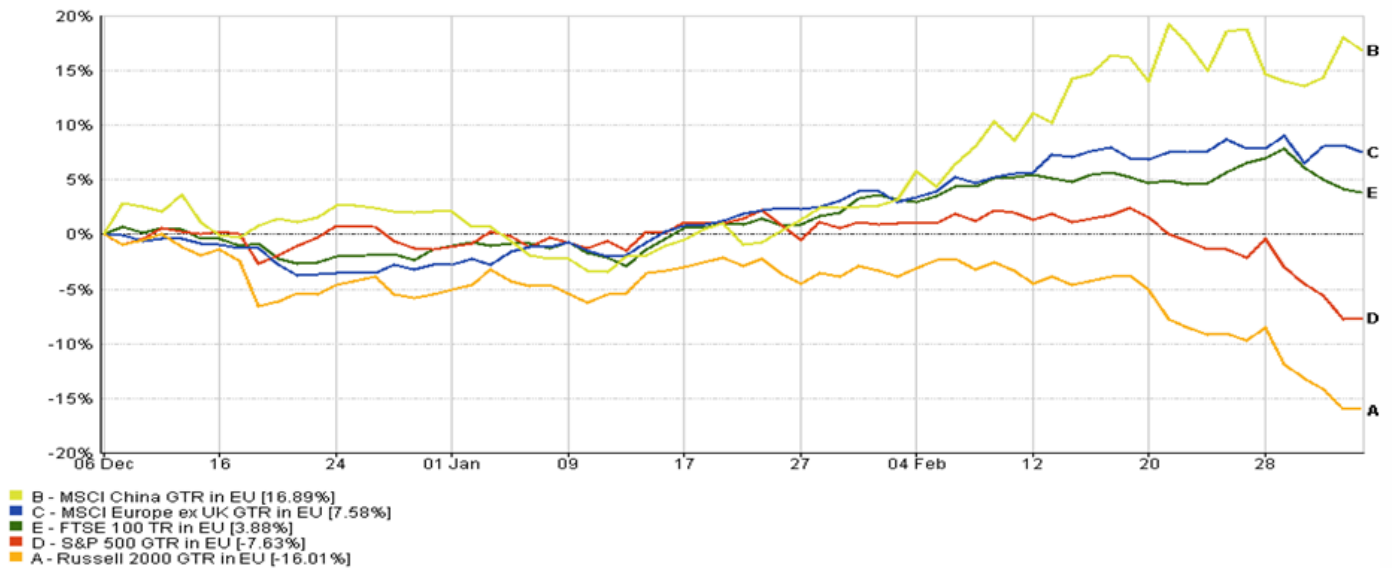


Market Matters - with Tom McGrath

It Just Got Ugly

I honestly can't remember a time when financial markets faced such widespread uncertainty—from every angle. Conflicting economic data is clouding the outlook, while the White House's rapidly shifting tariff policies add another layer of unpredictability. Meanwhile, geopolitics are evolving at breakneck speed, with the US seemingly stepping back from its commitments to Ukraine, leaving Europe scrambling to fill the void. Or is this just another round of Trumpian posturing? The ambiguity is unnerving investors, and it's no surprise that we've seen another sharp selloff in US equities, accompanied by continued dollar weakness. The chart below illustrates the relative outperformance of European, UK, and Chinese markets versus the US over the past three months, priced in euros to capture the added impact of currency moves. If nothing else, it serves as a stark reminder of why diversification remains essential in global portfolios.



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As Heraclitus famously said, 'The only constant in life is change.' And yet, for all the noise surrounding markets, it often takes a while before change truly asserts itself. The past week has been a masterclass in uncertainty—trade policy whiplash, a jobs report that was neither strong enough to reinforce the US exceptionalism narrative nor weak enough to justify full-blown recession fears, and a market that remains deeply unsettled about what comes next.

US JOBS: Friday's Non-Farm Payrolls report offered something for everyone. Job growth came in just below expectations at 151,000, the unemployment rate nudged up to 4.1%, and wage growth held steady at 0.3% month-on-month. In isolation, this would be a classic 'Goldilocks' number—cooling, but not collapsing. Yet, in the current environment, where the market is trading more on psychology than fundamentals, relief was the prevailing emotion. Equities fluctuated, with the S&P 500 eventually closing modestly higher on the day after a really tough week. Yields moved lower initially but found support as traders acknowledged that the Fed is unlikely to see this as a game-changer.

