Monthly Market Commentary

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The art of the tariff and AI upheaval

Markets stumbled into February as President Trump's tariff offensive against major trading partners sparked a broad selloff in risk assets, with global equities and currencies particularly hard hit. Equities fell sharply as investors grappled with the implications of 25% tariffs on Canadian and Mexican imports, alongside 10% duties on Chinese goods. The scale of this move dwarfs anything from Trump's first term, amounting to tariffs on $1.4 trillion of imports, with Canada and Mexico alone making up around 30% of US trade.

The Mexican peso tumbled to three-year lows against a surging dollar, while European automakers saw their shares plunge as markets calculated the cost of disrupted supply chains. Some analysts at UBS estimate US growth could be hit as much as 1.1% this year, with Trump himself acknowledging potential pain ahead.

Following ‘friendly conversations’ in which Mexican President Sheinbaum agreed to deploy 10,000 soldiers to curb the flow of fentanyl and illegal migrants, and Canadian President Trudeau created the role of border Tsar with a further $200m of investment on border security, Trump announced a one-month delay on tariffs for both countries. Since this news, markets have pared much of the losses, though Xi Jinping’s retaliation of counter tariffs between 10% and 15% on crude oil, liquefied natural gas, coal, farm equipment and some car exports shows that the Chinese are less inclined to acquiesce to President Trump’s demands.

Beneath the headline volatility, the measured response in credit markets and strong corporate earnings suggests investors have a copy of President Trump’s playbook and view the deployment of tariffs as negotiating tactics rather than permanent economic barriers. This view is supported by Treasury Secretary Scott Bessent's recent comments that Trump is ultimately "a free trader" and uses an "escalate to de-escalate" approach.

The diverging paths of major central banks has added another layer of complexity to the market narrative. The Federal Reserve maintained its cautious stance to further rate cuts at its January meeting. Markets now price in just two rate cuts for 2025, down from four at the start of the year. Meanwhile, the European Central Bank delivered its fifth consecutive rate cut, lowering its deposit rate to 2.75% as the region's economy continued to stagnate, with policymakers signalling more cuts ahead. The Bank of England is also widely expected to cut interest rates this week as the outlook for growth in the UK flounders.

The most surprising development of the month was the sudden success of DeepSeek, a Chinese startup. The company unveiled an AI model matching the capabilities of Silicon Valley giants at a fraction of the cost. This announcement triggered the largest single-day market value loss in Wall Street history, with Nvidia shedding $593 billion. The reverberations extended beyond semiconductors, hitting data centre operators and power utilities that had bet heavily on AI infrastructure expansion.

Corporate earnings have emerged as a bright spot in recent weeks, with fourth-quarter results exceeding expectations. As we approach the half-way mark, US companies are reporting 13.2% profits growth, the fastest pace since 2021. The Financial sector posted the strongest growth in earnings followed by Technology and Communications.

Markets made several adjustments heading into 2025, based on Trump's pre-inauguration rhetoric. This included a stronger dollar, higher bond yields and a selloff in European and emerging market stocks. Despite this, the speed and breadth of Trump's policy actions have surprised investors. While the pain felt by the US economy could be real, it remains far stronger and more able to weather these shocks than other markets underpinned by weaker economies.

We have increased our exposure to higher quality companies in 2025 whilst reducing smaller company, Asian and European allocations. While we see value in a variety of non-US markets, we are mindful of the risks from further economic deterioration. We will continue to monitor economic and market data to best position portfolios in the weeks and months ahead.