Global Outlook

April 2025

This Time is Serious

Liberation Day tariffs signal a return to protectionist policies not seen since the early 20th century

The new tariffs will trigger a cascade of disruptions across trade, investment, and economic growth

In the US, the Federal Reserve won't be coming to the rescue

Elsewhere, inflation and monetary policy will be determined by how individual countries respond

Tariffs are just a part of a far bigger plan to make America great again, so buckle up

BEVAN GRAHAM

Implications For Investors

Markets are increasingly dismayed by US policy directions

Conditions are deteriorating, so continue to manage risks closely

It is too early to go bargain-hunting in stocks; stick with quality and cash-flow

Bonds also need active selection as credit risks and sovereign debt impact

GREG FLEMING

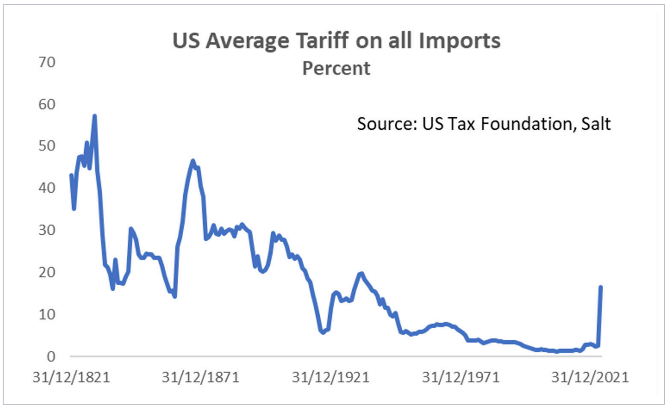
SALT
Funds Management

This time is serious

Note to readers: This report has been written during a period of significant policy and market disruption. Uncertainty is high and events are moving rapidly. As Yogi Berra once said, the future ain't what it used to be. Please note as you read this report that the text was finalised at 9.00am on Wednesday April 9th (NZT).

President Trump's "Liberation Day" tariffs surprised on both scale and the scope, marking a major break from decades of globalisation, signalling a return to protectionist policies not seen since the early 20th century. Further announcements are scheduled for April 9th.

The new tariffs, assuming they persist, will have profound implications for the global economy, triggering a cascade of disruptions across trade, investment, and economic growth. By imposing steep tariffs on key imports, the US is forcing global businesses to re-evaluate supply chains, which will ultimately lead to higher production costs and reduced efficiency. Over time, the fragmentation of global trade threatens to erode decades of economic integration, reduce global GDP growth, and foster a more unstable, competitive international economic order.



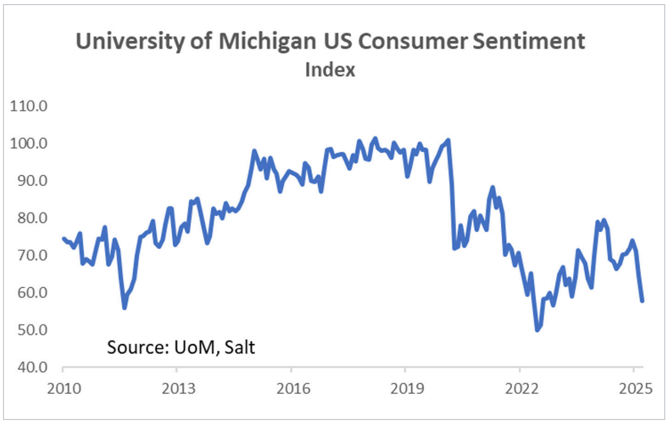
Much will happen in the coming days and weeks, and it remains to be seen which tariffs will remain as announced and which may be negotiated away, either in whole or in part. As we write, some countries have already retaliated in kind, while many are lining up to enter negotiations with the US for relief from the fresh tariff impost.

In the meantime, financial markets, politicians, central bankers and yes, even economists, are reeling from the biggest disruption to the generally accepted world order and rules-based trading environment in living memory.

US recession?

You may recall that in our January edition of Global Outlook, we anointed 2025 with the theme of "Uncertainty". In the first few months of the year, that uncertainty, especially as it related to tariffs, was already taking a toll.

US "soft" data, such as surveys of consumer and business sentiment, have taken a notable turn for the worse in recent months. The University of Michigan Consumer Sentiment Survey, shows US consumer sentiment has fallen sharply, driven mostly by a sharp rise in inflation expectations. Business sentiment surveys had also been weaker. For a firm, a loss of confidence means delaying a decision to hire someone, or to invest in a new piece of plant and equipment.



So, the mood was already dark and has more-than-likely darkened further since Liberation Day, especially for consumers given the extent of the drop in equity markets. Consumption spending was already moderating and will now likely slow further. Given consumption accounts for two-thirds of the economy how far this goes is critical for assessing the risk of recession.

A saving grace for activity in the near-term is that for some, lower confidence reflects grumpiness about higher prices and the prospect of loss of purchasing power which may have seen households bring forward purchases, particularly of larger consumer durable items. That will, however, leave a hole in demand further down the track.

A de-escalation of sorts is required to turn this around, so there is some hope if negotiations see proposed tariff levels reduced, thereby triggering an equity market partial recovery, but the President shows little sign of capitulation, at least for now.

To get to outright recession this year, we probably also need another hit to aggregate demand, such as fiscal policy. Our view prior to the election now looks optimistic. Our view then was that outside Medicare, Medicaid, Social Security, Veterans Affairs and debt servicing, there was little that could be cut. Mr Musk's Department of Government Efficiency has exceeded our expectations. Job losses will be a net loss to aggregate demand. It is, however, difficult to assess the overall impact on the economy.

On balance the best assumption right now is that the US is facing into a meaningful growth slowdown and recession risks have certainly increased, but it's too early to call a protracted contraction.

What's the FOMC to do?

Nothing, for now. At its March meeting the Federal Open Market Committee's (FOMC's) forecasts took a stagflationary turn. While interest rates were left unchanged, the Summary of Economic Projections showed slower growth and more stubborn inflation. Indeed, it is notable that nearly every participant now says risks to inflation are to the upside, risks to growth are to the downside, and risks to the unemployment rate are to the upside. But given the heightened level of uncertainty the appropriate policy path, as signalled by the infamous "dots", was unchanged at two 0.25% cuts this year and two cuts next year.

