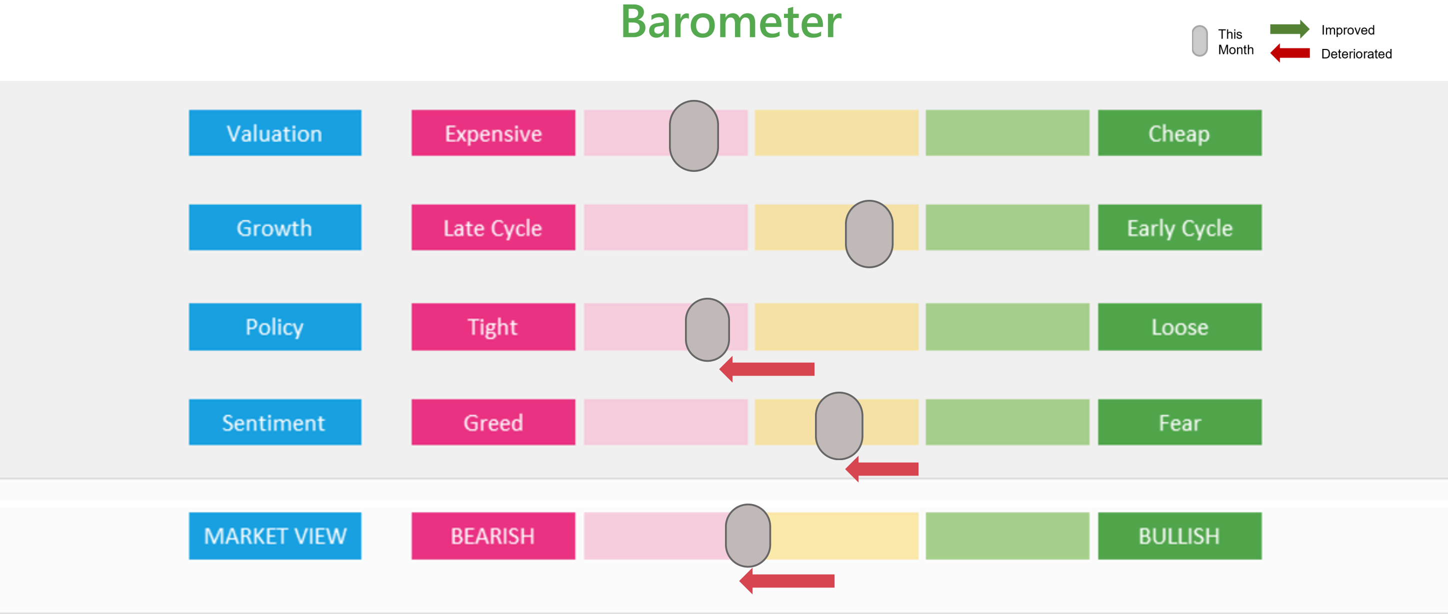
APRIL 2025

CCLA
GOOD INVESTMENT

Market Barometer

Barometer



Trade War On, Risk Off

- **We reduced equity exposure by 5% points** in our multi asset funds last month, raising index linked gilts and cash.
- We had not wanted to pre-position cautiously ahead of a trade war that might not happen but now believe a **trade war has started**
- Tariffs **depress growth and promote inflation**.
- We are mindful that bull markets run from recession to recession, so absent a recession **this should not be the end of this stock market cycle**. However, road bumps can occur and we have to anticipate them and take action.
- It's notable too that **earnings momentum is rolling over** even in the US, and leadership stocks (incl the Magnificent Seven) have been underperforming. Both factors can increase market turbulence.

In our **Charts of the Month** we look at:

- The dramatic **reversal of German austerity** as incoming Chancellor Merz secures €500bn to invest
- The likely **about turn in defence spending**, with the US spend/GDP ratio about to fall and everyone else's about to rise
- The early **impact of tariffs on the inflation outlook**, with consensus revising US inflation expectations higher
- US **tariffs in the context of history**. They can go much higher.

We are at 70% equity risk in our funds, down from 75%, and will have to see whether the trade war spill-over causes a recession. Probably not, but **it's prudent to take some risk off for now**, we think.

Contents

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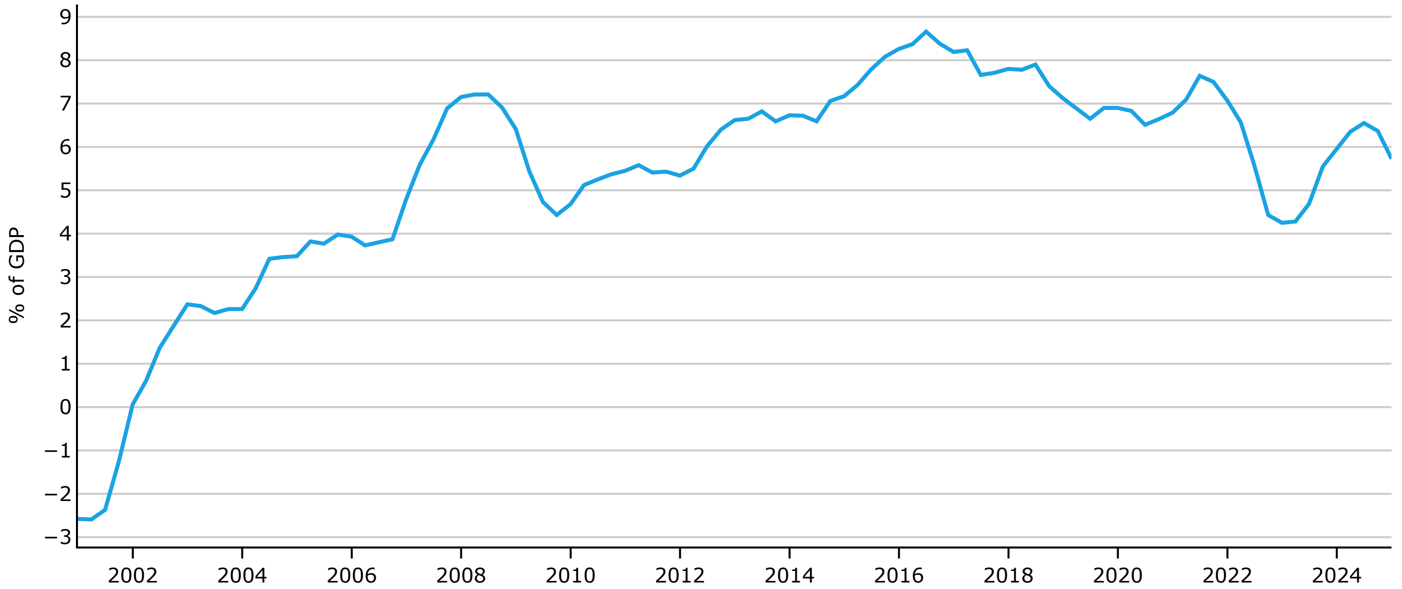
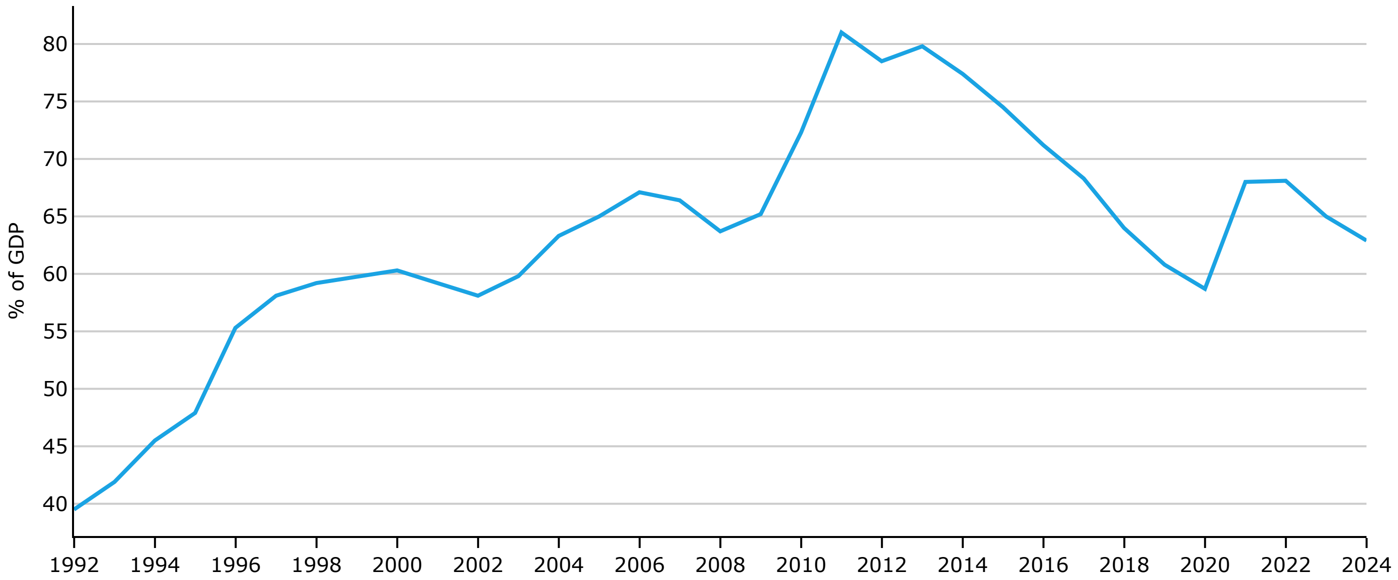
Charts of the Month (1 of 4)

Germany has executed a dramatic policy U-turn, reversing decades of austerity. It is impossible to overstate how important this might prove to be, not just for Germany but for Europe. Since Gerhard Schroeder's Harz labour market reforms in the early 2000s, Germany has run a current account surplus and since the Eurozone crisis of 2010/11 debt/GDP has been falling, in stark contrast to rapidly rising debt ratios in all other G7 countries. Incoming Chancellor Friedrich Merz ran in the general election on a platform to preserve the Schuldenbremse (debt brake), yet a month later and just two days after the Trump/Vance/Zelensky Oval Office melt-down, he proposed a EUR 500bn investment plan that could add 1% to German GDP annually for the next 10 years as Germany upgrades its infrastructure and re-arms. **This can unleash growth in Europe and revive European equity markets.**

Germany Current Account Balance (% GDP)



Germany Government Debt (% GDP)



Sources | CCLA, Bloomberg, Deutsche Bundesbank. Top chart: as at 31 December 2024, bottom chart: as at 31 December 2023

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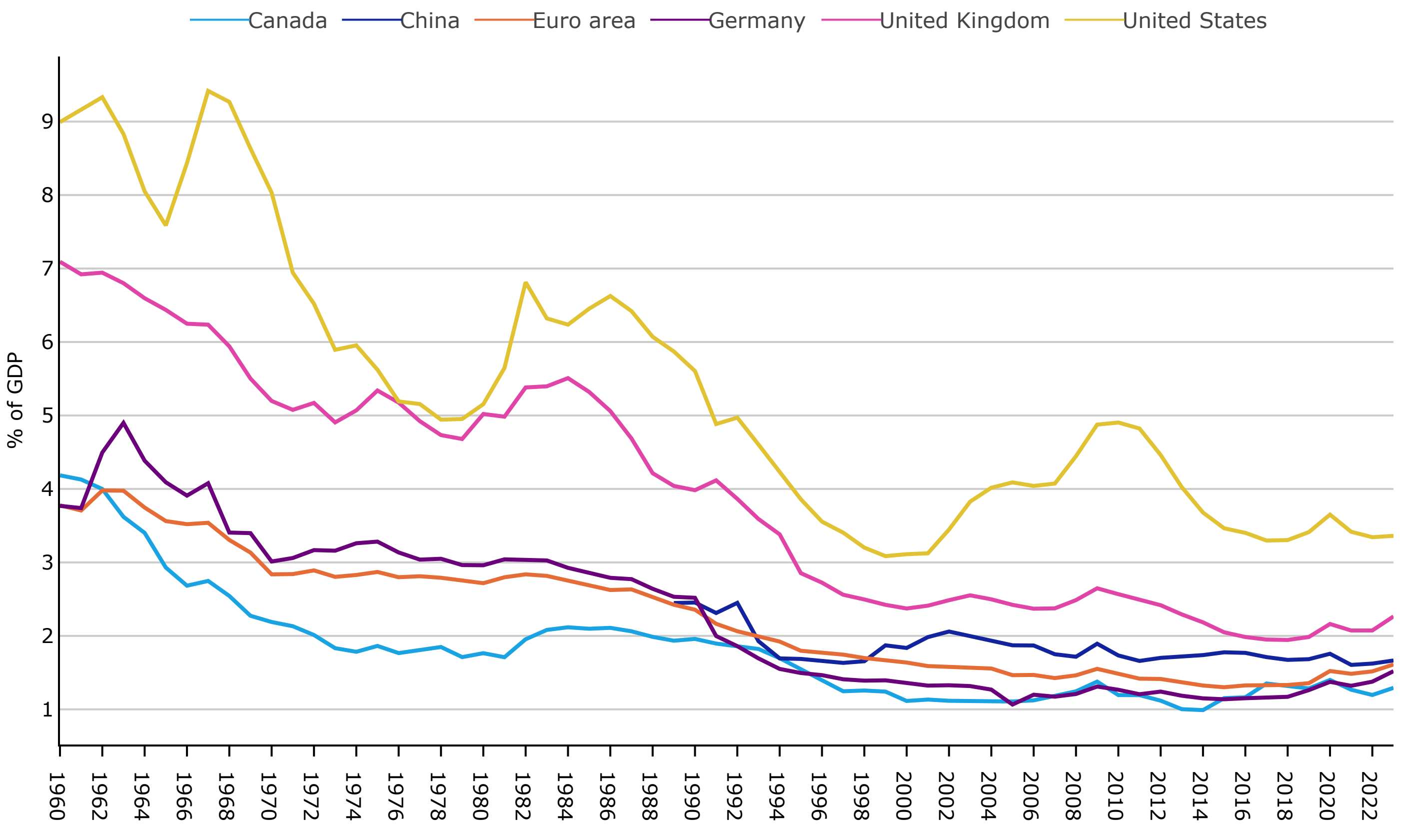
Charts of the Month (2 of 4)

