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INVESTMENT SERVICES

Hymans Robertson Investment Services (HRIS)

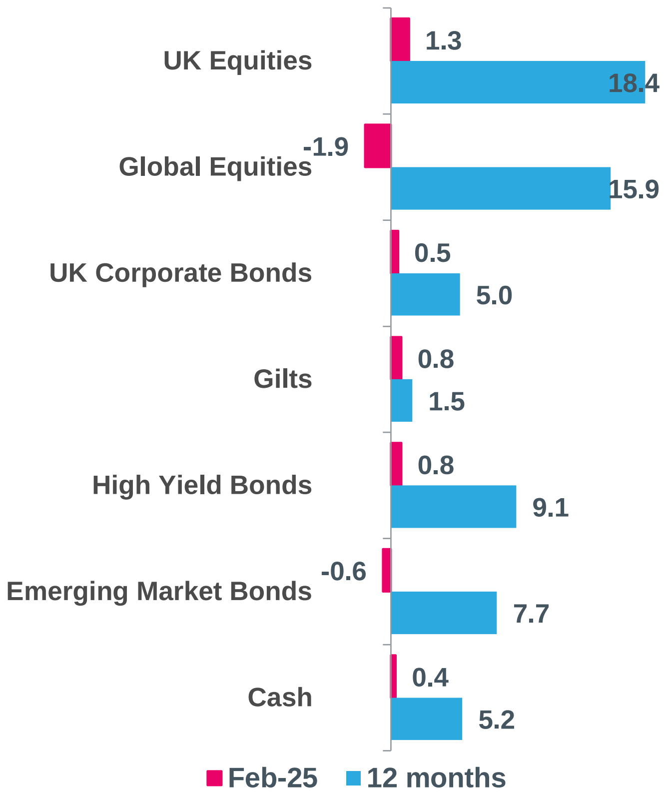
Market digest

February 2025

Monthly highlights

- Tariffs continued to preoccupy investors' thoughts, as President Trump's policy package started to hurt sentiment.
- Global equities fell over the month, but UK and European equities rose, while bonds provided some downside protection.
- On page 3 of this document, we provide market commentary to cover the 12 months to 31 December 2024.

Asset class returns (%)



Source: Morningstar. Figures to 28 February 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.
- President Trump's rhetoric was, once again, centre of attention for investors over February, as the market moved up and down with various tariff announcements. The political uncertainty has led to a pullback in sentiment, especially in the US.
- Global equities fell 1.9% over the month, partly reversing the large gains we saw in January. More expensive parts of the market, such as US technology, felt the pressure more acutely. The UK and Europe emerged as unlikely winners. For Europe, the improvement in outlook from 'very poor' to merely 'weak', as well as the prospect of a ceasefire between Ukraine & Russia, was enough to trigger a sharp rally of over 10% so far this year.
- Within bonds, yields fell (which means prices rose), especially on US bonds, as the weaker sentiment encouraged investors towards safer assets.
- At a portfolio level, bonds tended to outperform equities, resulting in lower risk portfolios producing greater returns than higher risk portfolios over the month.

Outlook and topical market themes

- Escalating trade war tensions will continue to concern investors.
- Sentiment looks poor in the US economy, indicating a slowdown in growth. However, this data is prone to overreaction. The reality is probably a normalisation of growth rates.

Trade war enters its next phase

President Trump raised investor concerns over an escalating trade war by giving no further reprieve for Canada and Mexico, as previously announced tariffs went into effect on 4th March. Further tariffs on China were also enacted. This was met with instant retaliation from Canada and China, who announced tariffs of their own. Mexico said they would announce countermeasures soon. The recent market volatility has been jarring to investors who have seen large drops followed by strong rallies over February as markets weigh up whether Trump is more bark or bite. Although the UK is probably more insulated than most, a knock to global growth and deglobalisation would still be felt due to the openness of the UK economy. For more background on tariffs, see our published article here.

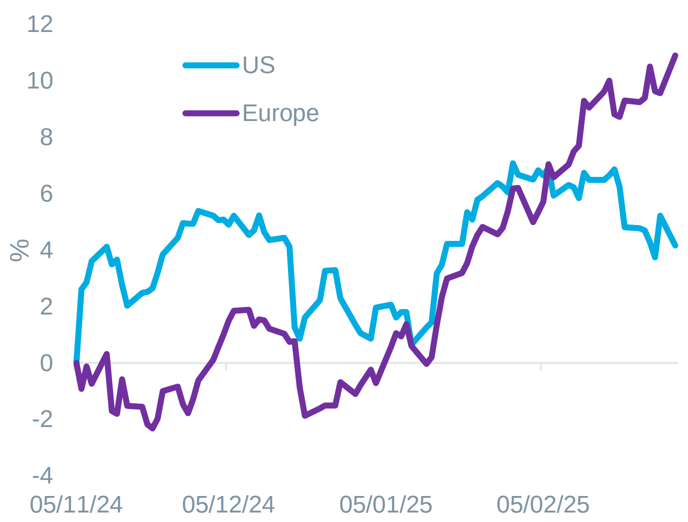
Is the US economy finally slowing?