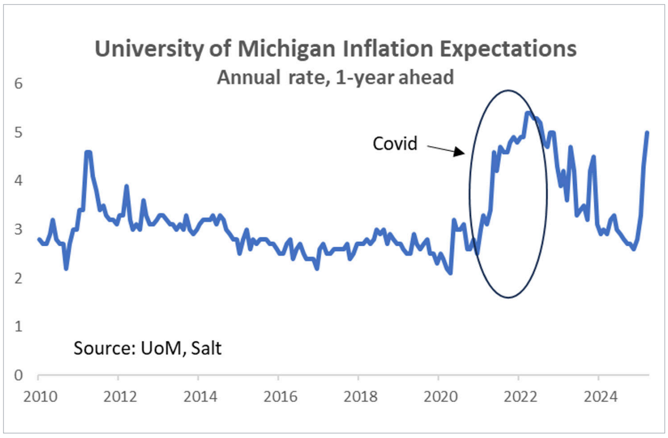
It was timely, therefore, that Fed Chairman Jerome Powell was scheduled to speak at a conference of business journalists just a couple of days after the Liberation Day announcement to provide us with at least a high-level assessment of his thinking after the event.

In those comments he acknowledged the tariffs were higher than expected and that the impacts on growth, inflation and the labour market will therefore also be greater than expected. But for the first time, he also acknowledged that the inflation emanating from the policy change may prove to be more persistent than first thought.

We concur with that assessment of the risk. Financial markets have quickly moved to price in up to four interest rate cuts from the FOMC this year. We are not convinced. While the impacts on growth are quite clear-cut, the impacts on inflation, especially longer term, are more ambiguous. And remember the Fed's dual mandate covers both inflation and the labour market.

Inflation expectations are critical

Powell also highlighted the need to keep inflation expectations well-anchored at 2%. But according to some surveys they have already become unanchored. In the University of Michigan survey, the estimate of annual inflation one-year out has increased to 5.0%. Five years out is now at 4.1%, the first time this has been above 4% since 1993.



In our view, the Fed also needs to be monitoring the labour market implications of tighter immigration restrictions. This part of the Trump administration policy program gets very little attention, but we worry about it a lot, especially given our view that most problems of persistent inflation emanate from the labour market.

Slower immigration means slower growth in the supply of labour which means slower growth in potential capacity of the economy. Slower potential growth means the Fed has to aim for slower growth in the economy to get inflation down to target, and a tighter labour market means that if employees seek higher wages in compensation for the loss of purchasing power, they are more likely to get them.

So, don't assume the Fed will come charging in to save the day. There will be no quick response, and that message was also reinforced by Powell on Friday. If you are looking for a quick interest cut, you will be disappointed. Our starting point assumption is no US interest rate cuts this year.

The good news is the US economy was in good health leading into the tariff imposition. Data out just before Powell's comments on Friday showed a still solid US labour market with stronger jobs growth over the month and a low and stable unemployment rate. The Fed has time on its hands before it needs to respond – one way or the other.

How is the rest of the world responding?

For the rest of the world, the implications on growth and labour markets are much the same as for the US: negative. The implications for inflation are more ambiguous with the result also determined, in part, by how individual countries respond to the new tariffs.

There are several ways countries can respond. These range from negotiation, retaliation – either with full blanket tariffs or more targeted measures, or to do nothing, at least initially.

Europe's initial response is to negotiate, offering up a "zero-for-zero" tariff deal for industrial goods. But they also appear ready to retaliate should their attempts at negotiation prove fruitless. Early signs are President Trump is not interested in Europe's proposal.

More generally the tariffs add uncertainty to an already fragile economic outlook, especially in export-driven economies like Germany and France. The outlook for inflation is more ambiguous and will depend on their governments' ultimate response. Retaliation simply imposes the same negative consequences for Europeans as Trump's initial tariffs do for Americans.

Overall, the tariffs threaten to dampen investment, disrupt supply chains, and, given the ambiguous inflation outlook, complicate the European Central Bank's efforts to balance achieving sustained target inflation with the desire to stimulate growth.

At the same time, Europe is about to experience a meaningful shift in German fiscal policy that will offset at least some of the tariff impact in Germany and therefore Europe.

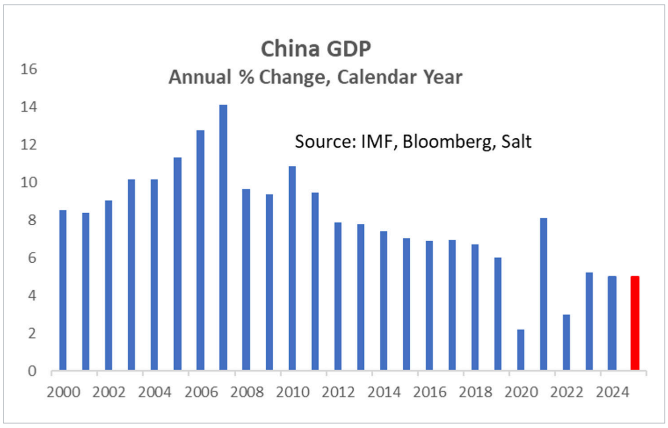
Germany has long been the bastion of fiscal caution in the Eurozone. Indeed, since 2009, Germany has had a "debt brake" built into its constitution. This law has required the federal government to limit its structural budget deficit to a maximum of 0.35% of GDP, while the German states are required to run balanced budgets, except under exceptional circumstances like a national emergency. But now, after two years of recession and clear signs from Washington that Europe will have to look after its own security interests, the new Chancellor-in-Waiting Friedrich Merz has engineered a significant shift in fiscal policy, enabled by a change to the constitution, that has secured a €1 trillion spending program on defence and infrastructure.

The more expansive fiscal policy and the tariffs will largely offset each other, but which side of the ledger comes out on top and what that means for inflation remains to be seen. For now, we expect the European Central Bank will continue to cut interest rates, though it's difficult to be precise about how much, right now. For now, we are sticking with our view of two further 25bp interest cuts, but that could quickly change.

China responds in kind

China responded to Trump's Liberation Day tariffs with a mix of condemnation and strategic countermeasures. Beijing criticised the tariffs as a violation of global trade rules and pledged to defend its economic interests, announcing targeted tariffs on select U.S. goods while accelerating efforts to boost domestic demand and diversify trade partnerships. Trump has re-retaliated with the threat of 104% tariffs on Chinese exports to the US.

The immediate impact on China's growth outlook is negative, as export sectors face greater uncertainty, disrupted supply chains and weaker external demand weakened. However, China's ongoing stimulus measures, including monetary easing and fiscal support, will help cushion the blow. That said, we were already of the view the 2025 growth target of 5% was a challenge.



As with the rest of the world, the inflationary implications are more ambiguous but come off a starting point of inflation being low and contained, reflecting several years' economic weakness.