Metric	Actual	Median estimate
Change in payrolls (MoM)	+151k	+160k
Unemployment rate	4.1%	4%
Average hourly earnings (MoM)	+0.3%	+0.3%

The bigger story remains the context in which this jobs report landed. Trade policy remains chaotic, with the White House briefly imposing and then lifting tariffs on Mexico and Canada within the span of three days. That kind of policy volatility is exactly why markets remain on edge. It's not just the cost of tariffs that investors are pricing in—it's the uncertainty of what happens next. The Federal Reserve's latest Beige Book made it clear that business leaders are far more worried about tariffs than they are about recession, a theme that has been reinforced by recent price action. The Nasdaq is now officially in correction territory, down more than 10% from recent highs, while the Magnificent Seven have fallen around 15% and just dropped below their 200-day moving average for the first time in over two years.



FED: Yet, the Federal Reserve remains in no rush to adjust policy. In remarks on Friday, Chair Jerome Powell acknowledged the heightened uncertainty in the economic outlook but reassured markets that the US economy remains in a good place. 'We do not need to be in a hurry, and are well positioned to wait for greater clarity,' he said, adding that while trade and immigration policies remain significant unknowns, the economy itself is not in need of immediate intervention.

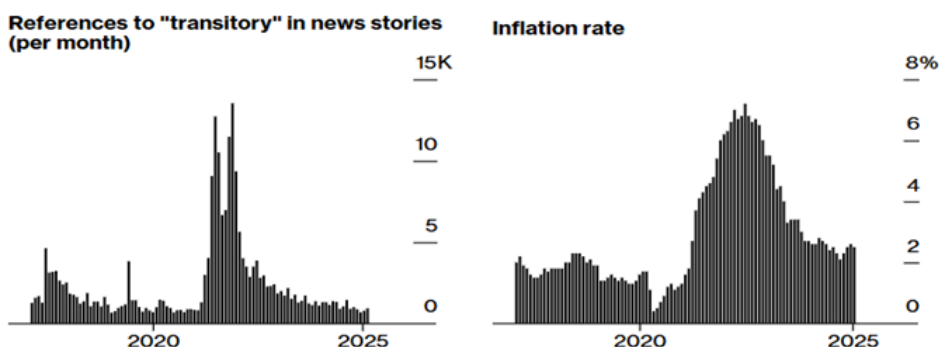
His comments reinforced the message that, while growth is slowing, it is not at risk of collapse. He noted that while consumer spending may moderate, the labour market remains in balance and is not a major source of inflationary pressure. That, in turn, gives the Fed room to remain cautious. 'The costs of being cautious are very, very low,' Powell said. 'The economy's fine. It doesn't need us to do anything, really, and so we can wait and we should wait.' That may yet change if economic momentum deteriorates, but I am comforted that they still have plenty of scope to cut rates if that proves necessary.

Bond markets initially took Powell's comments as a sign that the Fed is prepared to stay on hold for longer, with yields rising slightly across maturities. The Fed's base case remains that inflation is still on its bumpy path toward 2%, but Powell was careful to note that the central bank is watching for any signs that inflation expectations could drift higher. With policymakers widely expected to leave rates unchanged at their March 18-19 meeting, the next major test for markets will be next week's CPI report. If inflation remains sticky, Powell's message of patience could start to wear thin, forcing markets to reassess just how long they will have to wait for rate cuts.

Bessent: At the same time, the White House is navigating the early stages of its economic reset. Treasury Secretary Scott Bessent acknowledged that the US economy may experience some disruption as the Trump administration shifts its focus away from government-driven growth and toward private sector expansion. 'Could we be seeing this economy that we inherited starting to roll a bit? Sure,' Bessent said, framing the slowdown as part of a necessary 'detox period' from years of fiscal support. He compared the current adjustment to the Fed's handling of inflation in recent years, where policymakers initially labelled price pressures as 'transitory'—a term they would later come to regret as inflation proved far stickier than expected. Just as markets had to adjust to the reality that inflation was not going away quickly, Bessent argues that the economy now faces a similar transition as it adapts to reduced government intervention.

