Monthly Market Commentary with Portfolio Manager, Andrea Ciaccio
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Market Review

The US has recorded a net foreign trade deficit in goods and services every quarter save one (Q1 1992) since the second quarter of 1976. In other words, the US has imported from the Rest of the World (RoW) more than it has exported for almost 50 years, with the imbalance growing more acute over time. The Trump administration is determined to change the status quo and to bring manufacturing back to the US shores. However, one overlooked aspect of the present geopolitical equilibrium is that, because the US buys more goods from the RoW than it sends to, the RoW invests more in the US than Americans invest abroad. In fact, in exchange for their excess produce foreigners receive US Dollars, that is, claims on American wealth. Those greenbacks are then used to purchase financial and physical American assets, including Treasuries, corporate bonds and stocks. In short, the other side of the coin of the US having a persistent and large trade deficit is that the country has also been running an equally sized investment surplus. The insatiable demand of American assets coming from abroad has been one of the key pillars of the "American exceptionalism", and, as a result, the remaking of the American and global economies triggered by the return of Trump may cause tectonic shifts in international investment flows.

Latest cross-border data seems to validate the thesis of a developing overseas exodus from the US. According to the official Treasury International Capital (TIC) flows data, foreign central banks net sold US equities at the fastest-ever pace in January as they liquidated 28 Bil USD. In addition, net sales of all US assets by the private sector totalled 75 Bil USD, an abrupt reversal from the average 1 Trillion a year of net purchases occurred between 2022 and 2024. In fact, in the past three years alone foreign investors had accumulated 3.25 Trillion USD of US assets, increasing their ownership of US equities to 18%, its highest level since 1945 according to Goldman Sachs data. European allocators in particular were engaged in the "repatriation" of their capital, as in March they rotated 2.37 Bil USD away from US equity ETFs into local European equity ETFs, as well as into vehicles focused on the Asia-Pacific region and emerging markets. The German market was an obvious beneficiary of that trend, capitalising on the historic decision of the Old Continent's biggest economy to ditch more than 15 years of self-imposed austerity and to embrace fiscal spending on defence and infrastructure. Chancellor-in-waiting Friedrich Merz pledged to do "whatever it takes" to defend the country, igniting a furious rally in the domestic stock market. As a result, in Q1 2025 the MSCI Daily TR Net Germany outperformed the MSCI Daily TR Net USA by more than 20% for only the fifth time in its history.

The remarkable aspect of the outperformance of the German market is that it happened in the context of US equities selling off. Such an event is even rarer and points to a "paradigm shift" in the financial system, with long-standing correlations among markets and asset classes potentially breaking down. Indeed, the gyrations recorded in currencies, in fixed income and in commodities during Q1 were anything but usual. As the MSCI Daily TR Net USA dropped -4.60%, the Dollar Index (DXY) declined -3.94%. Once again, to observe a softening of the US Dollar of such a magnitude at a time of sinking equities requires going back to the Great Financial Crisis (GFC) of 2008 and, before that, to the burst phase of the Dot-Com bubble in 2001-2002. Interest rates were another anomaly. While the US 10-year yield fell 36 Bps, from 4.57% to 4.21%, as investors flocked to Treasuries as a safe haven, the same did not hold true in the European Union and in Japan, respectively the second and the fourth largest bond markets in the world. The Germany 10-year yield shot up 37 Bps, from 2.37% to 2.74%, while the Japan 10-year yield added 12 Bps, from 1.38% to 1.50%, reaching its highest monthly closure since July 2008. At those levels, they both look more attractive than Treasuries to European and Japanese investors who hedge their US dollar exposure when buying US securities.

It is speculated that the policies pursued by the Trump administration may diminish the allure of Treasuries as global reserve assets. Apart from their own domestic government bond markets, foreign investors may choose to divert their capital flows into key resources. China for example has recently announced its intention to accelerate the annual stockpiling of strategic fuels, food and other commodities. Copper jumped to new all-time highs in March, but the movement appears to have been prompted by the fear that tariffs will be imposed on the imports of the red metal rather than by a deliberate diversification strategy. Conversely, the rally in gold may be an early indicator that the "golden age" promised by Trump could be more beneficial for the yellow metal than the US. In fact, Stephen Miran, the Chairman of the Council of Economic Advisers, has put forth the proposition of a "Mar-a-Lago Accord" to lower the value of the US Dollar in international markets. His solution entails foreign countries "voluntarily" swapping their holdings of short-term US Treasuries into long-term, zero-coupon obligations, including century bonds, at a much lower implicit yield. The prospects of such an unorthodox policy may be one of the reasons behind the accumulation of gold by central banks, which in 2024 added 1,045 tons to global bullion reserves. Gold surged +18.8% in Q1 2025, ending March above 3,000 USD per troy ounce for the first time ever and outperforming a declining US stock market by more than 20%.