The unintended consequence of Putin's aggression: the west re-arms. We've been here before, in the 1980s, when an arms race bankrupted Russia and caused the collapse of the USSR and the unification of Germany. It looks as though we might be going there again. He will thus have guaranteed a more muscular NATO (assuming the US doesn't leave) and has already promoted its geographical expansion (Finland, Sweden), presumably in contrast to his intention. Perhaps he hopes that he can prise the US out of NATO. That feels unlikely but not, under Trump, impossible. But so much for amateur geopolitics. What we can say with conviction is that increased military spending equates to fiscal loosening. Trump wants US defence spending down and European defence spending up. That's fiscal tightening in the US, fiscal loosening in Europe. **As growth rates converge, European equity can continue to outperform US equity.**

Military Spending (% GDP)



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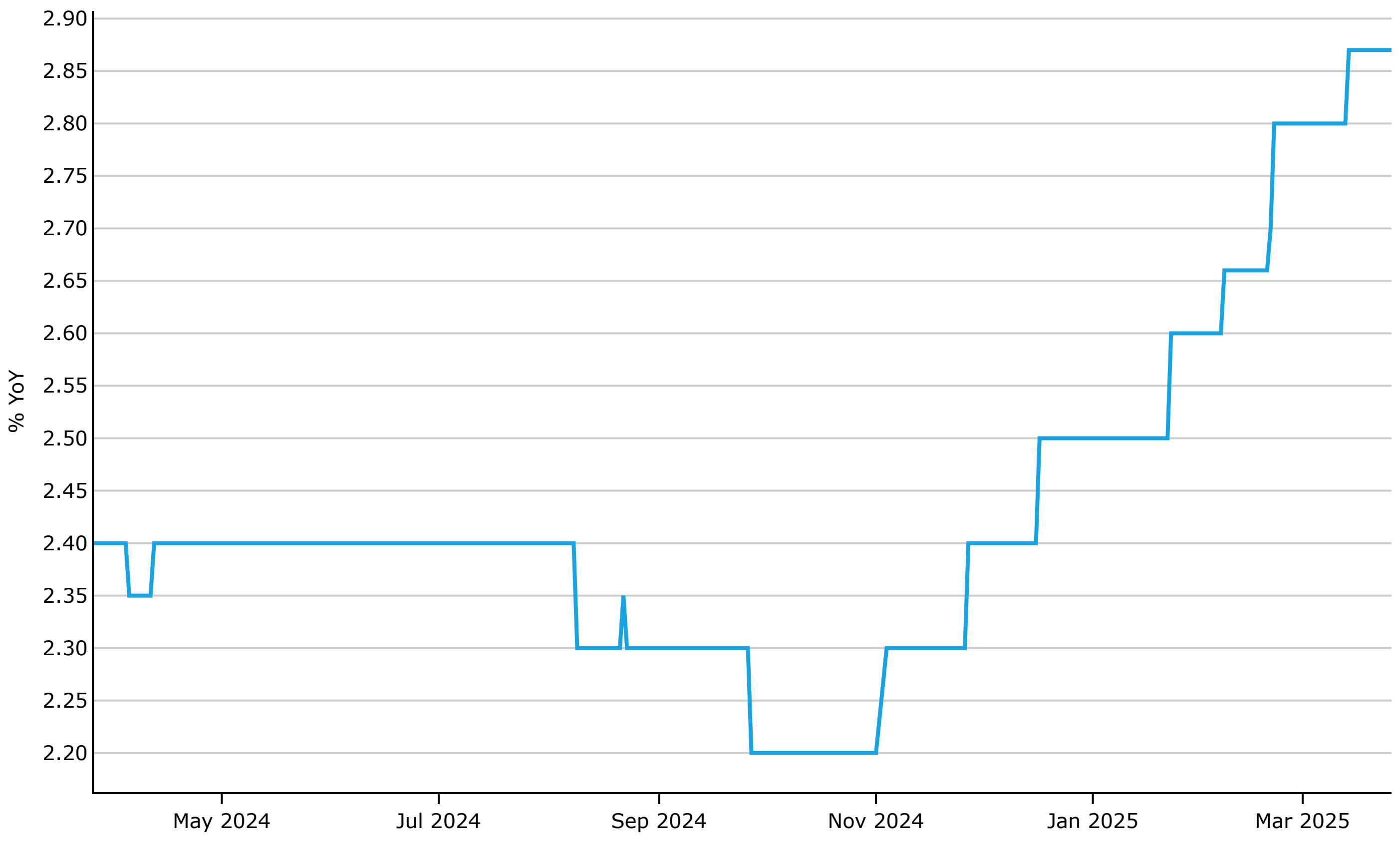
Charts of the Month (3 of 4)

US inflation forecasts are going higher just as growth forecasts are being cut. The change at the margin is therefore stagflationary, which is carbon monoxide for risk assets, i.e. not conducive to good health.

Under our Fire & Ice framework, which only considers the level and direction of inflation and does not consider growth, we are now in a Reflation regime (low and rising inflation). In Reflation, equities typically do well but bonds tread water. Absent a recession, equities can continue to work, but we feel they have to absorb upside inflation risk and downside growth risk as the trade war plays out.

That is why **we have temporarily retreated from our risk-on stance of the last two years**.

US CPI Forecast (YoY %)



Sources | Bloomberg, CCLA as at March 2025.

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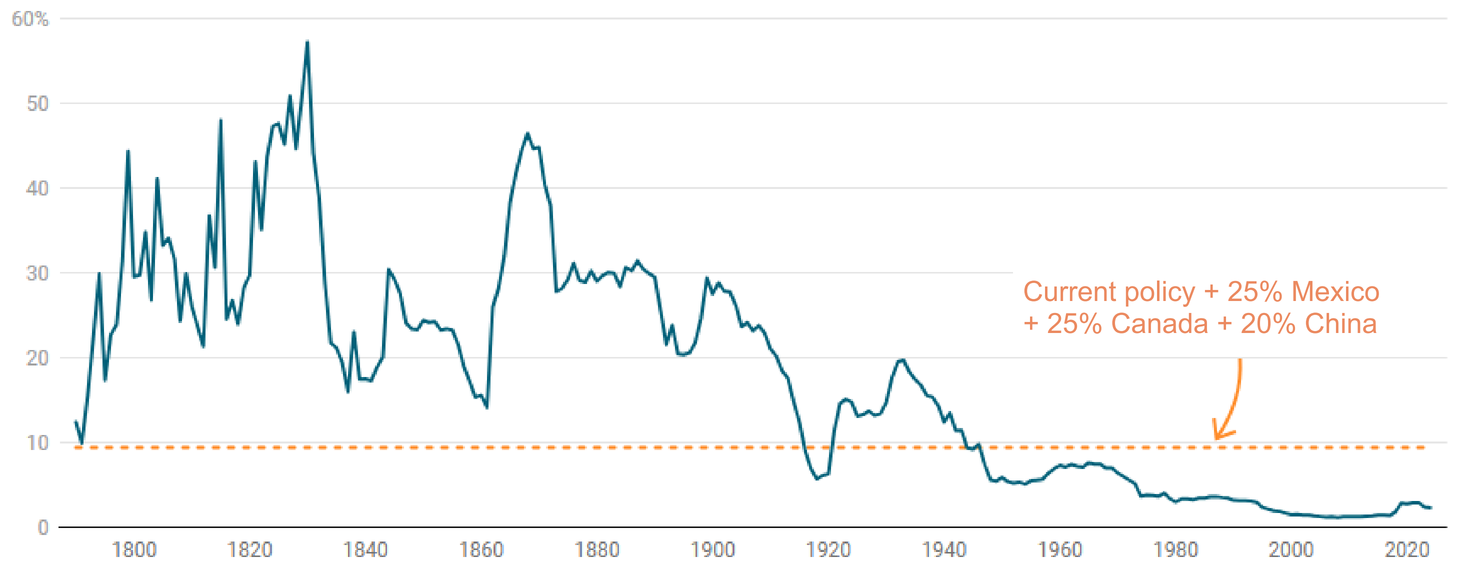
Charts of the Month (4 of 4)

Tariffs now are nothing compared to what they once were. Even post the first round of Trump's new tariff increases, tariffs on US imports will average 10%, according to the Budget Lab at Yale. After the notorious Smoot-Hawley Tariff Act of 1930, they averaged 20%. However, Trump will take tariffs to levels not seen since before the Second World War. They could well go higher still.

The economic, and therefore market impact of this, is clear. **Higher tariffs restrict growth and raise prices**.

These are penalties that this US administration is prepared to pay in the hope of restoring the US manufacturing base. When the President of the United States calls himself "Tariff Man" we should probably take him at his word.

Average US Tariff Rates (%, 1790 - 2023)



Sources | CCLA, www.BudgetLab.Yale.Edu as at March 2025

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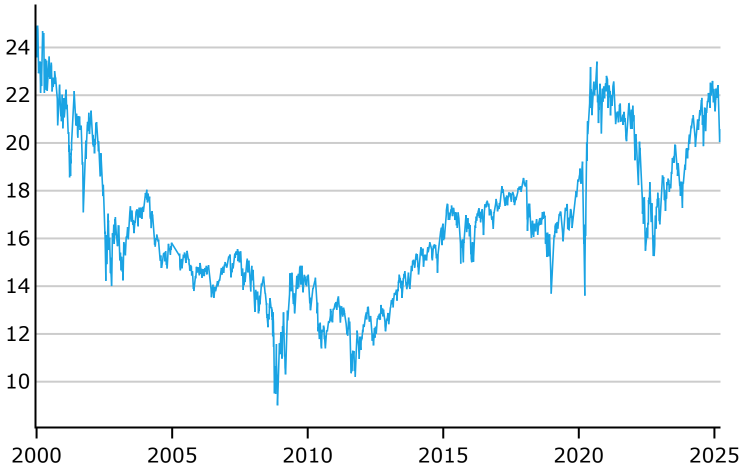
Equity | USA

"*Corrections occur when the stock market starts to discount a recession that doesn't occur. It is almost always attributable to a drop in the forward P/E, while forward earnings continue to rise (or at least don't fall).*" – Ed Yardeni*. This sums up the current situation in the US markets very well. From February's high, the price is down ~6%, forward P/E is down ~8%, while forward earnings growth is ***up*** ~1%. Currently, a recession does not look likely either. The labour market remains healthy, real wage growth remains above 1%, and spending on discretionary categories remains broadly stable verses last year**.

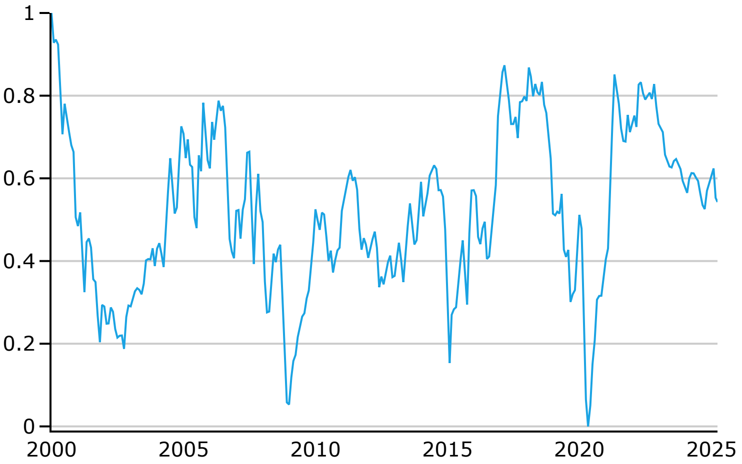
Having said that, an all-out trade war is shaping up to be the biggest risk to the US-exceptionalism story. Research publications are revising down their GDP growth estimates from 2% to 1.8%[1] and inflation up by 50-100bps[2]. Yet, valuations remain stretched, forward P/E ~20x +2.5 standard deviations from the 20Y mean and ERP is below 1%.

S&P 500 Valuations

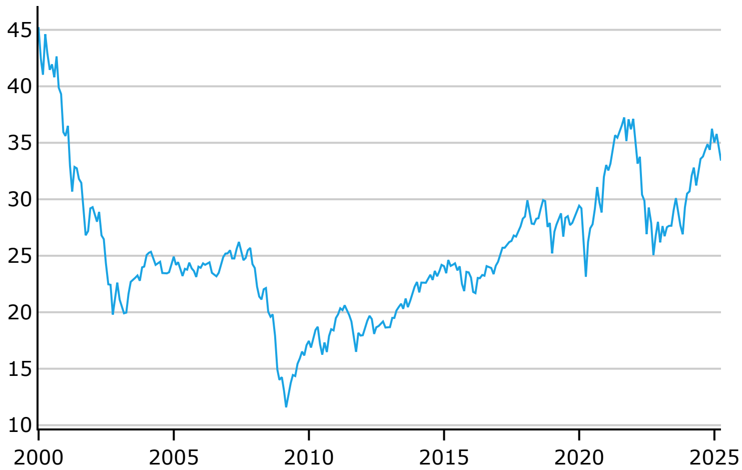
S&P 500 Forward PE



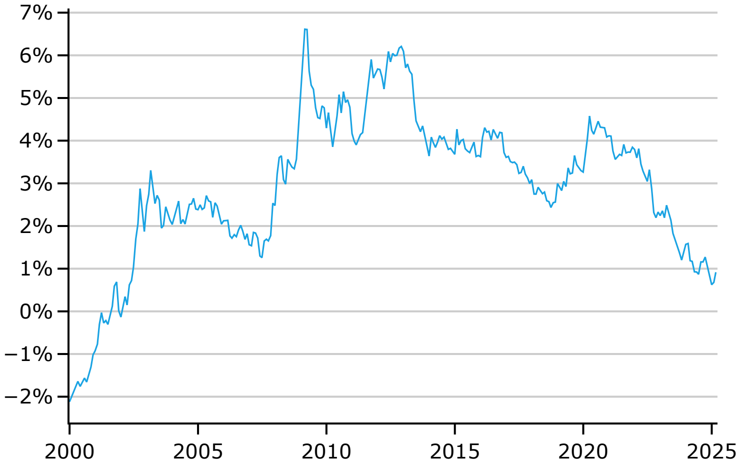
Composite Value Indicator Model



CAPE / Shiller P/E



S&P 500 Equity Risk Premium



Note | Composite Value Indicator was built at Morgan Stanley in 1997 and is published with permission. It is an aggregate of seven equity yields adjusted for bond yield, T bills yield and inflation, and is expressed here in its percentile range. The CAPE / Shiller PE is today's price divided by the average earnings of the last 10 years. The Equity Risk Premium is calculated as the Shiller earnings yield minus the real bond yield. *The Valuation Problem 21 March 2025. **Bank of America: Consumer Morsel 20 March 2025. [1] JP Morgan March 2025, [2] Empirical Research March 2025.

