HYMANS ROBERTSON INVESTMENT SERVICES

Hymans Robertson Investment Services (HRIS)

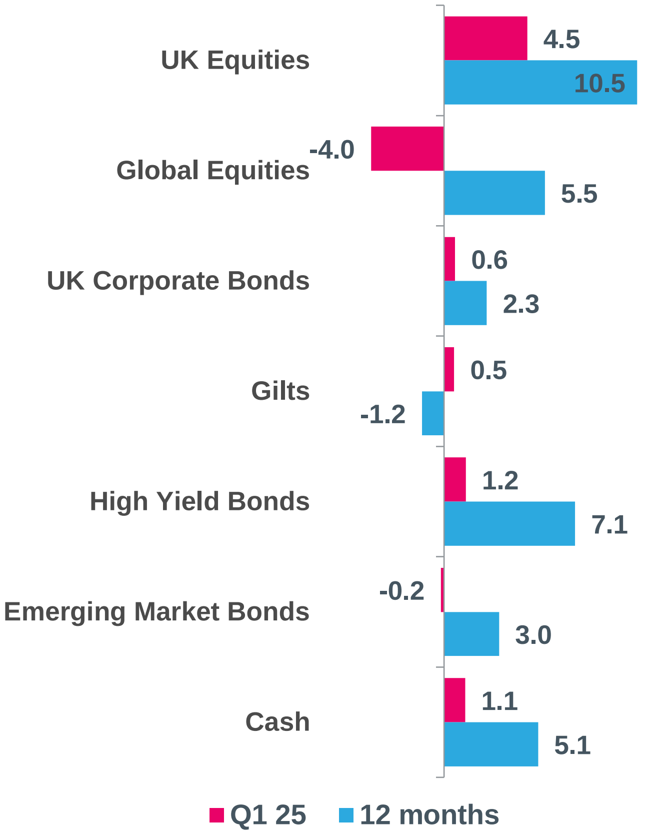
Market digest

Q1 2025

Quarterly highlights

- President Trump's focus on tariff policies spooked investors causing a sharp selloff in equity markets.
- US equity markets fell while UK equities and bonds performed better. Significant volatility in all asset prices continued after quarter-end.
- On page 3 of this document, we provide market commentary to cover the 12 months to 31 March 2025.

Asset class returns (%)



Source: Morningstar. Figures to 31 March 2025. Returns in sterling terms except high Yield bonds which are hedged. EM bonds are 50% local currency denominated and 50% US dollar denominated bonds.

Market summary

- Our model portfolios typically invest in a combination of the asset classes shown in the left-hand chart.
- Fears over an escalating trade war emerged in Q1 as President Trump's tariff policies increased market volatility. Post quarter-end, this volatility accelerated, especially after Trump's reciprocal tariff announcements on "Liberation Day".
- US equity markets fell over the quarter, as the escalating trade war drove uncertainty and concerns over a US economic slowdown.
- Other equity regions, including the UK, generated positive performance. However, post quarter-end, the selloff widened out, impacting all equity regions.
- Bond markets provided some protection for investors, as the heightened uncertainty led many investors to initially move to safer assets such as government bonds, pushing down yields (yields fall as prices rise). Post quarter-end, we have seen the market volatility leak into bond markets too, but they have held up better than equities.
- At a portfolio level, bonds tended to outperform equities, resulting in lower risk portfolios producing greater returns than higher risk portfolios over the quarter.

Outlook and topical market themes

- President Trump's tariffs unleashed a surge of volatility on markets. A week later he paused a lot of the heavier tariffs, but we continue to see volatility in equity and bond markets.
- The heightened volatility highlights the need for investors to stay the course instead of making short-term decisions. We wrote more about the fallout from tariffs here and here.

