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BILBoard February 2025 – Repainting the global trade system



When President Trump took office on January 20th, it was clear that tackling the US trade deficit would be a high priority. This is not only due to his frequent discourse on the subject, but also because the Republicans currently hold the slimmest majority in the House than any administration has had in a century, necessitating the support of at least seven Democrats to advance most legislation in the Senate. This situation compels the President to rely on executive orders as a means to bypass Congressional hurdles. As a result, he is now concentrating on issues such as geopolitics, immigration, and trade, in contrast to 2016, when he kicked-off his term with a focus on the domestic economy—for that, you largely need Congress on side.

So, while markets had a clue about *what* Trump might do in his first 100 days, more important was the *how*. A genuine concern was a set of broad-brushed and indiscriminate tariffs on America's allies and adversaries alike; tariffs implemented with the same reckless abandon as Jackson Pollock splashing paint across his canvas, creating chaotic effects. However, it seems that Trump is, in fact, "painting-by-numbers", having signed an action for his staff to design a

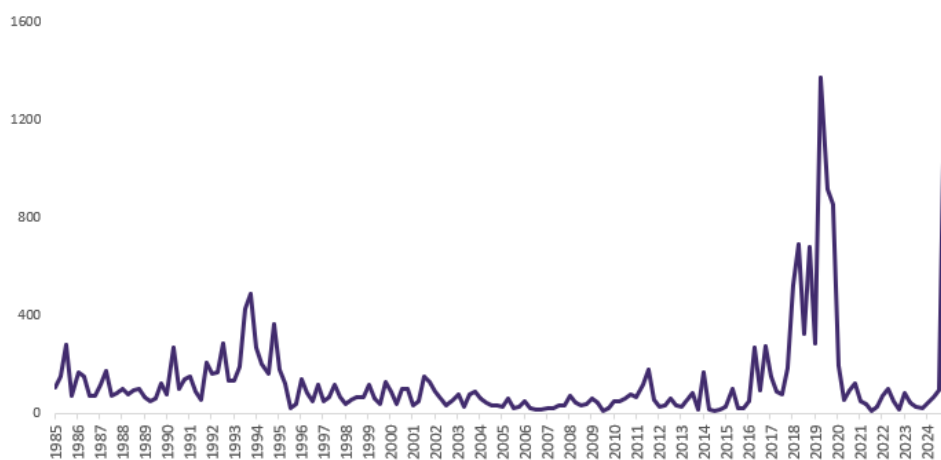
plan to impose tariffs on US trade partners based on “reciprocity”. The *vernissage* for the unveiling of the new US trade architecture is scheduled for early April.

In the meantime, markets have embraced the approach as it appears to be more measured and also affords time for negotiation. As of today, it is generally emerging market countries with limited trading relationships that impose meaty tariffs on US goods. Canada and Mexico have 0% tariff rates with the US, the EU has just a mere +1.2 percentage point (pp) tariff rate differential with the US, while for China it is even negative.^[1] Given that Canada, Mexico, China and the EU make up more than 60% of US imports, the overall impact therefore might be manageable. However, it could be more dramatic if the administration proceeds with the inclusion of VAT and other non-tariff barriers in its calculations. For now, it seems the market senses that the extreme starting point and extended timeline might in fact just be a canvas from which Trump can initiate negotiations.

Indeed, of the tariffs that Trump has announced, he has only implemented one of them as of today: 10% tariffs on China, while subsequently commenting that a trade deal is “possible”. Tariffs on aluminum, steel, Canada, Mexico and Colombia were all pushed out, leaving time for concessions to be struck.

Trump 2.0 will no doubt drive a realignment in global supply chains. However, knee-jerk investing based on trade announcements is a risk as the picture currently looking like a Chagall, full of tricks and pranks. We, like the Fed, await more clarity before acting further in our portfolios. The key problem is that if uncertainty persists for too long, that alone could start to hinder corporate confidence, investment and economic activity.

US Categorical Economic Policy Uncertainty Trade Policy



Source: Bloomberg, BIL

THE MACRO LANDSCAPE

After the US recorded growth of 2.8% in 2024, consensus expectations are for a still-respectable pace of 2.2% in 2025. Consumption is the key driver of US exceptionalism but evidence suggests that households are beginning to tighten their belts, with a resurgence of inflation fears weighing on confidence. For now, we think that as long as the labour market remains resilient, it will put a floor under spending. The hope is that business-friendly policies will catalyse an upturn in the corporate sector, keeping activity – and employment dynamics – supported. Sentiment is improving, primarily in the manufacturing sector, where new orders are on the rise, and where business confidence hit a 34-month high in January.

