Monthly Market Commentary with Portfolio Manager, Andrea Ciaccio
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Market Review

The first 40 days of the Trump administration has upended decades of domestic, geopolitical and economic policies, challenging key aspects of the post War World II order. In just over a month, the President has signed 76 executive orders, more than the total number he signed in any single year of his first term, and more than any other President in their first 100 days. His “transactional” approach has been widely interpreted as “paradigm shift”, signalling a departure from multilateralism and international cooperation towards a more nationalistic and isolationist attitude. A “global realignment” appears to be underway. On February 4th, Trump signed a directive mandating a comprehensive review within 180 days of all current multilateral organisations of which the US is a member and of all international treaties to which it is party, with the aim of determining whether such support should be withdrawn. His administration has tasked the “Department of Government Efficiency” (DOGE), a new advisory body helmed by Elon Musk, to reshape the federal government by streamlining operations and reducing expenditures. That initiative has led to the abrupt closure of the “United States Agency for International Development” (USAID), a long-established tool of American soft power which had administered humanitarian aid programmes on behalf of the US government since its creation in November 1961. The US spent 68 billion USD on foreign assistance in 2023, with USAID's budget constituting more than half of it at around 40 billion USD. However, Trump has made it clear, he wants overseas spending to be closely aligned with his "America First" policy.

The President moved swiftly in February to make good on the promise he made following his historic win in November to penalise the US’ three largest trading partners. On February 1st, the administration announced blanket 25% tariffs on Mexico and Canada and 10% additional duties on imports from China, justifying those measures on the grounds of a “national emergency” prompted by “the extraordinary threat posed by illegal aliens and drugs, including deadly fentanyl”. Trade tensions escalated significantly, leading to the eruption of a “Trade War 2.0” as Canada and China retaliated, although in a targeted and restrained manner. Trump pivoted a few days later, granting a 30-day pause to the two neighbouring countries in exchange for concessions on their border and crime enforcement efforts, but not to China; as a result, the tariffs on the latter came into force on February 4th. One week later, Trump issued a proclamation raising his 2018 tariffs on steel and aluminium to a flat 25% (from the previous 10%) and eliminating all country exceptions and quota deals. The US is the world's largest aluminium importer and the second-largest steel importer, with more than half of those volumes coming from Canada, Mexico and Brazil. On February 13th, the President signed a memorandum on reciprocal trade and tariffs aimed at addressing perceived imbalances by imposing tariffs that match those levied by other countries on American products. The plan applies to all US trading partners, including close allies, and has a broad scope. It directs the federal government to conduct a review of, among others, tariffs and taxes, including value-added tax (VAT), and non-tariff barriers the likes of subsidies, burdensome regulatory requirements and exchange rates, and to provide its recommendations by April 1st. The implementation is set to begin shortly thereafter with the imposition of tariffs on imports from countries that have higher tariffs on American exports.

It is speculated that the second term of Trump will mark the “end of Pax Americana”, a potential, seismic transformation that is already causing widespread consternation in the Western World and in countries that rely on US military backing, such as Japan, South Korea and Taiwan. Secretary of State Marco Rubio has recently stated that having a unipolar power was an “anomaly”, “a product of the Cold War”, and that “eventually you were going to reach back to a point where you had a multipolar world, multi-great powers in different parts of the planet”. For his first trip outside of the US as Vice President, J.D. Vance chose to visit Europe. On February 14th, he delivered a keynote speech at the 61st Munich Security Conference in which he strongly criticised European governments, focusing on free speech, immigration, and democratic principles. He emphasised that the greatest threat to Europe is its retreat “from some of its most fundamental values” shared with the US and, as such, it comes from within rather than from external actors like China or Russia. He also briefly mentioned European defence spending and the situation in Ukraine, echoing Trump’s call for the Old Continent to increase its contribution to its own security. However, the most visible and dramatic break with traditional diplomatic norms occurred on February 28th, during a televised Oval Office meeting among Trump, J.D. Vance and Ukrainian President Volodymyr Zelensky. The discussion, originally intended to strengthen ties and sign a mineral deal, spiralled into a confrontation after Zelensky pushed back at the suggestion that he should agree to a ceasefire with Russia, even without clear security guarantees from the US. The Vice President criticised Zelensky for being “disrespectful”, not expressing enough gratitude for American support and “litigating” the dispute in front of the media. Trump accused Zelensky of “gambling with World War III” and conclusively stated that “you’re either going to make a deal or we're out, and if we're out, you'll fight it out. I don't think it's going to be pretty”.

