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Investment Management

Window on the World

APRIL 2025

The first quarter of 2025 has been quite eventful, characterised by a succession of market-moving events, each of which, under different circumstances, would warrant detailed coverage in their own right. However, events since the end of the quarter – namely President Trump unveiling a swathe of tariffs on 2 April – are much more relevant and will be the focus of attention in this quarter's update.

CAPITAL MARKET RETURNS Q1 2025

	Total Returns (%)			
	1 Month	3 Months	12 Months	YTD
UK Equities	-2.0	6.1	11.8	6.1
US Equities	-5.6	-4.3	8.2	-4.3
European Equities	-3.8	7.7	6.7	7.7
Japanese Equities	0.2	-3.5	-1.7	-3.5
Emerging Market Equities	0.6	3.0	8.5	3.0
UK Gilts	-1.2	0.5	-1.8	0.5
UK Corporate Bonds	-1.2	0.4	2.3	0.4
UK High Yield Bolds	-0.6	1.9	9.7	1.9
US Corporate Bonds	-0.2	2.4	5.2	2.4
US High Yield Bonds	-1.1	0.9	7.6	0.9

Source: Bloomberg, Verso Investment Management, as of end March 2025

Following two years of above-normal returns, the first three months of this year have been challenging for the US equity market. It has underperformed compared to both developed and emerging market peers, primarily due to heightened uncertainty resulting from US trade policy and its potential impact on the US economy. Since taking office, investors have known that President Trump was likely to impose new tariffs, which he did on Mexican, Canadian and Chinese imports in February, and then followed up with tariffs on steel, aluminium and autos in March. Unsurprisingly, this weighed heavily on market sentiment. Signs of some weakness in the economic data because of these anticipated tariffs didn't help the mood either, and the uncertainty stemming from this meant it was likely the Federal Reserve would hold fire on interest rate cuts. Within US equities, the companies that had been the drivers of returns in 2024 – namely the Magnificent Seven – underperformed the rest of the US equity market. Pleasingly, we were underweight on US equities and the Magnificent Seven across our portfolios.

Outside of the US, and except for Japan, other equity markets fared somewhat better. Europe was the standout performer, posting one of its best performances relative to US equities in some time, and confounding expectations that it would be a net loser under Trump's "America First" policy. The key catalyst for this turnaround and renewed investor flows into the region stemmed from the German election in February, and subsequent plans to dramatically ramp up spending on defence and infrastructure. In addition, the European Commission (EC) President, Ursula von der Leyen, unveiled plans to relax EU fiscal rules to bolster defence spending across the region. Collectively, this raised expectations that the region can deliver better growth in the medium and longer term. Meanwhile, UK equities, where we are overweight, also delivered positive returns as investors focused on undervalued regions.

China led the emerging market higher (we are overweight in both areas), which rallied on expectations of additional financial support for the economy from the authorities. While the earlier unveiling of DeepSeek – an AI model built at a fraction of the cost of Western equivalents – renewed focused on Chinese technology companies, which trade on a compelling discount to their global peers.

Fixed-income markets also performed well, with nominal yields declining in the UK and US, driving a positive return from government bonds. The move lower in yields was more pronounced in the US, as investors moved to price in a slower growth environment and allocated to more defensive and predictable government bonds. Corporate bonds – both investment-grade and high-yield – also rallied, benefiting from the move lower in yields. However, towards the end of the month, the difference between government bond yields and corporate bond yields had shown some signs of widening, a feature that has continued into April, reflecting the uncertainty ahead.

