Aberdeen MPS

Market highlights in Q1 2025

April 2025

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In what was a volatile quarter for global markets, the broadest index for world equities ended the period down more than 4%. In the face of increased geopolitical tensions, predominantly characterised by a burgeoning tariff war between the US and its trade partners, central banks struck a 'wait and see' tone in the early months of 2025, when considering reducing interest rates. The first quarter of 2025 did, however, see both the Bank of England (BoE) and European Central Bank (ECB) cut rates by 25 and 50 basis points respectively.

January saw the inauguration of Donald Trump, serving for a second term, this time as the 47th President of the United States. Following through with many of his proposals on trade, the new man in the White House set about proposing a long list of tariffs, including a 25% levy against goods from Mexico and Canada, a 10% tariff on Canadian energy imports, 20% on all Chinese goods and a 25% tax on all cars and car parts entering the US. While some measures were withdrawn or delayed, the tit-for-tat tariff war playing out with many of America's traditional trade partners only served to spook investors.

Reflationary worries were also unleashed on domestic shores as the Labour Party's first Budget, announced last year, continually stoked fears into the new year that higher corporate national insurance contributions and an increased minimum wage would force companies to hike prices at the tills. In October, the UK government's official economic forecaster, the Office for Budget Responsibility said that the government would be able to meet that rule with £9.9 billion to spare. However, an increase in government borrowing costs since then, has meant that this headroom has all but disappeared.

Moving in a different direction to the majority of western economies, the Bank of Japan (BoJ) continued to tighten monetary policy over the first quarter, raising Japan's borrowing costs to 0.5% in response to rising wage pressures and services inflation. BoJ Governor Kazuo Ueda commented that "if such moves lead to broad-based inflation across the economy, we must respond by raising interest rates." Japan's core consumer inflation hit 3% in February.

Source: Bloomberg.

Strategic Asset Allocation

- The re-election of Donald Trump as US President has ushered in something of a sea change for global markets during the quarter, with the historically outperforming US market now underperforming its peers in Europe and China. Cracks also started to appear in the US technology index over the period, a previous darling for investors since the pandemic. With the advent of Deepseek, a Chinese artificial intelligence (AI) chatbot that is claimed to require significantly less computational resources to achieve results comparable to ChatGPT, and coupled with various macro headwinds, the tech heavy US market fell into correction territory during the quarter.
- European markets were the standout equity market over the early part of 2025. Investors were drawn to the region's attractive relative valuations, coupled with an accommodative central bank. Further positive news on the continent came in March as Germany's new government agreed to loosen fiscal rules for defence spending. This decision will allow the creation of a special €500 billion fund to boost the country's defence capability as well as implement a number of infrastructure projects. This policy is viewed as monumental in nature and its impact cannot be overstated.
- In the UK, the impact of Chancellor Rachel Reeves's October Budget continued to be felt by markets and the broader economy. The proposed policies are likely to see higher spending, which in turn, has fuelled inflation concerns and is likely to need additional government borrowing. The result was a rise in medium and longer maturity gilt yields during the first quarter of the year as inflation made its way above the BoE's 2% target, having briefly touched 1.7% in September last year. However, it must be noted that the final reading of the quarter saw inflation come in at 2.8%, below the 3% expected.
- The lower growth outlook, especially in the US, has also had a detrimental impact on the US dollar. The trade-weighted US dollar index declined by more than 2% over the first quarter. The decline versus the British pound was even starker, with more than a 3% weakening since the end of 2024. This foreign exchange translation effect will have proved a notable headwind for sterling investors that hold US assets.
- Global Infrastructure delivered solid returns over the quarter, while Global Real Estate Investment Trusts (REITs) faced more of a headwind due to their greater sensitivity to interest rate expectations.

Outlook

01

Higher inflationary pressures are likely to keep the US Federal Reserve (Fed) in a cautious mindset when it comes to cutting rates. The full impact of Trump's economic policies is most likely to be inflationary, although the precise impact of his tariffs is yet to be fully realised. Because of this, we now expect less easing from the Fed than the market is now pricing in.

02

Germany's 'whatever it takes' fiscal policy moment cannot be understated. After years of economic stagnation, the new German government wants to deliver a huge shift in fiscal policy, entailing a significant increase in defence spending and infrastructure investment. With the market focusing on geopolitical tensions, we feel that this shift in thinking has been largely overlooked by markets.

03

Despite the recent pullback in US equities, we believe that the American market should still be supported by strong earnings, while investors in European stocks will find a comfort in cheap valuations and easier fiscal policy.

04

The UK is likely to avoid the brunt of US tariff increases, however the domestic economy is exposed to shifts in financial conditions triggered by both the US and European policy. With the economy slowing, stickier inflation will keep the BoE cutting rates at a "gradual and careful" pace, with two to three 0.25% rate cuts still predicted for 2025.

05

In China, there are green shoots to be found in economic activity data, following recent government policy pivots. However, headwinds from the property market, low consumer confidence and now potential US trade tariffs, are all headwinds that the Chinese government will have to face. Without more consumption focused fiscal support, we believe growth will continue to slow in the world's second largest economy.

Source: Bloomberg.

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