Monthly Market Commentary
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Market Review

Global equities erased 8.56 trillion USD in market capitalisation as measured by the FTSE All-World Index between 3rd April and 8th April. The historic rout in markets was ignited by the unveiling of "reciprocal tariffs" designed to bring the average effective US tariff rate to a higher level than the 19.8% set by the Smoot-Hawley Tariff Act of 1930. As a result, while President Trump called 2nd April "Liberation Day", it quickly became known among market participants as "Obliteration Day". As much as the dramatic plunge in stock markets grabbed the headlines, the real action transpired in other areas of the financial system. In fact, movements across asset classes were unprecedented when considered in conjunction. Shortly after the White House Rose Garden address, government bonds began to decline as is customary during "risk-off" episodes, or, at least, as it was before the bear market of 2022. The US 10-year yield fell 27 basis points, from 4.13% to 3.86% during the first two days of the stock market crash. At the same time, gold slid more than US$100 per troy ounce, dipping below the US$3,000 threshold, as investors scrambled to raise cash in the context of a liquidity dry-up. Again, such a behaviour is consistent with historical precedents, unlike what came next. The flight to the (perceived) safety of Treasuries was indeed short lived, as between 7th April and 11th April the 10-year yield made an abrupt U-turn, spiking as high as 73 basis points to 4.59%. Gold exploded higher, recovering all losses and breaking to new all-time highs. Meanwhile, the Dollar Index (DXY) continued to soften, shedding close to 4%.

The only other time in modern history the S&P 500 and the DXY recorded a drawdown of such a magnitude in the context of the yellow metal and the 10-year yield ripping higher was in September 2008, shortly after the collapse of Lehman Brothers. In general, US government bonds and the greenback tend to fall in unison during "risk-on" periods, as capital rotates away from safe havens and piles into growth assets, sometimes after a prolonged bear market. However, in such circumstances the S&P 500 rallies hard, while this time round it continued its freefall until 9th April, when the administration announced a 90-day pause, contenting itself to (temporarily) subject imports from all trading partners except for China to a flat 10% duty. It is speculated that the wild gyrations in US Treasuries, rather than the crash of the stock market, "broke" Trump's resolution to address the "national emergency" represented by the "large and persistent" trade deficit. According to an article published by the Wall Street Journal, on that day, Treasury Secretary Scott Bessent and Commerce Secretary Howard Lutnick "rushed to the Oval Office to see Trump and propose a pause on some of the tariffs". The impromptu meeting sidelined the "China hawk" Peter Navarro, senior counsellor for trade and manufacturing, who all the while had an appointment "in a different part of the White House". After publicly backtracking on tariffs, thus igniting a strong recovery across asset classes, the President himself acknowledged that he had been watching the turmoil in the US$29 trillion government bond market closely. He remarked that "people were getting a little queasy" and that "the bond market is very tricky" but "right now is beautiful".

It remains unclear what exactly triggered the latest iteration of extreme volatility in Treasuries. The FED chose not to intervene, in contrast to the actions it took back in March 2020, when, as the COVID crisis intensified, it purchased US$1.6 trillion worth of securities in a single month to stabilise yields. One of the major culprits behind the stress appears to have been the unwinding of an obscure, but enormously popular, arbitrage strategy called "basis trade" that is primarily pursued by large, multi-strategy hedge funds. Here is how it works: because treasury futures contracts typically trade at a (small) premium to the underlying government bonds, alternative managers sell the former and buy the latter to capture an (almost) risk-free spread of a few basis points. And because Treasuries are considered safe, hedge funds can aggressively leverage the trade to amplify their gains. According to industry insiders, a 50:1 leverage ratio is normal, and up to 100:1 is not unheard of. In other words, a margin of US$10 million can support as much as US$1 billion of Treasury purchases. The “basis trade” has grown massively in recent years and today it is estimated to have reached US$800 billion. According to Ken Griffin, the founder of Citadel LLC, the strategy is instrumental in reducing the cost of issuing new government debt. Others contend instead that, given its sheer size, it has become a potential de facto source of instability at times of exogenous shock. The latter thesis seems to have been validated during the first half of April. As foreigners, primarily European and Japanese allocators, started to “repatriate” part of their outsized US portfolio, they unloaded the most liquid assets that they hold, that is, Treasuries. The sudden wave of selling caused yields to rise, putting pressure on highly levered hedge funds, which saw their positions getting forcibly liquidated, causing yields to rise further in a vicious spiral that ended only after Trump blinked. If this reconstruction of events is accurate, the question then becomes what instigated the capital exodus from the US, and whether it will continue in the foreseeable future. According to several market analysts, the US may have just experienced its first “good old capital flight”, the kind that afflicts emerging markets on a regular basis. In fact, the status of the US Dollar as the global reserve currency has allowed the country to finance its “twin deficits” for decades at a low cost. That may change in a world transitioning from “Pax Americana” to “America First”.