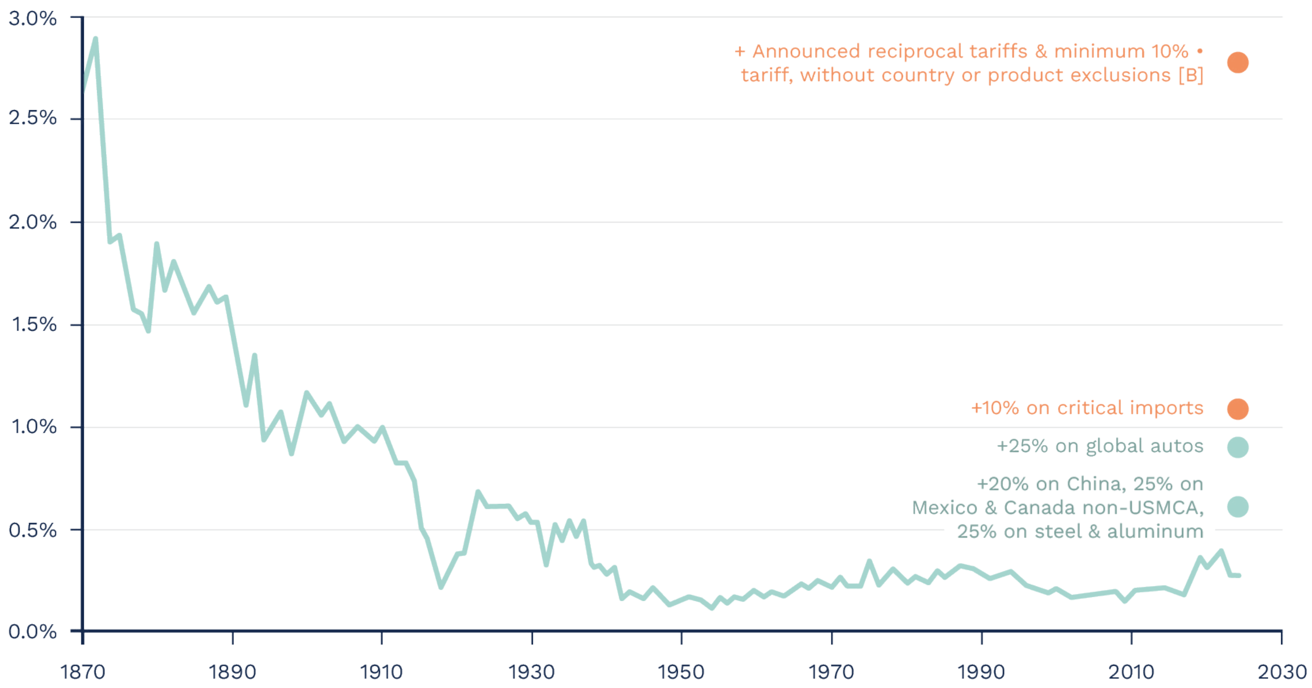
2 April - Liberation Day

Investor fears were elevated going into President Trump's "Liberation Day" on 2 April, but the size of the tariffs unveiled exceeded most economists' expectations. A universal tariff of 10% has been placed on all US imports, taking effect on 5 April.

More crucially, reciprocal tariffs were imposed on 60 nations, and in most cases, at very high levels. Asia looks to have come off the worst, with Chinese imports into the US facing tariffs of 54%, Indian imports 26%, Japanese imports 24%, South Korean imports 25%, and 32% on Taiwanese imports*. Imports from Europe will face a 20% tariff, and in the case of the UK, 10%. These are significant numbers, and if they stay at these high levels, the effective tariff rate on imports into the US will exceed 20%, its highest level in over a century.

**At the time of writing 04/04/25*

\ TARIFF DUTY SHARE OF US GDP, BASED ON THE ANNOUNCED UNIVERSAL AND RECIPROCAL TARIFFS, WILL REACH 3%, LEVELS LAST SEEN OVER 100 YEARS AGO



Source: JP Morgan

Not surprisingly, these tariffs have raised concerns around the prospect of an escalating trade war, accompanied by higher inflation and lower growth, including a possible recession.