Overall, the tariffs will only add to China's structural challenges, prompting a faster shift toward a consumption-driven economy while reinforcing a cautious approach to managing both growth and inflation risks.

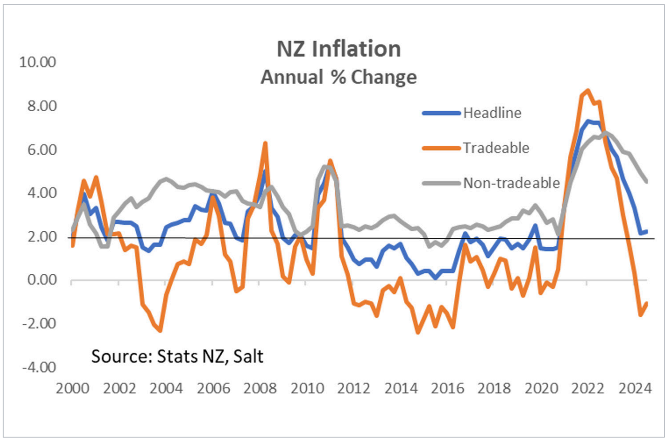
New Zealand turns the corner, slowly

New Zealand's response to Liberation Day has been entirely befitting a small, open, export country that relies on a rules-based trading environment to meet our growth aspirations: do nothing. In reality, it would be costly and therefore ultimately pointless to retaliate, and to demand an audience in which to negotiate with the President would likely fall on deaf ears, given our minnow status.

Leading into Liberation Day it was becoming clear the New Zealand economy was stabilising and slowly turning the corner. After two sharp contractions in the middle quarters of last year, the final three months of the year saw a return to modest growth. Our prior assumption was that the economy would remain flat-ish out to the middle of this year before staging a more meaningful pickup in growth in the second half of the year as the labour market starts to improve.

The direct impact of the tariffs cast a dampening pall over that trajectory. More meaningful than the direct tariff effect is the likely larger indirect effect of tariffs generating a lower growth environment in some of our Asian trading partners that spills over into their reduced demand for our products.

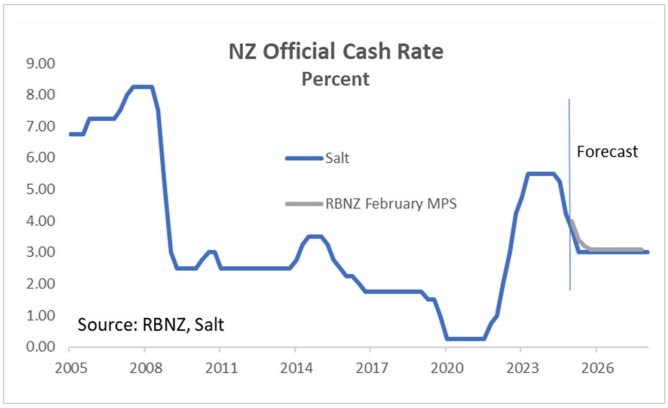
As in other countries, the inflation implications are harder to assess, as are the implications for monetary policy. The good news is we are starting from a point at which inflation is already back to 2% and monetary policy has already delivered a significant easing.



Looking ahead, our assumption of a relatively benign outlook for CPI inflation, borne of a combination of rising traded goods prices offset by continued non-tradable disinflation, has fundamentally changed. That's particularly so, given the likelihood of lower import prices as exports from other countries previously destined for the US look for a new home at likely discounted prices, offset by the lower NZ dollar. That said, the NZD is only back to its levels at the start of the year.

The point is there are a few moving parts and considerable uncertainty. In that environment we are expecting the Reserve Bank of New Zealand to deliver the well-flagged 25bp cut in the Official Cash Rate at their April meeting. The good news from a communicating-in-a-world-of-heightened-uncertainty perspective is this is just a Monetary Policy Review, not a full Monetary Policy Statement. So, just a press release for this meeting, with a full set of refreshed projections not being due until May.

We know in their last set of projections the RBNZ was undecided between two or three further 25bp cuts. I've been assuming two further cuts to 3.25% but now add the third, taking the OCR down to 3.0% as an acknowledgement of the downside risks to interest rates from here.



This isn't just about tariffs: the Mar-a-Lago Accord

An optimistic take on Trump's tariff strategy is that higher tariffs are the first play in resetting the baseline for negotiations with trading partners for trade access to the United States. Only time will tell.

The reality is that tariffs are but a tactical part of a grander plan to achieve the Trump administration's ambition to revive the US economy, particularly via a rejuvenation of its manufacturing sector. This plan has been borne of Trump's long-held view that, over time, the strength of the USD has hollowed out US manufacturing, and that the US has been "ripped off" over many decades by unfair trade arrangements, alongside either implicit or explicit security guarantees.

This policy plan to address these concerns runs far deeper than just tariffs. It is the construct of economist Stephen Miran who now chairs President Trump's Council of Economic Advisors. This plan or blueprint has become informally described as the "Mar-a-Lago Accord," perhaps drawing inspiration from the 1985 Plaza Accord. Its aim, put simply, is to reshape the U.S. economy by adjusting exchange rates, restructuring debt, and leveraging military and trade relationships in favour of U.S. economic dominance.

The key tenets of the plan are:

1) Weakening the US dollar. The plan seeks to lower the value of the dollar to boost American manufacturing and reduce trade deficits. This could be achieved through tariffs and foreign exchange

interventions, possibly using a U.S. sovereign wealth fund to buy foreign currencies like the euro and yen.

2) Debt Restructuring and Fiscal Realignment – The U.S. government would restructure its national debt by issuing ultra-long "Century Bonds" and forcing allies to absorb portions of U.S. debt in exchange for continued military protection.

3) Tariffs and Trade Leverage – The administration aims to use tariffs both as a revenue source and as a bargaining tool to pressure countries into accepting financial and security arrangements favourable to the U.S. This protectionist approach is aimed at encouraging the reshoring of manufacturing.

Path to Prosperity or Highway to Hardship?

The plan is deeply flawed for several reasons. First and foremost, 1985's Plaza Accord was built and enacted in a spirit of global co-operation. This plan is centred in confrontation and combativeness. It has shown more Discord than Accord in its early stages.

More specifically:

1) American consumers and producers will be the biggest losers - When the U.S. imposes tariffs on imports, foreign companies do not always absorb the added costs. Instead, American consumers and businesses end up paying higher prices. For example, tariffs on steel and aluminium have made it more expensive for American manufacturers to produce goods, weakening their competitiveness rather than strengthening it.

