azimut

AZIMUT GLOBAL VIEW

14.
04.
25

Main Events

CHINESE DATA First quarter GDP, along with March industrial production and retail sales, will provide a snapshot of the state of the Chinese economy prior to Trump's tariffs	**ECB MEETING** How will the ECB respond to the significant uncertainties arising from Trump's tariffs?	**JAPAN CPI** A further acceleration of inflation could add pressure on Japanese interest rates, which are already at a multi-year highs	**GLOBAL PMI** The April PMI readings from major economies will help gauge the extent to which sentiment has deteriorated following Trump's tariffs
16.04	17.04	18.04	23.04

Azimut Global Network

- Milan
- Abu Dhabi
- Austin
- Cairo
- Dubai
- Dublin
- Estoril
- Geneva
- Hong Kong
- Istanbul
- Lugano
- Luxembourg
- Mexico City
- Miami
- Monaco
- New York
- Rabat
- Santiago
- São Paulo
- Shanghai
- Singapore
- St Louis
- Sydney
- Taipei

TARIFFS CHAOS

- **The tariffs announced by Trump on April 2 wreaked havoc on the market, with the stock market plummeting along with U.S. bonds and the dollar**
- **These movements can be attributed not only to the increased risk of recession following the announcement of the tariffs, but also to the Trump administration's changing attitude toward the rest of the world, which has likely spooked international investors**
- **However, the three-month tariff reprieve could lead to a reduction in market stress and volatility, allowing some of the abnormal movements of recent weeks to be at least partially reversed**

As anticipated in the last commentary, April 2nd unfortunately did not mark a “Liberation Day” from the pervasive and frustrating uncertainty caused by Trump's tariff saga.

The tariffs announced to the world on April 2nd were a far cry from the concept of “reciprocal tariffs” that Trump had been touting in prior weeks. Reciprocal tariffs would imply that for every good exported from the United States and subject to duties in the importing country, the United States would impose duties at the same rate on the exact same type of good exported from that country to the United States.

The tariffs announced by Trump, however, were based on a mathematical formula (trade balance divided by the value of imports, floored at 10%) that lacks economic rationale and does not reflect the actual tariffs imposed on U.S. goods by other countries. The resulting tariff rates, applied to all U.S. imports, were significantly higher than the average duties levied by other countries on U.S. exports—several times higher in some cases. As mentioned, this diverges substantially from the principle of “reciprocal tariffs” and could be interpreted as an act of coercion against the rest of the world.

The other countries did not react, petrified by what had just been announced. The few countries that did speak out, immediately sought negotiations with the United States.

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The only exception was China, which immediately responded by imposing counter-tariffs. The situation between the two countries quickly degenerated, and the ensuing tit-for-tat resulted in the United States imposing tariffs of 145% on China and China imposing tariffs of 125% on the United States. Obviously, such tariff rates would simply make trade between the two countries no longer viable.

On Wednesday, everything changed once again. Trump announced that, with the sole exception of China—for which tariffs will remain at 145%—all other countries will be subject to a 10% import tax for the next three months. During this period, if the countries make the concessions that Trump is asking for, the duties could be completely scrapped.

Then, on Friday evening, Trump exempted imports of a wide range of electronic devices, including smartphones, laptops, and related components, equating them to semiconductors. Imports of these goods from China, however, will still be subject to 20% tariffs. Finally, over the weekend, Trump made it clear that these technological goods will still be subject to tariffs, but the rate will be set in the coming weeks.

Since it is still not possible to make any predictions about the evolution of duties, given the ever-changing circumstances, let's try to understand what the most likely consequences could be.

Based on David Ricardo's theory of comparative advantage, countries can benefit from trade with each other by focusing on producing what they do best, while buying the things they are not as good at making from other countries. In an ideal world without international trade friction, comparative advantages lead to maximization of efficiency, aggregate production, GDP, and corporate profits, while at the same time lowering prices. Introducing trade barriers leads to the opposite result. Plain and simple.

