March 2025

BDHL WEALTH

March Market Update

Stagflationary Worries Persist

INFORMATION CONTAINED IN THIS REPORT CURRENT AS AT 28 APRIL 2025

Global share and bond markets endured a turbulent March quarter with share market indices sustaining significant falls. This accelerated in early April as reciprocal tariffs were announced by the Trump administration. This flip and flop tariff policy will continue to destabilise markets. Each time I have "put pen to paper" President Trump posts yet another update, the latest being that most Reciprocal Tariffs would be paused other than a base 10%, and that China tariffs would be further increased. It would appear that President Trump did not (and probably still doesn't) fully appreciate the implications of his aggressive policies.

The US bore the brunt of the market's wrath with ongoing trade tensions and broader political instability worrying the market. The NASDAQ saw an 8.1% fall whilst the broader S&P 500 index pulled back 5.8%. In Australia, despite a welcomed interest rate reduction by the Reserve Bank of Australia in February, investors sought to sell stocks across the board with the S&P/ASX 200 dropping 3.4% (having fallen 4.0% in February) whilst the S&P/ASX Small Ordinaries and S&P/ ASX Small Industrials Accumulation Indices retraced 3.5% and 6.7% respectively.

Survey data is now the most insightful information we can use to help analyse the economic tealeaves as we try to guess the impact of the tariffs on future economic growth and inflation. To this extent we look at sentiment and expectation surveys.

In the US, the preliminary April University of Michigan Consumer Sentiment Index fell to 50.8 from 57.0 in March which was well below expectations. The decline was broad-based, affecting both current conditions and expectations. Inflation expectations surged. Inflation expectations are important because they can influence actual price and wage setting. One-year expectations climbed toward COVID time highs at 6.7%, while 5-to-10-year expectations jumped to 4.4%, the highest reading since the early 1990s. A sustained rise in inflation expectations should make the Federal Reserve reluctant to ease policy, even as growth slows. This is because of the risk that a reduction in the Federal Reserve's Funds rate will spur growth and raise inflation from elevated levels. While political views can sometimes skew sentiment surveys, the deterioration was consistent across party lines. The recent consumer sentiment survey showed further weakness suggesting the likelihood that actual consumption, which has been the backbone of the post-COVID recovery will slow materially. Employment expectations have also deteriorated as businesses delay hiring and investment amid the policy uncertainty.

Emmanuel Calligeris
Chairman of the Investment Committee

Yet another market warning to the Trump administration came in the breakdown in the correlation between the US dollar, stock market and the bond market. The breakdown highlights mounting risk on US assets. Bond yields increased abruptly, a move that I expected quite some months ago. The bond market turmoil had already broken the positive correlation between stocks and bond yields when growth fears rise, but the dollar also fell victim to the shifts. Global growth scares usually drive the US dollar higher and bond yields lower. This time, the opposite happened. Other currencies benefited, including the euro, Japanese yen, British pound, and Canadian dollar. Yield differentials have failed to explain foreign exchange moves, pointing instead to an emerging exodus from US assets.

Year-over-year inflation continued to fall - Core personal consumption expenditure PCE (the Federal Reserve's preferred measure of inflation) slowed to +2.6% over the year, however, the recent month-on-month trend remains above the target. The uncertain outlook impacted profit expectations as the US share market saw profit downgrades by analysts. Profit estimates for 2025 are now -1% below their end-2024 levels.

In China, Beijing sees the tariffs as a declaration of economic war and has shifted towards a more confrontational stance. Policymakers are now prepared to let the currency weaken, framing it as a justified defence of Chinese industry. This clears the way for the PBoC to cut rates more aggressively, adding to downward pressure on the yuan and other emerging market currencies against the USD. From a political standpoint, China is better equipped than the US to endure short-term financial and economic pain for strategic gain.

In Australia, the latest OECD report cut the GDP growth projections from 2.5% to 1.8% in 2026. Our Federal Government went further, cutting economic growth in the March Budget from 1.75% to 1.5% for 2025. This is soft and it should see the unemployment rate increase. Whilst good for inflation, wage growth and consumption will remain under pressure. Interestingly, the Westpac–Melbourne Institute Leading Index, which indicates the likely pace of economic activity relative to trend three to nine months into the future, slowed to 0.6% in March from 0.9% in February. The softening marks an important shift. The Index is only just starting to capture the effects from the trade policy disruptions that escalated sharply following US President Trump's tariff announcement on April 2. The situation is uncertain and some further softening in the growth pulse looks likely in the months ahead.

Although we know that data remains moderate, increased tariffs will cause higher inflation and an eventual slowing of growth a term coined in the 1970's as 'stagflation'. We are looking around corners to try and determine the rate of slowdown and indeed whether a recession will be induced on the US. While reciprocal tariffs were postponed, overall US tariff rates remain at their highest since the 1930s. Even if China-specific tariffs are reduced, sector-specific hikes and higher tariffs on countries without US trade deals will likely offset this. Trade uncertainty is already weighing on growth, with job openings declining and real wage growth slowing. Real wage and salaries increased just 1% year-over-year in February and they are expected to turn negative, which will stall consumption.

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