2) Global Retaliation - The aggressive tariff strategy rests on the assumption that other nations will passively accept U.S. demands. Right now, that appears unlikely. While many countries will choose to negotiate, failure to secure a favourable agreement is more likely to see countries reducing reliance on US markets and seeking alternative trade alliances.

3) Currency Manipulation Will Backfire - One of the more contradictory elements of the plan is its attempt to weaken the U.S. dollar while keeping it the dominant global reserve currency. A weaker dollar would increase inflation, making imports more expensive for American consumers, while also discouraging foreign investment in U.S. assets. If international investors lose confidence in the dollar, Treasury yields will rise. Also, Germany is about to issue a lot more debt; right now, would you rather hold more Treasury's or invest in the new supply of Bund's? Furthermore, manufacturing competitiveness requires far more than just a lower exchange rate: a skilled workforce and a strong environment for R&D are also essential.

4) Undermining Federal Reserve Independence: The plan's reliance on central bank coordination raises serious concerns about Federal Reserve independence. If the government pressures the Fed to support undesirably (from an inflation targeting perspective) lower interest rates and artificial currency adjustments, financial markets may lose faith in its ability to control inflation. This could trigger capital flight, higher interest rates, and economic instability.

5) Establishment of a Sovereign Wealth Fund: This is the most interesting part of the plan. At face value, such a fund has some merit. Why would it be a good idea to effectively monetise the assets on the federal government's massive balance sheet? Unlike countries that successfully operate sovereign wealth funds, such as Norway or Singapore, the U.S. lacks the political consensus and fiscal discipline required to manage a fund insulated from short-term partisan interests. American policymakers are deeply divided, and any large pool of public capital would inevitably become a battleground for competing agendas. Furthermore, the US already struggles with unsustainable deficits and mounting debt; diverting resources into a sovereign wealth fund would strain federal finances further without guaranteeing returns sufficient to justify the cost. In short, the plan is an ill-conceived attempt to impose a centralised investment strategy on a system inherently resistant to it.

6) Political and Market Instability - Even within the US, Congress, Wall Street, and financial regulators are likely to resist such an experimental policy framework. The uncertainty created by sudden shifts in trade and monetary policy would lead to higher market volatility, discouraging investment and destabilising the economy. One also wonders about the degree of patience amongst the American people to wear the higher prices, lower growth and higher unemployment that will define the first part of the strategy with no guarantee the next bit will even happen or deliver the expected benefits. The mid-term elections at the end of 2026 could be quite interesting.

7) Strains on U.S. Alliances - By conditioning security guarantees on financial contributions, the Mar-a-Lago Accord risks alienating NATO and Indo-Pacific allies. Many of these nations depend on U.S. security support but may be unwilling to pay what amounts to protection money. President

> Trump does not appears overly concerned by this possibility, but it could be an issue in regions where the U.S. is trying to counter China's influence.

While the Mar-a-Lago Accord aims to reassert U.S. economic primacy, it is a high-risk gamble with a high risk of unintended consequences. The plan overestimates U.S. leverage while underestimating global resistance, making it more likely to trigger inflation, trade wars, financial instability, and geopolitical backlash rather than economic prosperity. Without international cooperation and sound economic planning, the Accord is more likely to be remembered as a major policy failure rather than a turning point for the US economy

A better path to fairer trade?

Regular readers of our research will be aware that in 2021, as we were building our new diversified funds, we went through a process of identifying the key themes that our new funds would need to navigate over the next decade or two. De-globalisation was one of those themes. Collectively, those themes led us to the view that our funds would have to navigate a period of lower growth, higher inflation, and higher interest rates.

Global trade as a proportion global GDP has held up better than expected in the last four years, but now it faces its greatest test. Historically, increasing trade has been a clear benefit for global growth and has been a key contributor to lower inflation and lower interest rates around the world.

Around the world it has also lifted hundreds of millions of people out of poverty and has closed the inequality gap between rich and poor nations. However, it has contributed to rising inequality within countries. Discontent with that part of globalisation has been bubbling away since the aftermath of the Global Financial Crisis and has been a contributor to the rise of populism and more protectional ideals since then.

While globalisation has contributed to that problem, de-globalisation and going backwards is not the solution. As America imposes tariffs, other nations respond in kind, making it harder for American exporters to sell their products abroad. Farmers, manufacturers, and tech companies have all felt the sting of foreign retaliatory tariffs. This cycle of protectionism ultimately shrinks markets rather than expanding them, harming the very industries tariffs are meant to protect.

If the goal is to create a level playing field, there are far more effective and less damaging ways to do so.

1) Strengthening Trade Agreements - Instead of engaging in tariff wars, the U.S. should negotiate and enforce trade agreements that ensure a fair playing field. Multilateral deals offer a better way to set high standards for labour rights, environmental protections, and intellectual property. By working with allies, the U.S. can put pressure on countries that engage in unfair trade practices without resorting to tariffs.

2) Using the WTO and Targeted Sanctions - Rather than imposing blanket tariffs that hurt a wide range of industries, the U.S. should work through the World Trade Organisation (WTO) to resolve trade disputes. When necessary, targeted sanctions—such as restrictions on specific companies that engage in unfair practices—can be a more precise tool than broad tariffs that penalise entire industries. That said, we would be the first to accept that serious reform of the WTO was already required prior to Trump 2.0 to make it a more effective champion of free trade in the twenty-first century.

3) Investing in Domestic Competitiveness - If the US, or any country for that matter, wants to outcompete other nations, the best approach is to invest in itself. Funding education, infrastructure, and research & development will make American businesses more innovative and resilient. Policies that support advanced manufacturing, green energy, and technology will help the US stay ahead without resorting to protectionism.

A More Constructive Path Forward?

Fairness in our trading relationships is a legitimate concern, but tariffs are an outdated and ineffective tool. They create economic uncertainty, harm consumers, and escalate tensions without addressing the root causes of unfair competition. By focusing on trade agreements, enforcing rules through international institutions, and strengthening domestic industries, the US can promote fairness in global trade without resorting to counterproductive protectionism. Rather than engaging in trade wars, the U.S. should be leading the world in shaping fair, open, and rules-based trade. That is the true path to economic strength and global leadership.

Bevan Graham

Implications for Investors

The US equity market weakness that we warned of in our January Global Outlook came rapidly to fruition from the second half of February onward. A barrage of political broadsides emanating from the Trump Administration threw off course the earnings optimism-based market positivity that prevailed in 2024. Vulnerability to such US policy shocks was a key reason we implemented a more defensive positioning in diversified funds toward the end of 2024, and we have retained that throughout 2025 to date.