Having a deficit, therefore, means being less efficient, on average, compared to other countries. However, the other side of the trade deficit is a capital account surplus—or, in other words, a net inflow of capital from the rest of the world. This is what has been happening in the United States for decades: the rest of the world has massively accumulated U.S. Treasury bonds. This has been enormously advantageous for the U.S., allowing it to finance itself at a much lower cost than it would have had to if it hadn't had a trade deficit. Given the size of the U.S. public debt, this privilege has saved trillions in interest over the years.

For a country that also runs a fiscal deficit, the consequences could be far from trivial for financing its debt. Huge amounts of foreign capital were also attracted into U.S. stocks, enabling them to finance technological development and the growth of the real economy, which grew faster than the rest of the world. Aiming to end the trade deficit means being willing to give up these advantages as well. Strangely, no one talks about these facts. However, the consequences of reversing these trends will only be felt in the medium term, as this process will take time to play out.

In consideration of the above, it can be considered untimely and unwise that the Trump administration is also trying in these very days to approve the extension of the tax cuts granted in his first term and to secure others. The cost of these measures is estimated at 5 trillion dollars over the next decade. Against this increase in expenditure, only 1.5 trillion dollars of spending cuts are planned, resulting in a further increase in the U.S. public deficit, which in recent years was already at unsustainable levels.

It is, thus not so surprising, that yields on U.S. Treasuries have risen so rapidly. This is in stark contrast to what has always happened in the past, namely that during sharp market corrections Treasuries have largely been sought after as a safe haven. Put another way, with his decisive push on tariffs and the expansion of the fiscal deficit, Trump risked suffering his “Liz Truss moment”, as 30-year interest rates rose by 70 basis points in just 3 days, stopping at around 5%, not far from the highs of late 2022.The unusual behavior of bonds has been accompanied by an equally unusual trend in the dollar. Like Treasury bonds, the dollar has also generally strengthened during periods of market turbulence. In addition, the dollar—and in particular the euro/dollar exchange rate—has always moved in line with the interest rate differential. In recent days, however, despite the fact that U.S. rates have risen while German rates have fallen, leading to a significant widening of the rate differential in favor of the dollar, the greenback has not only failed to strengthen, but has undergone a 5% correction against the euro.

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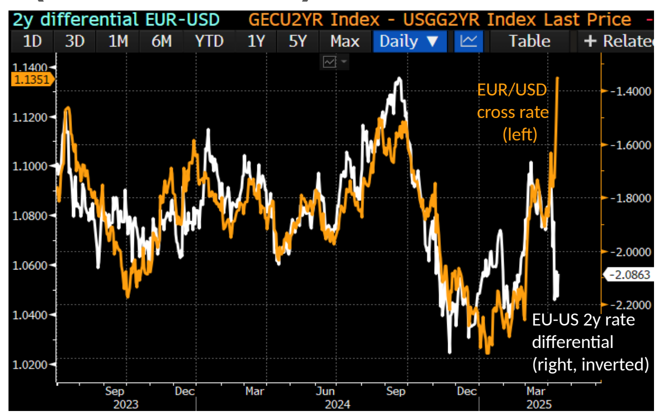
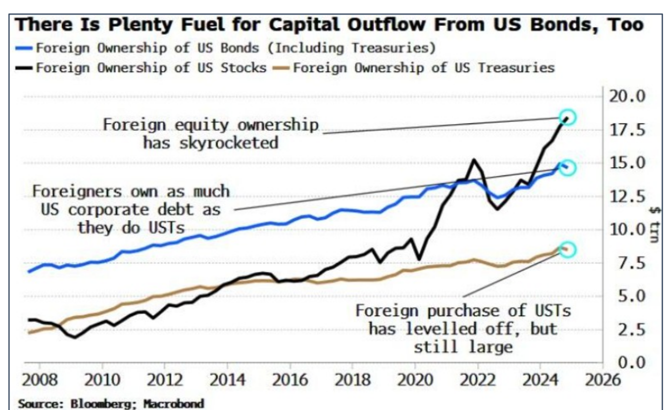


Source: Bloomberg



Source: Bloomberg, Macrobond

This trend not exactly what you would expect from the world's reserve currency. This behavior is typical of emerging countries, where in periods of stress, investors sell stocks and bonds, causing yields to rise, but despite the higher yields, the exchange rate weakens because an exodus of capital is occurring.