International Equities

The White House’s newfound “move fast and break things” ethos weighed on US equities in February. Wall Street sentiment soured amid softer economic data and worries over the frenetic pace at which Trump is shaking the status quo. The Dow Jones Industrial (-1.58% in USD terms) and the S&P 500 (-1.42%) outperformed the Nasdaq 100 (-2.76%) for the month, with the latter index falling into negative territory since the beginning of the year. The “Magnificent Seven” slumped while the rest of US large caps ended February modestly in the black, recording their 3rd best month ever vis-à-vis the tech behemoths. Tesla crashed out of the 1 trillion USD club after sales of its vehicles in Europe sank -45% YoY in January, with its market share there almost halving from 1.8% to 1%. Amazon dropped double-digits after announcing that it will spend nearly an entire year of revenues generated by Amazon Web Services (AWS) cloud for investments in AI servers and data centres. Not surprisingly, consumer discretionary was the worst performing sector for the month as the two names account for more than 30% of its composition. Technology and industrials underperformed the general index, while communication services and materials curbed losses. All other sectors rose, with consumer staples, real estate and energy posting gains ranging from +3% to +6%. As a result, the S&P 500 Low Volatility TR Index beat the S&P 500 High Beta Index by the most since June 2022, as the so-called “momentum trade” started to unwind mid-month.

US equities underperformed the rest of the world (as exemplified by the MSCI AC World Index ex USA TR Index) for the third month in a row and by the largest amount since December 2022. Europe topped the list, buoyed by banks and defence stocks; the former recorded robust corporate earnings and unveiled plans for record dividends and share buybacks, while the latter rallied on expectations of increased military spending. Emerging markets beat the general index as the so-called “Terrific Ten” group of stocks, that is, China’s top tech firms, continued their recovery. Conversely, Japan lagged as AI-related stocks and exporters sold off. All in all, the MSCI AC World Daily TR was down -0.60% in USD terms, but up +0.20% in AUD terms.

Australian Equities

Australian equities continued to struggle vis-à-vis their international peers in February, as the MSCI Daily TR Net Australia Index underperformed the MSCI AC World Daily TR Index for the fifth month out of the last 6. The S&P/ASX 300 tumbled -3.79%, weighed down by technology, healthcare, A-REITs, energy and banks. Several stocks experienced disproportionate price movements in response to reasonable results, primarily on the back of downgraded earnings forecasts. Westpac and NAB fell hard after missing expectations, prompting investors to lock in profits in the sector and look for cheaper opportunities in defensives. Utilities, telecom, consumer staples and industrials bucked the trend, propelled higher by the respective index heavyweights. Origin Energy, Telstra and Brambles were standout performers for the month. Smaller companies outperformed the Top 20, while mid-caps lagged. Finally, value stocks interrupted a 3-month losing streak vis-à-vis growth stocks.

International Fixed Income

February was a relatively uneventful month for global central banks, with only two meetings ensuing in a cumulative 50 basis points of cuts. On February 6th, the Bank of England's (BOE) Monetary Policy Committee (MPC) voted 7-2 to lower its official bank rate by 25 bps to 4.5%, its third reduction since August 2024. Two dissenting policymakers voted for a larger 50 bps cut, prompting markets to boost bets on further easing. The communication from the central bank was mixed. It revised its inflation expectations sharply higher on the back of regulated price hikes. At the same time, it suggested that it may look through the inflationary spike and indicated that only two more cuts may be needed to bring inflation back to its 2% target. On February 19th, the Reserve Bank of New Zealand (RBNZ) lowered its Official Cash Rate (OCR) by 50 basis points, from 4.25% to 3.75%, its fourth consecutive cut since August 2024. The central bank reiterated its dovish stance despite having delivered 175 bps of easing in the last 6 months. Governor Orr forecasted a lower terminal rate compared to that provided in the November projections and signalled two more 25 bps reductions in April and May.

The Bloomberg Barclays Global Aggregate Index hedged back to AUD added +1.20% for the month. Yield curves steepened around the world, with rates falling the most in the US. Conversely, credit spreads diverged, widening in the US and tightening in Europe. In general, investment grade, primarily within the banking sector, were the best performing segment, while high yield, leveraged loans and emerging markets lagged.