International Equities

After a rollercoaster ride, US equities ended April mixed. The S&P 500 (-0.76% in USD terms) and the Dow Jones Industrial (-3.17%) declined for the third month in a row, while the Nasdaq 100 (+1.52%) recovered all its post “Liberation Day” losses, closing solidly in the black. At the end of month, the S&P 500 was down 7.13% in USD terms since the second inauguration of Donald Trump occurred on January 20th; that is the worst run during a president’s first 100 days since Gerald Ford in 1974. The “Magnificent Seven” regained momentum in April, outperforming the rest of the US large caps for the first time in 2025. Tesla missed analysts’ expectations on both top and bottom lines, with revenues and net income plummeting -20% and -71% respectively from a year earlier. Despite reporting its least profitable quarter since Q1 2021 and its lowest sales since Q2 2022, the stock caught a bid after Elon Musk vowed to pull back “significantly” from his work with the US government and to devote “far more” of his time to the electric car maker starting in May. Alphabet rose after its revenues and earnings topped consensus estimates, with its search and advertising units continuing to exhibit strong growth despite AI competition. In addition, the company's investment in Musk's privately held SpaceX, initiated back in 2015, generated unrealised gains that boosted Q1 profit. Microsoft was another winner on strong growth in its Azure cloud business. Nvidia ended the month mostly unchanged, while Apple, Amazon and Meta suffered steep losses. Technology, consumer staples, industrials, utilities and consumer discretionary outperformed the general index, while healthcare, communication services, materials, financials and real estate lagged. Energy plummeted by double-digits after the WTI crude price crashed (down 18.56%), its worst month since November 2021.

US equities underperformed the rest of the world (as exemplified by the MSCI AC World Index ex USA TR Index) for the fifth month in a row. All major regions outside of the US outperformed the general index. Japan topped the list as the country secured priority tariff negotiations with the US. Europe gained on the back of GDP growth in the Eurozone accelerating in Q1 2025. Emerging markets outperformed developed markets despite the marked drop recorded by Chinese equities. All in all, the MSCI AC World Daily TR was up +0.93% in USD terms, but down -1.49% in AUD terms.

Australian Equities

Australian equities rebounded in April, returning to positive territory since the beginning of the year. In addition, they outperformed their international peers by the largest amount since March 2022, at the time of the Russian invasion of Ukraine. As a result, the MSCI Daily TR Net Australia ended the first 4 months of 2025 ahead of the MSCI AC World Daily TR. Given its relative insulation from trade tensions, the domestic market attracted foreign inflows from investors switching out of Asian markets more directly impacted by “reciprocal tariffs". The S&P/ASX 300 surged +3.60%, buoyed by banks, A-REITs, telecoms, technology, consumer discretionary and consumer staples. Gains for materials were muted, as lower prices for iron ore and copper weighed on major miners, while gold miners fared better. Energy bucked the trend on concerns about global demand and in response to the decision of eight OPEC+ countries to phase out oil output cuts, thus increasing supply. Mid-caps and smaller companies lagged the Top 20. Finally, growth stocks outperformed value stocks by the most since November 2021.

International Fixed Income

Two of the four major global central banks that met during the month left interest rates unchanged; those include the Bank of Canada (BOC) and the Bank of Japan (BOJ). On April 8th, Christian Hawkesby was appointed Governor of the Reserve Bank of New Zealand (RBNZ) for a period of six months. One day later, the central bank lowered its Official Cash Rate (OCR) by 25 basis points, from 3.75% to 3.50%, a widely anticipated decision aimed at countering weak household spending and residential investment and “the recently announced increases in global trade barriers”. On 17th April, the European Central Bank (ECB) lowered its policy interest rate for the seventh consecutive time, from 2.50% to 2.25%. In her press conference, President Lagarde warned of renewed downside risks to economic growth brought about by “the major escalation in global trade tensions and associated uncertainties” which will likely dampen exports. Following her dovish remarks, the probability of another rate reduction in June increased; however, the Euro remained bid vis-à-vis all major currencies despite the narrowing of interest rate differentials. The FOMC did not meet in April, but that did not prevent Trump from expressing his frustration with Chairman Powell, whom he called “a major loser”, guilty of being “always too late and wrong”. The President also hinted at his potential removal stating that “if I want him out, he’ll be out of there real fast, believe me”. A few days later, he adjusted his tone, continuing to call for lower interest rates, but clarifying that he has “no intention of firing him”.

