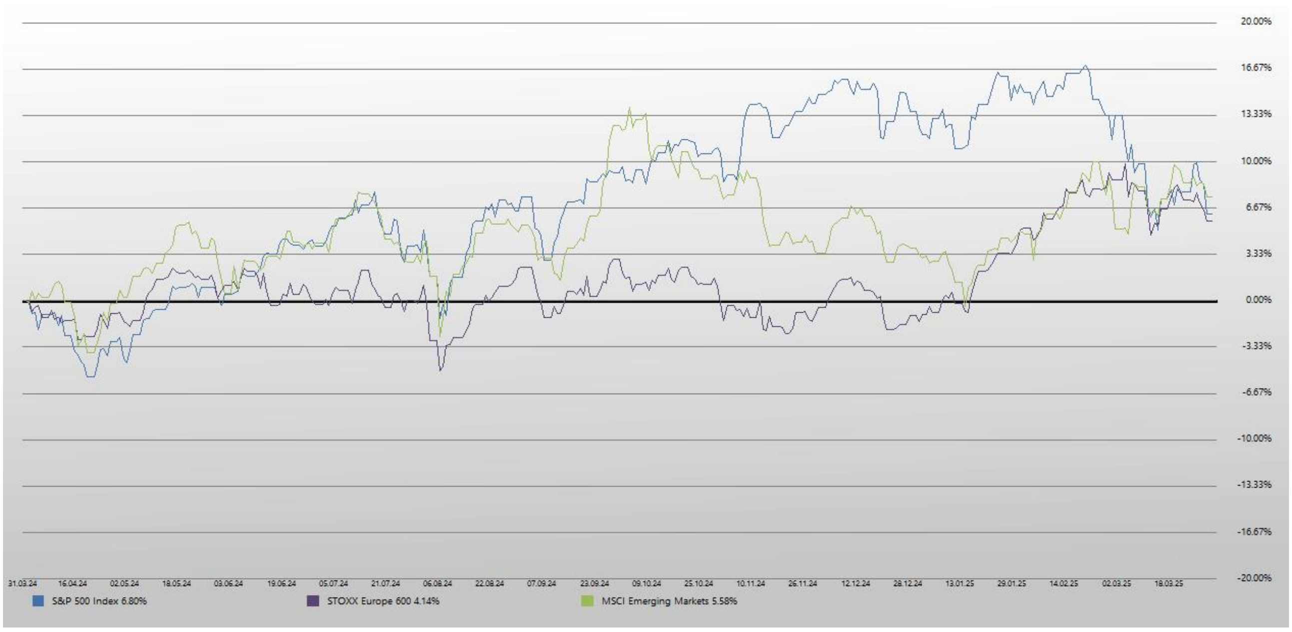
Kestrel Wealth Management

Quarterly Financial Market Update, March 2025

During the first quarter of the year, it has all been about President Trump. Since he took office on 20th January, it is virtually impossible to have a day without news about him or from him and his administration. This is unlikely to change in the foreseeable future, as he still has four years to go (even more if he manages to have the US Constitution changed, based on some rumours). As we experienced during his first term, Mr. Trump's unpredictability creates uncertainties. With these uncertainties comes investors' nervousness and thus the level of volatility in the financial markets increases sharply.

As we have mentioned in the past, periods of intense volatility such as the one we are currently experiencing will continue to occur during Trump 2.0. Indeed, global equity prices declined 1.7% during the first quarter. However, after rising by 5.5% until mid-February, stock prices dropped by 6.8% since then. Significant discrepancies between regions also took place. For instance, US stocks posted a negative return of 4.3% for the quarter (-10.3% for the tech-heavy NASDAQ Composite Index), whilst European and Emerging Markets shares generated positive returns of 5.9% and 3.0% respectively.

Equity Index Performance, rolling 12 months (%)



Source: Kestrel Wealth Management

The recent period of weakness is due to many factors, chief of them being the tariffs that the Trump's administration imposes on goods/materials imported into the USA. These tariffs create the threat of rising inflation on the one hand and increase the likelihood of sending the US – and the world's - economy into a recession on the other hand. The 2nd of April, the day of new tariffs will be announced and proclaimed to be the "Liberation Day" by Mr. Trump, could mark the start of an extended period of negotiations. This will not help in clarifying the situation about tariffs in the short-term unfortunately. However, unless governments increase tariffs tit for tat continuously, the overall market environment should improve as the year progresses, based on some readings. Indeed, the US economy may prove to be much more resilient that what the market fears. Some economists have reduced their objectives on US stocks to reflect a higher inflation and lower US GDP growth estimates, but we did not see any that have changed their opinion based on Mr. Trump's unpredictability, at the time of writing.

Besides, as a businessman who wishes to make America great again, it is not in the interest of President Trump to put the US economy in jeopardy. To a certain level, higher tariffs will generate greater flows of funds for the United States of America. But tariffs that are too high will be counterproductive, seizing up the economy. Whilst the economic activity remains in expansion territories, based on the ISM Manufacturing and Service Indices, with readings at 50.3 and 53.5 respectively, weak figures arose in regards to the labour market (the unemployment rate was up 0.1 percentage point in the last month to 4.1%) and consumption (consumer confidence declined to the lowest level since COVID).

President Trump is also shaking up international relationships between the US and the rest of the world in regards to the conflict in Ukraine. These days, it is difficult to see where the world is heading, with Mr. Trump somehow diminishing the responsibility of Russia, for example. On a positive note for investors, the growing differences between allies over the situation in Ukraine, culminating - so far - in the unprecedented confrontation in front of the cameras between Presidents Trump and Zelenskyy, have led to strong commitments from European countries to increase spending on defense and infrastructure significantly, in an effort to become less dependent on the US. For example, Germany approved a change in its debt policies that was limiting defense spending and decided on a USD 548 billion infrastructure and climate fund over ten years. These measures have improved the European economic prospects and GDP growth might be above-average over the next years in that region.

That said, the above-mentioned concerns have led investors to be in a risk-off mood generally speaking, preferring safe havens, such as gold and bonds, over equities. Whilst we are not exposed to gold unfortunately, we are well exposed to bonds in general and to Investment Grade bonds in particular. This shows the importance of diversification across different asset classes, unless an aggressive investor is willing to take on some risks. In that particular case and unless a recession is coming, which is not the central scenario, the current weakness in stocks may be a good opportunity to invest in the long-term, all else being equal.

Bonds posted a positive return of 2.6% globally over the quarter. Uncertainties regarding the economy have supported demand for this asset class. Whilst risks of rising inflation in the US led to a pause in cuts in the benchmark interest rate by the US Federal Reserve, the consensus still foresees two decreases this year (vs. four expected at the end of last year). Although very volatile, yields in the US were in a downtrend during the first quarter. For example, the yield on the US 10-year government bond ended the quarter at 4.20%, down 36 basis points since end-2024.

If investors had forgotten how erratically the financial markets evolved during Mr. Trump's first term, the first quarter of 2025 was a wake-up call. Trump 2.0 appears to be more prepared and with a drastic change in diplomatic rules, now almost exclusively focused on commercial trades and to future monetisable benefits for the USA, to the detriment of humanitarian treaties and organisations. Despite the nervousness that his comments, intentions and decrees are creating in the financial markets, we doubt that President Trump is willing to go down in history as the president that left corporate America in tatters though.

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