Australian Fixed Income

On February 18th, the RBA joined the global easing wave by delivering its first, long-awaited 25 basis point cut. After having kept the cash rate at 4.35% since November 2023, the central bank finally lowered it to 4.10%, its first reduction since October 2020. In the accompanying statement and in the press conference, Governor Bullock maintained a hawkish rhetoric, going as far as explicitly stating that "today's decision does not imply that further rate cuts along the lines suggested by the markets are coming". The central bank acknowledged that "monetary policy has been restrictive and will remain so after this reduction in the cash rate" but cautioned that "if monetary policy is eased too much too soon, disinflation could stall". At the end of the month, the cash futures were pricing two additional cuts in the second half of the year. The domestic yield curve transposed lower, with the 2, 5 and 10-year yields declining 7 bps, 10 bps and 14 bps respectively to 3.73%, 3.89% and 4.29%. The Bloomberg AusBond Composite 0+ Yr rose +0.93%, while the Australian Dollar re-tested or fell past its recent lows vis-à-vis all major developed and emerging currencies.

Real Assets

Global property gained +2.53% in USD terms and +1.72% in AUD terms in February. The US rebounded strongly to top the list. Australia bucked the trend, as Goodman Group announced its first capital raise in 12 years to develop a global network of data centres. However, during the month Microsoft reportedly cancelled multiple data centre leases across the US, potentially indicating a slowdown in AI-related spending.

Global infrastructure was down -0.43% in USD terms but up +0.37% in AUD terms for the month. Utilities and communication infrastructure outperformed the general index, while transportation stocks lagged. Companies reporting disappointing results faced above average volatility.

Alternatives

Returns for Alternatives (+0.28%) were mixed across strategic mandates in February, with performance dispersion increasing during the month. Event Driven and fixed income led gains, while Long/Short equities and discretionary macro managers suffered losses.

Market Outlook

US equities have entered a correction phase after the S&P 500 and the Nasdaq 100 slid -10.46% and -13.81% respectively in USD terms between February 19th and March 13th. Market corrections, as recently highlighted by the US Treasury Secretary Scott Bessent, are "normal" and can be "healthy" for the market. Historical data supports his perspective. Corrections of -10% or more from all-time highs have occurred 48 times since World War II and only in 25% of the cases they spiralled in a full-blown bear market, that is, in stock prices falling by 20% or more. Typically, a market decline exceeding that level requires a significant event, such as a financial crisis or a recession, marked by a dramatic economic downturn and a spike in unemployment. Hence, the critical question now is whether such an event is on the horizon, and our assessment is that neither is likely in the coming months, although cracks have undoubtedly begun to appear. At the end of January, the US Economic Policy Uncertainty (EPU) was at its highest level since the onset of the pandemic in 2020. More worryingly, the US economy appears to have become highly sensitive to sudden movements in the stock market given its elevated degree of financialisation. As a result, the erasure of 5.28 trillion in market capitalisation in about three weeks (as calculated by FactSet) have tightened financial conditions and have the potential to flow through to consumers pretty quickly via the so-called "reverse wealth effect". However, tight credit spreads, a price of oil stuck in a trading range around 70 USD per barrel, lower interest rates and a softening US Dollar seem to point to a more benign outcome. As one astute commentator has observed, our base case is not a recession, but rather a "rebalance". We anticipate three primary rebalances in the first half of 2025: one of the US economy, one of the Treasury market, and one of investment flows and portfolios.

Bessent has repeatedly emphasised that during the Biden administration the US economy was artificially propped up by excessive government spending. This has resulted in record budget deficits year after year and in an escalating cost of servicing public debt, but it has also positively impacted companies' earnings, bolstering the stock market. His plan is to shift the economy from a government-supported growth model to one driven by the private sector, where innovation and productivity are the primary engines. However, that transition is not going to be easy. Bessent has likened the process to a "detox" that the US economy must undergo. We think that he will pursue this objective by deliberately frontloading the "bad" aspects of the agenda promised by Trump during his campaign trail, namely, implementing tariffs, restricting immigration, and curbing fiscal spending, to induce a "controlled" slowdown in the short term. Reigning in the profligacy of Uncle Sam appears to be a particularly pressing issue at the current juncture; in fact, in the first 5 months of the fiscal year 2025 the budget deficit has ballooned to an alarming 1.1 trillion USD, equivalent to 7.2% of GDP and one-third larger than it was back in 2024, on the back of out of control outlays. GDPNow, the "nowcasting" model created by the Federal Reserve Bank of Atlanta to provide a running estimate of the real US GDP growth, indicates that a significant economic deceleration extending beyond import figures may be underway. In our opinion, that trend will persist and gain traction going into Q2, ultimately morphing into a "growth scare", but not escalating into a recession. If the administration's rebalancing efforts are successful, we expect the long end of the yield curve to decline, signalling to the FED that its monetary policy is too tight and that it has to cut rates to prevent the yield curve from inverting once again. At that point, the central bank's response will be crucial. In our opinion, it may end up having to cut by the 100 bps it was projecting at the end of September, resume its easing campaign sometime in the second quarter, and potentially restart Quantitative Easing (QE) in the second half of the year.