President Trump's tariff warfare shakes markets

2nd April, or Liberation Day, as Trump called it, accelerated the rise in volatility of financial asset prices that we had been seeing in the week leading up to it. The tariffs announced by Trump were far higher than most analysts expected, bringing the US' average effective tariff rate to 20-25%. As a reminder, the main impacts of tariffs are:

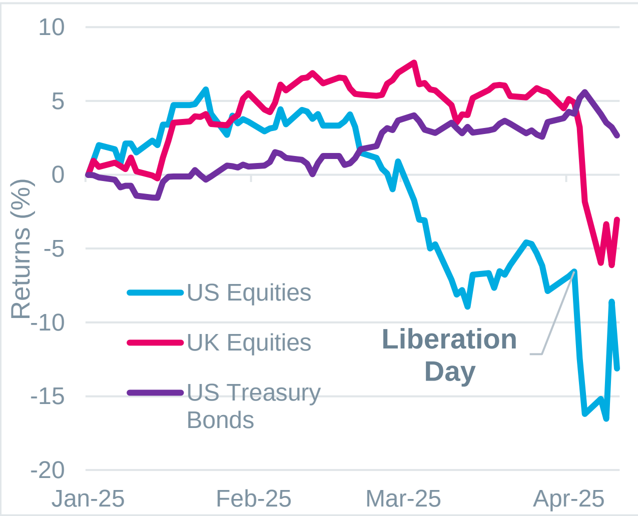
- Economic growth is expected to be lower. The US will feel it most acutely, but the rest of the world, including the UK, will also feel the impact. Concerns over a slowdown will be amplified, with some forecasters now starting to pencil in a US recession.
- Higher inflation in the US (estimated to be 1-2% higher), although this is likely to be a short-term, one-off adjustment to prices. This does, however, draw the US economy closer to the dreaded stagflation environment. The inflation impact on the UK is uncertain, but is not expected to be significant.
- Challenging for equities in short-term, as economic growth slows. Export-heavy businesses will be affected more, as will US small caps, which are more sensitive to the US economy.
- Supportive (ish) for government bonds. The lower growth environment potentially pushing down bond yields, raising bond prices. Some investors will also rotate into less risky assets like government bonds, pushing up prices further. That said, inflation pressures will add some concern to bond investors.

Over the week following Liberation Day, we saw incredible levels of market volatility, as the US market swung between losses and gains. On 9 April, the S&P 500 rose almost 10%, as Trump announced a 90-day reprieve on the reciprocal tariffs for every country excluding China. The baseline 10% tariffs remain in place and China's rate currently (changing almost daily), sits at 145%, so volatility is expected to continue in the near-term.

Government bonds initially acted as a ballast in the storm, providing downside protection to investors. Eventually however, investors started selling US treasuries, driving up bond yields in global bond markets. Reasons for the selloff in the Treasury market include hedge fund derisking, investors wanting to hold more cash, rumours of China dumping their US treasuries, and a general lack of faith in US assets.

Chart of the month

Tariff related uncertainty has hit US equities the hardest but other assets are also volatile



Source: Morningstar. S&P 500, FTSE All Share, 10y US Treasury bond

The chart shows the returns year-to-date for the US and UK equity markets, as well as US government bonds (Treasuries).

At first the US equity market felt most of the impact, but 'Liberation Day' spread the volatility to other asset markets.

Even Treasuries, traditionally a safe-haven asset, started to fall a few days after 2nd April. This looks to have fed into Trump's thinking when announcing his 90-day reprieve.

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Annual market summary: covering the 12 months to 31 March 2025

The key question for investors through 2024 was how fast central banks would start to reduce interest rates. As it turns out, the re-election of Donald Trump was of more importance over the period. A close election was expected, but what we got was an emphatic victory for Trump. Markets quickly pivoted towards 'Trump trades' reflecting the expected winners and losers from Trump's expected policy agenda.