Investor, consumer, and business sentiment in the US seems to have taken a bit of a hit over the last couple of months. Following Trump's election victory in November, the US stock market rallied sharply, led by smaller companies, as expectations grew that Trump's tax-cutting, regulation-shredding policies would be positive for the US economy and boost corporate earnings. But a shift in focus from the administration towards tariff policies has led to a reassessment. The PMIs, a set of business surveys that are seen as a leading indicator for the economy, showed a sudden drop for the US in January. Consumer sentiment surveys also contracted much more than expected. Rhetoric about additional tariffs has spooked markets, leading to some increasingly volatile dynamics. The VIX, a measure of equity volatility, has risen by about a third since the end of January.

So, is the US economy slowing? Probably, but this is from a very strong growth rate that was never likely to persist. The uncertainty around Trump's policies may have accelerated the economic path back towards a trend-like growth rate, but we don't expect this to be significant or anything approaching a recession this year. The data so far this year has been, what we call, soft data i.e. it is mostly survey data. This has less weight behind it compared to hard data such as formal gross domestic product (GDP) figures. Soft data can be oversensitive to sentiment and prone to overreactions. That said, a sustained period of uncertainty can eventually start to have real economic impacts.

Chart of the month

European equity markets have now outperformed US markets since Trump's election victory



Source: Morningstar.

Trump's election victory caused a sudden and sharp boost to US equity markets. At the same time, European markets fell as investors feared the EU would be a target for tariffs, hurting export-heavy countries like Germany.

Since the start of the year though, European equities have been performing strongly, while the US has wavered. So much so, that the European market has now outperformed the US since the election.

This acts as a useful reminder of how quickly markets can move, and the importance of being well diversified across our portfolios, rather than relying on a single asset class or market to generate returns.

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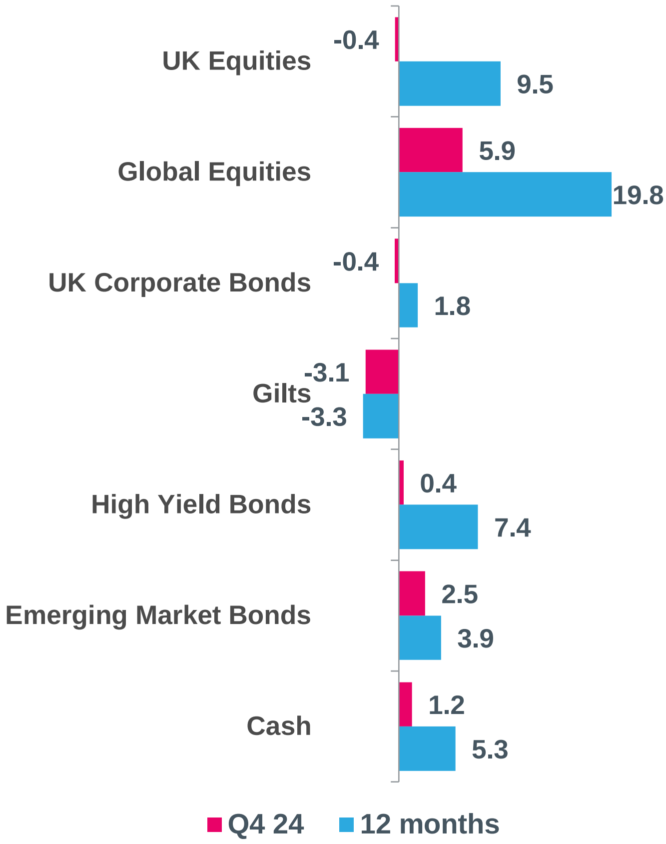
Annual market summary: covering the 12 months to 31 December 2024

The key question for investors going into 2024 was how fast central banks would start to reduce interest rates. Of equal importance was the reason for these cuts. Would it be because inflation had been contained or because of an economic slowdown? The answer, for now it seems, is the former. The Bank of England started cutting rates in August and has done so by 0.5% so far. The Federal Reserve (Fed) started later but has been cutting faster, by 1.0% in total. Economic growth, meanwhile, has held up, especially in the US.

Overall, the equity market had an incredibly strong year as the prospect of falling interest rates, without an economic slowdown, boosted investor sentiment. The strongest performance came from large American tech companies, especially chipmaker Nvidia, as enthusiasm towards leaders in the Artificial Intelligence (AI) sector continued. Even so, there were periods where anxieties towards an economic slowdown briefly appeared. In late August, a couple of weaker-than-expected data points temporarily caused panic around global markets. This spread to the Japanese market which fell by 12% in one day after a rapid strengthening of the yen. The panic was short-lived though, and the global equity market recovered in a matter of weeks.

2024 was dubbed as the year of the election, with over half the world going to the polls. The UK election had a limited impact on markets, given the strong expectation of a Labour victory going into election day. In the US, 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.

Asset class returns (%)



Source: Morningstar. Figures to 31 December 2024. Returns in sterling terms except High Yield Bonds which are hedged. EM bonds are 50% local currency denominated and 50% US dollar denominated bonds.

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. 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, while corporate bonds managed to eke out small gains.