Sources | S&P 500 PE: Bloomberg as at Mar 2025. CVI Model: CCLA as of Mar 2025, Shiller PE/CAPE: Morgan Stanley, Equity Risk Premium: CCLA as of Mar 2025

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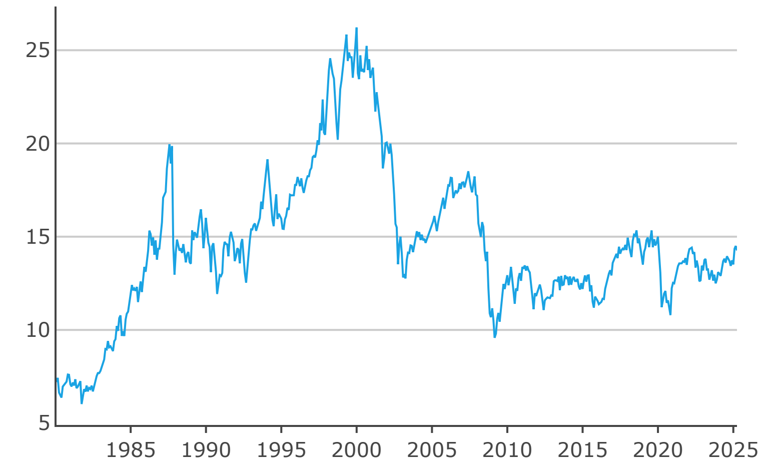
Equity | Regional

Given Germany's debt reforms and 'do whatever it takes' stance on defence, we now see a policy divergence between the US and EU. The EU is experiencing falling interest rates, expansive fiscal policy, and cheap starting valuations, while the US faces the opposite. The implications are profound. With the US pulling back on military, Germany may need to increase defence spending to 3.5% of GDP (~€140bn)[1].

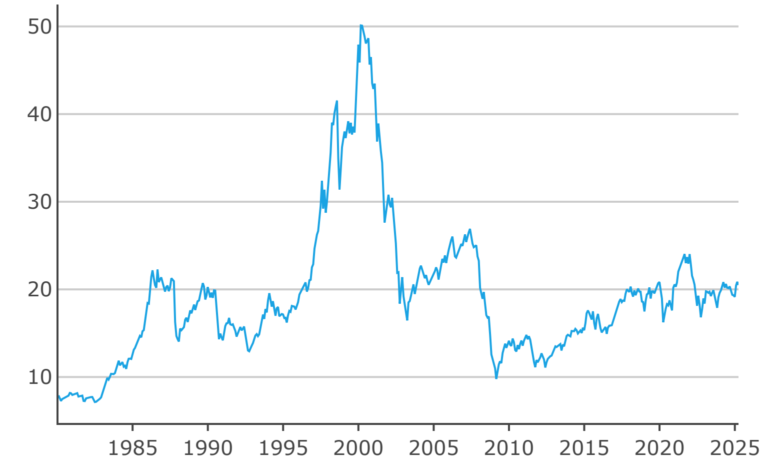
A welcome boon for European manufacturing and tech sectors. However, the defence industry is prone to capacity issues, in 2022 only 52% of the defence spend went to EU firms[2]. There is talk of repurposing old automotive plants to boost this capacity. If it works to meet the demand, the EU could see over 2% real GDP growth in 2025/26, with Germany's trend growth improving by 1.5% by 2030[1]. **Consequently, MSCI Europe (ex UK) has re-rated by ~8% YTD[3], we now wait to see if earnings can deliver to the hype.**

Europe

UK | Shiller P/E

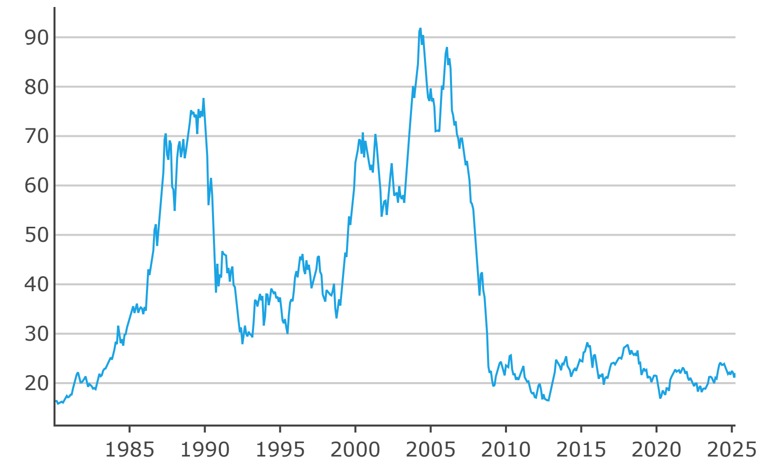


Europe (Ex-UK) | Shiller P/E

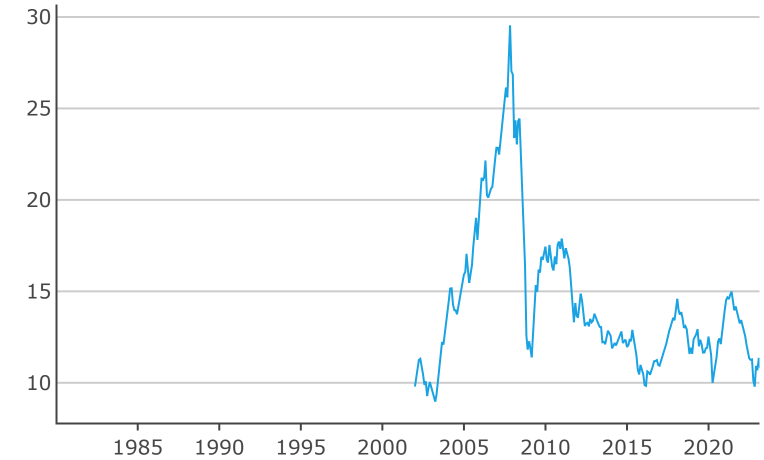


Asia & Emerging Markets

Japan | Shiller P/E



EM | Shiller P/E



Sources | Shiller P/Es: Morgan Stanley as of Mar 2025. Shiller P/E is calculated as today's price divided by the real average earnings of the last 10 years. 1. Morgan Stanley podcast: 'Europe for the Global Investor: Germany: A "Whatever it Takes" Moment' March 2025. 2. IISS: 'Strategic dossier reveals...." 8 Nov 2024. 3. 25 Mar 2025.

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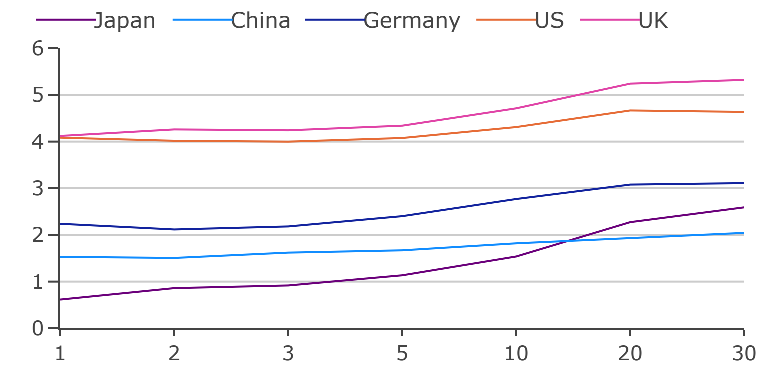
Bonds - Sovereigns

Germany's debt reforms have two key knock-on effects: Firstly, on Bunds and secondly, on the Euro. Bunds have already responded - the 10Y OIS swap to Bund spread hit -29bps[1], a level once linked to crises but now seen as a structural repricing. Barclays expects 10-year Bund yields to rise to 3% this year[1], which matters as current levels have lost appeal. For context, Japanese Life Insurers are earning ~1.2% on a 10-year Bund, lower than the ~1.5% return they can make on a hedged JGB.[1]

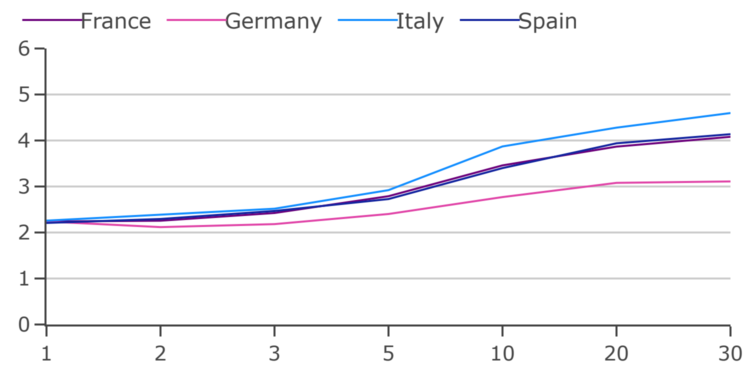
On the currency side, the Euro accounts for 20% of global reserves vs. 57% for the USD[2]. Central banks hold reserves in safe, high-quality sovereign assets - Bunds qualify. Rising issuance deepens the market and supports Euro demand. Combined with growing talk of de-dollarisation, this strengthens the long-term case for Euro reserves.

Global Government Yields

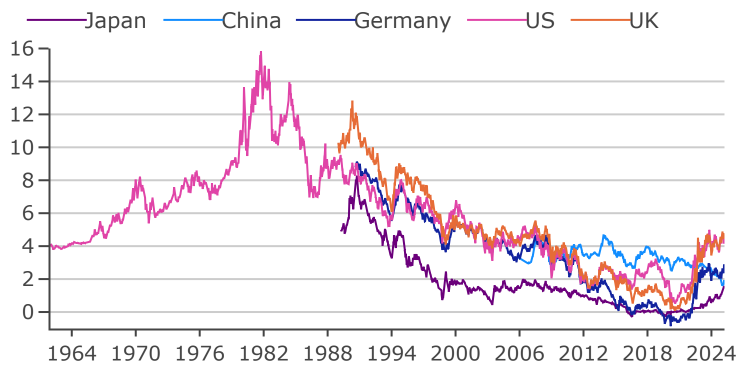
Global Treasury Yield Curves (Term vs %)



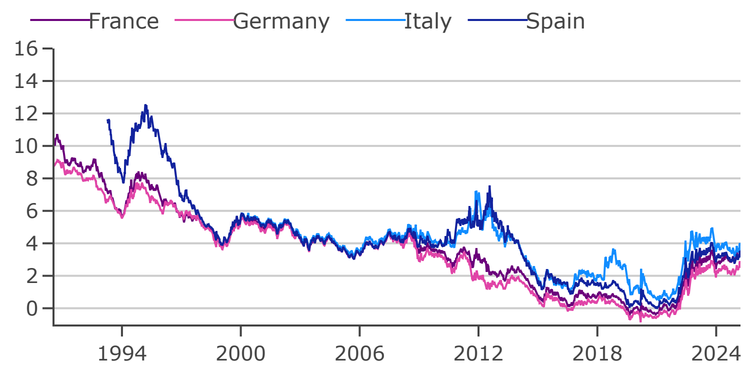
European Treasury Yield Curves (Term vs %)



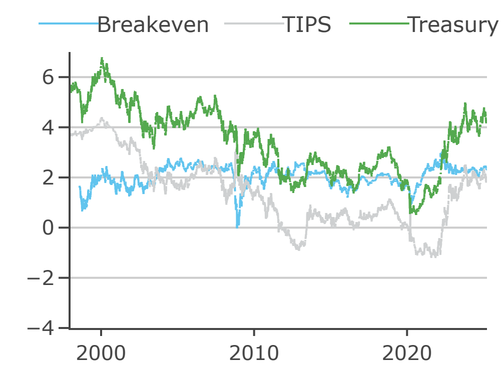
Global 10Y Yields %



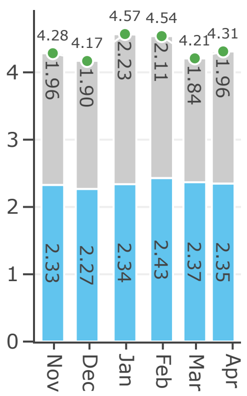
European 10Y Yields %



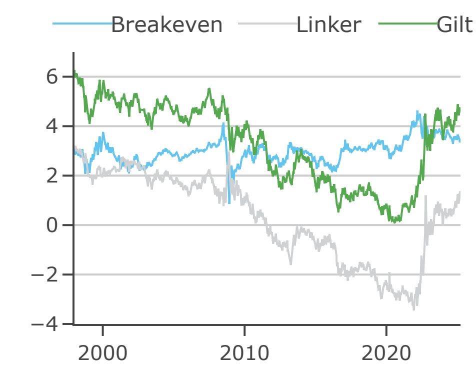
US 10Y Yields Breakdown %



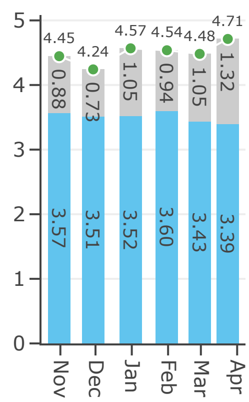
Last 6 Months



UK 10Y Yields Breakdown %



Last 6 Months



Sources | CCLA, Bloomberg as at Mar 2025. 1. Reuters: 'Bund safe-haven status holds...' 11 Mar 2025. 2 .www.atlanticcouncil.org

VALUATION

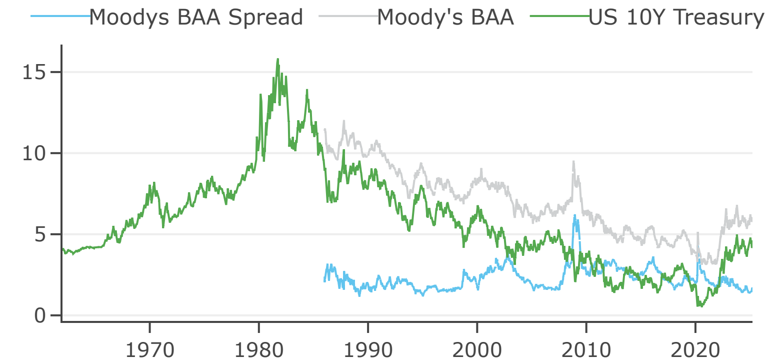
Bonds - Credit

US IG and HY returns fell in March, spreads rose marginally by ~7bps and ~30bps respectively. US HY spreads and the VIX are highly correlated, and during periods of high stress in equities, credit spreads tend to widen. However, despite the recent VIX spike to over 20 suggesting HY spreads should be around 5%, they remain tight at approximately 3%, indicating that technical factors are still influencing the market.

