Multi-Asset Perspectives

March 2025

1. Macro

- **Manufacturing indicators were mixed.**
  - **a)** Our global Manufacturing PMI index eased to 49.6 from 49.9 as U.S. dipped to 49 from 50.3. China improved marginally to 50.5 from 50.2.
  - **b)** Our leading regime indicator ticked up marginally, staying in mildly expansionary zone. The threat of tariffs under the Trump administration has been providing a short-term boost.
  - **c)** Economic surprises were positive in China and Europe, but negative in Japan and U.S.
- **Global financial conditions** (FCIs[1]) tightened due to wider spreads and weak equity momentum, though lower interest rates offset some of that drag.
- **Global inflation** dropped slightly to 2.5% in February 2025. Sixteen countries saw lower inflation rates, while seven saw higher rates. In developed countries, inflation was 2.4%, and in emerging markets, it was 3.5%, with a significant decrease in Asia. However, tariffs have caused people to expect higher inflation in the future.

2. Bottom-up

- Global credit **rating upgrades to total changes** were at 46% versus 50% at the end of 2024. Global IG was at 63% (66%) and Global HY at 37% (41%). Early days yet as rating actions have been limited thus far this year, but *if tariffs do cause growth to splutter, spreads are destined to widen, baking in increased credit stress.*
- **Expected earnings growth** for 2025 for MSCI AC World ticked up to 12% (+1%) with S&P 500 at 11% (+1%). IT (20%↓), Materials (18%↑) and Health Care (17%) and are expected to drive earnings growth with Financials (6%), Energy (7%), Staples (4%↓) & Utilities (5%) being the laggards. It will require both topline growth and solid margin expansion for expectations to be met at the index level. *Tariffs will cause analysts to downgrade earnings estimates in coming months.*

3. Valuations

- The U.S. 10-yr treasury yield, at 4.2%, moved towards the lower end of our model implied fair value range of 4-4.8%.
- A widening in spreads caused the U.S. IG [2]Index spread to finish at 32nd percentile in history vs. 21st the month prior and HY index spread at 30th percentile from 6th. The picture was broadly similar for ultra-long spreads (30-yrs), where A-rated finished at 44th percentile (31st) and BBB-rated at 25th percentile (13th). Post tariff widening in the first two days took spreads to their long-term medians for IG, HY and A-rated long bonds. BBB rated long bonds were at 38th %ile.
- Global equity valuations remained expensive, though a little less so than the month prior. MSCI ACWI was cheaper than current levels 87% of the time in history (93% prior month), driven by expensive U.S. stocks that remain expensive relative to ex-U.S. stocks (85th percentile vs 96th the month prior). Latin America and Asia remained cheap. U.S. Large Caps remained as expensive relative to small caps as they have ever been. *The post-tariff market shock would have pushed equities towards a neutral valuation zone.*

4. Markets during the month

- **Global Equities** dropped as tariff worries dented U.S. market sentiment further. U.S. equities underperformed the rest of the world yet again, with S&P 500 down -6% relative to -0.2% in MSCI AC world ex-US. 45% of the global markets we track gained though the median currency return was -1%. Latin American equities outperformed alongside India. The Chinese equity complex ended with marginal gains too. Within U.S., Nasdaq (-8%) had another bad month, impacted by two key factors. One was the sharp

[1] Financial Conditions Index
[2] Investment Grade

growth/momentum unwind on risk-off sentiment, and the second was related to free cash flow and margin pressure (huge capex spending plans on AI, potential tariff impacts given a globally integrated model followed by the tech leaders). Value and low volatility stocks outperformed. U.S. small caps were equally impacted (higher inflation pressures and potentially weaker growth). U.S. Reits (-4%) outperformed equity markets (-6%). *Post tariff action was deeply negative with U.S. equity indices crashing 9-10% in two days of trading (3rd and 4th April 2025). International equities fared better, with MSCI AC World ex-US Index dropping just -4%.*

