RATHBONES

WEEKLY DIGEST

EXTREMES

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15 APRIL 2025

Lately we've had to acknowledge the distinct possibility that some of the content in these weekly updates could be rendered out-of-date before they've even been read. President Trump duly obliged last week by announcing a ninety-day pause on the imposition of "reciprocal" tariffs for everyone apart from China. Cue unbridled euphoria in equity markets. The White House's somewhat arbitrary approach to policymaking suggests that we should brace ourselves for more of this volatile market behaviour, both positive and negative.

Hot & Cold

As I recently discovered, one of the "attractions" of an Alpine spa is to plunge straight from the sauna into a stream fed by water from the nearby, snow-capped mountains – possibly not everybody's idea of fun, but exhilarating nonetheless… really! Being invested in stock and bond markets over the last few months has been a similar experience, although I'm not sure there are any associated health benefits. In just the last couple of weeks, and with US markets providing the cue for global markets, we have witnessed a two-day decline of 10.5% for the S&P 500 following the "Liberation Day" reciprocal tariff announcement, and then a one-day rally of 9.5% when they were postponed for ninety days (China being the exception).

To put that gain into context, it's roughly equivalent to the historic average annual return from US equities, and it was the third biggest one-day increase for the index since 1950. The two biggest gains of 12% and 11% came during the Global Financial Crisis in October 2008 when policies were announced to provide support for banks which, at the time, were at risk of being declared insolvent en masse. The fourth and fifth ranked gains, both of 9%, were made in March 2020, in the middle of the covid crisis. These were in response to measures announced by the US government and central bank to provide stimulus to the economy (although not yet anything to combat the virus itself).

What is notable about all of these gains is that they were made during periods now labelled "crisis", which tends to suggest that we might be in one now. Indeed, many of the biggest up days for stock market indices have been achieved during bear markets, which brings us back to the evergreen investment topic of holding one's nerve when markets are not behaving well. There are any number of studies showing how much long-term return one might have missed out on by not being invested on, say, the ten best days over the last fifty years. Never underestimate the power of compounding the returns made on those days.

I am willing to concede, though, that these studies are somewhat disingenuous, because they assume that you are the world's worst trader who perfectly times their exit from the market on the day before the huge gains. There are similar studies showing how much better you could have done by missing out on the ten worst days. However, these days often come out of thin air and are well-nigh impossible to predict and so one would be missing out on the longer-term positive trends by trying to.

I would also note that the best and worst days tend to come in clusters, with the good days often being triggered by some sort of policy response to the bad days. If anything, one should be buying more after the historically bad days, although that requires extreme levels of mental fortitude.

There are several good quotes relating to the notion that successful investors should be greedy when others are fearful, but I will settle on just one, which is attributed to, amongst others, the legendary trader Stanley Druckenmiller: "The stock market is the only market where things go on sale and all the customers run out of the store."

Forced Sellers Meet "Greedy" Buyers

In the real world, there are always reasons why things go on sale, whether that's seasonal items that have to be cleared to make way for the next season or, in some cases, because a business has to liquidate its stock to raise cash to pay off loans. Indeed, the US retail company TJX (which trades under the TK Maxx brand in the UK) has made an extremely successful business out of selling other retailers' "leftovers". Remarkably, its shares sit at an all-time high today as investors have cottoned on to the fact that it has nothing to fear from tariffs because it buys all of its stock domestically (and from companies that will already have paid the tariff if required).

There are occasions when some groups of investors are forced into liquidating their inventory too, and these are moments that we can potentially take advantage of. When 'pro-cyclical' forces (economic variable or policy that move in the same direction as the business cycle) that tend to drive markets to extremes are working in your favour, the secret is to stay on the ride for as long as possible. But you have to remain disciplined around valuations and not succumb to FOMO.

Fiscal stimulus or liquidity provided by central banks are the sort of forces that can drive markets higher (and lower when they are withdrawn), but these forces can be turbocharged by leverage, or the use of debt. For example, last summer we saw the'yen carry trade' blow up as traders who had bought US technology stocks with cheap, borrowed yen, were forced to unwind their positions when the yen started to rise.

When shares or bonds start to fall, especially in response to specific 'bad' news (such as the imposition of much higher tariffs than anyone was realistically expecting), we also tend to witness a rise in implied volatility (the expected daily movement of an index or security). This is another factor that can force traders to reduce their positions, because one of the key determinants of what's known as the 'value at risk' of their portfolios is implied volatility. Basically, the more that their investments are expected to jump around, the less of them they should be exposed to, and so we see a deleveraging. It is usually the most crowded trades that are the biggest victims and, in the latest instance, it was largely the mega-cap technology stocks that had previously been leading global equity indices higher.