This dynamic can be at least partially explained as a reaction to Trump's attitude. If the United States has become what it is—there has been much talk in recent months of "American exceptionalism"—it is because the country has built its position of strength through respect for the rule of law, support for allied countries, and the ability to make the world spontaneously willing to hold dollars, thus establishing the U.S. dollar as the world's reserve currency. By upsetting the rest of the world and scaring investors through constant changes to the rules of the game, Trump is reversing this status quo, risking an exodus of capital from the United States.

Furthermore, Trump has made no secret of his intention to weaken the dollar, which would negatively impact the performance of all non-dollar-based investors holding U.S. assets. Should foreign investors begin to reduce their exposure to U.S. markets, the potential impact would be significant, considering that in recent years, huge amounts of capital have been invested in the U.S. by foreigners. However, there is a long way to go before one can say that the dollar is losing its status as the world's reserve currency—if only because there is no valid and viable alternative to the dollar.

While in the long term it is advisable to remain aware of the factors discussed above, in the short term, market dynamics could play out in the opposite direction. Assuming that peak stress in the markets is behind us and volatility subsides in the coming days, some of the unusual reactions we have recently observed could be reversed.

Starting with the U.S. curve, the rise in rates despite the drop in stock market indexes and the increased risk of recession—the uncertainties created by Trump are deterring business investment, with corporations freezing capital spending—is an anomalous phenomenon. In addition, the latest readings on producer and consumer prices have been more favorable than expected and do not yet incorporate the drastic declines in commodity prices—particularly energy prices—that have occurred since April 2. The increased risk of recession, together with diminished inflation risk (at least in the short term), will realistically prompt the Federal Reserve to prioritize its mandate of pursuing full employment over that of price stability. It is therefore possible that, as early as the June meeting, the Fed may begin cutting rates, with positive implications for bonds.

Furthermore, we know that one of Trump's main objectives is to push interest rates down, both to reduce federal interest expenditure and to alleviate the cost of household debt (mortgages, car loans, revolving credit, etc.). It is perhaps more than a coincidence that the reprieve on tariffs was announced on the same day that the 30-year U.S. yield reached 5%, up 70 basis points in three days. It is worth considering the possibility that Trump may adopt a more conciliatory policy stance if he realizes that his decisions are contributing to rising interest rates.

Moreover, once again assuming a normalization of market dynamics, it is possible that the dollar may recover at least part of its recent depreciation, considering the gap that has opened up between the exchange rate and the interest rate differential.

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Finally, it is possible that stock markets might enjoy a rebound in the short term. It is unlikely that we will again reach the levels of stress experienced after the shocking announcement of April 2. The three-month period during which the 10% reprieve applies to all countries could lead to a rebound in the stock markets, driven by hopes that an agreement can be reached with a large number of countries—thus avoiding not only a return to the tariff levels announced on April 2, but also raising the possibility that the duties will be completely scrapped. However, in the medium term, we cannot exclude the possibility that the increased risk of a slowdown or outright recession could lead to further declines.