- **Fixed income**
  - **Policy Rates:** Six rate cuts (ECB, Canada, Switzerland, Denmark, Mexico and Turkey) lowered our global policy rate indicator -7bps to 4.13% as focus shifted to growth in several economies. Brazil hiked 100bps (375bps in six months) to bring inflation expectations under check. The U.S. Federal Reserve stayed put at two cuts this year in its latest forecasts despite lower growth, but the market had moved to three even before the tariffs were announced. Our economists expect two cuts in their base case, but tariff developments are likely to induce them into baking more cuts. *Markets moved to pricing four cuts after the tariff announcements.*
  - **Bond Yields:** Our Global Sovereign 10-yr yield indicator ticked up 13bps to 4.25% as yield curves steepened, baking in potentially stickier inflation. U.S. 10-yr yield ended unchanged at 4.21%. with the 2-10 U.S. treasury spread widening 10bps to 32bps. *Post-tariff action was a noticeable downward shift in sovereign bond yields, with U.S. 10-yr treasury finishing at 3.99%.*
  - **Credit Spreads:** Credit spreads widened for a second successive month on rising economic uncertainty. U.S. IG +7bps to 94bps, and HY +67bps to 347bps but both remained on the tighter side relative to history. *Spreads widened significantly after the tariff announcements, with IG finishing at 115bps and HY at 427bps.*
  - **Returns:** Returns were muted, with wider credit spreads eating into returns. *Post-tariff action was tilted in favor of sovereign duration as credit products took a hit due to widening spreads.*
- **Currencies:** U.S. $ weakened yet again, with weakness more widespread (against 80% of the currencies) than in February. Bloomberg's U.S. $ Spot index eased -1.8% and the broad trade weighted dollar index -1.4%. U.S. $ remained overvalued based on real effective exchange rates. A mercantilist administration would welcome a weaker currency. *Post tariff action was a further weakening of the greenback as concerns mounted the trade action could dim the allure of the U.S. currency as a store of geopolitical value.*
- **Commodities:** The GS commodity index gained 3%, with gains across the board barring agricultural commodities (-2%). Precious metals ended the quarter with a whopping 19% gain as countries like China continued to buy gold to diversify their foreign exchange reserves, and higher haven investor demand in an environment of rising geo-political tensions. *The post tariff sell-off was brutal, with energy prices cracking -12%, base metals -8% and even precious metals -5%.*

5. U.S. Property Indicators

- U.S. housing affordability remains weak but is bottoming out with the recent decline in yields. Indeed, the 30-yr mortgage rate has dropped to 6.7% from a 2024 high of 8%. The residential sector remains in good stead, with low U.S. mortgage debt/GDP (45% vs 70% pre-GFC), high home equity (~75%), and low interest rates on outstanding mortgages (4.03% vs new 30-yr mortgages at 6.7%). Muted supply of existing homes is helping too. Lower mortgage rates could draw both buyers and sellers into the market, leading to better price discovery. Based on the Case-Schiller 20-City Price Index, home prices grew 4.7% in Jan'25 after rising 4.5% in 2024.
- The commercial property sector recovery continues, though at a slow pace. Public Reits markets, which tend to lead the private markets by 12-18 months, outperformed U.S. equities by 5% in 1Q25 though the recovery shown by office Reits late last year seemed to falter (it underperformed overall Reits by -11%). Real Capital Analytics' (RCA) indices show core commercial property prices gained 2% YoY in Feb'25. Sector level change was -3% for offices (-1% for suburban, -3% for Central Business Districts, CBD), -1% for apartments (oversupply is working itself out), and 5% for industrials.