The question now is whether the negative "marking" from the market directed at the US leadership, alongside ever-weaker public sentiment, will sway the US government away from its attempts to apply more rounds of shock therapy in the cause of structural change. While there may be superficial arguments for liberating market forces and lowering state interference in the US policy mix, the American economy is a complex entity and disrupting major pillars of the system that business and consumers are accustomed to is perilous.

This point on the microeconomics is also valid for the macroeconomics of international trade. Although the US has an enormous internal market, most manufactures consumed in the country involve significant components that originate outside its borders. April began with a super-aggressive tariff salvo fired from the White House in virtually all directions, and many markets reacted with a rapid decline and sharp shifts toward the most defensive sectors, companies and securities. We had, to a degree, pre-positioned for a global asset reallocation away from the "US Exceptionalism" thesis, which relied too much on everything going (implausibly) well to be a sound investment case, given the transformed political environment.

From an investment standpoint, the attractiveness of US assets (whether equity or debt) will inevitably be diminished near-term, as even if improvements in efficiency and perceived trade equity do eventually emerge, the road to that end goal is highly uncertain and financial markets tend not to take such vital factors on trust.

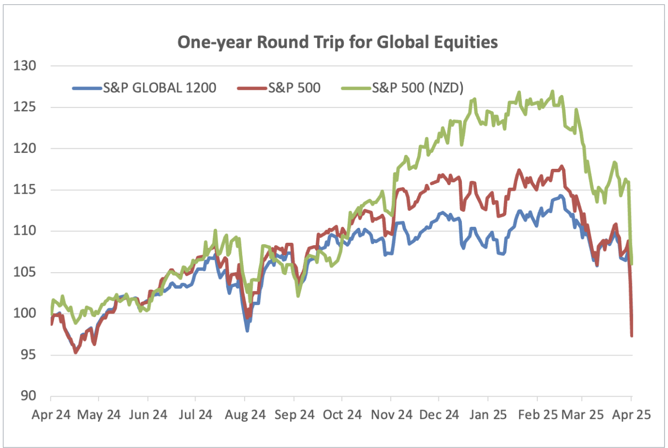
Probably the most significant market impact of the early-April tariff shock is that the sheer irrationality of such a move from the US has undermined the confidence of those investors who were giving the Trump Administration the benefit of the doubt. There has been a persistent school of thought that the "hard ball" negotiating style of the President and his team may be unconventional, but that they are ultimately business-friendly. That hope has been thrown into doubt, as no business can plan, allocate capital, hire staff or expand their marketing if their critical cost structures might shift drastically without warning. The yet-to-be-realised pay-off for disruption, in the form of tax cuts and lowered regulation, is still a promise rather than a reality.

Looks like investors finally found the catalyst

US equity market over-valuation has been an issue for some time. The question was, what would prove to be the catalyst for a correction and an enduring shift of funds out of the most optimistically-valued segments of the market? Recall that last quarter, we noted that the US Equity Risk Premium – the additional returns expectation from shares above that available from government bonds – had turned negative, and that thus some investors were prepared to effectively "pay" for the right to take on equity risk. We noted that this situation is rare, and proposed it suggested a correction could be near-at-hand.

The trigger for the overdue reconsideration of valuations and profit projections has now become clear – investors realise that the regular assumptions which a normal political environment allows them to take for granted can be stripped away quickly, if an unencumbered world leader decides to change the rules. The law of unintended consequences is one of the few reliable socio-political regularities, and the current episode of markets rapidly revising prior assumptions shows the law in action.

Consequently, the global equity markets have largely abandoned the optimistic hypothesis that Trumpism would present a bumpy political road, but that corporate profitability would remain largely unthreatened. In USD terms the American and Large Cap. Global equity indices have returned to slightly below their year-ago levels, while a decline over the period in NZD/USD has meant the US index is still around 6% higher in NZ dollar terms (after having been as much as 25% higher at the mid-February market peak.)



Source: S&P Global, Salt. Data as at 7 April 2025.

Trump bump rapidly mutates into Trump thump

As noted last quarter, some fairly "crazy kites" were flown during the US election a mere five months ago, but how many of them will ultimately land is unknowable. The tariff policies being unveiled and debates as at the time of writing suggest that it is safest to assume the probability of negative developments this year is high.

The sharp swing in the US political narrative away from the Biden administration's focus on industry-specific targeted stimulus spending toward the Republican prioritisation of deregulation and promoting (selective) US business interests introduces a vast degree of uncertainty, and investors need to be alert to both new opportunities and to the risks of severe disappointments. The American economy is a complex entity, which - while it is dominated by private consumer choices and a free-enterprise mindset with flexible capital markets – also relies substantially on the activities of State sector agents. Whether the latter can be substantially culled without negatively-disruptive impacts is fraught with potential unintended consequences.

While the recent focus has understandably been on the global impact of the "Tariff First, Ask Questions Later" salvo fired on 2nd April, the extremity of those measures has distracted attention from other problems in the US economy that are not particularly related to international trade. Economic growth momentum was already slowing before Trump's latest moves, and consumer confidence sharply weakening. Added to elevated uncertainty (which leads to postponed spending) the recent losses in portfolio value will act as a further drag on consumer spending. This compounds the already-flagged reductions in key planks of government spending. Rivalry in IT and AI as well as Electric Vehicles (EV) means those popular investments are no longer just a US story, and cost forces are coming into play.

There is a lot of economic activity in the US that relies on some form of government transfers or investments, even where some recipients of state largesse do not necessarily see it that way. One thinks of the numerous private downstream beneficiaries of massive military, social security or health spending. Key US professions also rely on interpreting (or contesting) the thicket of Federal regulations as their bread- and-butter work.

Acknowledgement from key US political players of a contractionary economic impact, as the Administration unfurls a swift and radical transition away from the status quo, has continued. However, for now, the US leadership appears unconcerned and in fact is defending the tariff initiative particularly with the zeal of true believers. It appears unlikely that there will be a substantial reversal of course. Further, high projected revenues from tariffs (coming in via the IRS to Treasury, from the US importers) are an important plank of the Republican Budget Reconciliation process which is designed to enable the extension of existing tax cuts and to give scope for more, as well as lifting military spending.

The Art of The Own Goal?

Before the post-inauguration Trumpian blitzkrieg of disruptions, markets had been optimistic on 2025, based on in the slowing inflation patterns observed in major economies, allowing central banks to progress to monetary policy easings, and on a continuation of decent corporate profits.