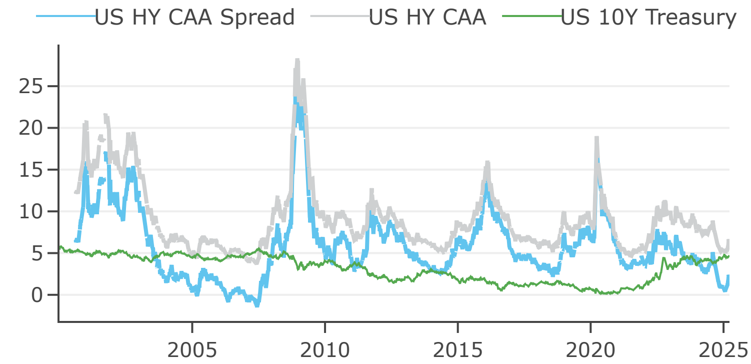
On the fundamentals front, US IG and HY non-financial issuers reported healthier gross and net leverage in the latest Q4'24 reports. Moreover, HY issuers experienced stronger EBITDA growth of 3.4% YoY*, even as sales growth remained soft at 1.6% YoY in the Q4'24 reports*. However, analysts' bottom-up view for Q1 '25 is less optimistic, with expectations for a slowdown in EBITDA YoY to -3%*, potentially leading to a slowdown in earnings before rising again later in the year. **We still believe spreads are too tight to bring about an attractive risk-reward.**

Global Credit Yields

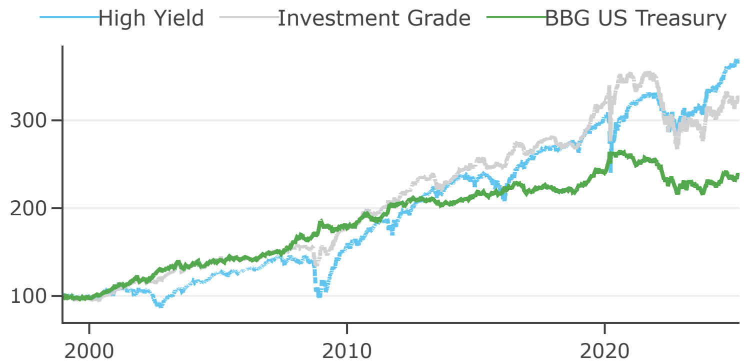
US Corporate Investment Grade Yield %



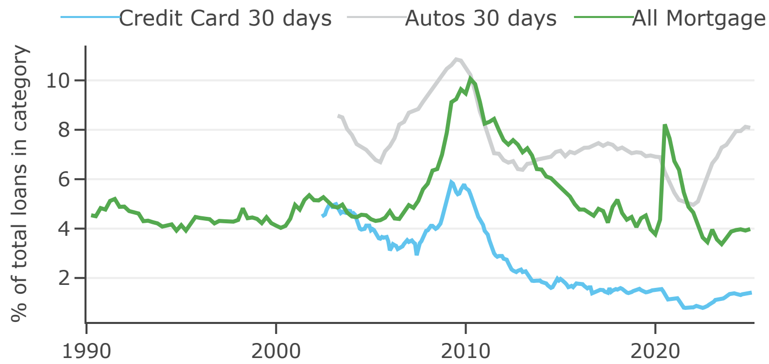
US Corporate Investment Grade Yield %



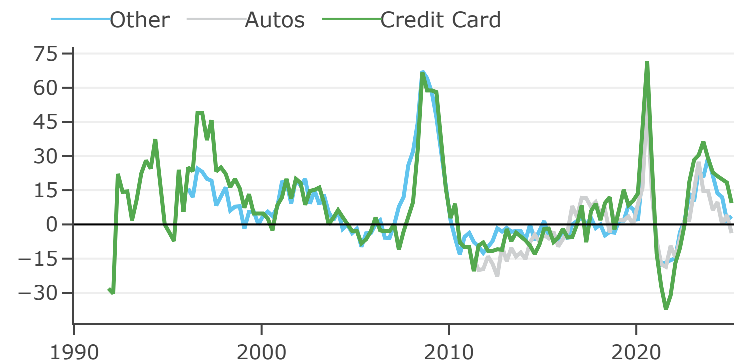
US Tr. vs IBoxx IG and HY Total Return $ (100= 31 Dec '98)



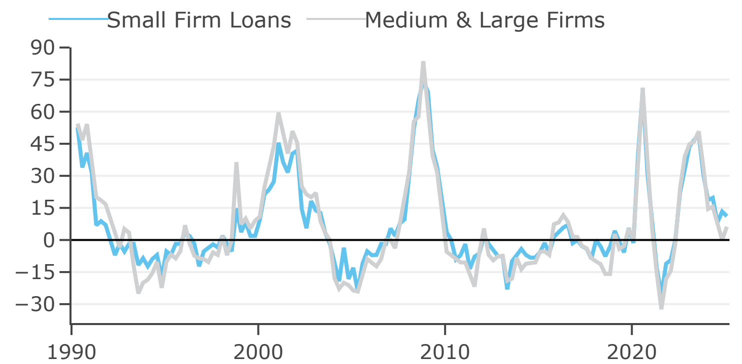
US Delinquencies %



Net % of Banks Tightening Consumers Credit Conditions



Net % of Banks Tightening C&I Credit Conditions



Sources | Federal Reserve, Senior Loans Officers Survey, CCLA, Bloomberg as at Mar 2025.*Figures taken from Morgan Stanley: 'US Credit Strategy' 25 Mar 25.

Alternatives

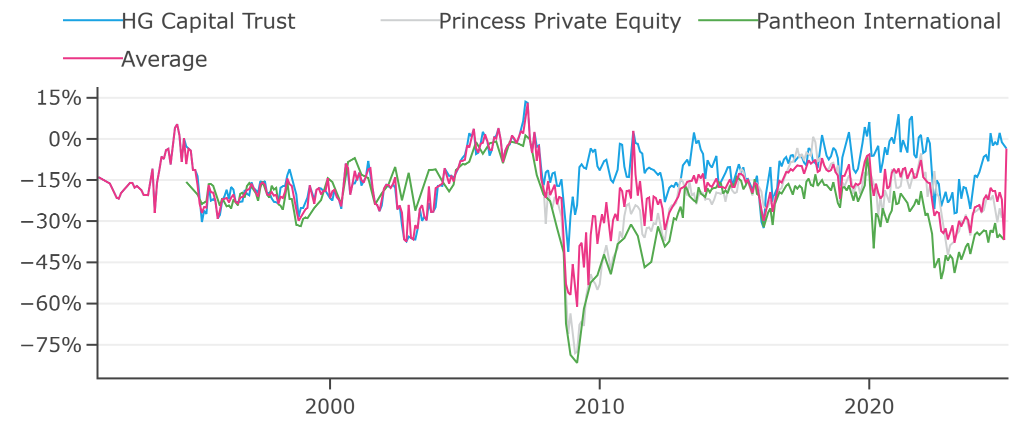
After discussing the oil industry in February, this edition explores dynamics impacting LNG. Demand has grown at a 6% CAGR from 2000–2023[1], led by Europe, China, and Japan. By 2030, China is expected to lead, followed by Europe and emerging markets like India and Bangladesh. Power generation is a key driver - US usage rose from ~10% in 1997 to ~40% in 2023[1], with AI-focussed data centres expected to boost it further.

LNG supply moves in cycles: slow growth, then capex surges when LNG prices rise. Since new LNG plant projects take 3-5 years to complete, it creates alternating periods of shortage and oversupply. Projects launched after the Russia-Ukraine war are set to add ~40% supply between 2025-28[1]. But projects expected to go-live near 2030 are delayed due to low SPA* margins, which don't look likely to improve. **A peace deal reviving Russian gas could depress prices further, side-lining even more new projects. This could cap supply just as all-gas demand rises again in the mid-2030s - risking the formation of another upward price cycle[1].**

Global Valuations

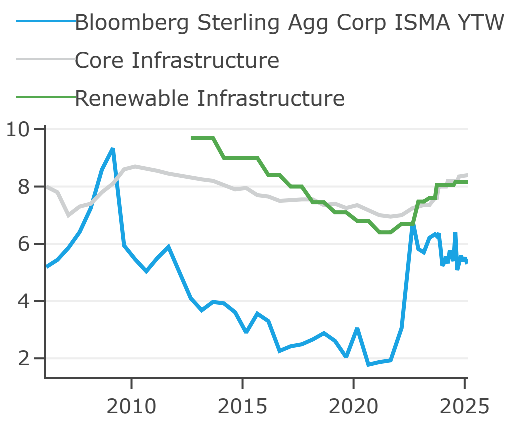
Listed Private Equity

Discount To NAVs



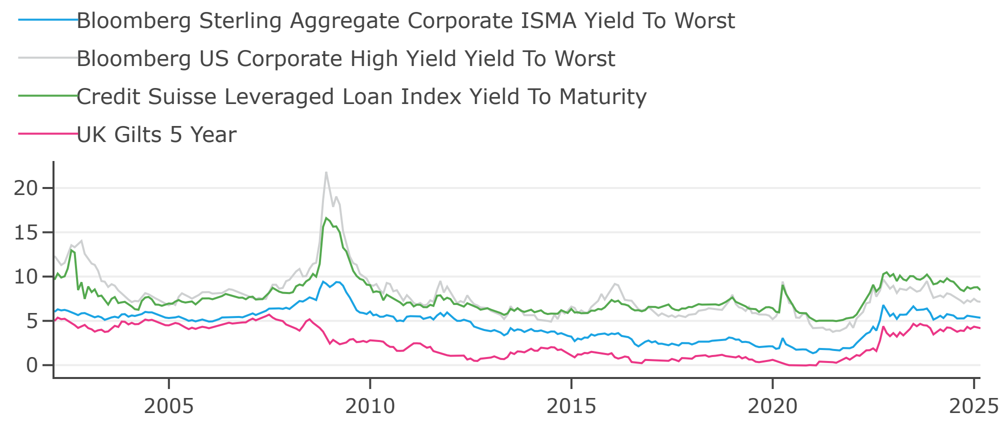
Infrastructure

Infrastructure Discount Rates vs Bond Y…



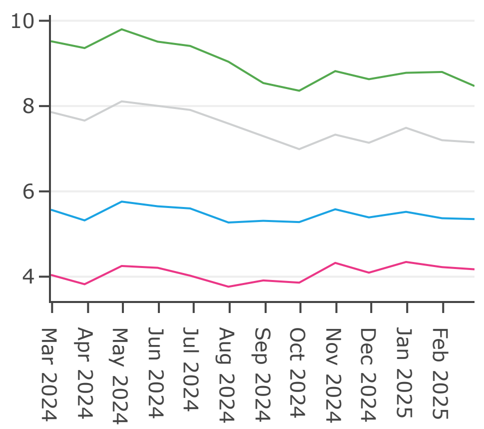
Contractual Income

Income Yields



Last 12 Months

Income Yields



Sources | Infrastructure: CCLA, Bloomberg; Bloomberg; Private Equity: Bain Global Private Equity Report, Bloomberg, Pitchbook; Contractual Income: Bloomberg, Pitchbook. As of Mar 2025. 1. Bank of America: LNG 101 Market Primer 20 Mar. 2025 used as source for much of this commentary. *SPA: Sale Purchase Agreement: a contract agreeing the price of liquifying/facilitating LNG between the LNG plant and the consumer (utility company, trader, etc.).