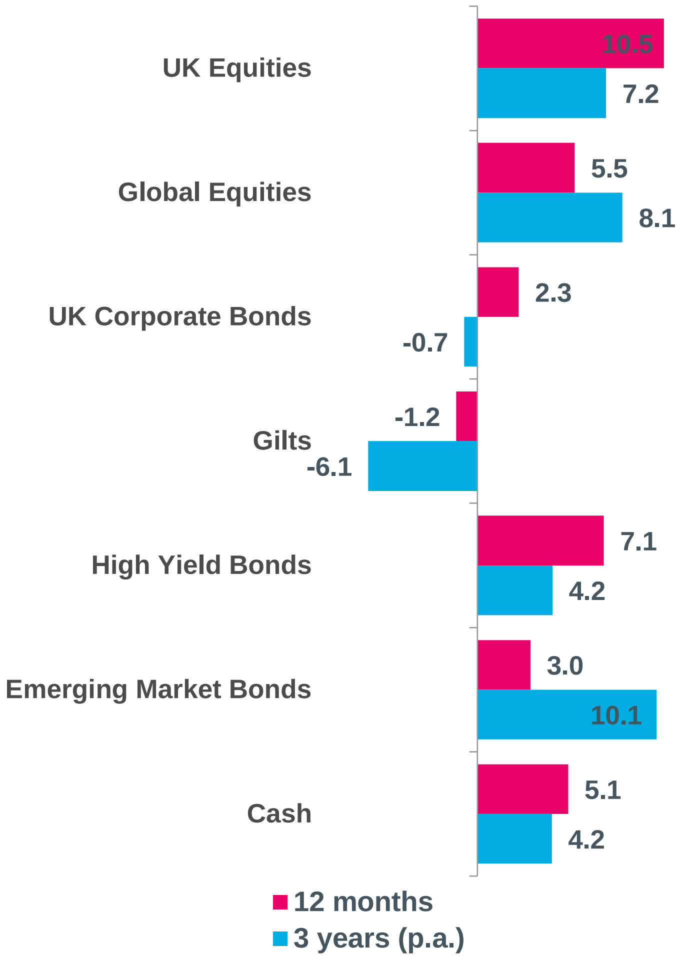
However, investors' early enthusiasm for President Trump's policy agenda started to wane, and then completely evaporated, as Trump prioritised implementing heavy tariffs on trade partners, as opposed to working on the more market friendly policies such as tax cuts and deregulation.

Central banks started on their path towards lower interest rates. The Bank of England cut by 0.75% over the period to 4.5%, while the US Federal Reserve cut rates by 1%. Trump's tariff policies have led to greater uncertainty over the near-term path for interest rates in the US, as inflation is expected to rise in the short term at the same time as economic growth slows.

The first three quarters of the period were largely positive for equity performance, but some gains were given back in Q1 2025. The UK equity market ended the period as one of the top performing regions, after the US market fell heavily in Q1 25. The equity market has continued on a downward trend after 31 March.

Bond performance was mixed over the period, as expectations on inflation and interest rates were ever changing. Although central banks began their rate cutting cycle, bond yields ended up rising over the period. Trump's election victory was a big driver of bond yields upwards, as was the Budget in the UK, and German fiscal stimulus announcements. On top of that, strong US economic growth, and sticky inflation, lowered expectations as to how far central banks will cut rates. Given these events, gilts fell over the period. Performance on corporate bonds, especially high-yield bonds, was better as credit spreads (the additional yield on corporate bonds over government bonds) fell, pushing up prices.

Asset class returns (%)



Source: Morningstar. Figures to 31 March 2025. Returns in sterling terms except High Yield Bonds which are hedged. EM bonds are 50% local currency denominated and 50% US dollar denominated bonds.

Risk warning

The value of your investments and the income from them may go down as well as up and neither is guaranteed. Investors could get back less than they invested. Past performance is not a reliable indicator of future results. Changes in exchange rates may have an adverse effect on the value of an investment. Changes in interest rates may also impact the value of fixed income investments. The value of your investment may be impacted if the issuers of underlying fixed income holdings default, or market perceptions of their credit risk change. There are additional risks associated with investments in emerging or developing markets. The information in this document does not constitute advice, nor a recommendation, and investment decisions should not be made on the basis of it. The material provided should not be released or otherwise disclosed to any third party without prior consent from HRIS.

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