The Bloomberg Barclays Global Aggregate Index hedged back to AUD rose 0.95% for the month, as yield curves continued to steepen around the world. In the US, the short end fell though the long end held steady, while in Europe both the short and the long ends tumbled. Credit spreads widened sharply, primarily in the high yield and bank subordinated debt spaces but recovered significantly into the end of the month.

Australian Fixed Income

On 1st April, the RBA held the cash rate at 4.10%, refraining from loosening further its monetary policy ahead of the federal election. In her press conference, Governor Bullock stated that the central bank did not "explicitly" consider the case for a rate cut, while rejecting any suggestion that politics may have influenced its decision. Domestic fixed income rose for the sixth consecutive month, with the Bloomberg AusBond Composite 0+ Yr climbing +1.70%, its largest monthly increase since December 2023. The 2-, 5- and 10- year yields were 41, 32 and 22 basis points lower at 3.27%, 3.54% and 4.16% respectively. At the end of April, the cash futures were pricing a 25-basis point cut in May, and two additional reductions in the second half of the year. The Australian Dollar briefly sank below 60 US cents for the first time in 5 years, before staging a +8.11% comeback to end April at its strongest level of 2025, just shy of 64 US cents. However, the domestic currency fell to multi-year lows against European and Asian major currencies and, in the case of the Swiss Franc (CHF), to new all-time lows.

Real Assets

Global property was up +0.74% in USD terms, but down 1.68% in AUD terms in April. Europe was the best performing region, benefiting from the reversal of the "American Exceptionalism" theme. Data centres rebounded strongly but failed to lift the US, which ended the month at the bottom of the list.

Global infrastructure soared +3.41% in USD terms and +0.92% in AUD terms for the month. Communication infrastructure outperformed the general index, while the potential repeal of the Inflation Reduction Act (IRA) weighed on selected US utilities. Transportation was a mixed bag, with more economically sensitive sectors like railroad trailing and toll-roads outperforming.

Alternatives

Alternatives (-0.43%) recorded mixed returns in April. Long/Short equities successfully navigated volatility, posting modest gains. Conversely, discretionary macro and trend following mandates were hit by the whipsaw pattern of rates, equities and commodities.

Market Outlook

The trade war is effectively over, the US economy will no longer undergo a "detox" period and large global allocators will continue to rebalance their portfolios, reducing the quantum of their exposure to US financial assets over time. Those seem to be the conclusions we can draw after the first three hectic weeks of May. First, starting from tariffs, our statement is not meant to imply that they will be lifted any time soon; rather, we maintain that they have now become a permanent feature of global trade policy. However, we would argue that the US administration has pivoted away from using trade policy as a geopolitical tool to fundamentally reshape global supply chains. Efforts to reshore industries and contain China's influence will persist at the margin, but the initial aggressive impetus is no longer there. And the rationale is, in our opinion, the unwillingness to endure the negative financial repercussions associated with the sustained foreign divestments observed in the aftermath of "Liberation Day". The fact that Trump capitulated should not be considered a declaration of victory or defeat for either side. In fact, the virtual trading embargo between China and the US was cutting both ways, and most likely hurting the former disproportionately more than the latter. Ultimately, the US decided to recalibrate its approach for strategic and economic reasons, that is, to avoid destabilising its domestic financial system through a prolonged capital flight, and to generate revenues from tariffs to help fund domestic initiatives, particularly tax reform.

There is also a political angle at play, as tariffs have proven deeply unpopular with both business leaders and voters. The calculus is straightforward: while tariffs can be imposed via executive order, tax cuts require congressional approval. Achieving this necessitates a unified Republican front, which may have been jeopardised by growing corporate dissatisfaction with trade policy. Thus, the administration had to regroup to secure the political capital required to enact its expansive fiscal reform. As a result, the "One, Big, Beautiful Bill" has now taken centre stage and, if passed in its current form, it will cause an increase, rather than a decrease, of the budget deficit, with a substantial front-loading of the positive fiscal impulse in the next 18 months. Moreover, initial plans for fiscal consolidation and a transition towards a private sector-led growth model have been dramatically scaled back. The "Department of Government Efficiency" (DOGE) has reduced its proposed spending cuts from 2 trillion USD to just 150 billion USD, ending prematurely the austerity narrative. In short, deficit reduction is no longer on the agenda. Fiscal stimulus is returning, albeit through a different channel. The focus has shifted to capital expenditure and investment, which, if implemented efficiently, could prove less economically wasteful than prior stimulus packages. That said, it is doubtful whether tariffs will generate sufficient revenues to offset the deficit expansion resulting from the tax cuts. The US public debt continues to be firmly on an upward trajectory, and a significant near-term acceleration may be on the cards.