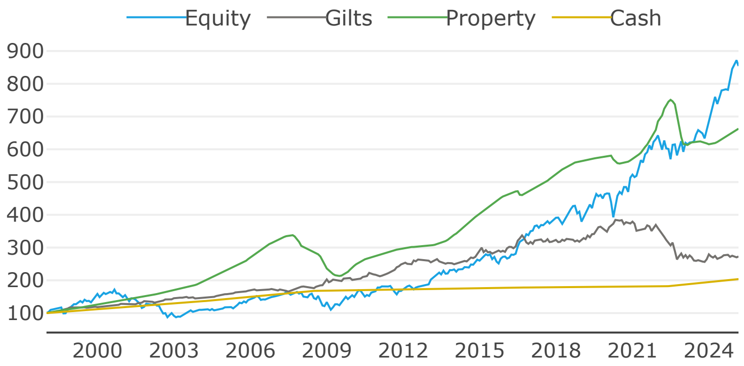
Property

Public listed markets for European and UK real estate have not seen much upside over recent months. The YTD* performance for the FTSE UK EPRA/NAREIT is approximately 1%, and the 12-month return is around -7%. While, European industrial and logistics properties have fallen by about 20% from their peaks[1]. **Despite this negative sentiment in the public markets, private markets have been keen to continue making new real estate deals.**

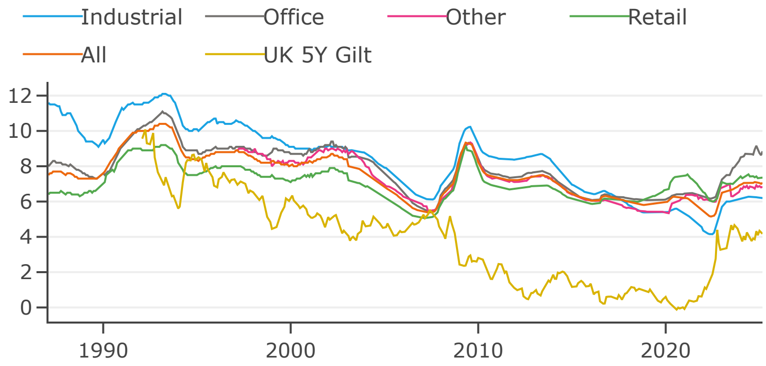
This could be driven by the substantial discounts to NAV (DTN) listed landlords are currently facing. This matters because the real estate sector is a conglomerate of small-to-medium-sized players who become prime targets for larger, sophisticated firms. The DTNs pressures smaller players to sell up or consolidate. **Already in 2025, we have seen announcements such as KKR-Assura, Blackstone/Sixth Street-Warehouse REIT, Blackstone-Burstone, and others.**

UK Commercial Property Market

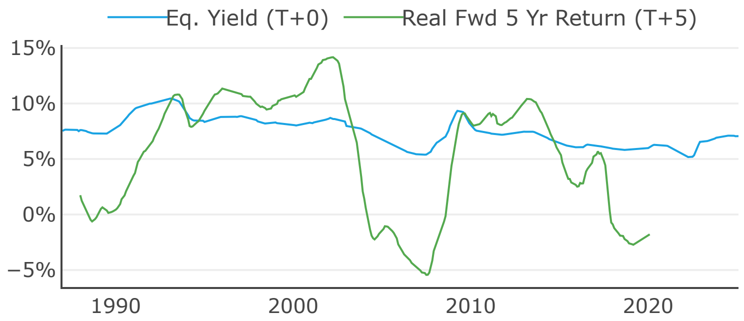
25 Years Of Return 1998=100



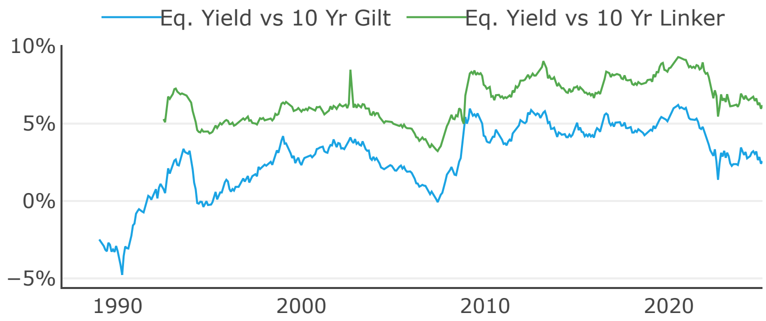
Equivalent Yields vs Gilt Yields %



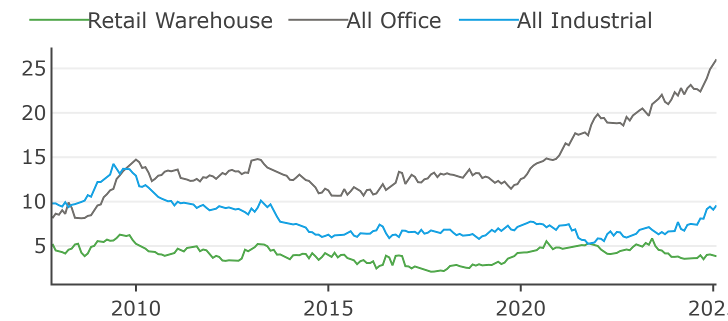
MSCI UK All Property Monthly TR Index %



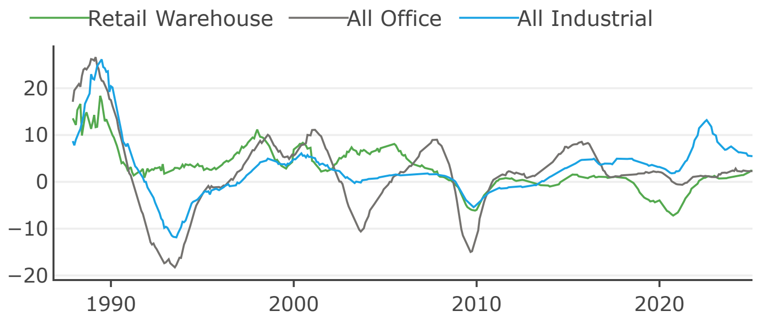
MSCI UK All Property Index - Equivalent Yield Spreads



Vacancy Rate %



Nominal Rental Value YoY Growth %



Sources | Equivalent Yields, Vacancy Rate, and Nominal Rental Value charts: MSCI UK Monthly Property Index as at Feb 2025. 25 Years of Return, All Property Monthly TR Index as at Feb 2025. 1. Financial Times: 'Blackstone raises bid...' 25 Mar. 2025. *25 Mar 2025.

VALUATION

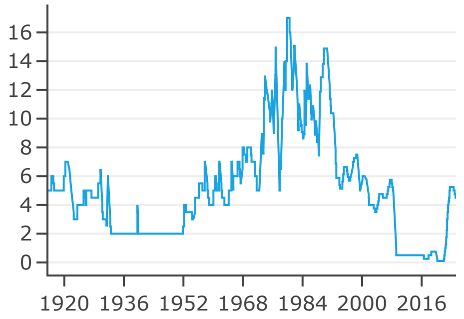
Cash

The OBR halved its 2025 economic growth forecast to 1%, revised down productivity expectations, and, after factoring in higher debt interest costs, now projects a £4bn headroom deficit by 2029–30. In response, the Chancellor unveiled a £14bn package of savings.

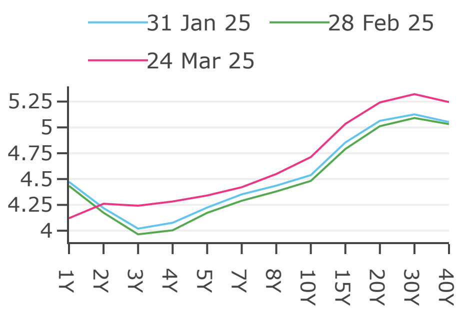
These adjustments include raising £2.2bn from tougher enforcement of tax evasion, £4.8bn savings from welfare cuts, and £3.6bn savings from reduced day-to-day spending. These measures restore around £10bn in headroom. **The overall result is a shift to tighter fiscal policy, with growth expectations deferred: real GDP is projected to grow more strongly from 2026 onwards, but total growth by 2029 is still ~0.4% below October's forecast.**

UK Sterling Market

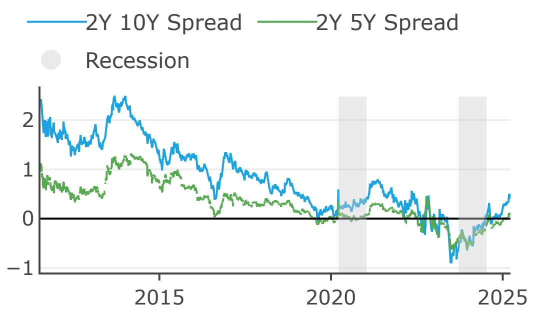
Official Bank Rate



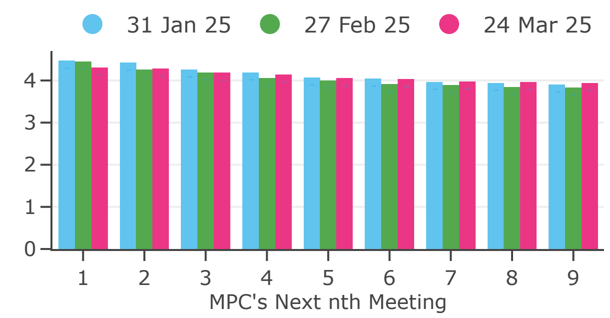
UK Gilt Curve



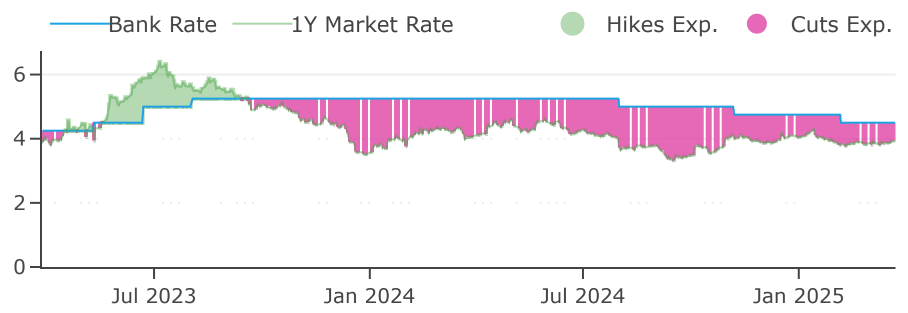
Gilt Spreads



Rate Expectations For Future MPC Meetings



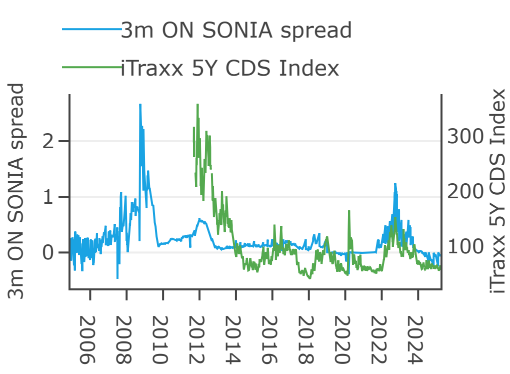
1Y Forward Market Rate Expectations



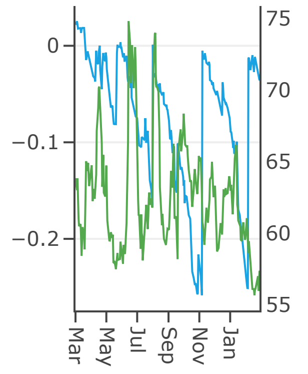
Inflation Readings YoY% | Colour by 10Y Z-Score*

Year	2024				2025	
	Sep…	Oct…	No…	Dec…	Jan…	Feb…
RPI	2.70	3.40	3.60	3.50	3.60	3.40
CPI	1.70	2.30	2.60	2.50	3.00	2.80
CPI Core	3.20	3.30	3.50	3.20	3.70	3.50
CPI Services	4.90	5.00	5.00	4.40	5.00	5.00
CPI Goods	-1.40	-0.30	0.40	0.70	1.00	0.80
Priv. Wages	5.10	6.70	5.90	6.10	6.20	

Market Stress



Last 12 Months



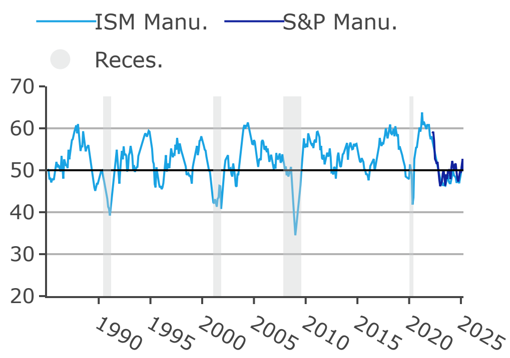
Sources | ITraxx CDS is the Markit iTraxx Europe Senior Financial Index, comprising 30 equally weighted credit default swaps on IG European entities. *10 year z-score applied on each series, coloured using gradient with score of 0 as green, at least +/- 2 standard deviations away scores as red. Bloomberg for all charts, as of Mar 2025.

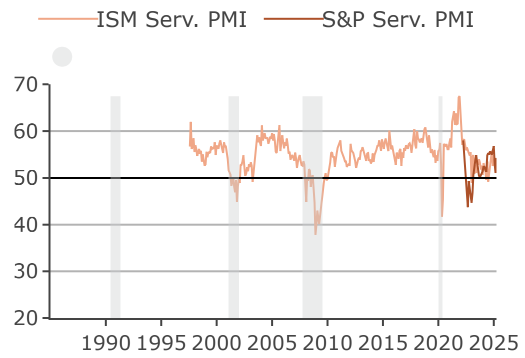
Global PMIs

S&P Global's US Flash Services PMI for March came in at a three-month high (54.3), comfortably in expansionary territory. Improved new business, better weather and some signs of continued customer demand were cited. Worth noting, however, the underlying picture is mixed. Some businesses raised concerns about economic outlook, often citing worries over customer demand and impact of new government policies.