International Equities

US equities fell for the second month in a row in March. The S&P 500 (-5.75%) and the Nasdaq 100 (-7.69%) dropped the most since December 2022 and underperformed the Dow Jones Industrial (-4.20% in USD terms). All three averages fell into negative territory since the beginning of the year, with the latter one curbing losses on the back of its higher exposure to "Old economy" sectors. The "Magnificent Seven" sank, underperforming the rest of US large caps for the third month out of 3 in 2025, and giving back the entire outperformance they had generated in Q4 2024 leading up to and following the historic election of Trump. In a stunning and quick reversal, the "animal spirits" rekindled by the promises of tax cuts and deregulation made way for exhaustion and concerns about potential adverse effects on the tech behemoths, prompting the "Mag7" to morph into the "Lag7". Tesla and Amazon continued to weigh on consumer discretionary, with the electric car maker becoming the target of a protest movement. Technology and communication services underperformed the general index, while consumer staples, healthcare, real estate and materials curbed losses. Energy and utilities bucked the trend, ending the month in the black. As a result, the S&P 500 Low Volatility TR bested the S&P 500 High Beta by the most since March 2020 as the unwinding of the so-called "momentum trade" gathered speed.

US equities underperformed the rest of the world (as exemplified by the MSCI AC World Index ex USA TR Index) for the fourth month in a row and by the largest amount since November 2022. All major regions outside of the US bested the general index. Emerging markets topped the list, buoyed by the so-called "Terrific Ten" group of China's top tech stocks. India and Latin America posted strong gains as well. Concerns of a global economic slowdown ignited by US tariffs on cars and other goods weighed on Europe and Japan. Finally, the MSCI World Value Index recorded its 8th best monthly outperformance ever vis-à-vis the MSCI World Growth Index. All in all, the MSCI AC World Daily TR was down -3.95% in USD terms and -4.50% in AUD terms.

Australian Equities

Australian equities extended their losses in March while marginally outperforming their international peers for the second month out of 3 in 2025. However, at the end of the quarter the MSCI AC World Daily TR remained ahead of the MSCI Daily TR Net Australia since the beginning of the year. The S&P/ASX 300 tumbled -3.34%, weighed down by technology, consumer discretionary, A-REITs and healthcare. Names such as Aristocrat Leisure, Treasury Wine and Breville sold off sharply on the back of their exposure to international markets in general and to the US consumers in particular. Conversely, consumer staples companies with a domestic focus held up better. Materials ended the month modestly in the red, helped by positive returns within the mining sectors, primarily in gold. Banks and energy outperformed the general index, while insurance and utilities bucked the trend, propelled higher by the respective index heavyweights. Mid-caps and smaller companies lagged the Top 20. Finally, value stocks bested growth stocks by the most since April 2023.

International Fixed Income

On March 5th, Adrian Orr, Governor of the Reserve Bank of New Zealand (RBNZ), resigned with three years still to run in his second five-year term. His refusal to lessen the strict capital requirements for Australia's four major banks he announced back in 2019 was a factor in his sudden departure. Global central banks cut by a cumulative 75 Bps during the month. On March 6th, the European Central Bank (ECB) lowered its policy interest rate for the sixth time, from 2.75% to 2.50%. In her press conference, President Lagarde reiterated that policymakers were unable to pre-commit to a rate path given the "huge uncertainty". On March 12th, the Bank of Canada (BOC) reduced its benchmark overnight rate by 25 Bps to 2.75%, its seventh consecutive reduction since June. On March 19th, the FED kept rates unchanged and announced a further scaling back of the pace of its quantitative tightening, lowering the cap on the amount of Treasury securities rolling off from 25 Bil USD to 5 Bil USD each month. Chairman Powell struck a dovish tone during his press conference, stating that the potential price increase caused by tariffs may prove to be "temporary" and that it could be "appropriate" for the central bank to look through them. Finally, on March 20th the Swiss National Bank (SNB) reduced its policy rate for the fifth time by 25 Bps, from 0.50% to 0.25%.