Trapped by 'Transitory'

The Fed regretted using the label after pandemic inflation proved sticky

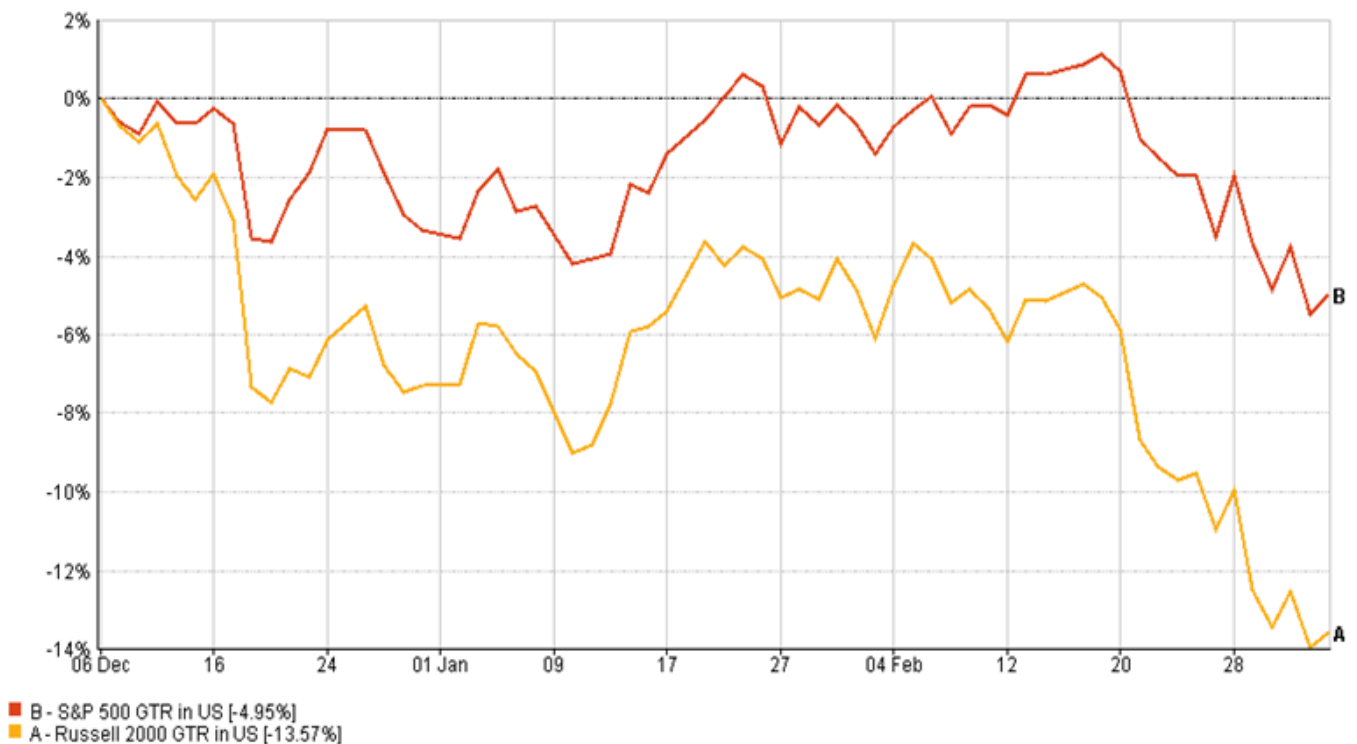


Source: Bureau of Economic Analysis, Bloomberg
 Note: Search covers all news sources carried on Bloomberg terminal

Despite this, it remains difficult to believe that Trump is indifferent to the stock market's performance. While Bessent dismissed the idea of a 'Trump put', stating that the administration is not actively managing policy to support equities, there is little doubt that Trump still cares at the optics but is not a man to admit that fact when it's not going his way. With stocks having sold off sharply over the past week, Trump has publicly downplayed the market's reaction to his policies, arguing that tariffs and other economic shifts are necessary for long-term strength. 'There'll always be a little short-term interruption. I don't think it's going to be big,' he said. But behind the scenes, the administration is clearly watching market moves closely. Bessent himself conceded, 'I watch everything.'

Market Volatility Set to Continue: Ultimately, markets are still stuck in a state of flux. On one hand, the US economy isn't collapsing, and for now, the labour market remains resilient. On the other, equity market sentiment remains fragile, with investors caught between concerns over policy uncertainty, stretched valuations in certain sectors, and the risk that rate cuts may not arrive as soon as they had hoped. This week's jobs data provided some short-term relief, but the bigger questions remain unanswered.

For now, the path of least resistance is a market that continues to wobble—until something forces a more definitive resolution. Let's not forget that there should be some good news coming further down the road in the form of tax cuts and probably a Fed rate cut or two. I think if the US economy can prove resilient over the next 6 months, then this current bull market will remain intact and equity markets will finish the year higher with economic momentum accelerating. If the recent tariff back and forth has actually undermined business and consumer confidence too much and the economy tips in to a recession, then there is the real possibility that the recent stock market correction might fall more than 20% and trigger an official bear market – although I believe it would be very short lived.