6. Liberation Day Tariffs

- On 2nd April, the U.S. Government announced **reciprocal tariffs** on imported goods, subject to a base tariff of 10% on all. The severity of tariffs exceeded all market estimates, sending risk assets into a freefall. The tariffs also sharply raise the probability of a recession at a time when the U.S. economy was already slowing.
- The reciprocity in tariff calculation was not based on the average level of tariffs charged by other countries on U.S. goods exports, rather a formula which used a ratio of U.S. goods deficit with a country relative to that country's total exports to the U.S., with a tariff equal to roughly 50% of that ratio. For instance, if U.S. had a deficit of $60bn and total imports of $100bn from a country, the country was deemed to be tariffing U.S. goods at 60%, and a reciprocal tariff of 30% was levied on it. The goal seems to be to recover substantially the U.S. goods deficit through tariffs. In 2024, U.S. imported goods worth $3.3 trillion, and exported $2.1 trillion, leading to a deficit of -$1.2 trillion.
- Our economists estimate the average tariff rate to be in the vicinity of 25% before exemptions. Factoring in exemptions and using some other assumptions, we estimate the Government could be targeting a 20% tariff on all goods, which could get them $660bn in annual tariff revenues using a very simplistic model, as detailed below.

US$ Bn	Exports by U.S.	Imports by U.S.	U.S. Goods Deficit	Deemed Tariff on U.S. exports	Discounted Reciprocal Tariff	Other Tariff	Total Effective Tariff	Estimated Annual Tariff Revenue [c]
China	144	439	295	67%	34%	20%	54%	237
EU	370	606	236	39%	20%	0%	20%	121
Vietnam	13	137	124	91%	46%	0%	46%	63
Taiwan	42	116	74	64%	32%	0%	32%	37
Japan	79	148	69	47%	24%	0%	24%	36
South Korea	66	132	66	50%	25%	0%	25%	33
Mexico [a]	334	506	172	34%	0%	10%	10%	51
Canada [a]	348	413	65	16%	0%	10%	10%	41
All Others [b]	704	803	99	12%	5%	0%	5%	40
Total	**2,100**	**3,300**					**20%**	**659**

a. *Canada and Mexico tariff rates are assumed at 10% to account for other tariffs imposed on them though they were exempted from reciprocal tariffs.*

b. *Tariffs on all other countries was assumed at 5% to account for exempted products like pharmaceuticals and chips, specific tariffs, and the base level of 10% on all imports.*

c. *No elasticity was assumed to announced tariffs i.e., imports and exports were assumed to be at 2024 levels, though they would very likely undergo a shift in the years to come.*

- The U.S. Government has offered to negotiate with a warning that consequences would be bad if countries retaliated.
- Given the market backlash, the Republican leadership must be under pressure to get the budget passed as soon as possible to restore expiring tax cuts under the Tax Cuts and Jobs Act of 2018 (a key election promise). Assuming an annual $350bn deficit impact from renewing the cuts, and an additional $50bn of additional giveaways, the Government must show revenue generation of at least $400bn annually. Since other sources of revenue are not visible immediately (if the U.S. is able to push up its export share of global trade by forcing other countries to bring down their duties, the benefit will flow over a period), the estimated tariff revenue becomes critical in getting the budget passed to get the tax measures through. That implies a few things -
  - Serious negotiations on reducing tariffs would begin after the budget is passed
  - There is a minimum level of tariff revenue below which the Government would not want to go to if they are serious about reducing the burgeoning deficit.
  - If the tariffs stay, the burden will be shared by overseas producers, many of whom are suppliers to U.S. companies, U.S. consumers (higher prices), and domestic sellers (lower margins).
  - U.S. corporate margins, running at decadal highs, could take a hit though tax cuts would, over a period, result in higher nominal growth rates.

- Markets will likely remain volatile as they digest implications of this significant change in the world order.

Summary

a. Growth

Weaker

While manufacturing activity in the last few months was supported by inventory build ahead of potential tariffs, trade and tariff uncertainty has softened the forward-looking outlook in recent weeks, particularly in the U.S. and countries closely tied to it through supply-chain dynamics (Mexico, Canada and China in particular). For the U.S., our economists lowered their U.S. growth forecast for 2025 to 1.9% from 2.2% earlier (growth averaged 2.8% in 2024). They are also building a mild recession (-0.7%) in their downside scenario. On the other hand, Europe, under pressure from the U.S. to shore up its defense spending, and to counter downside from U.S. tariffs, embarked on what could become a meaningful fiscal regime shift. The growth uplift will depend on the speed at which they can agree on plan details and start spending. In China, trade which propped growth in 4Q24 (advance buying by importing nations ahead of tariffs) could become a headwind in 2025. Fiscal spending and monetary support hold the keys to their 2025 growth target of 5%. *Risks to global growth are tilted to the downside, given the tariff announcements*.