Corporate earnings in the US for the First Quarter of 2025 are just beginning to be reported this week, with a 7% annual earnings growth rate expected by analysts. This figure, while still respectable, has been revised downwards by 4% from the prevailing view at the beginning of 2025 when double-digit earnings growth was anticipated. The upcoming earnings releases will be more watched for management guidance, as the tariff news post-dates the end of quarter, although many firms will have pre-emptively begun adapting.

The jury is still out on whether there are any "saner voices" within the Trump Cabinet or Inner Circle, but if there are, the President may still choose to over-rule them. It also remains to be proven that damage to equity market capitalisation would be sufficient to sway his commitment to the MAGA reform agenda, because it is early in the Presidential term (although partial Congressional elections are coming due in 18 months' time.)

Sector concentration risk unveiled

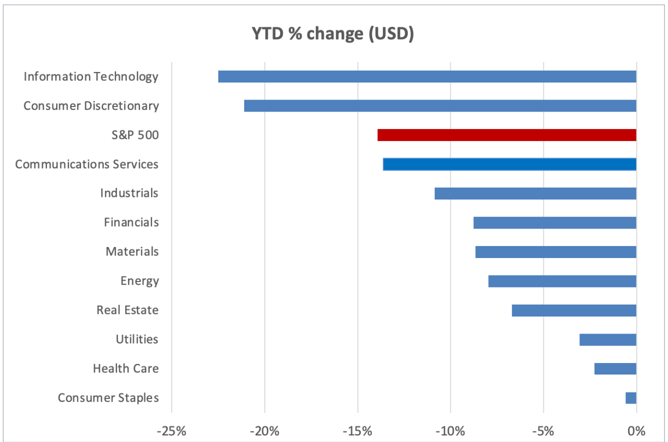
Over the last year, we have frequently observed the dangers in the burgeoning concentration of US market gains in the technology and communications services sectors, while also noting that there were some valid bases for valuing the sectors' best firms at a premium to the broad market. However, we have been skeptical of the durability of the "crowded trades" that resulted from momentum-driven and passive fund flows, and which were highly apparent by the end of 2024.

Tech had behaved as the undisputed engine room of US equity returns last year, and many managers concerned about valuations accordingly lagged benchmarks, as a small set of "Superstar stocks" contributed most of major index returns. Meantime, Staples, Health Care, Utilities and Real Estate trailed.

Although our investment partner Morgan Stanley's strategists noted that markets tend not to worry about high valuation multiples so long as strong earnings growth persists, any knock or fading in earnings growth can rapidly spell trouble, particularly for a distorted index which seemed to be priced for perfection.

The worst instances of over-valuation often developed at the nexus of Tech-Trump-Crypto themed securities, and assets qualifying for the status of "Trump Trades" were still powering ahead in January. However, from mid-February, a greater realism re-entered markets and the stage was this set for a negative catalyst, which was in the event unleashed by the sheer economic perversity of the tariff shock.

US S&P 500 sector returns in 2025



Source: Standard & Poors, data to 7 April 2025

The quarter ahead will provide more clarity on US corporate profits' trajectory, and whether market participants are prepared to look through the scale of economic disruption now that valuations are less stretched than they had become before April's severe correction. The tax cut programme working its way through the Republican-controlled congress could, if fully and swiftly enacted, provide quite a boost to prospective corporate earnings from 2026 onward. However, there is a heightened level of awareness now that almost anything is possible, where the Trump Administration is concerned, and that assuming anything in advance about the future policy mix is dangerous for investors. At present, analysts' US earnings revisions for 2025 are moving downwards but it remains unclear what the final variables from either tariff impact or tax changes will be, so analysts are awaiting further key information. Interest rate assumptions are also a vital factor at play, given that the Federal Reserve has very limited scope to deliver interest relief until it is more confident that another inflation spiral is not the post-tariff trajectory for US producer and consumer prices.

Corporate earnings diminishing as economy slows

During the first quarter of 2025, analysts lowered earnings per share (EPS) estimates by a larger margin, as compared to the three most recent quarterly averages. The Q1 2025 bottom-up EPS estimate (which is an aggregation of the median EPS estimates for Q1 for all the companies in the index) decreased by 4.2% from December 31 to March 31. At the time of writing, US earnings reporting season has just begun, and while historical earnings may satisfy these moderated expectations, the focus has shifted definitively onto the guidance that CEOs will provide on their enterprise's response to the palette of challenges now facing the US and global economy. Earnings warnings are never received well, in a market primed for bad news.

Source: MSCI, IBES MS Research as at 31 March 2025

The chart above shows the deterioration already noted in the balance of revisions for the US market. It seems certain that once post-April tariff impact information is provisionally incorporated in analysts' weighing of individual companies' outlooks and whether to downgrade their enterprise-specific forecast earnings, this downtrend will persist. In an environment of mounting pessimism on the US economy, expectations could be reasonably expected to undershoot as caution becomes the dominant mood.

Gauging the soundness of asset structures

After an extended period of bullish returns up until the broad US market peaked on 19 February 2025, followed by a severe reaction delivering an 19% decline in the S&P 500 (as at 8th April) there is considerable confusion about whether the new environment is stagflationary, recessionary, or merely highly disruptive but nevertheless still one that will resolve within an acceptable timeframe of three-to-six months.

We are not convinced that the current episode of intense volatility and risk-aversion is suited to the indiscriminate "dip-buying" approach which paid off in several prior corrections since Covid-19 hit markets five years ago. There are quite different wild card risks to returns now, which would not necessarily be quickly overturned by central bank liquidity injections.

As noted earlier, we tend toward the interpretation that US growth will slow sharply and that persistent need to contain inflation expectations will forestall a major monetary stimulus from the Central Bank. The ramifications of that scenario for investment assets are complex, but broadly, the safest course is to align portfolios with the most secure earning streams and the most defensible credit profiles. Sector-wise, this continues to argue for the best-quality and defensive equity sectors with individual selections taken from sectors such as Consumer Staples, Health Care, and carefully-chosen Financials.

Additionally, the world is entering an economic phase in which diversification really comes into its own. Investment portfolio allocators have been under some pressure in recent years to diminish the diversifying components of their portfolios, as concentration (its polar opposite) was rewarded due to a range of compelling market narratives and investment trends.

It is important to realise that the world has now entered a new, multi-year market cycle. The environment the world is leaving behind was one of persistently low interest rates, relatively low economic volatility, short recessions quickly combated with stimulus, few enduring geopolitical hostilities threatening economic growth, and therefore, a benign regime allowing equity returns that were persistently higher-than-historical norms.

