Monthly Market Commentary & Volatility Note

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Turbulent times for markets and the world

A measured response is needed to respond to emerging economic trends that are not yet clear.

When President Donald Trump began his second term, he was clear that he would move fast and hard on his agenda. He has not disappointed his supporters.

Recent weeks have been dominated by the implementation of new tariffs, often announced, temporarily paused, and then re-announced at break-neck speed.

In addition, his decision to largely withdraw from US support for Ukraine and even threaten the principles of Nato mutual defence in the mind of European leaders, has led to a broad re-assessment of the framework required for national security across the West.

These actions, of course, come with consequences for the market. The challenge for investment managers is to determine whether the recent economic data driving market movements signals a fundamental shift in the economy or merely a temporary reaction to policy changes.

We have seen evidence of weakening in the US economy. This has come through weak jobs reports and evidence of softening business and consumer sentiment. This can hardly be surprising. The action to reduce the size of the US state by the new Department for Government Efficiency effectively puts 15% of the US workforce on notice that their jobs are at risk, not to mention the millions of jobs associated with US government contracts. Major industry leaders are battling to understand how to cope with tariffs that are of course paid by the importers of goods into the United States, not the exporters. Whilst President Trump shows some willingness to adapt, for example pausing tariffs on automakers for a month on 5th March, triggering a brief market rally, this is hardly a basis for long-term business planning.

The markets have responded in three key ways. Firstly, expectations of US interest rate cuts have built from around one this year to three. This is a significant move and suggests the bond market believes that the risk of a slowdown has grown significantly. Secondly, the US market, as measured by the S&P 500, has fallen by 4.4% over the three months to 5 March. Meanwhile the MSCI Europe index has rallied 8.56% and the FTSE 100 by 5.46%.

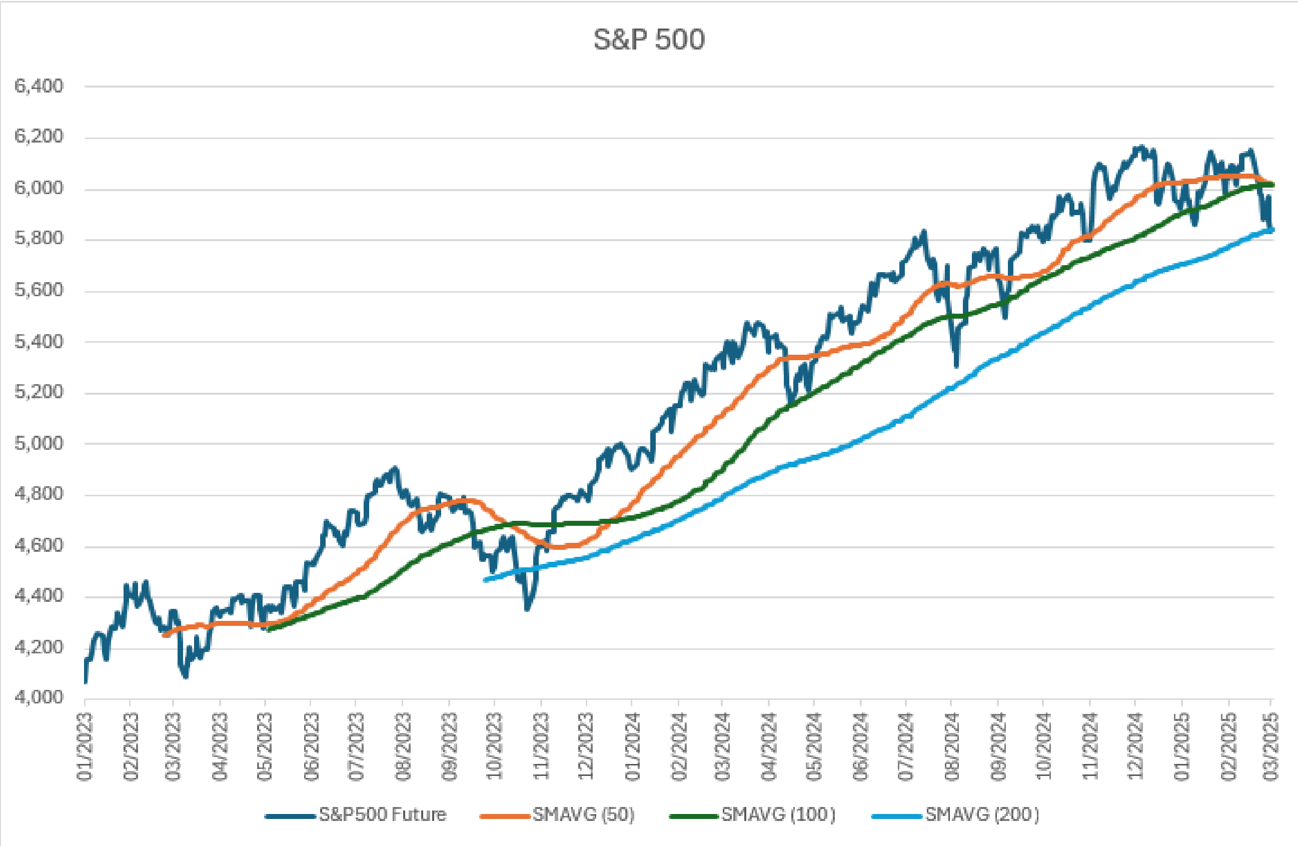
This sharp divergence reflects the view that Europe will need to spend a huge amount of money on its own defence, reinforced by Germany's decision to back away from its spending restrictions. This provides contracts for European businesses and generally boosts the economy. For UK investors, the falls in the US market have been exacerbated by a fall in the dollar.
The question of course is how should one best respond to these changes? At the moment, it is not entirely clear. The evidence we have seen is real of a weakening in the US and indeed a commensurate increase in European economic expectations.