The Bloomberg Barclays Global Aggregate Index hedged back to AUD shed -0.44% for the month as Germany's bonds kicked off March with their worst week since the reunification in 1990 and credit spreads widened. Yield curves continued to steepen around the world; however, in the US the short end fell faster than the long end while in Europe the long end rose faster than the short end.

Australian Fixed Income

According to the Australian Bureau of Statistics (ABS), the domestic economy unexpectedly lost 52,800 jobs in February. The unemployment rate held steady at 4.1% as the participation rate declined to 66.8% from a record high of 67.3% in January. In addition, the monthly indicator of consumer prices (CPI) decelerated to +2.4% YoY, below the consensus forecast of +2.5%, and the CPI Trimmed Mean ticked down to +2.7%, remaining within the RBA's target range. Domestic fixed income rose for the fifth consecutive month, ending the quarter solidly ahead of global bonds. The Bloomberg AusBond Composite 0+ Yr was up +0.17% in March. The 2- and the 5-year yield were 5 and 3 Bps lower at 3.68% and 3.86% respectively, while the 10-year yield increased by 9 Bps to 4.38%. At the end of the month, the cash futures were pricing a 25 Bps cut in May, and two additional reductions in the second half of the year. The Australian Dollar marginally strengthened vis-à-vis the US Dollar, while softening sharply against European major currencies.

Real Assets

Global property was down -1.97% in USD terms and -2.52% in AUD terms in March. Asia was the only region to post gains on the back of the resilience exhibited by Singapore's REITs. Australia was at the bottom of the list as weakness in data centres weighed on Goodman Group. The CoreLogic - Median City Values rose to a fresh high in March, led by the key Sydney and Melbourne markets.

Global infrastructure soared +2.39% in USD terms and +1.82% in AUD terms for the month. Utilities bested the general index, while transportation stocks lagged. European infrastructure construction companies jumped on the news of the proposed German fiscal stimulus.

Alternatives

Alternatives (-0.77%) outperformed global equities in March. Returns were mostly negative across strategic mandates, with performance dispersion increasing during the month. Discretionary macro managers recorded gains, while Long/Short equities suffered losses.

Market Outlook

Trump shocked markets when, on April 2nd, he unleashed new “Liberation Day” tariffs on 57 named countries and the European Union. In fact, those levies, customised to each trading partner and calculated on bilateral trade imbalances, were instituted at levels substantially exceeding investors’ expectations and preparedness. As a result, the S&P 500 crashed -10.53% between April 3rd and April 4th, erasing 5.38 Trillion USD in market capitalisation, its fifth steepest two days of losses since 1950. However, the President had another surprise in store for markets. One week later, he suddenly changed course, and, on April 9th, he announced a 90-day pause on what the administration had termed “reciprocal” tariffs, subjecting imports from all trading partners except for China to a flat 10% duty. The S&P 500 roared back, jumping +9.52% in a single day, its 8th largest daily percentage gain in history. In our opinion, the elevated figures initially proposed will not be reinstated as they are unlikely to represent the final policy. They appear to have been formulated in a seemingly arbitrary manner rather than a rational one to maximise Trump’s negotiating leverage in the early stages of the process. We posit that tariffs are more akin to the introduction of a form of Goods and Services Tax (GST), which does not exist at the federal level in the US, without explicitly labelling it as such. When a GST is implemented, the direct impact on consumers through price increases is generally understood. However, the impact of tariffs is less direct and less predictable. Consumers may ultimately bear the cost through higher prices, or corporations could also absorb them by reducing their profit margins, or foreign countries, such as China, may choose to mitigate their effects on the purchasing power of importers through currency devaluation, impoverishing instead their own citizens. In short, the impact of duties is more ambiguous compared to a GST. As tariffs can indeed affect corporate earnings, they are a contributing factor to the current decline in the stock market. Ultimately, tariffs, like a GST, are enacted to increase revenues for the government, and this leads us to believe that the administration's objective is to move towards a universal tariff structure, possibly in the range of 10% to 20%, applicable to all countries globally. If our thesis is correct, we may be nearing the end of the most severe phase of volatility induced by the tariffs’ chaos.