The market cycle which has replaced that is one of normalised interest rates, slowing global growth (with many downward pressures and few accelerants) more economic instability and diminishing expectations for broad equity returns, accompanied by elevated volatility in both equity and bond prices.

Some asset structures that have in the past provided successful bases for portfolio investor returns relied on intricate component factors that can no longer be taken for granted. For instance, the delicate multinational supply chains critical to many manufacturers, the security of computer data and of information storage facilities, the easy rollover of maturing debt obligations and ample demand for international financing mechanisms, and the network of military and multi-lateral alliances which made most of the "Investable West" broadly comparable as a value-at-risk proposition. To adapt the words of Canada's very market-savvy new Prime Minister Mark Carney, "those old relationships are over."

However, investors will likely take some time to adapt to the changed circumstances and this raises the risk that some will continue to apply what they regard as "tried-and-true" playbooks in a period where critical factors have changed more profoundly than they are willing to acknowledge. The tension between these new market influences and established allocation practices is guaranteed to prolong volatility, as investors and traders test sets of hypotheses and initiate (or reverse out of) their strategies swiftly.

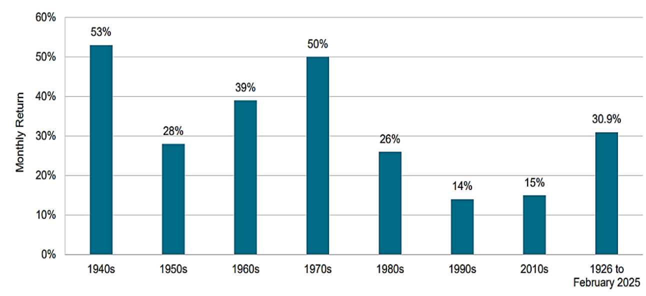
Crucial differentiating characteristics of real assets and dividend-payers

Aware as we have been of the rising risks to broad equity markets, in addition to our focus on Quality as a selection criterion, we have been consistent in highlighting the distinctive features of the Real Asset classes, listed global infrastructure and property, and we believe these are well-suited to a new market regime which could well persist through the rest of the 2020s.

Don't diss. dividends

A first point to make is one that is easily overlooked, in an investment climate that has been transfixed for more than two decades on the capital gains available from a subset of "growth" equities. That is, that the ability to pay steady and sustainable dividends over time, which can compound when re-invested, historically makes up a substantial share of the total returns from equities. In some decades, such as the 1940s and 1970s, dividend income accounted for more than one half of total returns, whereas during the 1990s, dividends accounted for as little as 14%. Dividend payers are often (but not always) "value" stocks, which have been out of favour in the last decade or so.

Dividend Income as a Percent of Monthly Total Return of the S&P 500



Source: S&P Global, Salt

Companies use stable and increasing dividends as a signal of confidence in their firm's prospects, while market participants consider such track records as a sign of corporate maturity and balance sheet strength. While in the century to 2025, for the S&P 500 Index dividends account for 31% of total returns on average, if all dividends received were hypothetically immediately re-invested in the Index, compounding would mean that the dividend streams converted back into equity would dominate returns.

Bearing in mind that in the decade ahead, due to cyclical and valuation considerations it is possible that the scope for substantial capital growth scope for US equities will be erratic or at times supressed, it makes sense to look to the parts of the listed equity markets where capital gain potential is supplanted by sustainable dividend provisioning. Consumer Staples, Health Care, Financials, Industrials, Real Estate and Utilities are reliably the sectors where quality dividend-paying equity opportunities are located.

To go further, in addition to an actively selected portfolio of equities we also favour the specific addition of listed real assets. Such a supplementary dedicated real asset portfolio pillar offers under-appreciated merits of diversification and cyclical resilience.

Our investment partner for listed real assets, Cohen & Steers, have reprised the compelling arguments for considering the inclusion of such assets in multi-sector portfolios. They noted this month that "Real assets have less exposure to tariffs relative to many other asset classes, generally predictable earnings, and are well positioned in a new market cycle." Other positive features given current risks are:

- Real assets tend to generate predictable revenues, and high dividend yields due to longer-term leases or contracts. Those less volatile earnings streams have provided strong returns historically but can be particularly attractive in times of market uncertainty.
- Most real assets have much lower direct exposure to tariffs than many other asset classes.
- They generally are not exporters or major importers.
- Real assets are benefiting from strong secular themes that we believe will keep their momentum almost regardless of tariff pressures.
- The starting point for valuations for real assets is relatively attractive.
- Real assets have historically outperformed in inflationary environments, particularly when inflation surprises to the upside. Tariffs will significantly contribute to deglobalisation, geopolitical friction, and more elevated commodity prices, each of which is inherently inflationary.

An investor with more elevated listed real asset holdings and commensurately lower broad, market-capitalisation driven equity share of portfolio would already have seen the benefits in the course of 2025. Our own funds in these asset classes have (as at the time of writing) proved more resilient to the Tariff shock and to cooling economic forecasts for 2025-26, with Year-to-Date returns for listed infrastructure in particular (whilst down around 3%) are significantly better than the negative returns from the international equity asset class (expressed in local currency terms.) Although bond interest rates have been volatile and no sustained down-shift in sovereign yields has developed despite the growth shock, the Real Asset classes have as expected shown considerable diversification merit since Trump's inauguration in January.

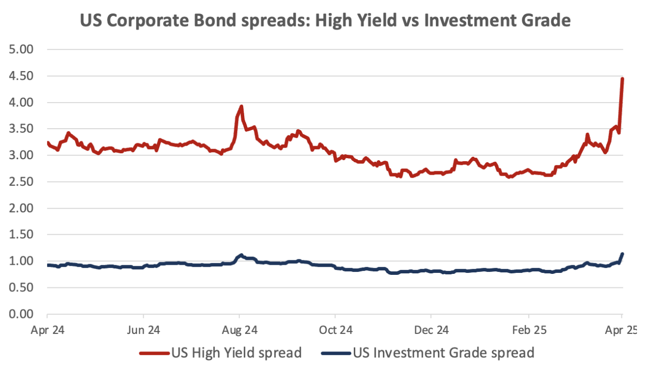
Fixed Income exposures still need to be active

Forward-looking rates markets have recently re-calibrated to factor in some scope for small interest rate reductions in 2025 for the US, which the Federal Reserve has attempted to manage via "Fedspeak," so that markets do not rush to price in any "emergency easings" of the Fed Funds Rate. Returns from government debt securities have remained volatile. The US 10-Year Bond yield has fallen by 0.4 percentage points since the New Year, although yields on Treasury maturities longer than 7-Years have not sustained any moves below 4.0%. Sovereign debt investors still must uneasily contemplate the high Treasury issuance schedule ahead, alongside Republican fiscal stimulus via tax cut extensions.