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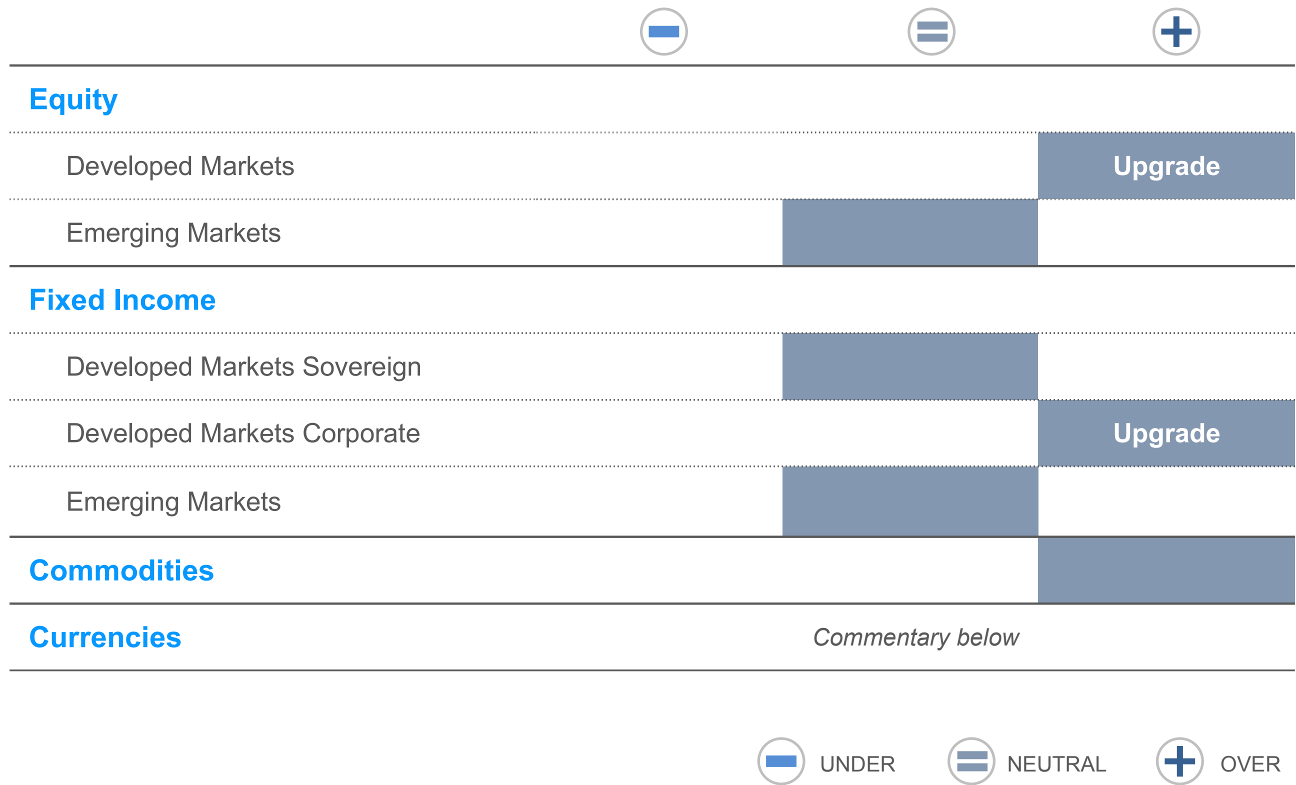
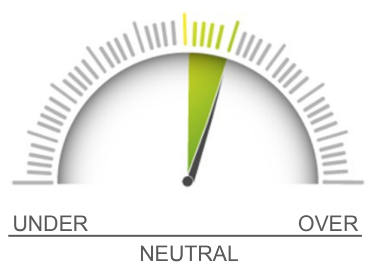
Asset Allocation View



	Under	Neutral	Over
Equity			
Developed Markets			Upgrade
Emerging Markets		■	
Fixed Income			
Developed Markets Sovereign		■	
Developed Markets Corporate			Upgrade
Emerging Markets		■	
Commodities			■
Currencies		*Commentary below*	

Equity

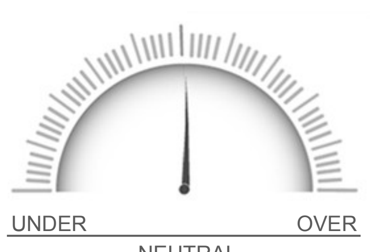
Developed Markets



We have upgraded our recommendation on Developed Market Equities to **Slightly Overweight**. Stock markets have tumbled due to the much higher-than-expected tariffs. Following the reprieve announced last Wednesday, the market may have reached peak tariff anxiety and could recover in the hope that an agreement will be reached with the various countries within the three-month window. This is a tactical trading buy, considering that the uncertainties surrounding tariffs could continue to weigh on economic growth, potentially leading to a slowdown in the coming months that may not yet be fully priced in by the markets.