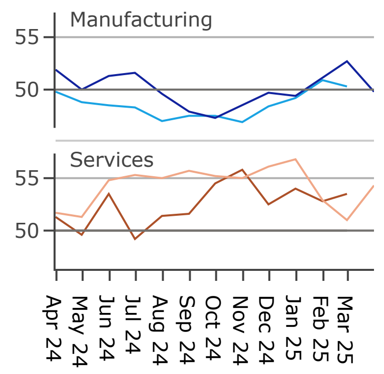
On the other hand, Manufacturing had another down-beat reading of 48.8, after spending Feb in expansionary territory (54.5). Despite reduced output, businesses' sentiment remains at a 3-year high, with hopes supportive trade and tax policies. **Both sectors experienced an increase in price levels.**

United States

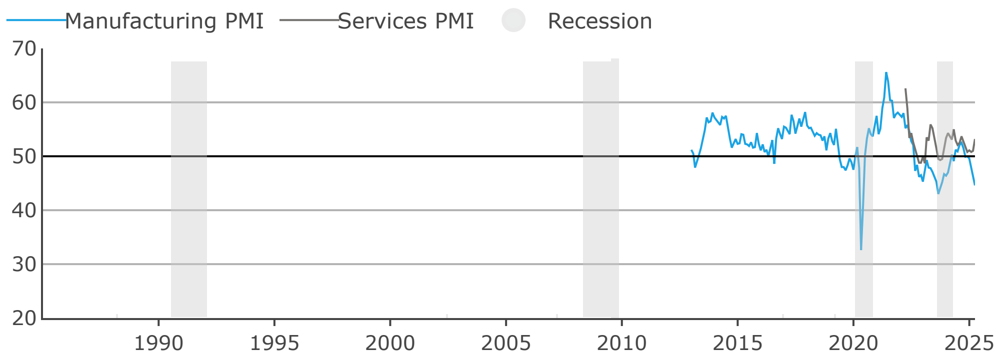




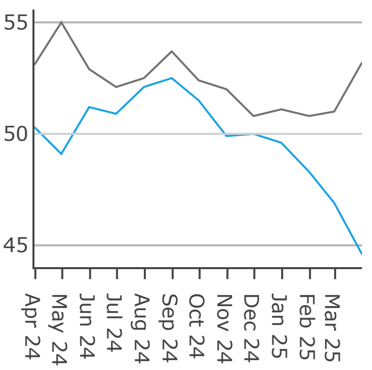
Last 12 Months



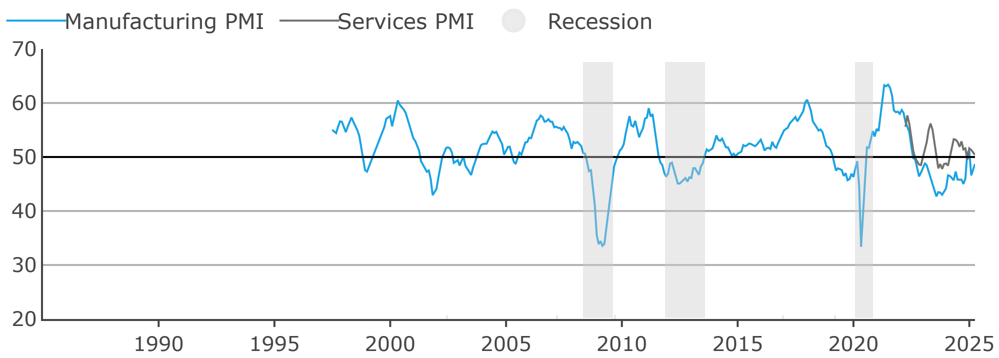
United Kingdom



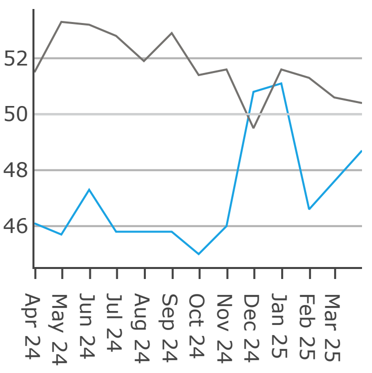
Last 12 Months



Eurozone



Last 12 Months



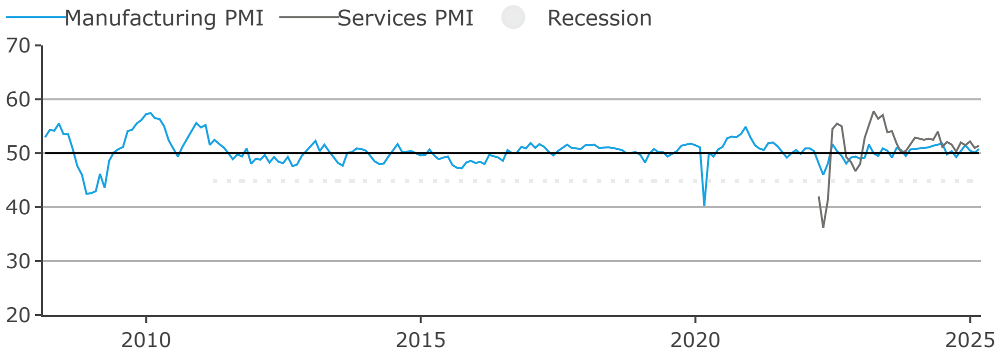
Sources | US Services and Manufacturing: ISM; All other countries including global: S&P Global as of Mar 2025. Recession defined as two consecutive negative quarters of GDP, recession ends with two consecutive positive quarters in GDP

GROWTH

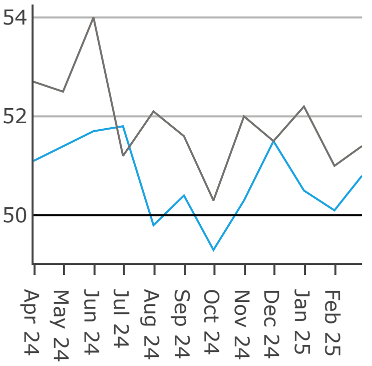
Global PMIs

Although remaining in expansion territory, February saw the rate of global economic expansion slow for the second consecutive month, with a composite reading of 51.5. Global Manufacturing pleasantly surprised, it grew at its quickest pace since June 2024. Worthing noting, this could well be due to businesses front-running April's tariff reforms.

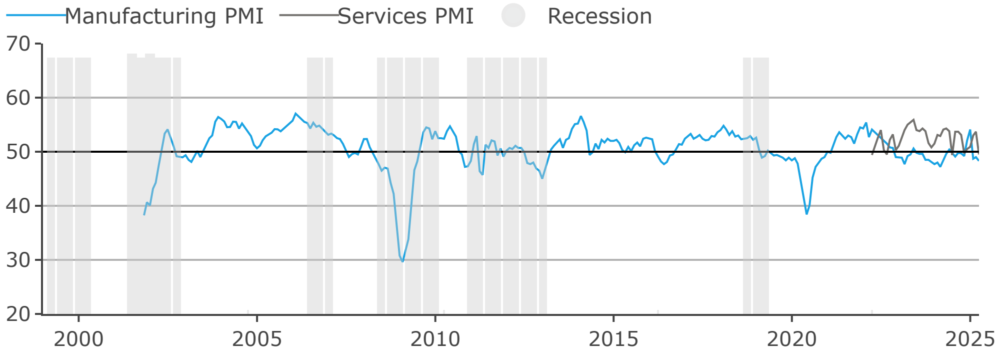
China



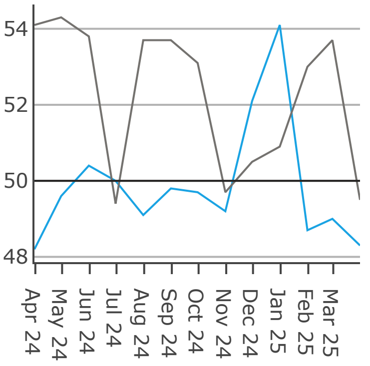
Last 12 Months



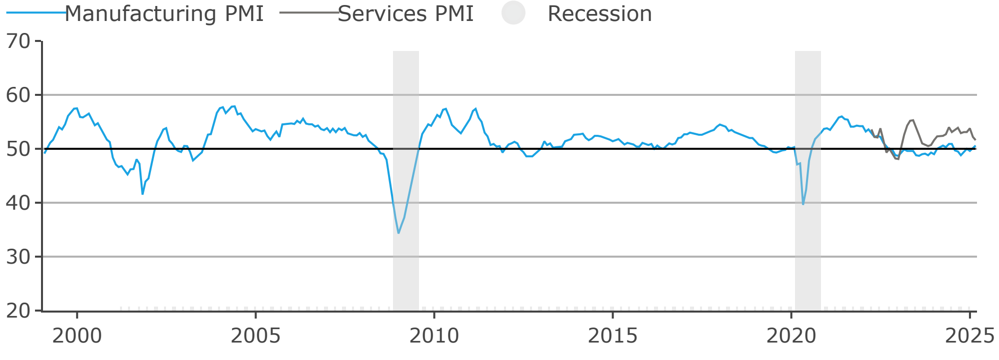
Japan



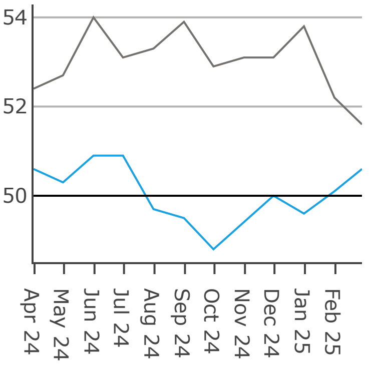
Last 12 Months



Global



Last 12 Months



Sources | US Services and Manufacturing: ISM; All other countries including global: S&P Global as of Mar 2025. Recession defined as two consecutive negative quarters of GDP, recession ends with two consecutive positive quarters in GDP.

GROWTH

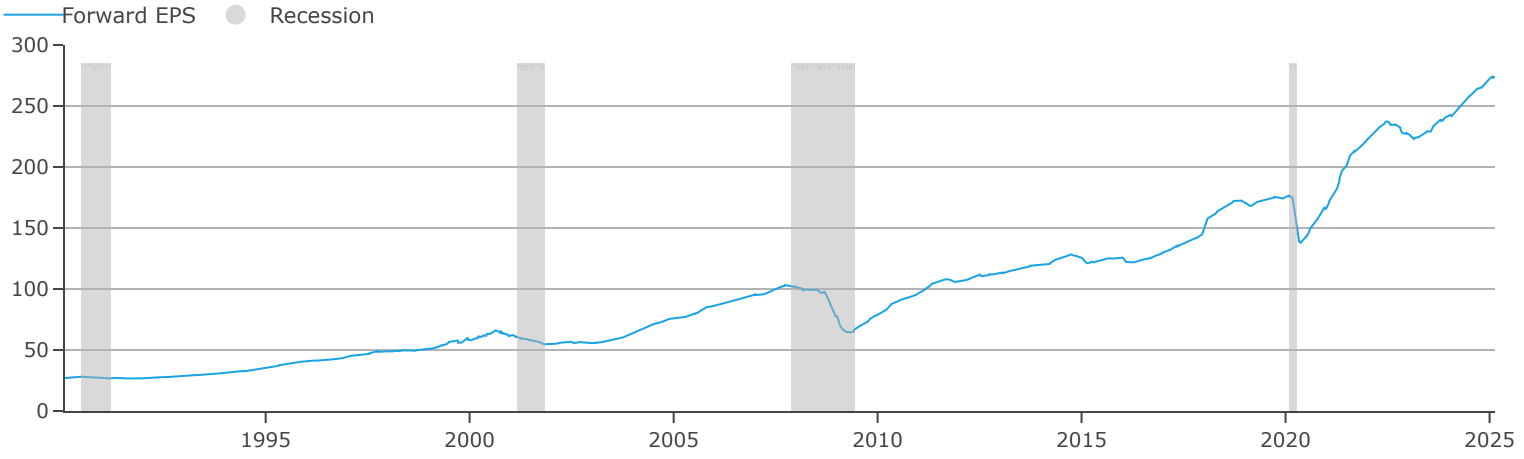
Earnings

Although US earnings revisions (as shown on the following page), have been negative since the start of this year, it is worth putting this into perspective. S&P500 earnings growth for 2025 is still expected to be over 11%[1] - very much in line with last year. Similarly, 2026 and 2027 are positioned at ~14% and ~12%[1] respectively. Granted, there is scope of softening in the 2026/7 forecasts, but so far all these estimates are very much in line, if not better than, the 2001-2021 year average of ~9% growth[2].

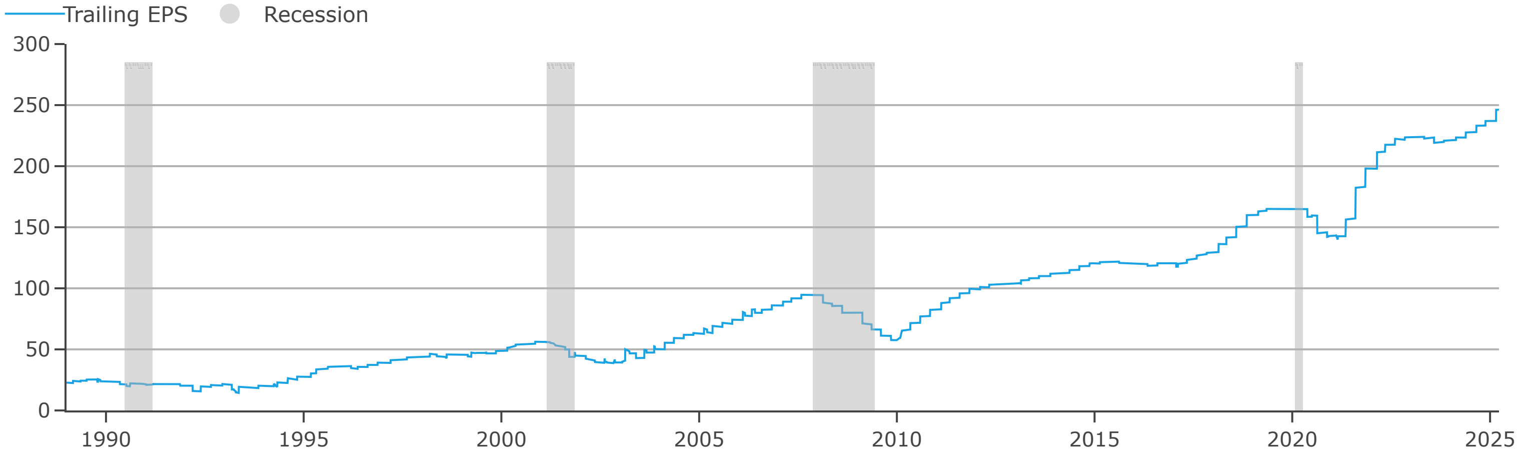
Sectors leading the way for 2025 are IT (+20%), Healthcare (+19%) and Industrials (+14%)[3].

