telecoms and airlines. Somewhere there is a deal to be done, because the US needs one, the EU needs one more and the President 'likes to do a deal'. Chinese imports will be a 'cash cow' because the President knows the Chinese will export at a loss if they have to, so affording the US Treasury billions of dollars in tariffs. Onshoring cheap, labour-intensive manufacturing is not the President's objective – he simply wants the Chinese to become less rich doing so.

When the Presidential flurry of activity eventually subsides, markets will be able to take a measured view. According to the Fed, the US will be the fastest growing major developed economy in 2025 – so US corporations ought to be profitable and to remain attractive to investors, except if over-valued based on previous growth expectations.



If you have any queries please do not hesitate to contact your Cartlidge Morland consultant.

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