LONGLEY
ASSET MANAGEMENT

Q1 2025 Commentary

The first quarter of the year has seen much volatility in financial markets. The year began well with a continuation of the especially good performance seen in the final few months of 2024, with asset prices rising in January until mid-February. Following President Trump's inauguration (for the second time) in late January, concerns among investors grew about the trade tariffs that Trump would impose, and this was coupled with equity valuations becoming stretched. Financial markets saw some sharp falls from the later part of February to the end of the quarter.

Emerging markets, Europe, UK and other developed markets have, for the first time in many years, outperformed the US equity markets over the recent period. The Eurostoxx rose 8% in the first quarter, and with a price earnings valuation of 16x versus the S&P 500's price earnings valuation of 23x, investors have clearly chosen to invest in equities deemed to have more attractive valuations than those of the US. There have been large regional variations, with China A shares rising 15% and German equities increasing 11%, but Japanese equities falling 10% and US equities falling 5%. The good performance in Chinese equities has come after a few years of underperformance and the country's recent special action plan aimed at boosting household consumption.

In terms of sectors and performance, defence stocks have led and risen across the board, especially in UK and Europe. This follows the news that European countries will increase their defence spending to limit the impact of the US threat to reduce its support for NATO, after President Trump insisted on the European members of NATO paying more for their defence and shouldering more of the burden of providing troops and weapons for security of Europe. This reallocation of budget spending is likely to impact welfare spending and net zero ambitions.

Global bonds have performed well, but like global equities with wide dispersion of returns. German and Japanese yields have risen (and their bond prices have fallen) whereas yields on US bonds have fallen (and their bond prices have risen).

We write this report following the news, and indeed shock, of the extent of the trade tariffs announced by President Trump on 2nd April. The tariffs are considerably above Trump's campaign promises. On 9th April, there was news that the additional tariffs (i.e. those above 10%) are to be paused for 90 days (except for those with China), and we will wait to see what the results of the negotiations may be.

Jerome Powell, Chair of the Federal Reserve, has commented that these tariffs will result in inflation and lower growth in the US. Following good economic growth of 2.4% in the final quarter of 2024, analyst expectations are now forecasting an economic slowdown in 2025.

Commodity prices have remained benign, despite the ongoing Middle East tensions, and have benefited from increased oil production, thus moderating inflation pressures from elevated oil prices. Further increases in production have recently been announced to begin in May, and US oil production is also likely to increase under President Trump.

Additionally, geopolitics remain a focused area of concern to investors. Despite there being more hopeful signs that the combatants are seeing the need to negotiate, the protracted discussions and uncertain outcome is concerning. President Trump had hoped to bring the war in Ukraine to an end early in his second term, however, the Russian president has made it clear he does not intend to be rushed in the ongoing negotiations for peace.

President Trump has indicated that he will support Israel in the Middle East and seek to rebuild the US/Arab/Israel coalition against Iran and its proxies in the region. Success in these ventures would be a great relief to the troubled war zones, and an added bonus for the markets. A peace dividend could add to US as well as global economic growth.

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