S&P 500

Bloomberg Est. EPS



12M Trailing EPS



Sources | S&P500 12M Forward EPS using Bloomberg BF transformation, 12M Trailing EPS from Bloomberg as at Mar 2025. 1. JP Morgan: Equity Strategy 24 Mar 2025. 3: JP Morgan Global Development Market Strategy 24 Mar 2025.

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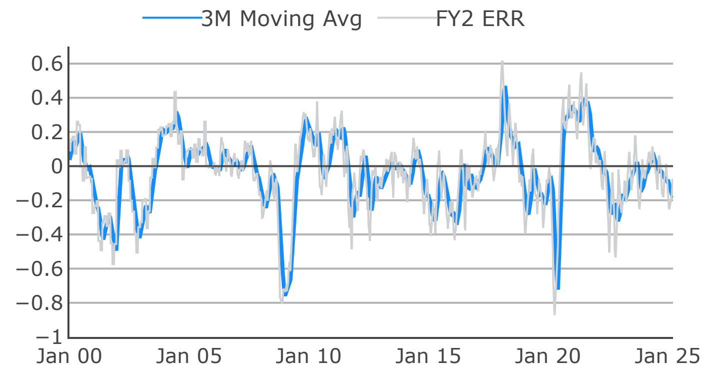
Earnings

These charts show the breadth of earnings revisions, i.e. # upgrades minus # downgrades / total estimates, so it is a directional measure showing how widespread upgrades or downgrades are. Historically, troughs in revisions breadth have been excellent times to add risk.

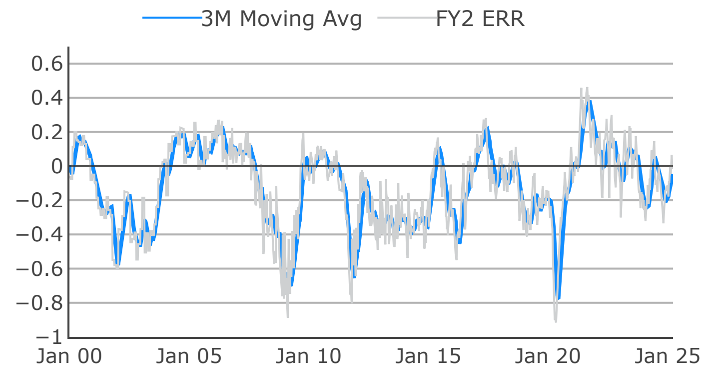
US earnings revisions breadth have deteriorated over the last few months. However, revisions are very seasonal and the current change is very much in line with the last 25+ years of average monthly trend revision. Worth noting, while US revisions remain on a downward trajectory, EU and UK have troughed, and are showing signs of recovering.

Global Earnings Revisions Ratios

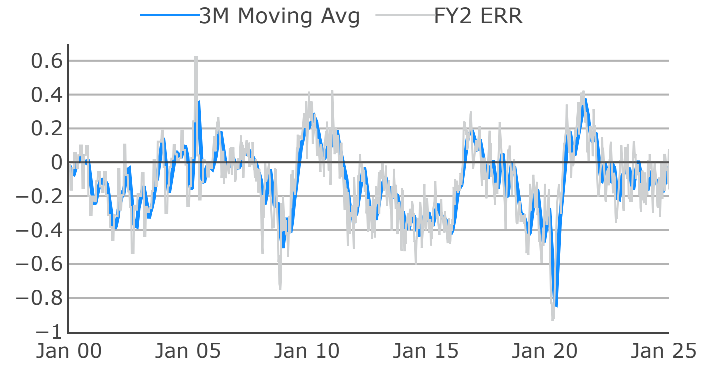
USA



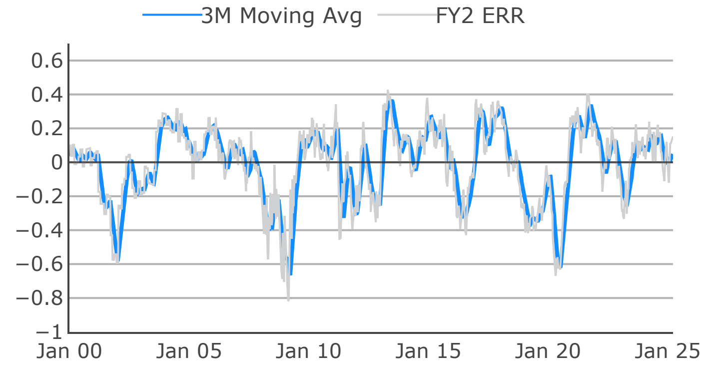
Eurozone



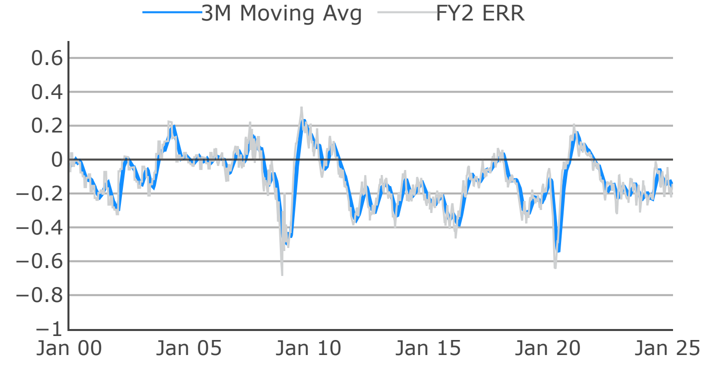
UK



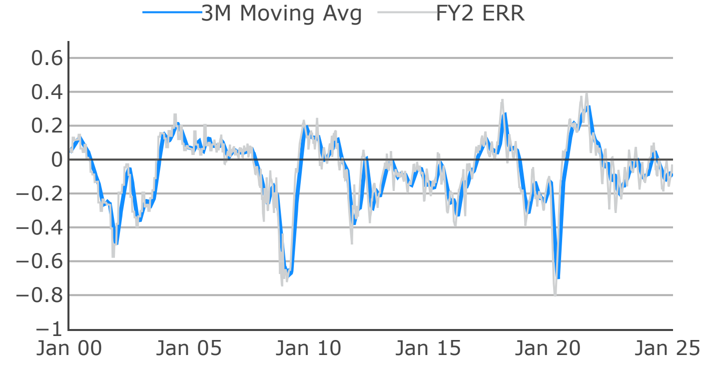
Japan



Emerging Markets



World



Sources | Eikon, the MSCI index has been used for each respective region, as at Mar 2025.

POLICY

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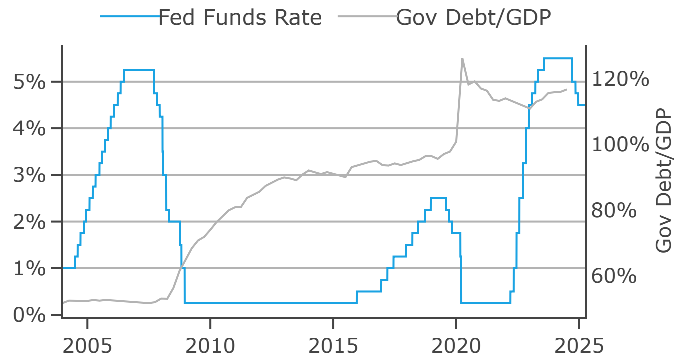
Interest Rates

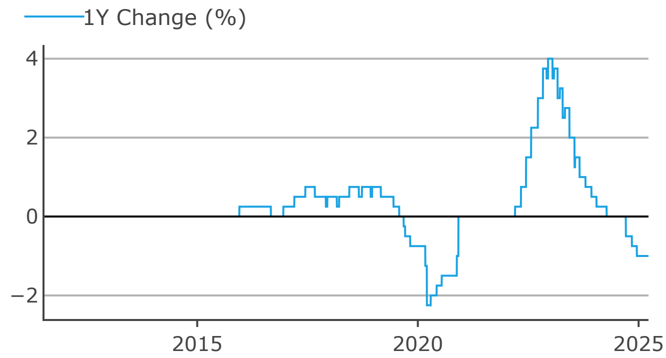
US Fed. Reserve chair Jay Powell reiterated in the March FOMC meeting that the Fed is "not in a hurry" to reduce rates. This stance is unsurprising as Donald Trump plans to launch new tariffs on 2 April, likely affecting 40% of US goods[1] and potentially causing short-term inflationary pressures. Powell described this risk as 'transitory,' but if left unattended any second-round effects could slow this transition.

The University of Michigan poll showed households are already worrying about inflation. Their long-term inflation projections are at 3.9%, the highest since 1993. While maintaining public confidence is crucial to avoid another wage spiral, this type of soft data should be taken cautiously. The five-year, five year rate is still around 2%, indicating anchored inflation expectations. **Thus, a steady approach is sensible, allowing clarity on tariffs and the disinflationary process to continue. The market anticipates only two rate cuts this year.**

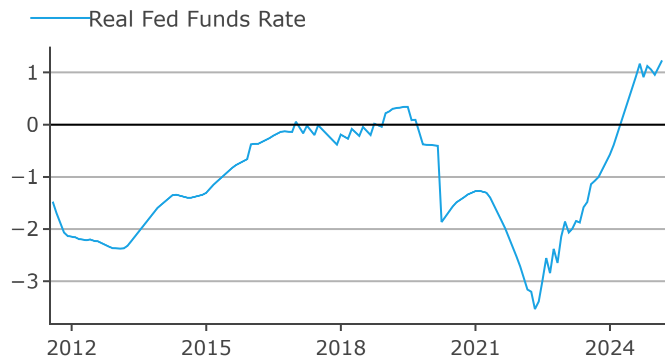
Fed Funds Rate



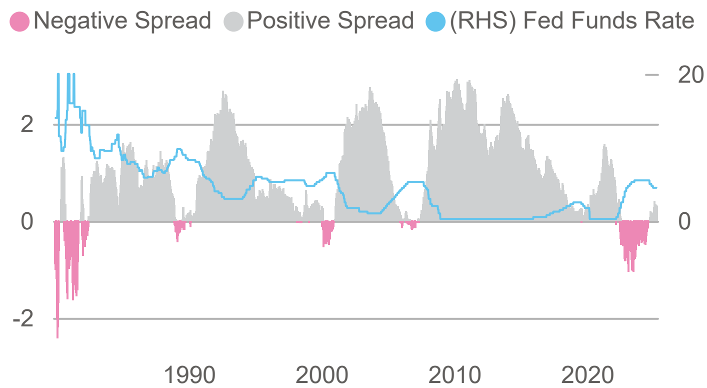
Change in Fed Funds Rate



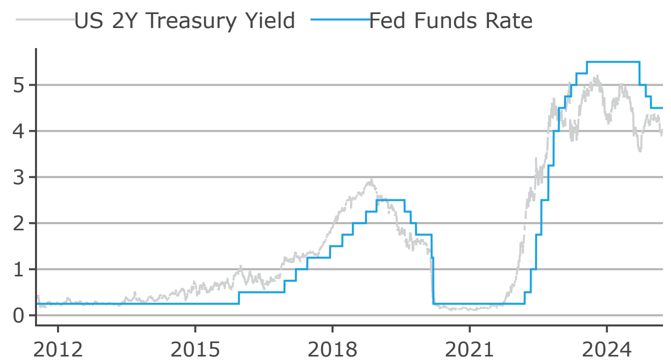
Real Fed Funds Rate (Using 2Y MA CPI)



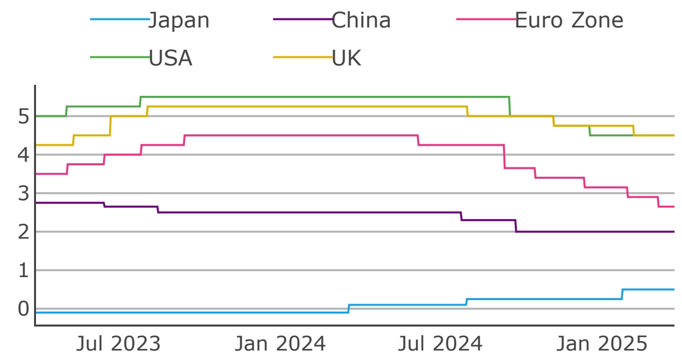
Fed Funds Rate vs 2s10s Curve



Fed Funds Rate vs 2Y Treasury



Global Comparison



Sources | Bloomberg for all charts, as of Mar 2025. 1. Empirical Research

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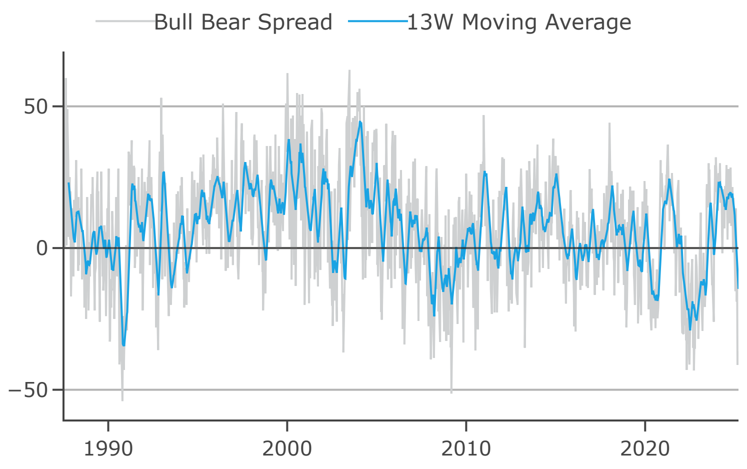
Sentiment

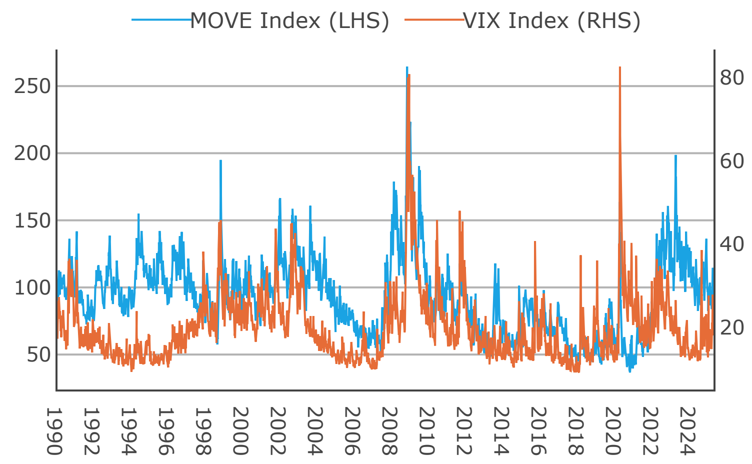
The BAML Hartnett Bull & Bear Indicator has continued to increase towards neutral territory (which remains good for forward returns). Now at 5.3 vs last month at 4.8. The increase can be attributed to improvement in the credit markets, equity market breadth, increased bond flows and even more equity allocation in long-only positioning.