Of course, there has been some adverse shift in the 'fundamentals' because the tariffs will directly affect some of these companies, but that is only part of what has been driving share prices. Our clients' portfolios are not leveraged and so we are not forced sellers. Indeed, in moments of dislocation, we have the capacity to head for the sales rack and to look for shares that have been caught up in the liquidation.

Happy Easter!

The forthcoming long weekend offers a welcome opportunity to step back from these volatile markets and reflect on what has been an extraordinary first 'term' of 2025. These are fast-moving markets, sadly beholden largely to the whim of one man and his acolytes. But as long as we continue to stick to our investment process, we should not be fearful. We should also note that, for all the craziness, it does seem as though markets still have the power to rein back the more disruptive elements of White House policy. Sometimes it also helps to fall back on something reliable that has stood the test of time through thick and thin, and so I will dust off my mum's Zesty Easter Lemon Cake recipe this weekend. One of the ingredients is raw eggs, and so its greatest moment of crisis was in 1988 when we had the big salmonella scare, which my mum defiantly ignored! It's been an Easter staple since the 1970s. It will be around longer than any US President!

On 29 April we will host a live webinar on the 'Liberation Day' tariffs, their effects on markets and how we are navigating them for our clients. All are welcome to join our co-chief investment officer Ed Smith and head of equities Sanjiv Tumkur discuss how to manage the risks but also take advantage of opportunities presented by America's new trade policies. Sign up here.

If you have any questions or comments, or if there's anything you would like to see covered here, please get in touch by emailing review@rathbones.com. We'd love to hear from you.

Please see below for this week's economic highlights

ECONOMIC HIGHLIGHTS

UK – A positive surprise, at last, from the UK economic data! GDP increased by 0.5% month-on-month in February against a flat forecast. It looks as though consumers are defying the gloomy headlines, with wholesale and retail activity rising by 1%. Service sectors overall saw growth of 0.7%. Manufacturing sectors were also perky, with industrial production up 1.5%, although it's possible that this could have been the result of inventory building in anticipation of tariffs. However, with higher taxes on business finally kicking in in April, there is still a risk that this is something of a false dawn. The jobs market also shows some signs of cooling growth, but is still relatively resilient, especially in terms of wage growth. The economy shed 78k jobs in March, as measured by PAYE data, the first monthly fall since April 2021. This may be a sign of corporate belt-tightening, with job vacancies also falling from 799k to 781k. Even so, wages grew by 5.9% in the rolling three months to February, and this is one of the factors restraining the Bank of England when it comes to cutting interest rates. However, with US tariffs set to weigh on global trade, the Bank will also be sensitive to the risks to growth. As such, the interest-rate futures market is pricing in three quarter-point cuts by the end of the year from the current 4.5% base rate, with the first of those widely expected to come in May.

US – 'Hard' US economic data might all be a bit irrelevant given the policy changes announced in the last few weeks, but the latest inflation data was reasonably encouraging. The headline consumer price index (CPI) of inflation fell from 2.8% to 2.4% in March, with the core CPI (excluding volatile items such as food and energy) dropping from 3.1% to 2.8%. Both were lower than forecast. This was followed by weaker-than-expected producer price inflation, down from 3.2% to 2.7%, suggesting lower inflation in the pipeline. However, we know that tariffs are yet to bite and it remains difficult to forecast given the circumstances. Still, we continue to see tariffs as being fundamentally inflationary for the US economy. 'Soft' survey data continues reflect inflation fears, with the inflation expectations component of the latest University of Michigan sentiment survey jumping from 5% to 6.7% over the next year and from 4.1% to 4.4% over a longer period of 5-10 years. Even allowing for partisan bias amongst respondents, the trend is disturbing. But, with threats to economic growth increasing, market expectations are for the Federal Reserve to reduce interest rates from a current effective rate of 4.33% to around 3.5% by year end.

Europe – There had been signs of confidence building earlier in the year as the EU (led by Germany) contemplated looser fiscal rules to fund growth, especially in terms of defence spending. This was reflected in the ZEW Index for expectations of economic growth in the eurozone, which rose from 17 to 40. However, the tariff war effect has been punishing on sentiment, with the index falling back to -18.5 in April. Along with recent benign inflation prints, this will keep the European Central Bank in rate cutting mode, with another quarter-point cut to its deposit rate expected to be announced this week. That would take the rate down to 2.25% from 4% last June. The market expects another three such cuts by year end.

China – There was a healthy jump in new loans in March, to 9.8bn renminbi from 6.1bn in February, with aggregate financing (a broader measure of demand for credit) up from 9.3bn renminbi to 15.1bn. Both numbers were well ahead of expectations and suggest that stimulus measures being promoted by the government are having some effect at last. It remains to be seen how much of this was a function of boosting production ahead of impending tariffs from the US. Exports jumped by 12.4% year-on-year in March, which does suggests some urgency to get stuff moving before tariffs were imposed. The data could be choppy for a while until these distortions are washed out.

ADDITONAL INFORMATION

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