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EUROPE: But while the US market digests its growing policy risks, Europe's equity story is becoming harder to ignore. For much of the last ten years, investing has been a simple equation: overweight the US, disregard the rest. Global funds have poured capital into US markets, and for good reason. US policymakers, whether consciously or not, have governed with an eye on stock market performance. Europe and Asia, by contrast, have been more focused on debt sustainability than fostering an equity-friendly environment. The results speak for themselves.

Yet, there are signs that this trend is reversing. The US administration's recent manoeuvres suggest that taming debt costs may be taking precedence over stock market performance. With the pandemic-era borrowing binge now needing refinancing at significantly higher rates, bringing down the cost of capital has become a clear priority. A well-performing equity market is useful, but it is secondary to preventing a fiscal squeeze.

Meanwhile, Europe is entering a new phase of deficit-driven investment, particularly in defence and infrastructure. Historically, its Achilles' heel has been its unwillingness to spend, but that restraint is fading fast. The result? European bond markets may struggle, but equity markets could stand to benefit.

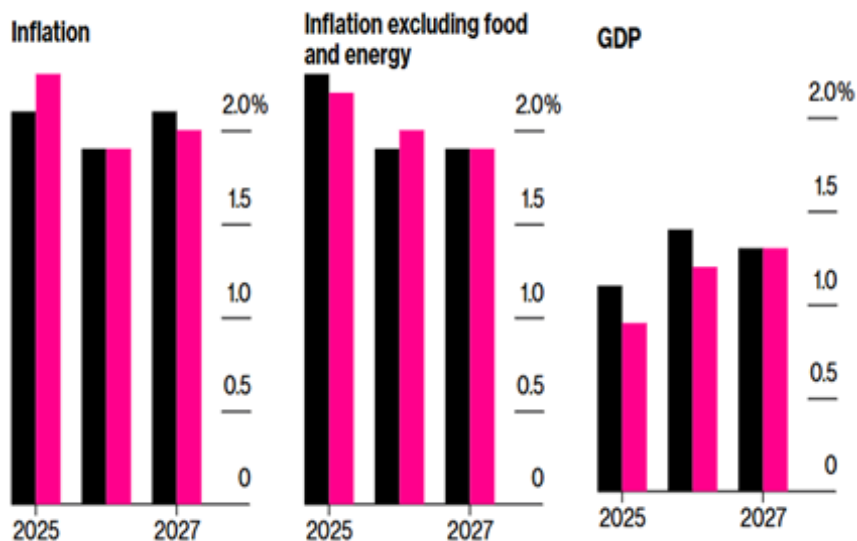
The ECB's latest rate cut reflects this shifting landscape. The central bank lowered its deposit rate by a quarter point to 2.5%, the sixth reduction since June, but signalled that the easing cycle may be nearing its end. President Christine Lagarde described policy as 'meaningfully less restrictive,' acknowledging that while inflation will take slightly longer to return to 2%, it remains on track. The ECB is now in a position to slow the pace of cuts as it assesses the impact of geopolitical shifts, including increased fiscal spending on defence in response to shifting US foreign policy priorities.

Economic data from Europe is also providing some reasons for optimism. Fourth-quarter GDP was revised higher to 0.2% quarter-on-quarter, double the initial estimate, driven by consumer spending and business investment. While growth remains weak, the eurozone economy has so far avoided the worst-case scenarios feared last year. Fiscal policy is also stepping in to fill the gap. European leaders are working on plans for a significant expansion of defence spending, with Germany leading the charge. The EU is looking to mobilise around €800 billion for military expenditure, a shift that could have meaningful economic implications.

Still, the contrast between Europe and the US is growing starker. While the Fed remains in wait-and-see mode, the ECB is actively managing its policy to balance growth risks with inflation control. If the US continues to prioritise debt markets over equity markets, and if European fiscal stimulus gains traction, then the long-standing bias toward US equities may finally begin to shift. For now, capital flows are only beginning to adjust, but the groundwork for a more durable shift in global asset allocation is being laid and at 8AM we will be reflecting this move with a reduction in US equities in favour of Europe, UK and Asia.

ECB's New Inflation and Growth Forecasts

■ December forecast ■ March forecast



Source: ECB
Note: 2027 forecasts are first predictions from ECB



TOM MCGRATH
Chief Investment Officer & Portfolio Manager