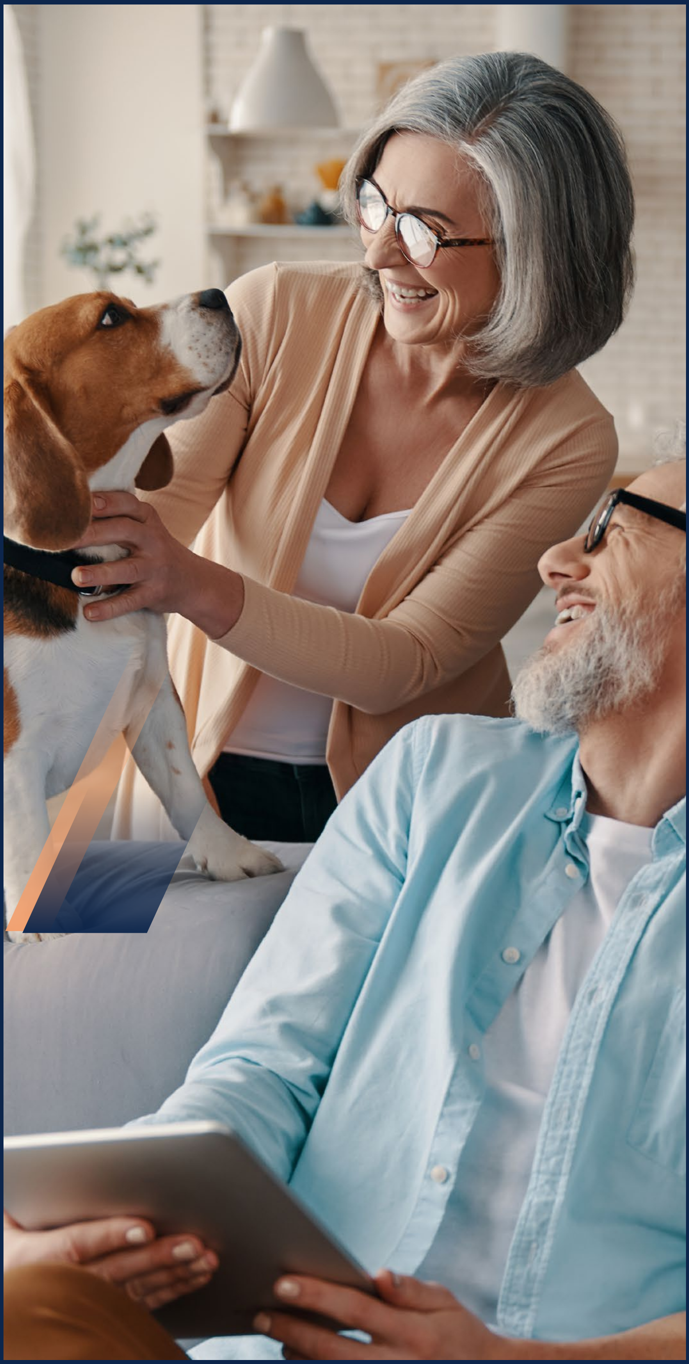
The prospects of a trade war seem likely to depend on countermeasures and responses from the many countries affected, although China has moved quickly to impose 34% duties on all imports from the US. Global equity markets have been quick to exhibit their concerns around these risks with sharp falls across all regions; US equities recorded their worst one-day return since the Covid-19 pandemic in 2020 – and many other indices have also fallen into correction territory (defined as a 10% fall from its peak).

Predicting the investment roadmap in the near term does remain challenging, and investors should remain focused on the longer-term picture. One of the aims of this trade policy is for the US to rebuild its industrial base, create jobs at home, and raise revenues to help improve the country's fiscal standing. The former will take a long time and involve a significant amount of capital investment, theoretically providing support to the economy in the medium and long term. There is also a desire within the US administration to deliver tax cuts this year, which will help to offset the negative impact of tariffs.

President Trump, who authored The Art of the Deal, has likely imposed these high tariff rates in order to bring people to the table and negotiate better trade deals for both parties. As such, it is likely that many of these higher tariff rates will be negotiated lower in the coming weeks, and so mitigating some of the negative economic repercussions.

Nevertheless, the longer the uncertainty around that outcome persists, the more it can filter through to the economy – via delayed capital investment, job cuts, and delayed spending. Key to this is likely to be the US consumer, who remains the core driver behind US growth. With US data showing some softness ahead of the "Liberation Day" announcement, the economy is likely to slow from its very high levels of the previous two years, and a recession cannot be ruled out. There is little doubt that other regions will also experience a slowdown in economic activity.