We therefore maintain our high conviction that the prudent course is not to substantially lift sovereign bond allocations (as one might in anticipation of recession) but rather, to continue to select very well-diversified and differentiated specialised types of fixed income securities from credible global issuers.

As shown below, while in the US and elsewhere, credit investors have at last awoken and begun more actively pricing risk into their debt securities, the adjustment upward in spreads has so far been predominantly a High-Yield (below BBB- rated) phenomenon. The Investment Grade spread is often a good barometer of impending recession or equity bear market, and we will be alert to any further deterioration in that indicator (which has a 3–6-month lead time on historical average.)

Give credit where its due



Source: ICE. Bank of America, St Louis Fed. Data to 4 April 2025

We see limited scope for spread compression, as spreads are unlikely to retest the historically-narrow levels seen in the First Quarter. But in the bull case of lighter tariff implementation in the course of the Second Quarter than had been initially feared and a quicker policy resolution, our investment partners at Morgan Stanley see the High Yield spread moving back toward +300 basis points. At the same time, they have revised the expected 2025 default rate forecasts upward. Slower growth and more limited policy easing pose increasing risk for credits at the lower end of the quality spectrum.

That all means that while a meaningful allocation to credit is desirable and its shorter typical duration profile makes it less prone to inflation surprises, responding to the Trump Tariff Turbulence news-flow by shifting allocations substantially in favour of bonds remains premature. We will revisit this in the course of the current quarter but see a mid-year addition to fixed income allocations in multi-sector funds as more probable.

New Zealand equities were forming a base, until…

Whilst the New Zealand economy is still in the throes of the very difficult domestic trading environment, we believe that the easing path now well-advanced by the Reserve Bank of New Zealand and the defensive nature of the industries that are heavily represented on the NZ exchange means that we can anticipate a our NZ equity holdings contributing improving returns to the total returns of both the Salt Sustainable Growth and Income Funds. However, as the negative influence of US markets never leaves New Zealand unaffected, this exposure should be carefully managed, and we are only cautiously and incrementally adding to the NZ equity positioning in our diversified funds.

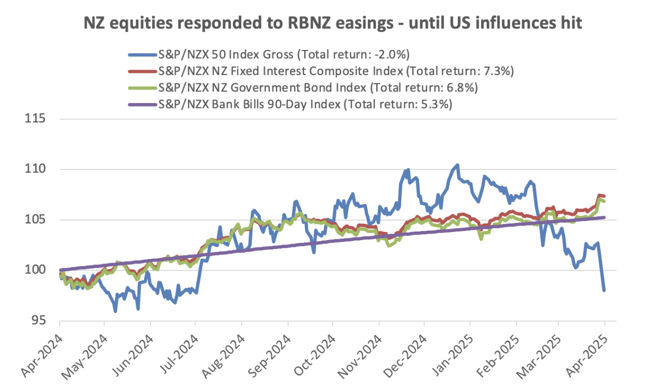
There are many unresolved macroeconomic and industrial uncertainties affecting the domestic share market. Nevertheless, the investment managers domiciled in New Zealand (particularly KiwiSaver managers) can be substantial marginal buyers of domestic shares, and on fundamentals, there is a rising rationale for re-building domestic share allocations within multi-sector portfolios.

This has been supported by a sense that the NZ corporate earnings downgrade cycle is at an advanced stage, and that the latter part of 2025 could begin to see positive surprises in guidance. Certain fundamental valuation indicators like our Equity Risk Premium measure have recently signalled that the domestic market is slightly "cheap" to Fair Value (rather than neutrally-valued previously.)

However, headline risks remain as enterprises are still being liquidated and the Government has not yet identified a "circuit breaker" for the rather downbeat domestic economic narrative, leading to substantial emigration flows across the Tasman which weigh on private demand.

The most recent hit to sentiment is of course the imposition of a 10% tariff on NZ exports into the US, which – though milder than the imposts placed on many of our export competitors – will nevertheless hit earnings from listed exporting companies who manufacture outside the US and will have second-round effects in suppressing demand from our Asia Region customers, who have been hit much harder in the Tariff Schedule announced on April 2nd.

NZ equities' improving trend interrupted by US correction



Source: S&P Global Indices, data to 7 April 2025

Greg Fleming

Strategy conclusions

We expect 2025 to be choppy, as positive tailwinds fade for Growth assets, but conditions should incrementally improve for select Income types. In our Sustainable Income Fund, we continue to diversify via superior yield sources into the global bond markets and will begin incrementally moving from neutral, to a small overweight position in global fixed income securities. In our Sustainable Growth Fund, we took opportunities to lower the International Equity exposure a little further, as the "Trump and Tech effects" narrative prevailing late last year has been overturned by total unpredictability. Thus, we do not yet favour buying on weakness and anticipate more volatility given the slowdown building in US and global growth. We have a modest overweighting to Global Bonds within our Growth Fund, and will retain this tilt.

Our current investment market views are:

- US corporate earnings are less central to market prices, given the political shock factor, but in the medium-term earnings-derived valuations matter, to sort vulnerable from resilient enterprises.
- Equities (as a whole) should see average annual returns close to their long-term norms in the next 3 years, with interim weaker periods. The correction we argued was near in January is now in full swing. We are not yet prepared to rule out a bear market, but a US recession would be required.
- Selected equity sectors and markets have scope for resilience and show desirable investment features. There are all-weather stocks and defensive sectors that have lagged in recent years. Consumer Staples stocks and Health Care stand out.
- Within the broader market sectors, thematic and valuation support in Utilities and Consumer Staples, Healthcare, and Software as a Service (SaaS) enjoy pricing power which assists them to ride out sentiment storms on a medium-term timeframe even as fundamentals deteriorate.
- We will remain unhedged in International Equities (not Listed Real Assets) as the "natural hedge" of NZD's tending to fall in market shock periods has once again assisted in cushioning negative returns.
- Listed real assets still offer superior, defensible yields, can partially hedge against economic slowdown in a fraught macroeconomic and geopolitical phase, and increasingly stand out as cash interest rates slide.
- We see much better compensation for duration risk in bonds. However, yield levels will remain volatile. Within fixed income, thematic support is ready to be a prime differentiator, as sovereign and corporate bonds face major refinancing risks.
- We acknowledge sustainable, labelled and "green" bonds as a valuable theme, and this market will survive present US political hostility to ESG.

SALT

Funds Management