The “confidence shock” stemming from escalating tariffs is nevertheless real and it has important ramifications for the future behaviour of consumers and businesses. In an environment in which the policy trajectory remains unclear, adverse consequences on the US economy and a rise in unemployment are plausible. However, absent serious supply chain disruptions or a credit crunch, we currently do not anticipate a full-blown crisis scenario. Our base case is more aligned with the 2022 experience. Three years ago, a surge in inflation to unexpected heights and a more aggressive than anticipated tightening of monetary policy by the FED necessitated a market repricing. The S&P 500 experienced a peak-to-trough decline of -27.54% while the Nasdaq 100 plunged -37.72%. The US economy contracted for two consecutive quarters between January and June 2022, hitting the common rule of thumb for a “technical” recession. Eventually, the economy started to recover, and markets moved forward. Circumstances today are eerily similar. We were correct in predicting an unfavourable “sequencing” of the MAGA agenda, with a deliberate frontloading of its negative aspects, such as immigration restrictions, curtailed public spending and tariffs, positively offset by tax cuts and deregulation only afterward. That said, the fallout of tariffs has been more pronounced than initially expected, resulting in a more extreme predicament than every previously contemplated worst-case scenario. At the time of writing of this note (April 18th), US equities have officially entered a bear market after the S&P 500 and the Nasdaq 100 plummeted -21.35% and -25.56% respectively in USD terms between February 19th and April 7th. The possibility of stock markets re-testing or even falling past their lows in the next few months cannot be discounted. That said, a substantial amount of bad news has already been priced in, and at an exceptionally rapid pace. In fact, the key difference between today and 2022 is the speed of the adjustment; back then, it occurred over approximately ten months, whereas this time it has transpired in less than two months. Consequently, we are comfortable maintaining an overweight exposure to growth assets at present, with a preference for global equities and infrastructure. Over the past month, we have shifted our positioning away from the US, where we are underweight. We are overweight Europe and have moved to a neutral stance in emerging markets due to the potential for those countries to stimulate their economies, while simultaneously benefiting from large allocators putting capital to work in the RoW.

The abrupt collapse of the stock market has also caused a repricing of the US cash futures projections, with the numbers of FED cuts expected for the remainder of the year increasing from 1 to 3. In addition, the US 2-year yield has declined just shy of 50 Bps since mid-February, from 4.27% to 3.79%. It is widely acknowledged that the bond market leads the FED, and not the other way around, and historically the 2-year yield has had the best track record in anticipating the timing and the magnitude of any tightening/loosening cycle. As a result, we continue to anticipate a dovish response to the economic slowdown from the central bank. 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 fact, the FED may be already behind the curve and its monetary stance excessively restrictive, or at least, that seems to be the message of the bond market. 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. Clearly, a risk exists that the FED may maintain a too rigid policy and not implement the anticipated policy adjustments, or not in a timely manner, or provide insufficient accommodation. In that scenario, the long end of the curve may continue to experience significant fluctuations, mirroring movements in equity markets. However, we contend that in the medium term the trajectory for the US 10-year yield should be downward, below the 4% threshold rather than above it. Finally, we remain cautious on global credit, particularly high yield. In a deteriorating economic environment, companies face increased difficulty in servicing their debt, and non-investment grade bonds are typically the most vulnerable. Indeed, the spread between US “junk” bonds and Treasuries as measured by the ICE BofA US High Yield Index OAS shot up from a low of 262 Bps to a high of 461 Bps between February 19th and April 7th, before finding a new equilibrium (so far) just above 400 Bps. Despite the hasty and vertical movement, current spreads, that is, the additional premium high-yield issuers must pay, are consistent with a weakening economy and do not point to a recessionary outcome, let alone a financial crisis. In fact, before the current bout of volatility they were hovering near all-time lows, almost as tight as they were in 2007. Following their considerable increase, they have yet to exceed the levels reached in October 2023 during the last “growth scare” episode or reach the highs of March 2023, at the peak of the regional banking crisis. In conclusion, we believe it is prudent to favour investment-grade over high yield in the context of an underweight position in global credit overall.

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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