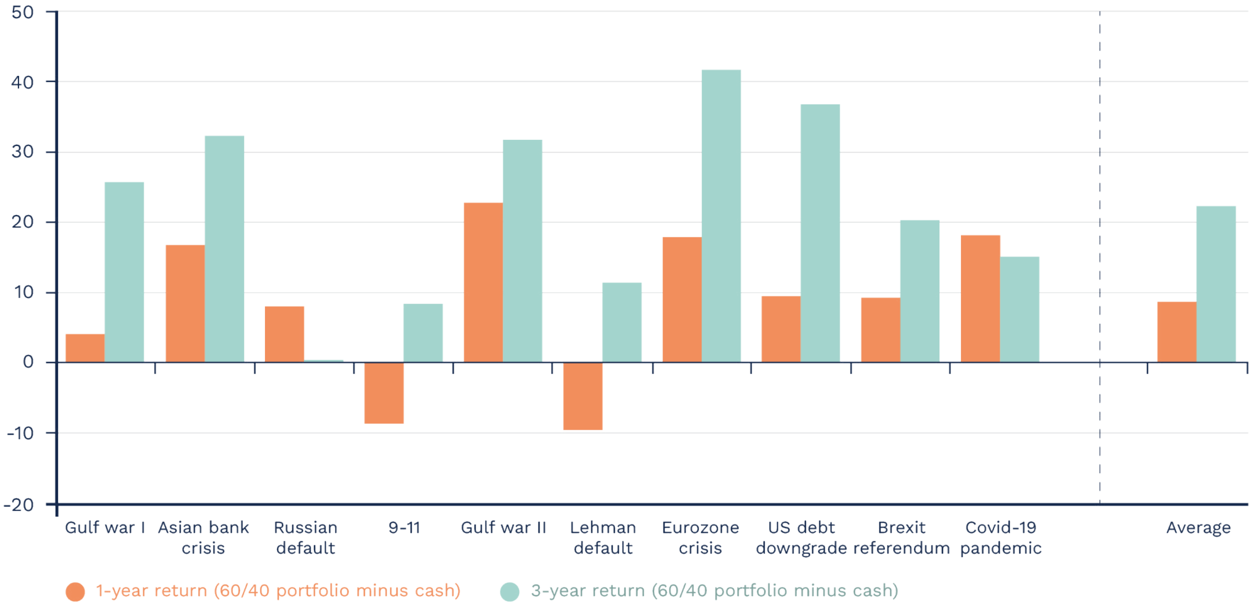
If global growth does slow, then there are several levers that can be pulled to support economies. Some of these countermeasures will include help for industries impacted by the tariffs – by providing subsidies or tax breaks. Central Banks also have a significant capacity to cut interest rates if needed and can revisit previously utilised measures to provide liquidity, including quantitative easing. In addition, as we are seeing in China and Europe, fiscal measures can be used to support and drive capital investment, while also supporting consumers. Expect these to come into play if required.



Corrections in equity markets happen frequently, and history shows us that US recessions happen once every six years. Both are challenging times for investors, and this current episode clearly feels no different. Nevertheless, history also shows us that timing markets is very difficult, time out of the market can be very costly, and it pays to stay the course. In time, market corrections tend to look like small blips on a long-term chart, and the returns achievable following a correction are typically sizeable.

\ OVER THE LONG TERM, A MULTI-ASSET PORTFOLIO OUTPERFORMS CASH BY A WIDE MARGIN, AND RETURNS ARE SIZEABLE FOLLOWING A MARKET SHOCK IN THE FOLLOWING ONE AND THREE YEARS.