Just one month ago, our base case included the likelihood of a technical recession, defined as two consecutive quarters of negative GDP growth. Indeed, the US economy contracted by -0.1% QoQ in the first quarter of 2025, while looking at the data on a yearly basis, growth decelerated to +2.1% YoY. Not surprisingly, in April, most investment banks were estimating recession odds in the 50% region and above. Those probabilities are now being revised downward across the board. Consequently, the US yield curve has repriced from anticipating four FED rate cuts for the remainder of the year to just two. At its last FOMC meeting, Chairman Powell sounded cautious, essentially signalling that the FED is likely to wait for more tangible signs of economic deterioration before resuming to ease its monetary stance. He also acknowledged the increased risks of both rising unemployment and inflation, in other words, of "stagflation". Still, price pressures do not appear to be a present concern and with tariff tensions receding, the justification for maintaining a restrictive monetary policy has diminished. Hence, we contend that a credible case can be made for a cut as early as in June/July given the current set of macroeconomic conditions. In fact, the "confidence shock" stemming from recent policy uncertainty is real, and residual economic damage may still weigh on corporate investment and consumer sentiment in the short term. However, the central bank's decision could be influenced by concerns regarding the fiscal implications of the proposed tax bill. All things considered, our outlook on bonds has shifted to neutral. 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 US 10- year yield is lingering below the level it was at the beginning of the year, but it is unclear whether in the medium term its path will remain downward, potentially to the 4% threshold or lower. Should the tax bill pass, and the FED proceed with rate cuts, we may need to reassess our duration exposure and overall bond positioning.

Turning our attention to capital flows, we think that a new factor has re-emerged as a meaningful consideration for international portfolios: Foreign Exchange (FX) risk. For at least a decade, global investors, especially those based in Europe, Asia and Australia, have accumulated financial assets in the US, drawn by their exceptional performance. The “American exceptionalism” has been underpinned by better economic and earnings growth, higher interest rates and a strong dollar. Because the greenback was generally providing a tailwind, currency risk was often ignored. However, the sharp depreciation suffered by the Dollar Index (DXY) in March and April served as a timely reminder. For instance, at the time of writing of this note (May 20th), the S&P 500 is up 1.39% YTD in USD terms, but down 6.60% in Euro (EUR) terms, down 6.74% in Taiwanese Dollar (TWD) terms and down 6.58% in Japanese Yen (JPY) terms. In plain English, equities have rebounded, but European, Taiwanese and Japanese investors, that is, some of the largest holders (and hoarders) of US financial assets, have suffered currency losses of approximately 8% that they have yet to recover. Geopolitical uncertainty stretched positioning and now currency risk will lead those investors to reduce their US exposure in favour of their domestic markets or of other neglected regions. Selling US equities these days equates to trimming positions in the “Magnificent Seven”, regardless of their underlying fundamentals. Hence, while the financial performance of many of these firms has been stellar, the group has underperformed the broader market, suggesting that their (high) multiples may undergo a gradual derating. Our current stance can be summarised as slightly underweight US equities, neutral on emerging markets and overweight Europe due to the potential for those regions to stimulate their economies. We believe this diversification is prudent given the prevailing macroeconomic uncertainties and valuation disparities across global markets. We are comfortable maintaining an overweight exposure to growth assets at present, with a preference for global equities and infrastructure, but we will also continue to evaluate the longer-term implications of the trade policy shift. In the absence of “currency offsets”, someone will have to “eat the tariffs”, and corporations may be pressured to absorb part of the higher costs rather than pass them fully to consumers. Finally, we maintain a neutral FX hedging strategy. The Australian dollar remains fundamentally undervalued, but it lacks a clear catalyst for appreciation. Nevertheless, the broader message is clear: FX risk has reared its ugly head, and it may contribute to a reallocation of capital away from the US and into the Rest of the World (RoW).