Yet the evidence is only short-lived and built on shaky ground. To be confident that this change is real and not transitory, we believe more data is needed. There are seasonal factors that can often depress these data points at this time of year. After all, European confidence could be undermined in a heartbeat by new aggressive tariffs on the EU which have at times been promised by President Trump; when these tariffs come, they seem to come with little notice or market preparation. Equally, the US market could adapt to the uncertainty of the new president and backed by strong ongoing corporate profits and falling interest rates choose to look through some of these issues. One key boost would be a public comment from the Federal Reserve affirming it is willing to cut rates as economic data softens.

When deciding how to respond to these situations, we are guided by some key principles. Firstly, we should never be intransigent. If the facts change then portfolios should change. Secondly, news and particularly loud news should not in itself lead to knee-jerk reactions. We use a range of tried and tested market signals to reinforce our own analysis about when to make changes in portfolios. Thirdly, we are mindful that rapid reactions to short-term data can so often simply whip-saw investors, taking initial pain without allowing the bounce back that can often follow. Rash reactions rarely work.

One of these signals revolves around the strength of the stock market. We examine the strength of the market over 50 days and 200 days looking at 'moving averages'. A key sign to consider our positioning is when the 50-day strength of the market becomes less than the 200-day strength. At the time of writing, the 50-day moving average is nearing a crossover with the 100-day moving average, as shown by the orange and green lines. While it remains above the 200-day moving average (blue line), the index itself is edging closer to this longer-term trendline, which could indicate a shift in market sentiment if breached.

We will be taking the coming weeks to monitor this data and decide whether it is appropriate to adjust portfolios, or whether the data proves temporary.



Source: Bloomberg, data to 06/03/2025
Past performance is not a guide to future performance

We should note that preparations for a weaker economic environment were already made at the start of 2025 across portfolios with the addition of global quality companies as a new asset class in our optimisation process. Global quality companies are often those best placed to thrive in turbulence. Should the trend we have seen in recent weeks continue further, steps could be taken such as removing residual smaller companies holdings from higher-risk portfolios and considering trimming our exposure to the United States in favour of a resurgent Europe.

For the coming days, though, we believe the right approach is vigilance, allowing the market to measure and price emerging data and see how the political tumult settles. As ever, we stand ready to act appropriately to ensure portfolios are best positioned to cope with a changing world.

We are reminded, as we so often were during the dark days of the pandemic, that it is time in the market not the timing the market that delivers the best long-term returns. Whilst jumping at news may relieve the anxiety created by such turbulent times, ultimately it is often those with cool heads who prevail.