Subsequent 1-year and 3-year returns over cash after shocks
% total returns

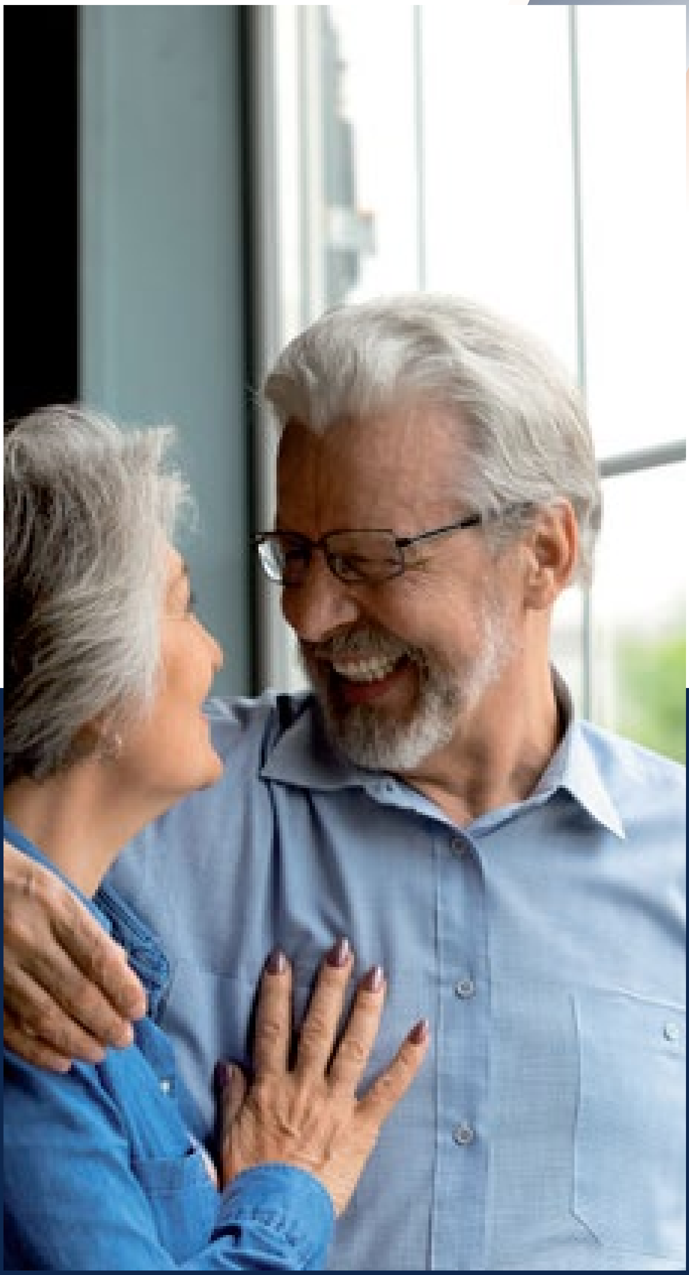


Source: JP Morgan

Portfolio Positioning

There is no question that this deluge of tariffs has created a highly fluid global economic situation, and we're continually assessing their implications and what this means for the global economic outlook, both in the short and long term. Having already positioned our portfolios for a broadening out across markets and, consequently, less dependence on US equities, we believe this remains appropriate, with little need at this stage for large-scale changes to our asset allocation. Nevertheless, we do expect this correction to present some attractive investment opportunities, which we will seek to take advantage of.

Within equities, we hold an overweight to UK and Emerging markets, with the former offering both attractive income and defensive characteristics, as well as being the cheapest developed equity market on valuation grounds. In emerging markets, we are examining the impact on Asia of these higher tariffs, although we do expect ongoing policy support will be provided in China.



We've been underweighted to US equities for a little while and, within that, have an underweight to the Magnificent Seven, which we feel remains appropriate for now. The latter, however, has declined by more than 24% year-to-date. Consequently, valuations are improving, and we are likely to get an opportunity to add to our positions at some stage if it seems appropriate. Within Europe, our weighting has increased as the market rose earlier in the year, and there are grounds for optimism that the region is entering a phase of greater integration and higher growth potential, driven in part by President Trump's stance on foreign policy and trade.

The safe-haven characteristics of government bonds clearly stand out in this environment, with yields moving lower, pushing values higher. Within our multi-asset portfolios, they have continued to prove a good counterbalance this year and still offer attractive income characteristics. We also anticipate that our index-linked exposure will provide attractive inflation-hedging characteristics should, as we expect, inflation move higher. Our corporate bonds positioning is conservative, invested in low-duration credit funds that provide less sensitivity to interest rate expectations and inflation but still provide a solid base for returns.

There's no avoiding the fact that the unprecedented scale of these tariffs is a shock to the global economy and markets and, in time, may result in a reshaping of the global order. This presents both challenges and opportunities to investors, which we have to navigate carefully, trying to avoid the distraction of the elevated noise of the market while focusing on fundamentals, valuations and diversification. That said, we believe uncertainty is going to prevail for a while yet, but central to weathering these types of events is to focus on the longer term and seek value. We believe we're currently well positioned but are also prepared to make appropriate changes should the outlook demand it.

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