US	**Europe**	**Japan**

Emerging Markets



We have maintained our recommendation on Emerging Market Equities as **Neutral**. Emerging markets reacted better than expected to the announcement of U.S. tariffs. Even with the reprieve, duties at the 10% rate will still weigh on emerging market economies. This is particularly true for China, as tariff rates remain at 145%, with the sole exception of semiconductors and certain other electronic products. We therefore view emerging market equities as potentially more vulnerable in the short term.

Asia ex-Japan	**EEMEA**	**LATAM**

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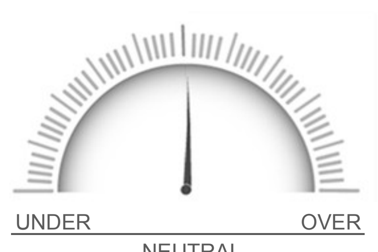
Fixed Income

Developed Markets Sovereign



We have maintained our **Neutral** recommendation on Developed Markets Sovereign Bonds. However, the view on the asset class is far from uniform. We are more constructive on the U.S. curve following the recent rapid increase in yields, though we continue to favor the short- and medium-term segments. After Standard & Poor's surprise upgrade of Italian debt, we consider the Italian curve to be the most attractive in the immediate future. Conversely, we have become more cautious on the German curve, as the recent drop in yields has brought rates back to levels not dissimilar to those seen prior to the announcement of the constitutional reform.

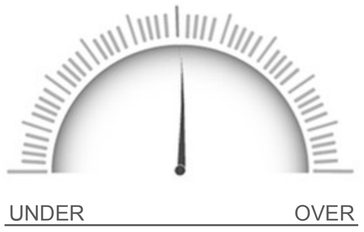
EU Core		EU Periphery		US Treasury		Japanese JGB	

Developed Markets Corporate

We have increased our recommendation on Developed Market Corporates to **Slightly Overweight**. The upgrade is entirely due to the higher yields offered by dollar-denominated corporate bonds, which have benefited both from the rise in U.S. risk-free rates, as discussed above, and from the widening of spreads over the past two weeks. We remain more cautious about European corporate bonds, given that their yield to maturity has not changed significantly, as the widening of spreads has been partially offset by the decline in the German yield curve. Within corporate bonds, we continue to favor investment-grade bonds over high-yield bonds.

IG Europe		IG US		HY Europe		HY US	

Emerging Markets



We have kept our **Neutral** recommendation for Emerging Market Bonds. The risks posed by tariffs and the contraction of overall market liquidity are counterbalanced by the relatively higher spreads currently offered by emerging market bonds compared to similarly rated corporate bonds in developed markets.

Local Currency		Hard Currency IG		Hard Currency HY	

Commodities

We have maintained our **Slightly Overweight** recommendation on Commodities. Our constructive stance is primarily focused on precious metals, which are in a bullish phase and could benefit from the uncertainties stemming from Trump's unpredictable behavior. These include his ever-changing tariff threats, the potential for other countries to impose counter-tariffs on the U.S., and the administration's stated intention to weaken the U.S. dollar.

Precious		Energy		Industrial		Agricultural	

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Currencies

The Committee has upgraded the U.S. Dollar to **Neutral with a bullish bias**. Following the recent sharp selloff, it is possible that the dollar will recover to some extent, especially considering how the rate differential has moved in favor of the U.S. Dollar. However, we remain cautious on the medium-term outlook, as the Trump's administration continues to push for a weaker dollar.

The Committee has downgraded its recommendation on the Euro to **Neutral with a bearish bias**. The recent strengthening of the euro versus all major currencies put it at risk of a short-term reversal. However, the main driver for the common currency in the short term will be the ECB's guidance on the future path of monetary policy, expected later this week.

The view on the **Chinese Renminbi** has been lowered to **Neutral with a bearish bias**. Trump's tariff are now hitting China far more than other countries, possibly forcing the PBOC to let the Renminbi to slide against the U.S. Dollar in order to limit the adverse impacts on the Chinese economy.

The outlook for other **emerging market currencies** is maintained at **Neutral**. These currencies have suffered following Trump's tariffs and may recover if investor risk aversion subsides.

Euro	=	USD	=	CNY	=	Other EM	=

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