In a recent interview Bessent stated that he and Trump want "lower rates", but that their focus is the 10-year yield and not the FED target rate. That makes sense, because effectively manipulating the former down by appropriately "sequencing" the President's priorities should de-facto lead to a reduction in the latter subsequently. In addition, it would bring two other considerable economic benefits. First, it would lessen the US Treasury's interest payment obligations and mitigate the impact of the slowdown by unlocking mortgage refinancing. The administration could then trigger a recovery by implementing the "good" aspects of the MAGA agenda, that is, tax cuts and deregulation, in the context of a revived housing market. More crucially, it would provide the US Treasury with the opportunity of issuing more long dated bonds to extend the maturity profile of the public debt, which currently sports a duration of just 3.5 years. In fact, in the past two years, the government opted to finance 60% of its burgeoning liabilities with bills. Former Treasury Secretary Janet Yellen refrained from tapping the long end due to the perceived unwillingness of the market to absorb the issuance of the "coupons" required to finance the massive fiscal largesse resulting from "Bidenomics" that was keeping the economy (and the inflation) "hot". Bessent has thus inherited a dysfunctional Treasury market and is keen to "rebalance" it given that the current predicament presents an acute risk for financial stability. In short, we think that, after having grown above 5% for the past 15 consecutive quarters, nominal GDP in the US is poised to moderate to a number closer to 3%, which would translate into a modest expansion once the rate of inflation is deducted. Hence, we remain comfortable maintaining a fixed income exposure characterised by a duration comparable to that of the benchmark, particularly in Australia, where we think that rates are too high relative to economic reality.

The final and most relevant rebalance is the one that directly affects investors. The US market has been the strongest performer over the past decade, driven by superior economic and earnings growth, higher interest rates and a strong dollar. However, the ongoing "rebalances" detailed above are challenging the pillars of the "American exceptionalism" notion, prompting global investors to reconsider the quantum of their exposure to US equities. Currently, they constitute roughly 75% of the MSCI World Index and 66% of the MSCI All Country World Index, which includes emerging markets in its composition. However, we suspect that several large allocators could be even more skewed towards the US given that any other regional positions have virtually been a detractor to returns up until the end of 2024. International markets such as Europe and China held well in February, and they have continued to perform strongly in March. The German parliament has just passed a historic bill amending the country's constitutionally enshrined fiscal rules, thus clearing the way for a historic debt-funded investment package for defence and infrastructure which could run to 1 trillion EUR over the next decade. China has seen continued government support for the economy, particularly in technology and AI sectors. Beijing chose to make its backing crystal clear on February 17th, when President Xi Jinping was briefly shown on national television shaking Jack Ma's hand at a meeting between Chinese leaders and the heads of China's biggest technology firms. The gesture denotes a rehabilitation of Alibaba's founder, who had disappeared from public eyes at the end of 2020 after having criticised the country's financial regulatory system. Putting it all together, we expect capital to flow out of US equities and into the Rest of the World (RoW). As those markets have been neglected for so long, they are poised to attract more capital as they outperform, prompting further investment, potentially giving rise to a self-reinforcing trend. Diversification will become once again an essential strategy for investors going forward, and the most critical tool to navigate the volatility and the chaos unleashed by the remaking of America, and of the world, triggered by the return of Trump.

AZ Sestante

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Important information

The Morningstar Historical Corporate Sustainability Score is a weighted average of the trailing 12 months of Morningstar Portfolio Corporate Sustainability Scores. Historical portfolio scores are not equal-weighted; rather, more-recent portfolios are weighted more heavily than older portfolios. Combining the trailing 12 months of portfolio scores adds consistency while still reflecting portfolio managers' current decisions by weighting the most recent portfolio scores more heavily.

ESG pillar scores are displayed as a number between 0 and 100 with most scores range between 0 and 25. It is the asset-weighted average of the company environmental, social, governance risk scores for the covered corporate holdings in a portfolio. The scores measure the degree to which a company's economic value may be at risk driven by environmental, social, and governance factors. The risk represents the unmanaged risk exposure after taking into account a company's management of such risks.

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