The flipside is that proposed policies might fan inflation, potentially derailing the Fed's easing campaign. Already, headline inflation is on the rise, having increased every month since September, hitting 3.0% YoY in January. The Fed has already revised the number of rate cuts that it projects for this year from four to two. Futures markets price in one rate cut for this year, and a second cut is priced as a coin toss. Minutes from the Fed's January meeting revealed a certain nervousness about the economic consequences of President Trump's policies. With the Fed likely on hold for the months to come, corporate earnings will likely come to the fore.

Things look promising on that front: of the S&P 500 companies that had reported their results at the time of writing, EPS growth was 16.9% on aggregate. If this rate holds, it will be the highest reported growth since Q4 2021. The fruitful earnings season has compelled analysts to make upwards revisions to future expected earnings.

In Europe, while the macroeconomic situation remains challenging, certain aspects are allowing markets to breath a collective sigh of relief: PMIs give hope that the manufacturing sector is bottoming out, Germany might soon have a government capable of action, a ceasefire in Ukraine could be on the cards, and France has managed to pass a 2025 budget. That said, the Euro Area continues to lag the US, and economists expect growth of just 0.9% this year. A weak economy, and signs of cooling in the job market should keep the ECB on track for sequential rate cuts in the coming months.

Looking to China, little has changed since our assessment in last month's BILBoard, even if market sentiment was positively impacted from debut of "DeepSeek". In all, 2025 will be another year in which Beijing will try to boost growth and domestic consumption. We await the annual "two sessions" parliamentary meeting on March 5 for a clearer roadmap.

INVESTMENT STRATEGY

While being **neutral on equities** overall, within that exposure, we maintain a **preference for the US** and a **bias towards small caps** as they could benefit from America First policies.

Worth noting, is that for Q1 2025, S&P 500 companies with more international revenue exposure are projected to report lower earnings than equivalents with more domestic revenue exposure. The estimated earnings growth rate for the S&P 500 overall for Q1 2025 is 8.1%. For companies that generate more than 50% of sales inside the US, it is 9.1%. For companies that generate more than 50% of sales outside the US, that figure falls to 6.6%.

With the market now considering the glass half-full when it comes to Europe, we have benefitted from having a relatively large proportion of European equities versus what we observe among other institutional investors. In light of better-than-feared corporate earnings and hopes for an improving macro picture, we are monitoring developments in order to weigh whether we would like to add further.

In the **Fixed Income** space, **investment grade** forms the cornerstone of our exposure, complimented by high-yield to boost income. With yields at depressed levels, out-of-the-box thinking is increasingly essential in order to introduce new income sources into portfolios.

This month, in Defensive and Low profiles, we reduced Sovereign exposure (by 3% and 2%, respectively), allocating the proceeds were equally to **corporate hybrids** and **CoCos** (high-yield). These products offer reduced sensitivity to interest rate fluctuations due to their lower duration profiles, and a more attractive risk-return trade off.

In Defensive profiles, we implemented a decision made in January to switch 4% of the investment grade exposure into **structured credit**. The asset class offers a more attractive yield pick-up, while increasing portfolio diversification given that structured credit has low correlation to other fixed income asset classes. The floating rate nature of structured credit means that duration risk in the portfolio is reduced.

THE ART OF THE DEAL

For the months to come, investors will have the increasingly difficult challenge of focusing on fundamentals amid a flurry of headlines and a flow of unconventional communication from the new US administration. At BIL, we strive to help our clients separate noise from signal, with the aim of achieving **stable** portfolio returns over time. While Trump's messages are oil-painting bold, the past has shown, that the outcome can sometimes be watered down, becoming more like an aquarelle. He himself writes in "The Art of the Deal": *I never get too attached to one deal or one approach. For starters, I keep a lot of balls in the air, because most deals fall out, no matter how promising they seem at first.*



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[1]

<https://www.fitchratings.com/research/sovereigns/us-reciprocal-trade-policy-widens-range-of-potential-tariff-outcomes-18-02-2025>

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