US Equity Indicators

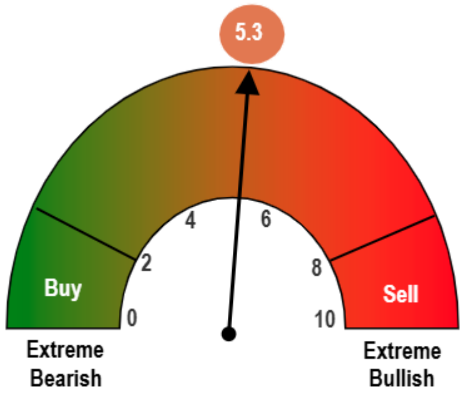
AAII Bull Bear Spread



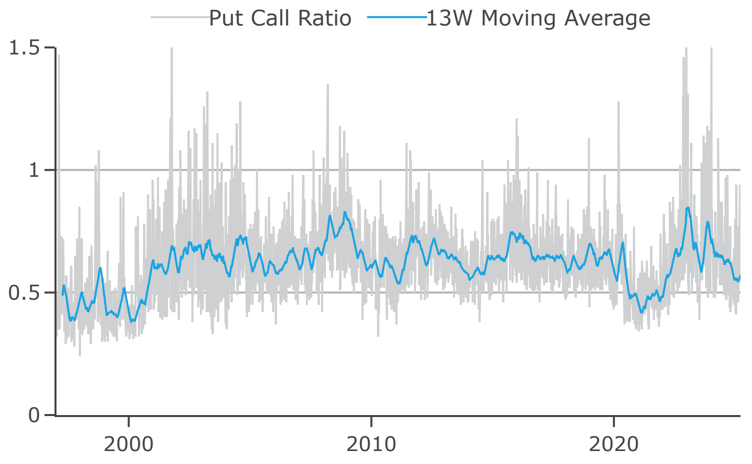
Equity vs. Bond Sentiment



Michael Hartnett's Bull & Bear Indicator (BAML)



Equity Put Call Ratio



Sources | Bull Bear Spread, Vix and Equity Put Call Ratio: Bloomberg. Michael Hartnett's Bull & Bear indicator by kind permission from Bank of America, as of Mar 2025

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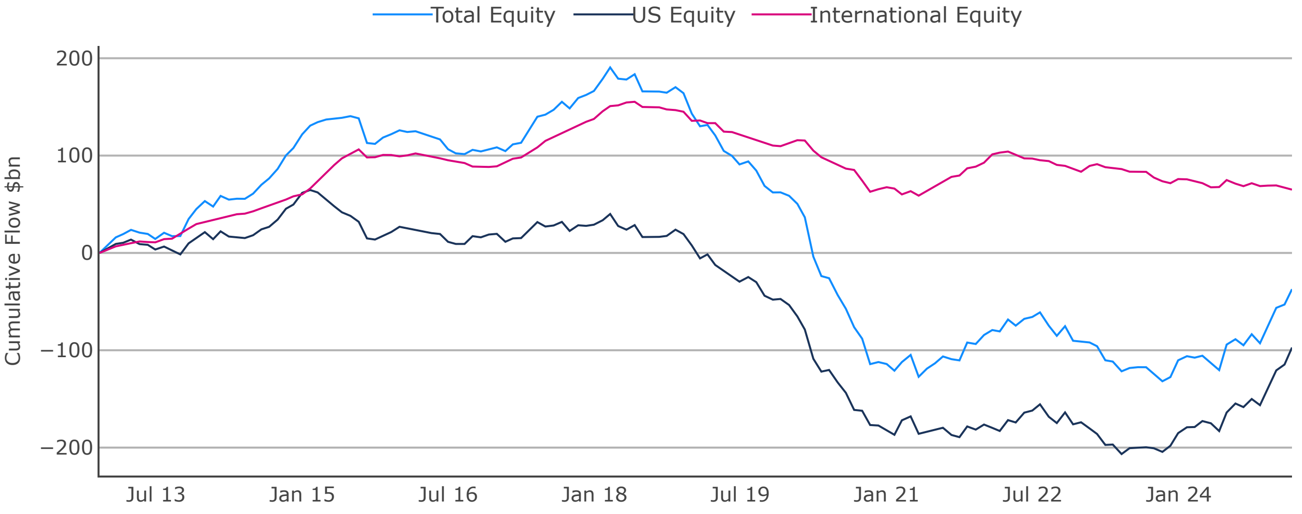
Fund Flows

This page captures US mutual fund flows as reported by the US Investment Company Institute, and flows are shown here as a cumulative total by adding successive months' flows. This excludes ETFs / passive and is therefore only for active flows. In later months we plan to add passive flows to get a feel for how fund liquidity is affecting markets.

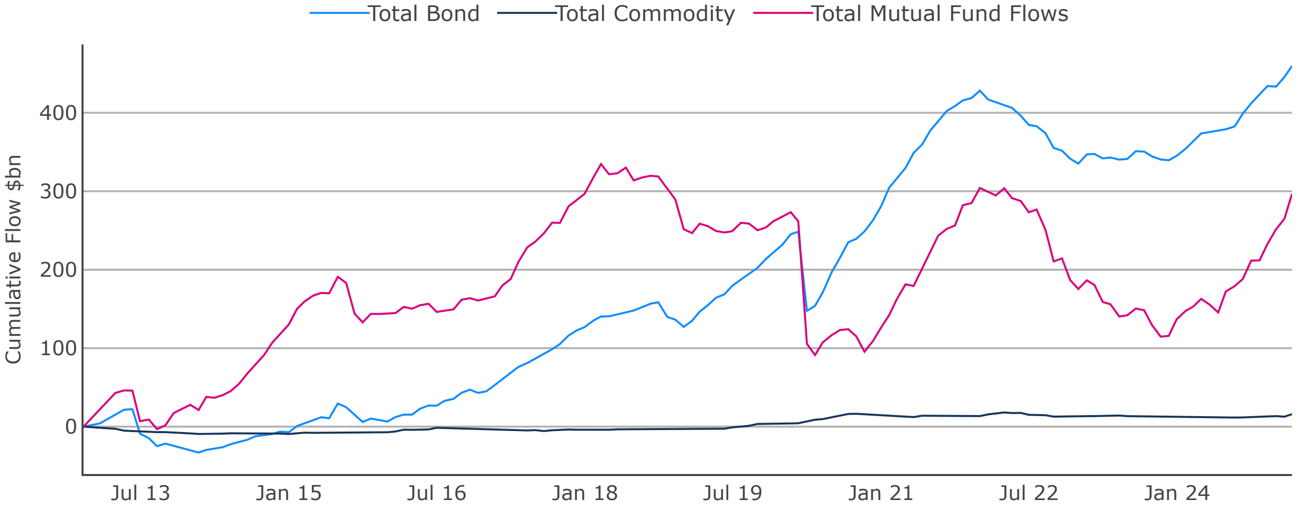
The message in these data points continues to be that there is little enthusiasm for actively managed funds even if the outflows from equity funds have stopped.

US Mutual Fund Flows

Equity Markets Cumulative $bn



Non-Equity Markets Cumulative $bn



Sources | All charts: Bloomberg ICI fund flow data. Data as at Mar 2025

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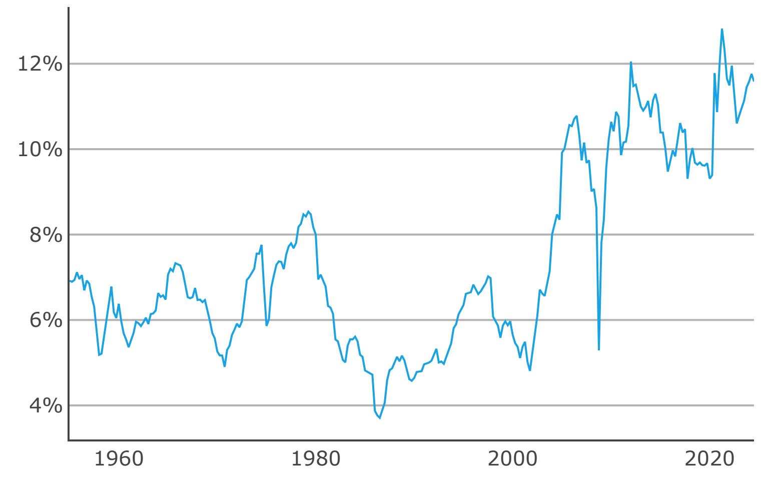
The Big Picture

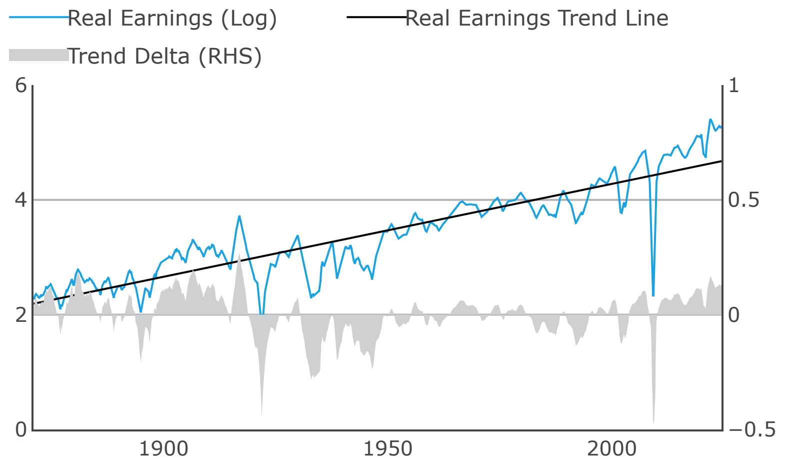
Here we highlight some longer-term imbalances that, **should** they correct, would have an outsized impact on risk asset returns. We don't make predictions but we do watch these. US corporate profit is just off the highest share of GDP that it has ever been since 1929. Its corollary (not shown) is that the wage share is at the lowest level it has been in almost as long. Allied to this, the top right chart shows that earnings are as far above their long run trend in absolute terms as they have also been since 1929. Domestic non-financial debt is also extremely elevated. All of this suggests that if old relationships hold and we get mean reversion, forward 10 year returns could be much lower than suggested by the ERPs.

Long Term Inbalances

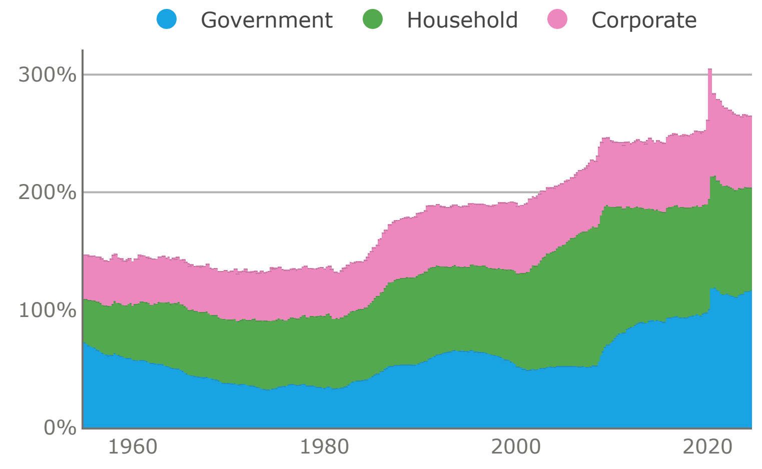
Profit Share of GDP



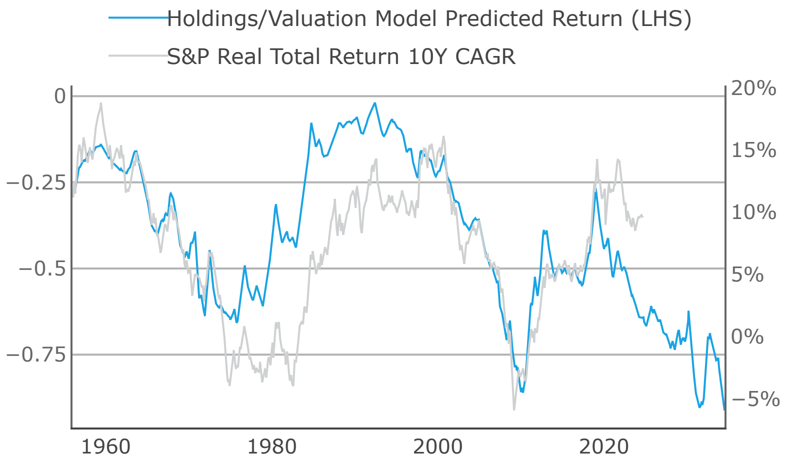
Earnings Deviation From Trend



Non Financial Debt as Share of GDP



S&P 500 10Y Forward Returns



Sources | Profit Share of GDP, and Non Financial Debt as Share of GDP: Federal Reserve Economic Data (FRED); Earnings Deviation From Trend: CCLA using Shiller CAPE data from Yale.edu; S&P 500 10Y Forward Returns: Holdings/Valuation Model uses three inputs: Tobin's Q, Shiller CAPE and Household Equity Holdings to predict 10Y forward returns. All data refreshed as at Mar 2025.

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