b. Inflation

Higher

Tariff impacts are being reflected by rising inflation expectations in the U.S. The Michigan 1-yr and 5-yr inflation have jumped in recent weeks, as also the break-even inflation implied by 1-2year TIPS. While the jury is out if the effect of tariffs will be transitory or permanent, one thing to note is that creation of trade hurdles to force onshore production would generally enhance pricing power of incumbents.

c. **Global financial conditions**

Range bound

Financial conditions tightened due to wider spreads and weak equity momentum, though lower rates offset some of that drag. We continue to expect financial conditions to be range bound (offsets between risk premiums and rates) though a stagflationary environment would start tightening them by expanding risk premiums without a commensurate offset from interest rates.

d. Risk premia

Tight

- **Risk-free rates** continue to present positive yielding anti-fragile alternatives.
- **Equity Valuations** remain expensive in the U.S., though a little less so after the March correction. They remain fair to cheap in most emerging markets.
- **Corporate spreads** widened from multi-year tights, baking in growth softness.

e. Asset allocation orientation

Defensive

Tight risk premia keep our stance defensive despite the noticeable downturn in investor sentiment in recent weeks. Key sources of frustration for risk assets are-

- Failure of the U.S. administration to strike deals leads to high mutual tariffs that pushes the global economy into stagflation.
- Consumer credit starts weakening as lower income households run out of excess savings at the same time as employment starts weakening.

Tax rates rise globally as governments try to flatten the income curve to fund expanded budget deficits.

Risk considerations
Investing involves risk, including possible loss of principal. Past Performance does not guarantee future return. All financial investments involve an element of risk. Therefore, the value of the investment and the income from it will vary and the initial investment amount cannot be guaranteed.

Important information
This material covers general information only and does not take account of any investor's investment objectives or financial situation and should not be construed as specific investment advice, a recommendation, or be relied on in any way as a guarantee, promise, forecast or prediction of future events regarding an investment or the markets in general. The opinions and predictions expressed are subject to change without prior notice. The information presented has been derived from sources believed to be accurate; however, we do not independently verify or guarantee its accuracy or validity. Any reference to a specific investment or security does not constitute a recommendation to buy, sell, or hold such investment or security, nor an indication that the investment manager or its affiliates has recommended a specific security for any client account. Subject to any contrary provisions of applicable law, the investment manager and its affiliates, and their officers, directors, employees, agents, disclaim any express or implied warranty of reliability or accuracy and any responsibility arising in any way (including by reason of negligence) for errors or omissions in the information or data provided.

This material may contain 'forward-looking' information that is not purely historical in nature and may include, among other things, projections and forecasts. There is no guarantee that any forecasts made will come to pass. Reliance upon information in this material is at the sole discretion of the reader.

Proprietary model output is based upon certain assumptions that may change, are not guaranteed, and should not be relied upon as a significant basis for an investment decision. Forecasts for each asset class can be conditional on economic scenarios; in the event a scenario comes to pass, actual returns could be significantly higher or lower than forecasted. Because of the inherent limitations of all models, potential investors should not rely exclusively on the model when making an investment decision. Forecasts of financial market trends that are based on current market conditions constitute our judgment and are subject to change without notice.

Indices are unmanaged and do not consider fees, expenses and transaction costs are not available for direct investment. The information provided here is neither tax nor legal advice. Investors should speak to their tax professional for specific information regarding their tax situation.

This material is not intended for distribution to or use by any person or entity in any jurisdiction or country where such distribution or use would be contrary to local law or regulation.

Disclaimer:
Ahli United Bank B.S.C.(c)
Bahrain: The views contained herein has been obtained from sources that Ahli United Bank B.S.C.(c) ("AUB") deems to be reliable but Ahli United Bank B.S.C.(c) makes no representation about the accuracy, completeness or timeliness of any information prepared by a third party and assumes no liability for the reliance thereon. The opinions and predictions expressed in the materials are subject to change without prior notice and has not been prepared by or with the involvement of Ahli United Bank B.S.C.(c); however, Ahli United Bank B.S.C.(c) does not independently verify or guarantee its accuracy or validity. Subject to any contrary provisions of applicable law, Ahli United Bank B.S.C.(c) and its affiliates, and their officers, directors, employees, agents, disclaim any express or implied warranty of reliability or accuracy and any responsibility arising in any way (including by reason of negligence) for errors or omissions in the information or data provided. Any forecasts, figures, opinions or investment techniques and strategies set out are for information purposes only and derived from numerous sources, based on certain assumptions and current market conditions and are subject to change without prior notice. All information presented herein is accurate at the time of production, but no warranty of accuracy is given and no liability in respect of any error or omission is accepted. IMPORTANT – If you are in any doubt about the contents of this document you should seek independent professional advice. AUB will not act and has not acted as your legal advisor to you in connection with this, and/or any related transaction and no reliance may be placed on AUB for advice or recommendations and/or solicitation of any sort. Ahli United Bank B.S.C.(c) is licensed as an Islamic Retail Bank by the Central Bank of Bahrain ("CBB"). For additional information about Ahli United Bank B.S.C.(c), please visit www.ahliunited.com/bh.

Dubai International Financial Center: This material is for distribution by Ahli United Bank B.S.C (C) (DIFC Branch) which is regulated and authorized by the Dubai Financial Services Authority (DFSA). This presentation/document is for information purposes only and is not an offer to sell or a solicitation to buy any fund, units, shares, securities, or financial products. Reliance should not be placed on the views and information in these presentations when making individual investment and/or strategic decisions. It is only intended for Professional Clients and/or Market Counterparties as defined by the DFSA rulebook. No other person should act upon this material or publication. It is not intended for Retail Clients. In addition to the above, this material or publication and information within it are not directed at any person resident in the territory or any country or jurisdiction action where such distribution will be contrary to local law or regulation. Nothing herein constitutes investment, legal, accounting or tax advice, or a representation that any particular investment (if any) mentioned herein is suitable for or appropriate to your investment objectives, financial situation, and particular needs, or otherwise constitutes a personal recommendation to you. All investments carry varying levels of risk, and the value of your investment may go up or down depending on several factors, including market movements. Past performance is not an indicator of current or future returns. The recipient(s) before acting on any information herein should make his/their own investigation and seek appropriate professional advice prior to any investment decision or entering any financial obligation based on information, statement or opinion which is expressed herein.

Egypt: The views contained herein has been obtained from sources that Kuwait Finance House Bank (Egypt) S.A.E. ("KFH") deems to be reliable but KFHE makes no representation about the accuracy, completeness or timeliness of any information prepared by a third party and assumes no liability for the reliance thereon. The opinions and predictions expressed in the materials are subject to change without prior notice and has not been prepared by or with the involvement of KFHE; however, KFHE does not independently verify or guarantee its accuracy or validity. Subject to any contrary provisions of applicable law, KFHE and its affiliates, and their officers, directors, employees, agents, disclaim any express or implied warranty of reliability or accuracy and any responsibility arising in any way (including by reason of negligence) for errors or omissions in the information or data provided. Any forecasts, figures, opinions or investment techniques and strategies set out are for information purposes only and derived from numerous sources, based on certain assumptions and current market conditions and are subject to change without prior notice. All information presented herein is accurate at the time of production, but no warranty of accuracy is given and no liability in respect of any error or omission is accepted. IMPORTANT – If you are in any doubt about the contents of this document you should seek independent professional advice. KFHE will not act and has not acted as your legal advisor to you in connection with this, and/or any related transaction and no reliance may be placed on KFHE for advice or recommendations and/or solicitation of any sort. Kuwait Finance House Bank (Egypt) S.A.E. is licensed and regulated by the Central Bank of Egypt. For additional information about Kuwait Finance House Bank (Egypt) S.A.E., please visit www.eg.kfh.com.